

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 BJP's representation will increase over the course of the Parliament
 - The Upper House's discretion only extends to non-finance related legislation and can be overcome by joint sittings if necessary
- 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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