



Birla Sun Life
Asset Management

Market Outlook

Opportunities & Challenges

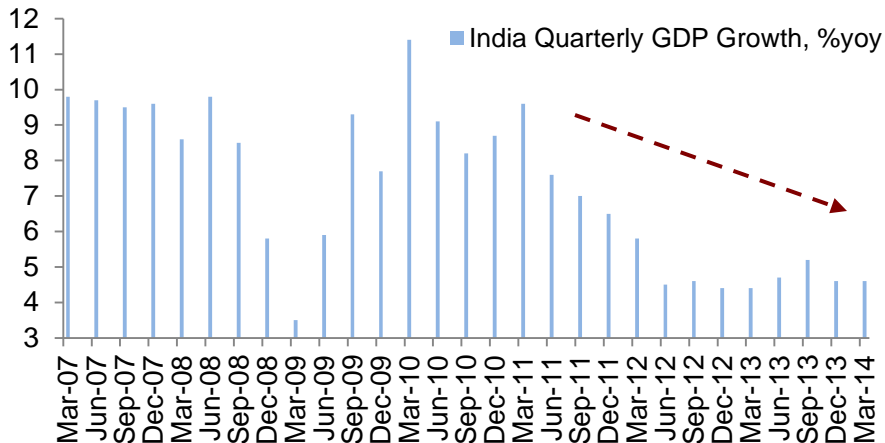
Birla Sun Life Asset Management Company Limited

Agenda

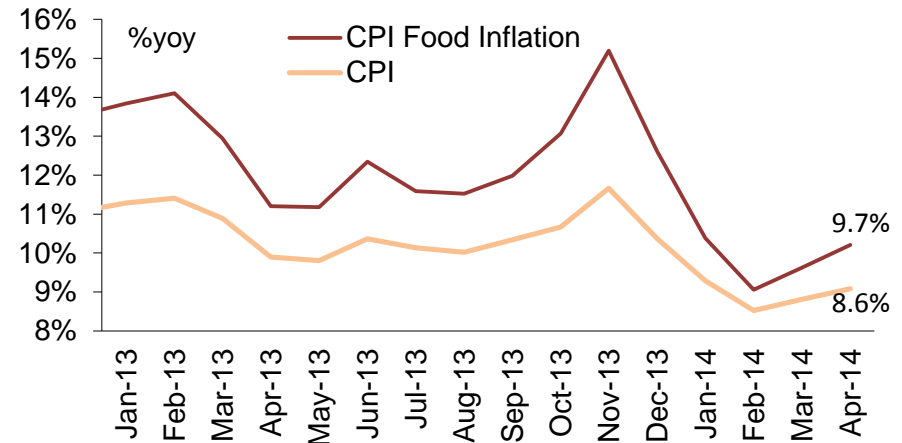
- Indian Markets
 - 2013: Where we got lost
 - 2014-15 : Winds of change- The way ahead
 - India Inc.: On the path to recovery
 - Budget view
 - Valuations and Expectations
- Market Outlook

Policy inertia impacted investments & growth

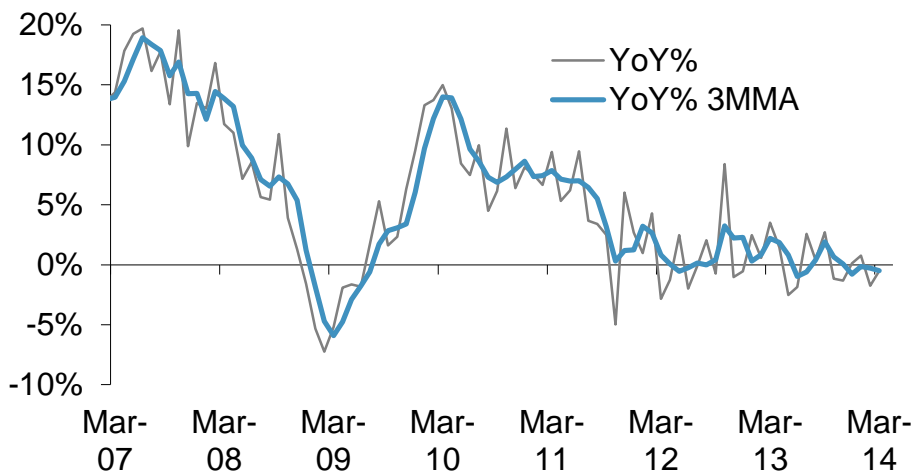
GDP Growth slowed down amid external and internal factors



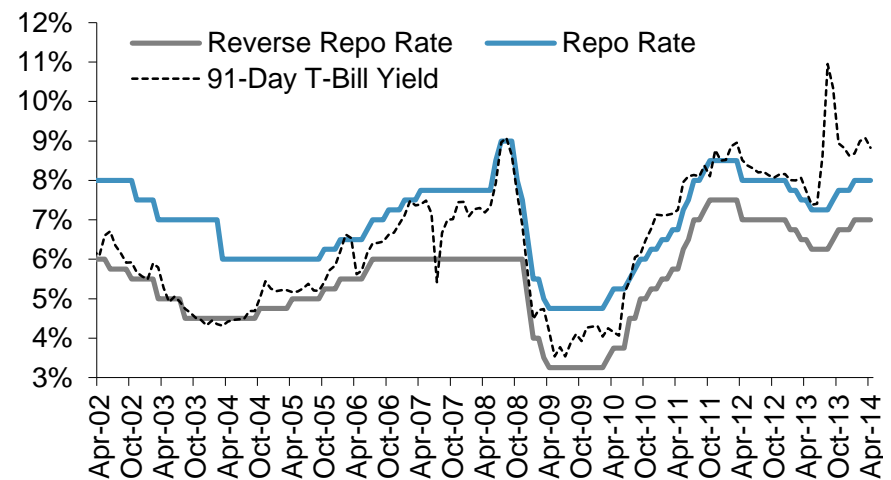
Persistent high inflation resulted in high rates, input costs



