March 2014

INDIA

A view from the ground

- MACRO OUTLOOK
- SECTOR OVERVIEW: INDIAN AGRICULTURE
- COMPANY IN FOCUS: KAVERI SEEDS

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OCEAN DIAL

David Cornell
Chief Investment Officer

I am delighted that you have taken the opportunity to consider our latest edition of "India: a view from the ground". 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.

On the back of successful fire-fighting by the RBI and Indian Government discussed in our last report, this quarter saw the Indian markets rebound with force. In anticipation of a positive General Election result as well as improving macroeconomic data the Rupee has stabilised and interest in India is starting to rekindle. Whilst the economy has almost certainly bottomed out and India no longer faces an impending crisis, all eyes are now fixed on the election, the outcome of which is seen as the key driver in facilitating reforms essential to restoring confidence, kickstarting growth and initiating an earnings recovery. There are many stumbling blocks in the path of the next Government ranging from a fragile banking sector to a hugely inefficient tax collecting environment and an infrastructure sector that has ground to a halt. We are nevertheless increasingly confident that the country will start to stand out from its peer group as these issues are finally revisited by a new and refreshed administration, allowing India to enter its next big growth phase.

One part of the economy badly in need of reform is agriculture. Rising rural incomes, harmful Government intervention and a supply constrained farming network has seen the sector struggle to accommodate the challenge of feeding a large, young and growing population. Our Sector in Focus (page 8) examines how this challenge has created opportunities for investors, as innovative and entrepreneurial management teams of exceptional quality have developed a track record in providing sustainable and cash generating solutions. This is especially so in the agricultural equipment space (tillers and tractors) as well as in companies specialising in seeds, pesticides and animal feeds, where value can be found particularly lower down the market cap spectrum.

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

This is an exciting time for equity investors in India.

A combination of improving headline macro-economic numbers, the rising expectation of a market friendly election result, and on-going uncertainty within the Emerging Market peer group, is drawing India back onto the global radar. This is a place we haven't been for some time.

Admittedly this renewed optimism is set in the context of a continued extreme under allocation in global portfolios to Emerging Markets versus Developed, and whilst we are sure of mean reversion as always the timing remains uncertain. In spite of this, the current antipathy towards the asset class provides an opportunity to reconsider an investment ahead of the pack. And whilst there are clearly issues to be resolved within Emerging Markets, the prevailing upshot is a wider dispersion of returns rather than potential capitulation across the board. Hence we continue to advocate the benefits of a single country strategy in Emerging Markets, and particularly in India.

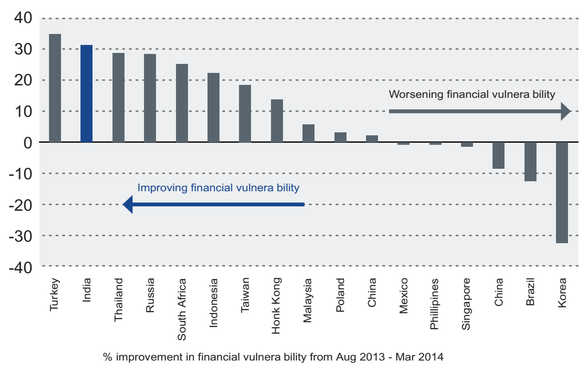
The Rupee's performance over the last six months exemplifies the better mood. Affirmative action by the Reserve Bank to under pin foreign exchange reserves and fix the Current Account are the principal reasons for heavily reduced volatility. The market is reassured by the Governor's impressive start, welcomes the current stability within the RBI as an anchor whilst the political tide turns, and is banking on balanced future progress. Steady fund flow, enhanced by capital flight drawn in by adverse conditions in other emerging economies, will also provide support.

In truth, though the economy seems to have bottomed, it remains in the doldrums following seven consecutive quarters of growth sub 5%.

The Rupee's stability has reassured investors and corporates alike, the latter stressing the benefits of operating in an environment of a settled currency, a critical prerequisite for a recovery in confidence. Behind the currency's better performance is a sharply reduced Current Account deficit, downward momentum in inflation, and a fiscal deficit which ended FY14 better than was forecast, and well ahead of the market's expectations. We are somewhat wary of the sustainability of all these numbers however. The main reason for the improving terms of trade has been a collapse in the demand for gold driven by the imposition of punitive import tariffs. These tariffs will not be maintained indefinitely. Indeed non gold imports will rise again in step with an economic recovery, and will need to be matched by export growth to ensure we don't end up back where we started. Inflation, another key requirement for an economic recovery, has rolled over, and we expect this trend to continue in the short term. But again this is as a consequence of a long awaited collapse in food prices, and not from much needed structural supply side improvements. The fiscal deficit performance has surprised the market positively also. But the fact that the Government simply deferred expenditure as fiscal year-end approached should not surprise anyone. Inflation and the fiscal deficit must be on a sustainably improving trend before the RBI is minded to signal easier monetary policy. We may yet be “on hold” for some time.