Industrial Production – flat for the last ~2.5 years now



Increasing interest rates have hit margins, investments



India 2015 & beyond : The way ahead

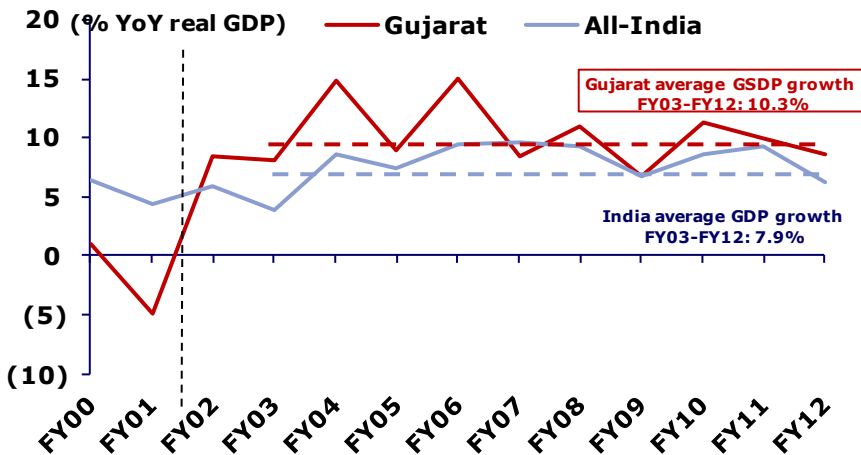
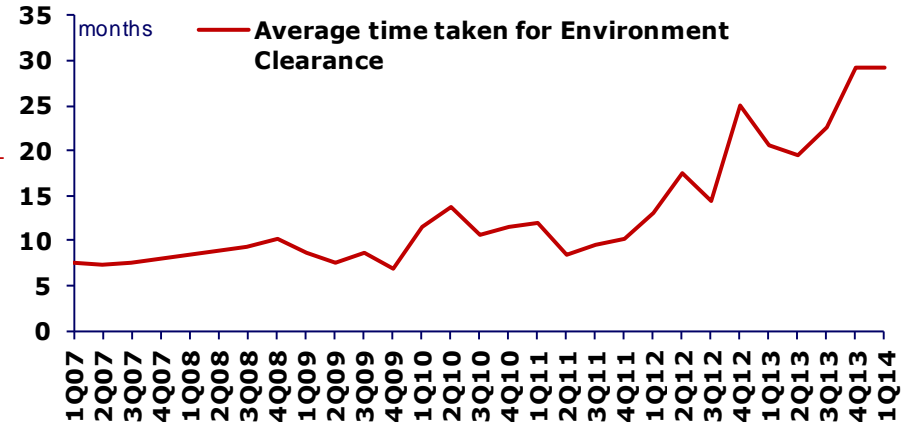
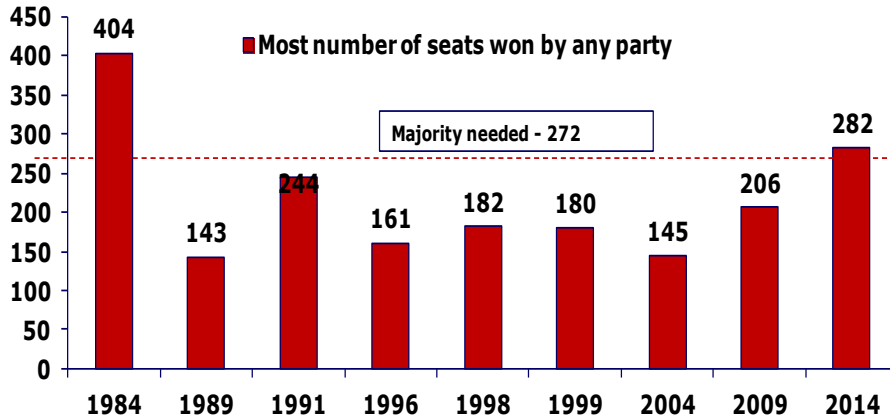
Pillar of future growth

Key drivers:

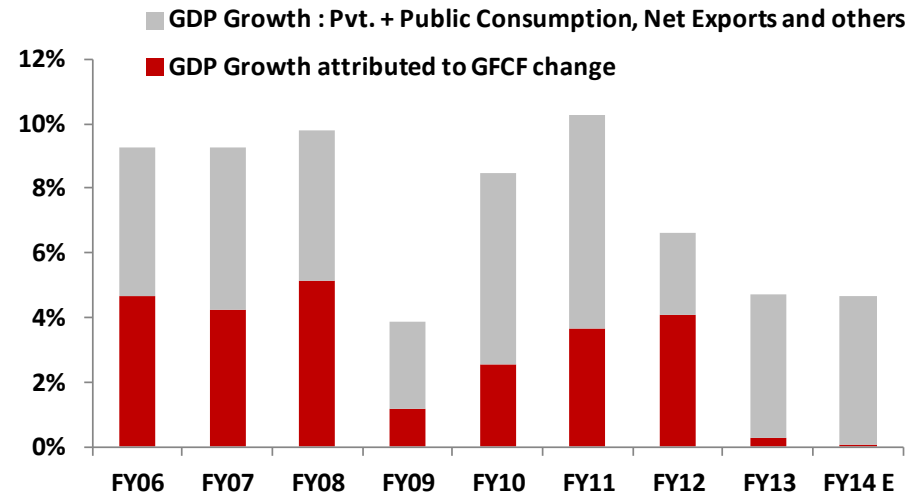
- 1. *Politics – stable, strong Government, after 30 years***
- 2. Investment cycle: policy push + cyclical upswing**
- 3. Inflation and interest rates to cool down**
- 4. Current Account and Currency have stabilized**
- 5. Budget View**

1: Politics: Stable, Strong.....after 30 years

Why is a stable Government so important?



Source: CLSA, BSLAMC



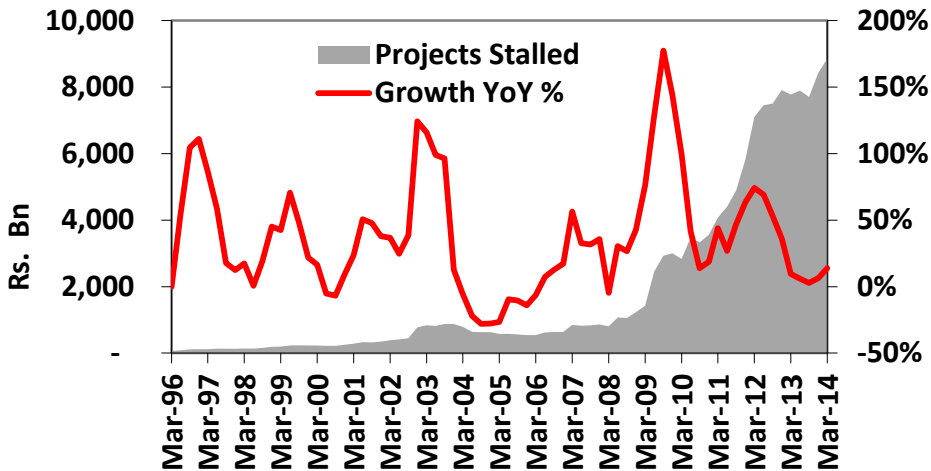
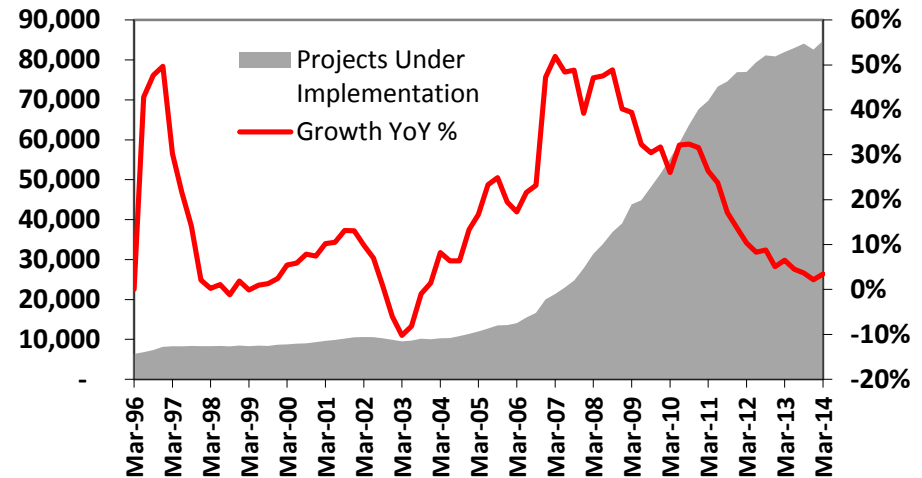
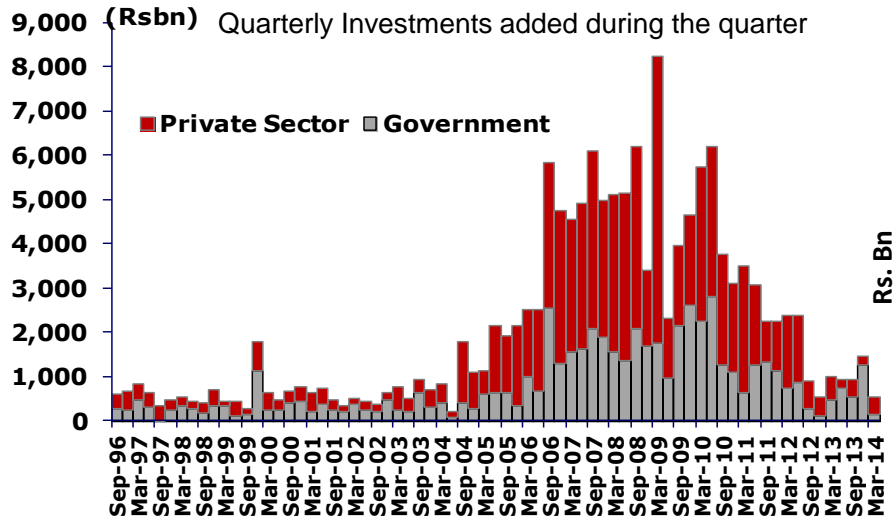
Politics: Stable, Strong.....after 30 years