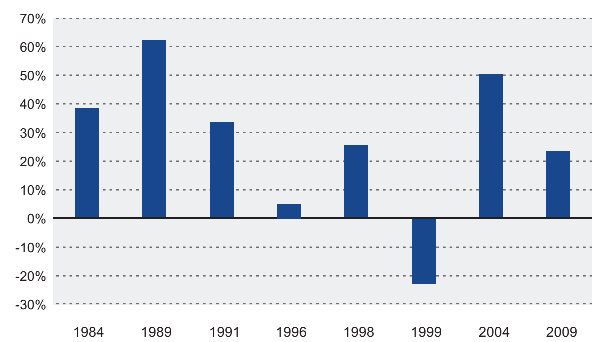
Whilst we are greatly encouraged by the market's recovery, earnings must also recover for stocks to continue their upward march. The multiple re-rating will not go on indefinitely. In truth, though the economy seems to have bottomed, it remains in the doldrums following seven consecutive quarters of growth sub 5%. There are some indicators that the worst is behind us, in so much that Industrial

Chart 1: India’s improving financial vulnerability



Source: Bank of America Merrill Lynch Global Research

Chart 2: Sensex two year returns, post elections (CAGR)



Source: Ambit Capital

The market was reassured by the Governor's impressive start, welcomes the current stability within the RBI as an anchor whilst the political tide turns, and is banking on balanced future progress. Steady fund flow, enhanced by capital flight drawn in by adverse conditions in other emerging economies, will also provide support.

Production data is turning positive, and manufacturing and service PMIs are also on a rising trend. But the fact is the corporate sector remains over leveraged, hampering a recovery. India's successful exit from the GFC encouraged companies to take on excessive debt, assuming GDP would grow at 8%-9% in perpetuity - ("Shining India"). In the 5%-6% environment faced today, "rightsizing" the corporate balance sheet must happen in order for the lines to be redrawn. In infrastructure related sectors particularly, there is still much introspection and requisite restructuring to occur before India's investment spirits can re-awaken. Poor investment decisions, bureaucratic logjams, high interest rates, falling growth; these have all caused damage to the pace of India's reform prospects, and until that re-calibration is complete, India cannot realistically re-start an investment led spending cycle. Bearish commentators suggest that this could be as much as six quarters away. The banking sector is similarly constrained as it continues to grapple with high levels of non-performing and restructured assets. This limits lenders' appetite and ability to expand asset books in support of a resumption of growth. This issue must be solved before the game can recommence.

However the over-riding reason for the economy to be "on hold" currently is the impending election. We are at the point where its outcome will define the market's next leg. All corporate decisions are pending, awaiting outcome and the implications thereof. Thus, current expectations suggest that the Narendra Modi led BJP will win the highest number of seats, and with coalition allies, may succeed in securing a working majority sufficient to control the political agenda. If this transpires, the size of this majority will dictate the market's reaction. The high expectations around Modi are as a consequence of his reputed achievements as a Chief Minister in Gujarat over the last 10 years. He is perceived to have a reputation for strong leadership, good governance, honest accountability, and has delivered a level of growth consistently in excess of the country's average. At the national level, these attributes are missing in action, and although there is no such thing as the "Gujarat model", if a step up in constructive Government can be achieved, investors' enthusiasm for India will be rediscovered rapidly. Expectations should be tempered however. The sheer size of the voting population suggests the market is making bold assumptions on account of apparent voter intentions and current polling trends. Such is the size and complexity of the process, there are extreme margins for error.

If a step up in constructive Government can be achieved, investor's enthusiasm for India will be rediscovered rapidly.

If there is strong leadership at the centre however, we anticipate that it will be met with some co-operation and support from the parties in opposition. Historically speaking the early years of a new Government have provided the best chance to bring about change as the opposition is less inclined to disrupt the legislative proceedings. This status quo has resulted in excellent returns for equity investors previously, enhanced further if, as is the case today, the outgoing Government has already initiated the beginnings of a reform agenda. What exactly a reform agenda may entail is hard to predict, but we highlight some key issues, which if prioritised will restore corporate confidence, and reduce the inflationary and fiscal drag. Renewed efforts are required to make progress on the direct tax code and the general sales tax, both of which are critical to adjusting the imbalances. Structural supply side issues causing food price inflation must be addressed by breaking down subsidises and allowing market prices to control demand and supply. Removing inefficiencies to agricultural productivity by allowing the corporates to farm, via land reform, is much needed. Working alongside recommendations from the RBI, a partial re-capitalisation of the banking sector could be achieved by reducing the Government's ownership limits thus allowing the private sector a greater share. The first budget, expected in June or July, could be the platform to launch new initiatives, creating a virtuous circle whereby a strong equity market reaction to these announcements facilitated primary and secondary market equity issuance, easing over leveraged balance sheets and de risking banks' lending books, washing away key investor concerns and enabling India to retest its potential, strengthened by lessons learned from the past.