Priorities of the new regime

1. **Reduce Inflation** - Release food stock, Restructure APMC laws
2. **Improve Governance, decision-making**
3. **Job creation by stimulating manufacturing investments** - liberalize FDI limits and law, create industrial clusters
4. **Reforms in mining, power sectors and land acquisition**
5. **PSU reforms** - Holding company structure
6. **Accelerate infrastructure creation**
 - Dedicated Freight Corridor, 100 new cities, River-linking, Road and Rail Diamond Quadrilateral, National Gas Grid, Strengthen Power Grid, High Speed Rail, Alternate Energy

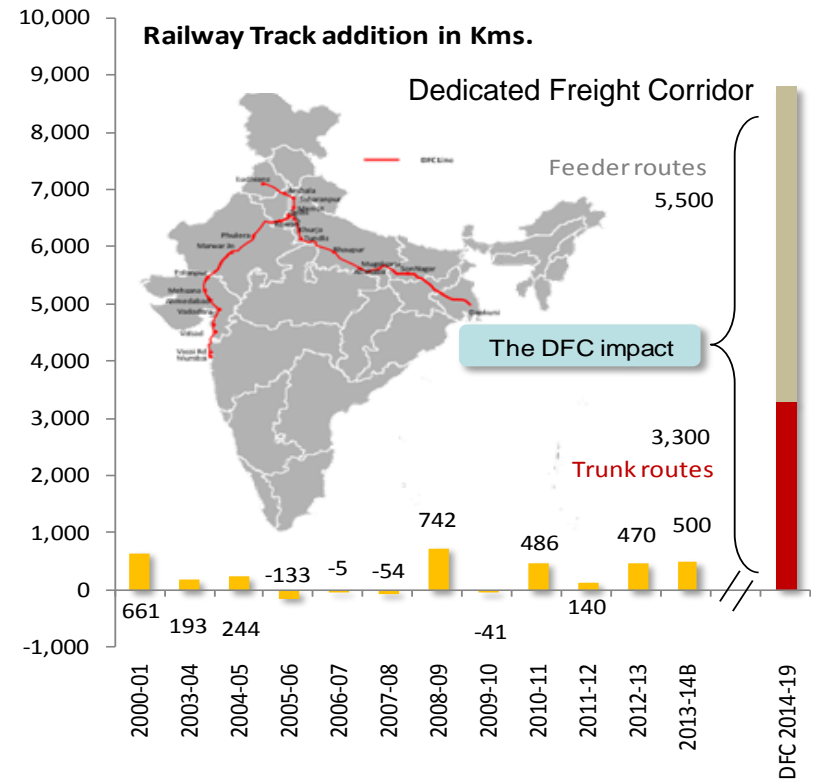
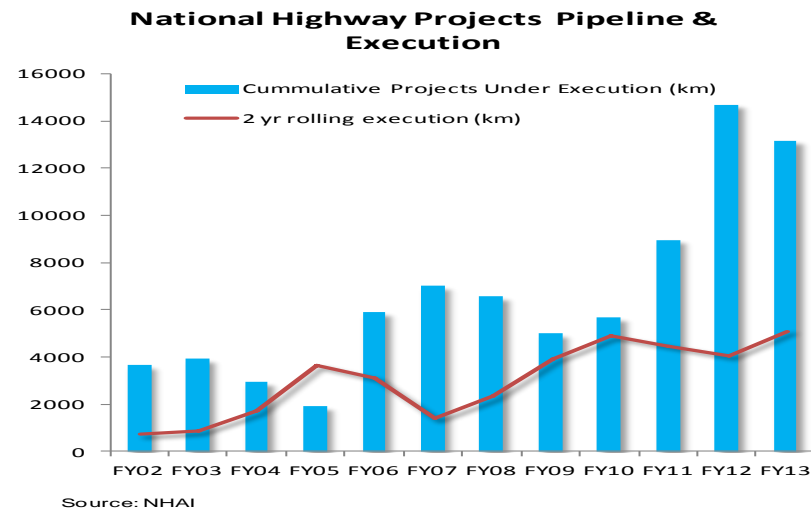
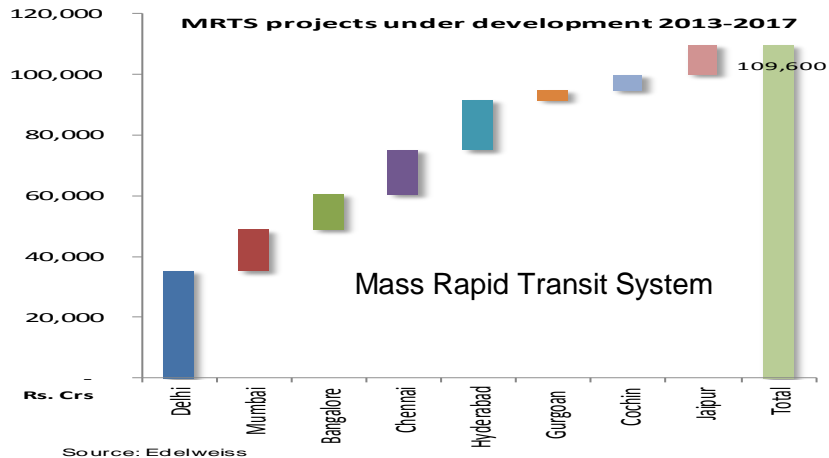
Investment cycle: Policy push + Cyclical upswing

As bad as it gets: USD 130 billion projects stalled



- Investment cycle suffered a virtual collapse. Corporate sentiments were impaired due to lack of clear road map, slowing GDP growth and elevated cost of capital.
- Projects worth INR 8,000 bn got stalled – due to Fuel linkages /EC/FC/Regulatory Clearances, creating a large back log of capital work in progress.
- Better policy framework and governance to revive investments.

Investment cycle: The opportunity

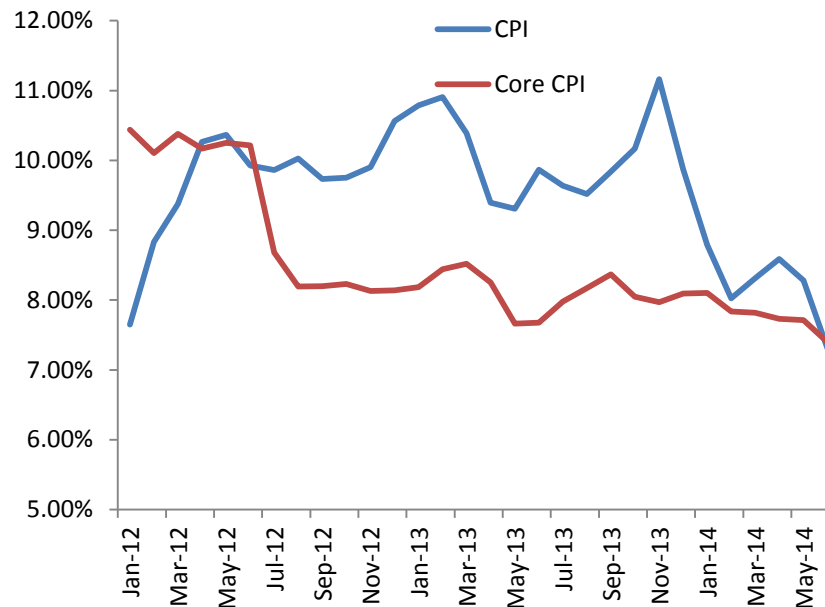
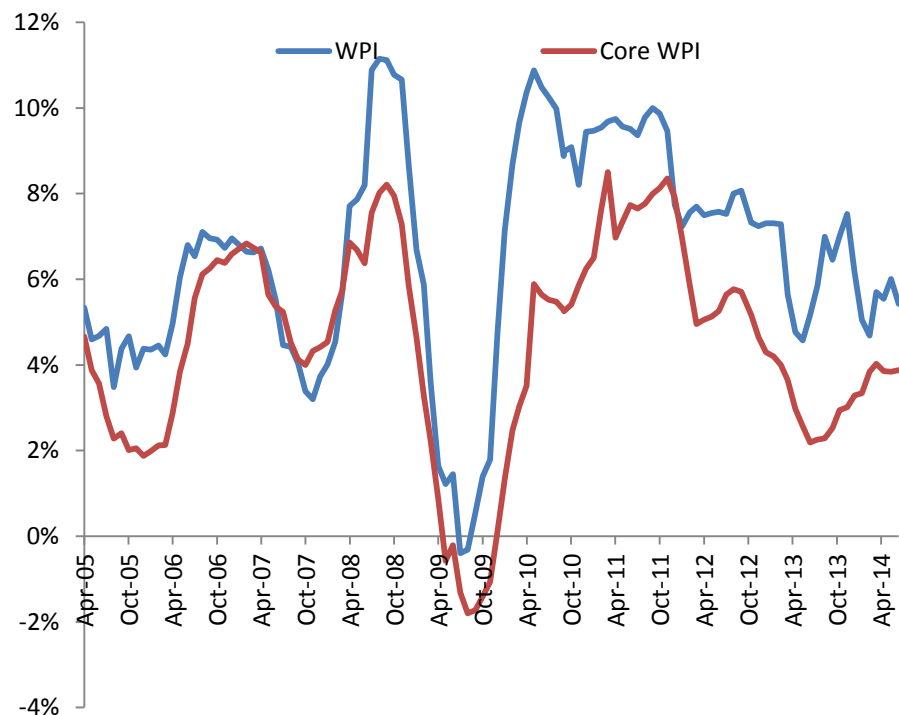


- FDI in critical sectors like defense, media
- Policy for labor-intensive sectors like textiles and construction are likely