MACRO OVERVIEW

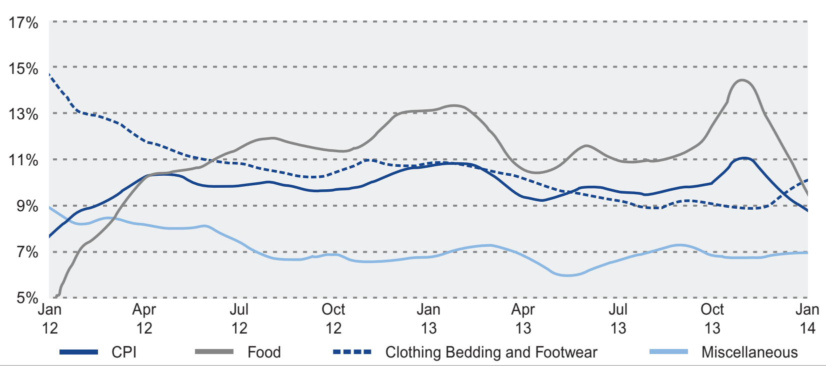
CHARTS & COMMENTARY

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

Source: Bloomberg

India's relative performance continues to strengthen. The delta on key macro economic variables is turning favourably both in absolute terms and relative to the broader GEM universe. This is being supported by a growing belief that the General Election will deliver a pro-business Government with the desire and the mandate to reform. We caution excessive optimism here.

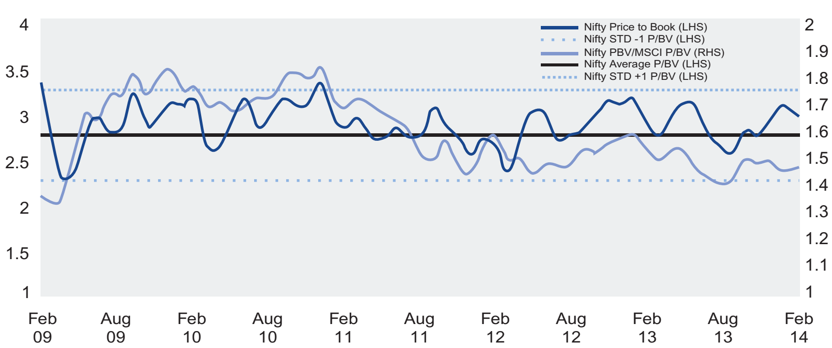
Chart 4: India's Consumer Price Index and components



Source: Bloomberg

The RBI has announced that CPI will now be the formal index by which inflation is measured. The formal target is to reach 8% by January 2015 and 6% by January 2016. Longer term the target will be 4% with a 2% band either side. CPI has now reached 8%, and may yet fall further. However its expected that interest rates will be remain on hold for an extended period in order to extinguish future expectations and drive real rates higher.

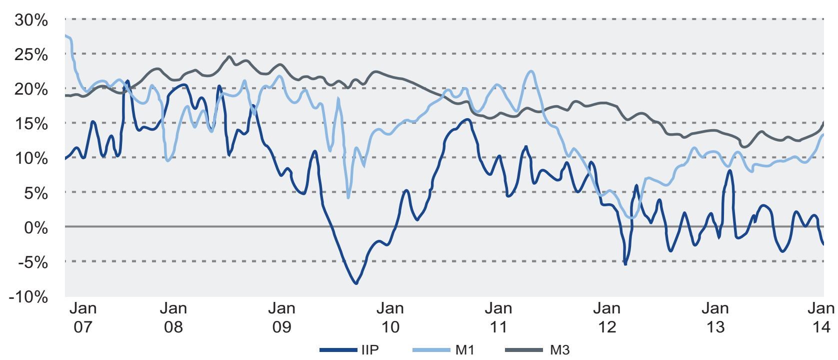
Chart 5: Nifty P/BV (LHS) & Nifty P/BV relative to MSCI EM (RHS)



Source: Bloomberg

Based on Price to Book, Return on Equity minus Cost of Equity approach, India looks to be within 5% of fair value.