New Government Report Card

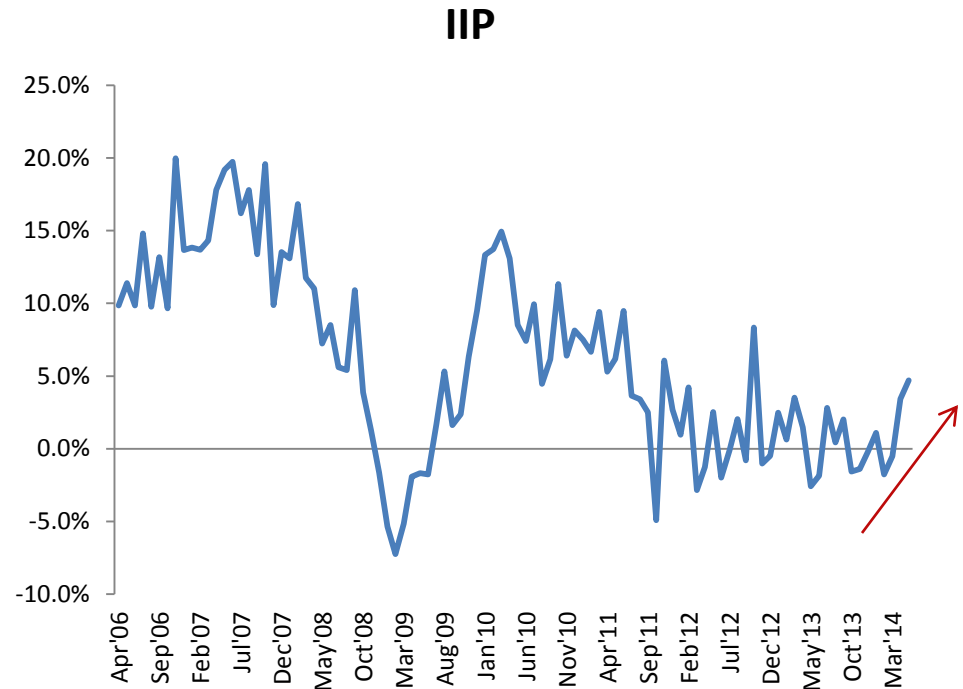
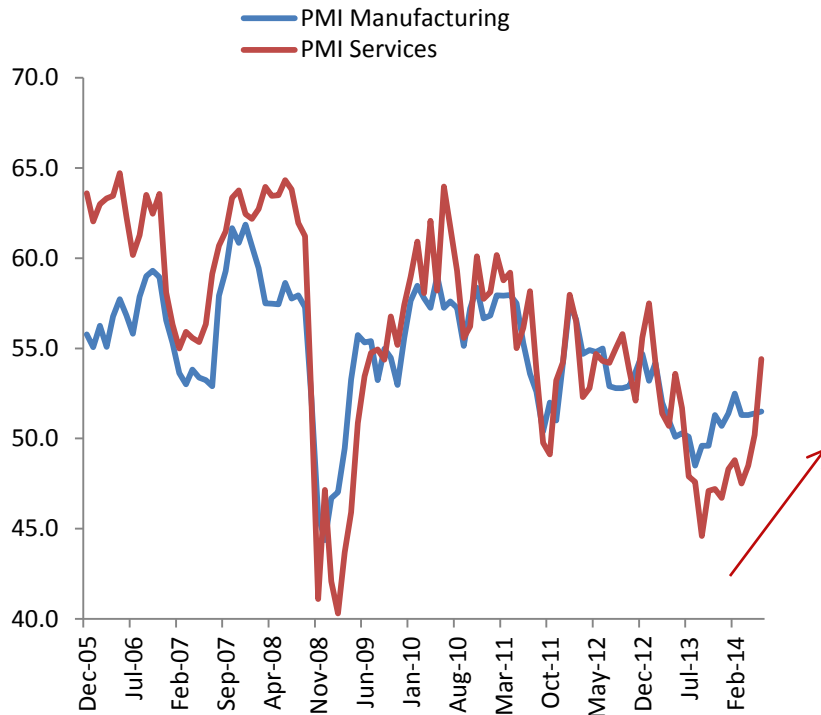
- **‘Minimum Government, Maximum Governance’ on its way**
 - a) Abolished several Group of Ministers (GoM) and Empowered GoM (EGoM)
 - b) Downsized the cabinet
 - c) Emphasized time-bound and transparent decision-making and sharply increased the accountability of bureaucrats and ministers alike.
- **Kick-starting the investment cycle**
 - a) Government promised to achieve 25km/day of road construction in FY15
 - b) Issues with 3 critical railway links for coal transportation – stuck for a long time on various issues – are being resolved with at least one project now on track.
- **Inflation Control: The road is long**
 - Measures to address inflation in the short term
 - Exhorting states to delist trade of fruits and vegetables through the Agriculture Produce Market Committees (APMCs)- so farmers can sell directly
 - The budget also promised a restructuring of the Food Corporation of India (FCI)

Inflation and Rates to cool down further



- Both the inflation matrix have registered a sharp decline in the month of June. Favorable base effects will continue to provide lower inflation prints till November.
- More importantly the momentum of Core inflation in case of both wholesale and retail has been trending down vs. its historical average.
- Going forward we expect inflation to atleast achieve RBI glide path thus creating a headroom for monetary easing eventually.

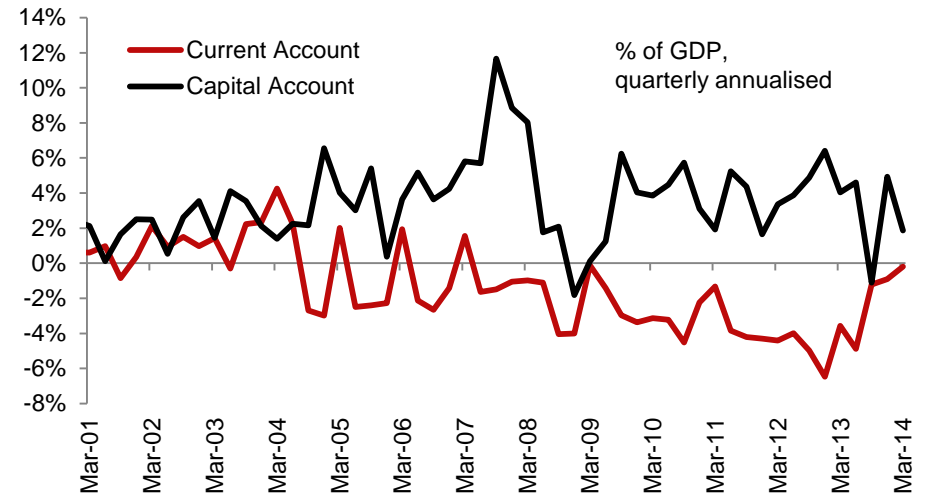
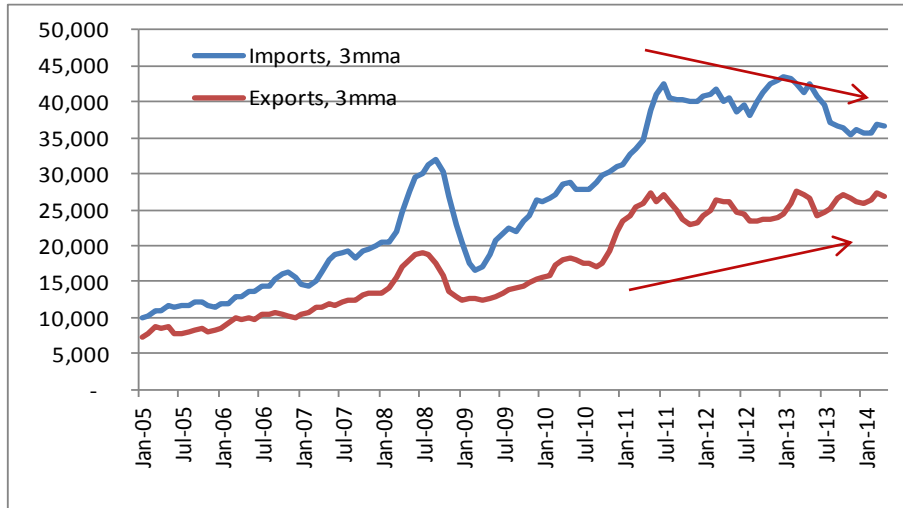
IIP and PMI pick up .. Early signs of recovery



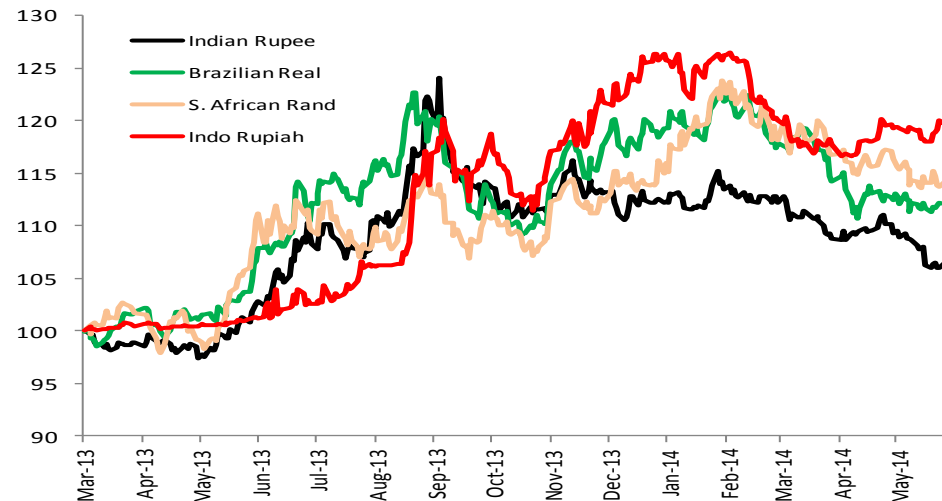
- Industrial activity has shown green shoots since the beginning of the fiscal. High frequency data such as automobile sales freight traffic etc. has also registered positive growth rates.
- The PMI for both manufacturing and services is back to expansionary mode. The business expectation index also hits at revival continuation.
- The nascent sign of recovery in PMI and IIP reflect a cyclical upturn in GDP growth rate.

Current Account and Currency have stabilized

Policy responses have worked..



- Dramatic reduction seen in India's trade deficit due to falling imports and rising exports
- Gold imports are down 70%. Non Oil, Non Gold imports also down. Current account deficit for quarter ended March 14 is the lowest in 4 years
- Indian Rupee is amongst the best performing in the past 9 months



Budget The guiding post

Budget Overview 2014-15

- ✓ GDP growth estimated between 5.4 - 5.9% as per the economic survey
- ✓ Fiscal deficit budgeted at 4.1 % of GDP- and fiscal path 3.6% in FY16 and 3% in FY17.
- ✓ Current account deficit expected at 2.1% of GDP
- ✓ Revenue deficit projected at 2.9% of GDP
- ✓ Net market borrowing to be Rs. 4.6 lakh crores

Road Map expected

- ✓ Market expected clarity on Road map for GST & reforms for Subsidy rationalization.
- ✓ Lack of clarity on the application of GAAR created uncertainty for a host of entities.