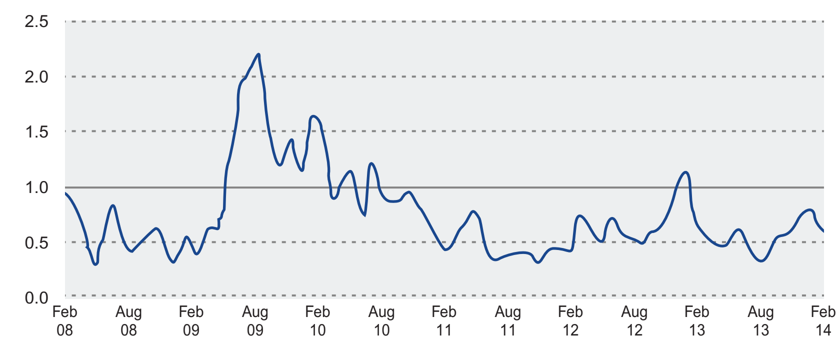
Chart 6: India's industrial production (IIP) and money supply (M1 and M3)



Source: Bloomberg

February's IIP data was marginally positive at 0.1%. Although we are cautiously optimisitc of a gradual recovery; Corporate India remains on hold until the outcome of the Election and monetary policy remains tight. Even post-election, it may take some time before activity meaningfully picks up. Monetary growth is expanding modestly, but the gap between IIP and M1 should provide support to the stock market.

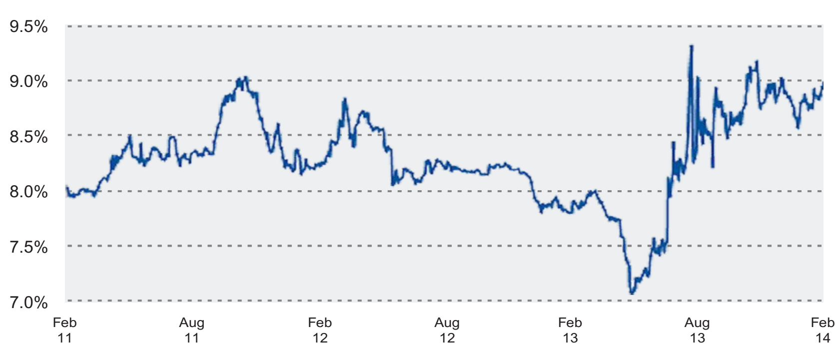
Chart 7: MSCI India Earnings Revision Index



Source: Bank of America Merrill Lynch Global Research

Earnings growth was supported by export related sectors benefitting from improving global growth and a more competitive currency. Offsetting that is continued disappointment from the Banks with the first signs of asset quality stress appearing in the private sector banks. Consumer stocks saw weaker top line growth.

Chart 8: Government of India 10 year bond yield



Source: Bloomberg

10 year yields have peaked but are expected to remain elevated despite significant falls in inflation. Repo rate has been hiked 75 bps to 8% since September last year (last rate hike 25bps in January 14), and the RBI is likely to maintain tight liquidity until it sees CPI inflation stabilise at lower levels.

SECTOR OVERVIEW

INDIAN AGRICULTURE – A SEEDY PROPOSITION

Realising India's full potential presents both major opportunities and serious challenges, perhaps nowhere more so than in agriculture. This is a sector which offers a curiously accurate reflection of the country's wider economic story. Huge strides continue to be made in agriculture, in spite of the Government, but there remains an urgent requirement for reform in order to keep pace with growth and changes in demand. From an investment point of view, we foresee agriculture providing a wealth of opportunities, stemming from a combination of modernisation, reform and the well-known Indian propensity for entrepreneurial innovation.

The challenge of providing nutrition for over a billion people by producing food more efficiently and securely, and delivering it from "farm to fork" more effectively, is one that has yet to be fully overcome. With irrigation spanning 45% of crop area, the majority of production is still reliant on a good annual monsoon. Rising incomes have caused a large pick-up in demand for pulses, proteins and vegetables but this, due to poor cold storage and transport infrastructure as well as pilfering, has sometimes resulted in riot-inducing inflation. Moreover, well intentioned Government policy has prevented consolidation and corporate investment into farming. Almost 85% of farmland is held by small and marginal farmers, which is evidence of the gross misallocation of capital that has resulted from political intervention. Amongst other things, it also goes some way to explain why crop yields in India are sub-par.

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At below 3,000 kgs/hectare, India's average crop yield is below the global average (Chart 9) and lower than in many other emerging and frontier economies. Unless this improves, India will face a significant food grain shortage of 57mtn over the next decade, with an estimated demand requirement of 293mtn by 2020. A demand/supply chasm and endless high food inflation is something that is neither politically nor economically viable. Despite this backdrop, there is plenty of evidence to show that India has the ability and appetite to overcome these hurdles.

India is now the world's largest producer of mangoes, bananas, chilies and black pepper, as well as being the second largest producer of rice, wheat, sugarcane, cotton (lint) and tea. It is also now the sixth largest seed market in the world. There have been several developments over the last few years which have not only changed the way farming is done, but also provided opportunities for companies focused on this sector.

The adoption of the mobile phone represents a leapfrog in technology, a revolution which has, amongst other things, given the farmer cheap and instant access to information including the latest prices at the local mandi (marketplace), so providing him with a more informed judgment as to how much of which crops to sow and produce. A combination of urbanization and Government employment guarantee schemes has seen the availability of cheap labour fall, encouraging both mechanization and the new practice of farmers leasing land to increase holdings to a more economic size. Indeed tractor unit sales have more than tripled between FY06 and FY13.

Further encouragement can be taken from the enthusiasm with which farmers have been embracing the use of hybrid seeds. The big success story

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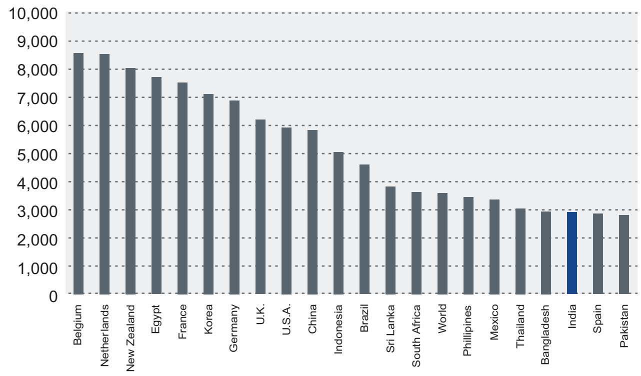
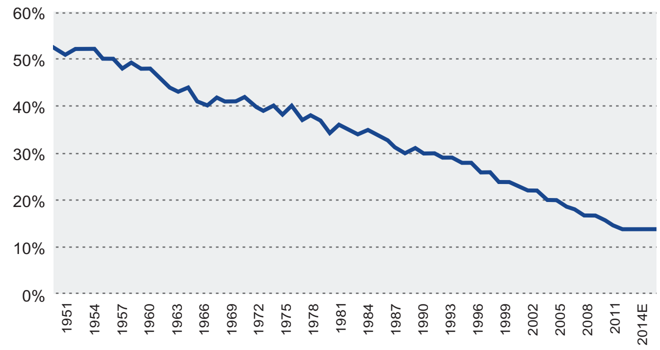
Chart 9: India's crop yields lag behind (kgs per hectare)



Source: World Bank

Chart 10: Agriculture's share of GDP



Source: Espirito Santo

on this front is cotton, where 95% of the crop is produced by hybridisation. Corn has seen yields increase from 1.9MT/ha to 2.6MT/ha since FY06 and other crops are also seeing hybrid seeds being increasingly used. We hear from corporates in this space that farmers are shrewd in their adoption of hybrid technology; if they see an increase in yields after one year, they almost always adopt the new seeds.

To be fair, the politicians have not completely covered themselves in shame on this front and have started to infuse a semblance of sanity to their interventions in the market. The Maharashtra Government has made it mandatory for sugarcane growers to switch to drip irrigation, thereby reducing the dependency on the monsoon for a good crop. Many more state Governments are now abolishing their Agricultural Produce and Marketing Act (APMA), which means that the farmer no longer has to sell his produce at the mandi via a middleman. This is reducing pilfering and increasing efficiency. Farmers are now able to negotiate directly with the buyer and are beginning to participate in contract farming. This increase in direct sourcing should help with efficiency in the supply chain. We are even hearing noises that the APMA legislation could be scrapped altogether at the central government level if the BJP forms the next Government which would be a huge boost for the entire sector.

These developments give us encouragement that this is a space that will surely throw up some exciting opportunities, but how exactly should one view this from a stock picking perspective? The universe is large with over a hundred listed companies to choose from, including the domestically listed MNCs Monsanto and Bayer Crop Science.

We hear from corporates in this space that farmers are shrewd in their adoption of hybrid technology; if they see an increase in yields after one year, they almost always adopt the new seeds.

A key challenge is assessing the level of impact that Government intervention and policy changes could make on earnings and steering clear if these risks are likely to be material. For instance, a direct play involving staple commodity crops such as sugar or rice always raises the fear that in difficult circumstances the politicians might resort to import/export restrictions. Another red flag is where a farmer is subsidised for certain expenditure. This is typically in the fertiliser and drip irrigation sectors where receivable days can run as high as 365 days outstanding.

As a consequence, we believe that the best investments can be found where the corporate has a direct relationship with the farmer and there is minimal Government involvement. These businesses tend to have built up substantial barriers to entry through branding, distribution infrastructure, R&D and strong relationships with the farmers. Companies which have strong balance sheets in categories such as seeds (see Kaveri Seeds, our Stock in Focus on page 10), pesticides, animal feeds and agricultural equipment such as tractors and tillers are the ones where we see the greatest upside. Management quality is crucial for long term sustainable growth and in companies such as Mahindra & Mahindra and VST Tillers, the scope for scaling up is huge.

Agriculture now accounts for 16% of GDP but India has come a long way since the 1960s when it constituted 40% of output (Chart 10). Whilst India prides itself on now being self-sufficient in staple grains, the challenge of reducing high food inflation and accommodating improvements in dietary habits will need to be met through corporate investment and expansion. We believe that this necessity, coupled with an improving policy environment and innovation, is already yielding higher returns both in terms of crop production and in terms of investment returns, and is set to continue doing so for the forseeable future in the agricultural sector.

COMPANY IN FOCUS

Kaveri Seeds

Led by brands like Jadoo and Jackpot, Kaveri's cotton seeds sales have grown at an exceptional clip of 111% over the last 3 years, tripling its pan-India market share. Given its product pipeline, this is likely to further expand to 19% by end FY15.

Kaveri Seeds (KSCL) is a research-driven, multi-crop hybrid seeds company with a meaningful market share in the cotton and corn segments. In the past 5 years, overall sales have increased at 55% CAGR and net profits at 50%. It is the second largest seeds company in the hybrid cotton segment and also has a substantial presence in the corn and paddy seed markets.

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The next major catalyst likely to drive growth for Kaveri is the introduction of high yielding variety (HYV) seeds in the paddy segment. Currently less than 5% of India's paddy is HYV, compared to 95% for cotton and approximately 50% for corn. The company has developed more than 10 highly promising HYVs at its modern research and seed processing facility near Hyderabad. The INR6bn paddy seed market is expected to quadruple over the next six years, driven by the adoption of improved hybrids. Usage of HYV paddy seeds is likely to grow from the current 5% to 20% of total cultivated area of 44m hectares. In addition, gains in yield (presently 3.6 t/hectare in India compared to the global average of 4.4 t/hectare and 6.7 t/hectare in China) will boost the market for hybrid paddy seeds.

The company has developed more than 10 highly promising HYVs at its modern research and seed processing facility near Hyderabad.

The corn seed market is growing fast and should double in the next 7-8 years because of increased demand for livestock feed and industrial applications. Monsanto is the leader in this market but Kaveri (third largest player) is well positioned as a profitable niche player with a share of 12%. Continued growth should benefit Kaveri significantly since the profit margin on corn seed is higher than for cotton.

In a bid to secure long term competitive advantage and strengthen relationships with farmers by delivering higher yields, Kaveri has

Kaveri has an extensive distribution network with excellent management of cash and receivables and minimal returns from farmers.

increased its R&D spend at 23% p.a. during the last five years. This has led to the introduction of leading HYVs in cotton (Jadoo, Jackpot, North Bullet, ATM), corn (Super Boss, Fauzi), red gram (Sampada) and paddy (Sampoorna). Kaveri established a 100% subsidiary, KexVeg India, in 2011 to capitalize on rapid growth in the domestic and export markets for high value exotic vegetables and herbs. The project currently involves cultivation of only five hectares in greenhouses but we expect commitment of meaningful resources over the next two years.

Kaveri has an extensive distribution network with excellent management of cash and receivables and minimal returns from farmers. Dealer advances have helped offset the cost of high inventories which need to be built ahead of the heavy crop. This is proven by the dramatic improvement in net working capital from an average of 85 days to only 21 days in the five years to FY13. The corresponding improvement in operating cash-flow has led to a marked reduction in financial leverage, giving considerable flexibility in tackling seasonality while permitting continuing research and innovation in product pipeline. We expect capital efficiency to remain impressive (ROE 35-40%) because of the gains in market share in cotton and the adoption of HYV paddy seeds. Introduction of new varieties and the emphasis on paddy should reduce seasonality in sales and improve cash-flows.

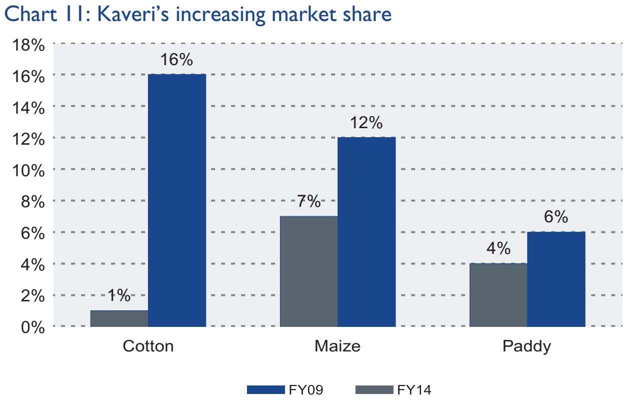
The corresponding improvement in operating cash-flow has led to a marked reduction in financial leverage, giving considerable flexibility in tackling seasonality.

A positive re-rating of the valuation multiples for Kaveri vis-à-vis peers is extremely likely, given its growing market share in cotton, the leveraging of existing brands by a rapid introduction of products from the research pipeline and a marked improvement in balance sheet quality from superior capital efficiency. The prospect of annual earnings growth exceeding 30% through a steady operating margins from a shift in product-mix towards paddy and corn hybrids is feasible.

The accelerated adoption of HYVs is a major long-term strategic positive for Kaveri. While apparently fully priced at 21x FY14 earnings, remarkable earnings growth and marked improvement in balance sheet quality suggest Kaveri should provide attractive returns for patient long term investors.

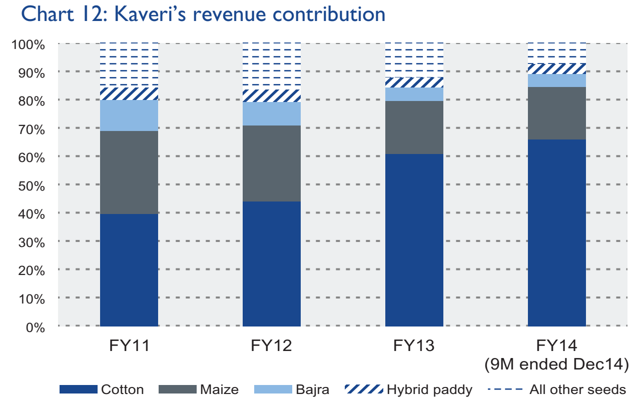
Company statistics	
Market capitalisation	US$729m
Dividend yield FY13	0.9%
P/E FY14	20.8x
P/B FY14	8.5x

Chart 11: Kaveri's increasing market share



Source: IIFL

Chart 12: Kaveri's revenue contribution



Source: IIFL

MACRO OVERVIEW

ECONOMIC DATA

Change over	2009	2010	2011	2012	2013	Last Qtr. (Sep-Nov)	This Qtr. (Dec-Feb)
Real GDP % Annual Change	6.7%	8.6%	8.9%	6.7%	4.5%	4.8%	4.7%
Avg. IIP % Annual Change	2.9%	5.3%	8.3%	3.1%	1.2%	0.1%	-0.05%*
Exports % Annual Change	14%	-4%	40%	22%	-3%	9.1%	1.3%
Fiscal Deficit % of GDP (Central Govt.)	6.0%	6.5%	4.9%	5.8%	4.9%	Govt. FY15 Est.	4.1%
Inflation (WPI) (Monthly Avg.)	8.1%	3.9%	9.6%	9.0%	7.4%	7.3%	5.4%
Inflation (CPI) (Avg.)	9.1%	12.3%	10.5%	8.4%	10.2%	10.4%	8.9%
Money Supply (M3) (Avg.)	20.5%	19.4%	15.9%	16.2%	13.5%	13.4%	14.6%
Interest Rates (Repo) (Avg.)	7.4%	4.8%	5.9%	8.0%	8.0%	7.5%	7.8%
10 year GOI Bond Yield (Avg.)	7.6%	7.2%	7.9%	8.4%	8.3%	9.0%	9.1%
FII Flows (US$bn) (CY)	+17.6	+29.3	-0.5	+24.5	+20.0	+5.9	+2.9
INR vs. US$bn (CY)	+3.7%	+4.0%	-18.9%	-2.8%	-13.0%	+6.3%	+0.5%
INR vs. GBP (CY)	-7.2%	+7.7%	-18.5%	-7.8%	-15.3%	+1.2%	-1.5%
MSCI GEM (US$) (CY)	+74%	+16%	-20%	+15%	-5%	+9.5%	-5.1%
MSCI Asia (US$) (CY)	+68%	+17%	-19%	+19%	+1%	+9.8%	-3.1%
Sensex (INR) (CY)	+81%	+17%	-25%	+26%	+9%	+11.7%	1.6%
S&P India Select (US$) (CY)	+73%	+17%	-41%	+26%	-4%	+18.5%	1.2%
BSE Midcap (INR) (CY)	+108%	+16%	-34%	+39%	-6%	+19.3%	+2.8%

* December to January

MACRO OVERVIEW

UPCOMING EVENTS

Event	Timeline	Comments
Financial sector	April - June	We expect the RBI to issue of new banking licences by June 2014.
National Election polling stage	April - May	Polling is scheduled in nine phases beginning 7 April, with the ninth and last phase ending on 12 May. With some 814 million eligible voters, India's election will be the largest the world has seen.
Election results	May	Election results will be declared on May 16. Based on recent assembly elections and trends in opinion polls, many believe that the anti-incumbency factor is strong and there exists a high possibility of BJP victory (220+ seats) more so, since the BJP has made significant progress in battleground states such as UP and Bihar, which represent 120 seats of the total 543.
Government formation	May	Given that the last date of the term of the current Government is May 31, 2014, the new Government is likely to be formed in the last week of May 2014.
Union Budget	July	The budget for FY15 by the new Government is likely to be presented on July 2014. This will be a keenly watched event, with the administration facing many challenges in bringing down the fiscal deficit whilst restoring growth.

A PRIMER ON

India's General Election 2014

A brief guide on the political landscape, probable outcomes and market implications

1. Foremost political organisations; what do they represent?

a. Main parties' social, economic and political philosophy

i. Only one truly "national" party which is Congress. It is left-of-centre social democrats but not as left as UK's Labour Party.
ii. BJP is the other major player but is focused more on the north and west of India and has little influence outside of that. They are right-of-centre both economically and in social matters.

b. How do the significant regional parties fit in?

i. There are 28 States in India with more than 70 registered State parties
ii. These regional parties have grown both in number and in importance over the last few election cycles by winning considerable seats in local contests and by prioritising their State over the national interest
iii. A coalition is the only way for a national party (Congress or BJP) to form a Government
iv. Regional parties in the North and Eastern regions of India tend to be left of centre (Communist in the case of West Bengal) and have historically allied with Congress
v. In the South, regional parties emphasise economic growth rather than handouts and it is here where the BJP will have a greater chance in finding coalition partners

2. Composition of the Electorate

a. Situation by region

i. 11 out of 28 states provide 420 seats out of 543 in Parliament. The key testing ground is Uttar Pradesh (UP)
ii. UP, the most populous state in India, is represented by 80 seats. In the last election BJP won only 10 seats here and is forecast to win at least 50 this time
iii. The other state to watch is Tamil Nadu in the South. The charismatic leader Jayalalitha will play kingmaker with her 20 seats and could help the BJP reach the finishing line

b. Concentration of caste and religious vote blocks

i. The saying goes in India "you do not caste your vote, you vote your caste" and Mayawati, the Dalit (untouchable) leader in UP is a case in point
ii. Especially amongst the young this voting preference is arguably losing its traction as jobs and prosperity are becoming a greater priority
iii. Overall the huge disparity in religions and castes make the science of polling a very tricky one

3. How is the outcome shaping up?

a. Coalition Government; what does it mean?

i. The latest poll suggests that the BJP led NDA coalition will achieve approximately 260 seats. To achieve the requisite 272 majority will therefore not pose any significant challenges
ii. A BJP win with more than 260 will provide stronger mandate for reform, noticeably lacking over the last five years

b. Fractured Government; what are the likely groupings and what are the implications?

i. Given the opinion poll strength for the BJP, a fractured Government remains a low probability scenario

4. Economic Agenda; what are the prospects?

a. Immediate priorities for the new administration

i. Providing a clear timeline of action to remove the policy logjam
ii. Sending a strong positive signal to international investors
iii. Restoring the hitherto broken relationship between the Government and the bureaucracy
iv. Bringing down the fiscal deficit to help control inflation, through reducing subsides and implementing tax reform via the Goods and Services Tax (GST) Bill

b. FX impact, relationship with the Reserve Bank of India

i. A BJP win will have a positive impact on the Rupee
ii. Any positive policy action from the new Government on the supply side, as well as curbing fiscal excesses, would help the RBI bring down interest rates sooner than expected

c. How effective can a new administration be?

i. Decision making may be frustrated in the Upper House of Parliament (Rajya Sabha)
ii. Tact, compromise and consensus building will be essential to getting through key reforms. A challenge for perhaps a more autocratic Prime Minister in the form of Modi
iii. The incoming Government will require the support of the opposition to achieve constructive legislation

d. What are the milestones to judge success?

i. Indicators such as the number of joint ventures, credit growth and corporate capex should be watched closely (more so than the stock market)
ii. The BJP manifesto has prioritised cutting the fiscal deficit which will be key to reducing the cost of capital
iii. Big ticket reforms, previously frustrated in opposition to spite Congress, such as FDI in insurance and defence, land acquisition reform, healthcare and the GST

REGULATORY INFORMATION

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