Budget Math and Our View

FY14 Deficit

- ✓ The fiscal deficit for FY14 was finally pegged at 4.5% of GDP v/s budget estimates of 4.8% of GDP
- ✓ Sharp cut in planned expenditure key reason (10.8% growth vs BE of 29.4%)
- ✓ Revenues were running below budget estimates due to slowdown in economic activity and shortfall in divestment receipts

FY15 budget math: More realistic

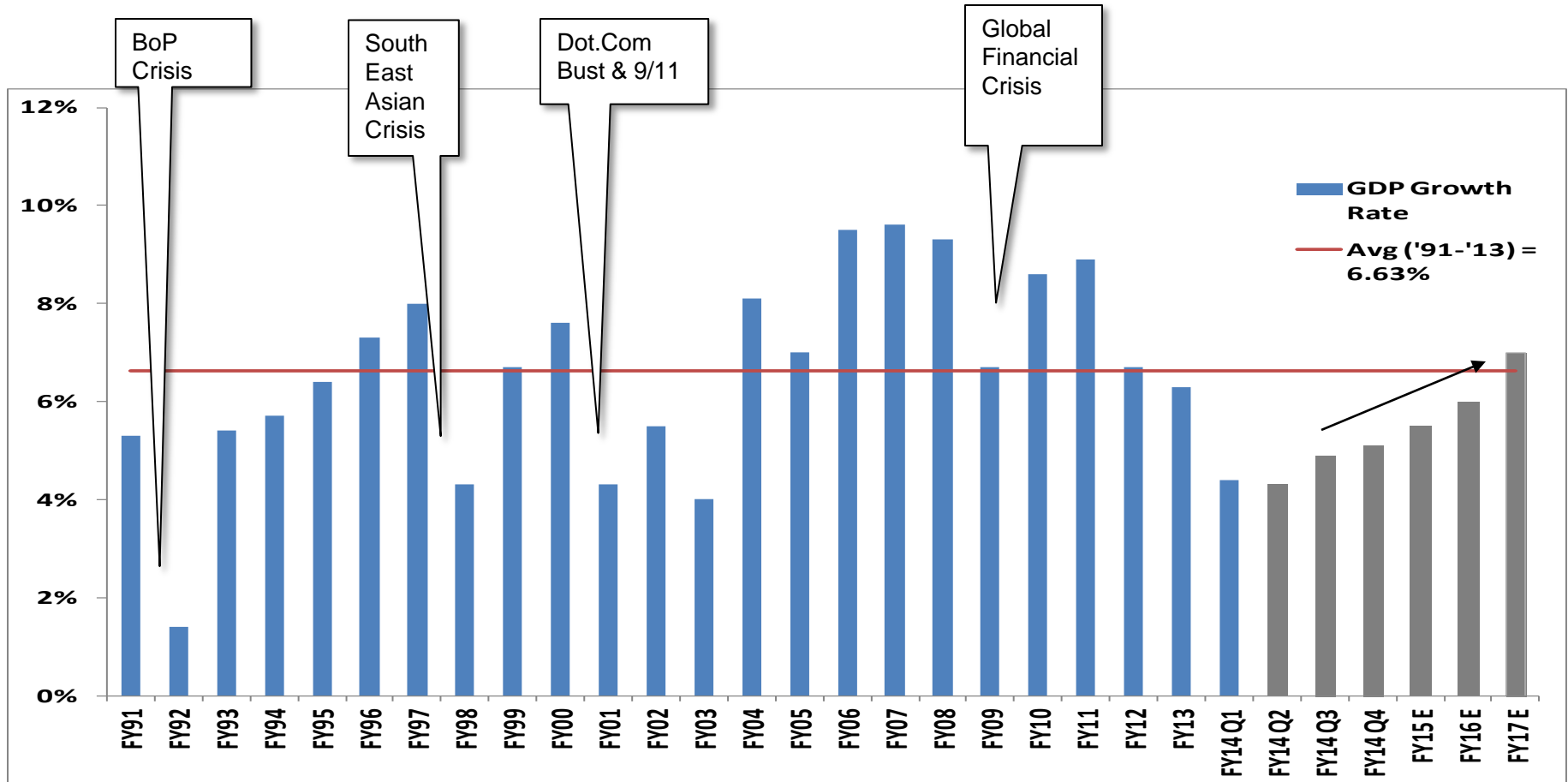
- ✓ The fiscal arithmetic is based on nominal GDP growth of 13.4%, total revenues rising 15.6% and expenditure rising 12.9%
- ✓ GDP growth assumption moderately optimistic, expect receipts targets to be met on account of non-tax revenues
- ✓ Higher expenditure budgeted for an investment starved economy
- ✓ Upside risks to fiscal deficit unlikely

Budget Key Sector announcements

Sector	Impact	Announcements
Infrastructure	Positive for all Road developers/ Asset Owners	NHAI allocation, Plan to construct 8000Km road, Increase in planned Expenditure, REIT
Capital Goods	Positive for T&D companies	New Feeder separation scheme
Capital Goods	Positive for all Industrial companies	Investment allowance of 15% for investments made above Rs250mn as compared to Rs1bn earlier for a period of 3 years.
Power Utilities	Positive for entire sector	Govt. to oversee that all power companies to get adequate coal supply
Banking	Positive for Infra-Finance	Banks to be permitted to raise long term funds for lending to infrastructure sector
Banking and Insurance	Positive for insurance companies	Proposed to increase foreign ownership limit in the insurance sector from 26% to 49% through the FIPB route

India Inc: On the path to recovery

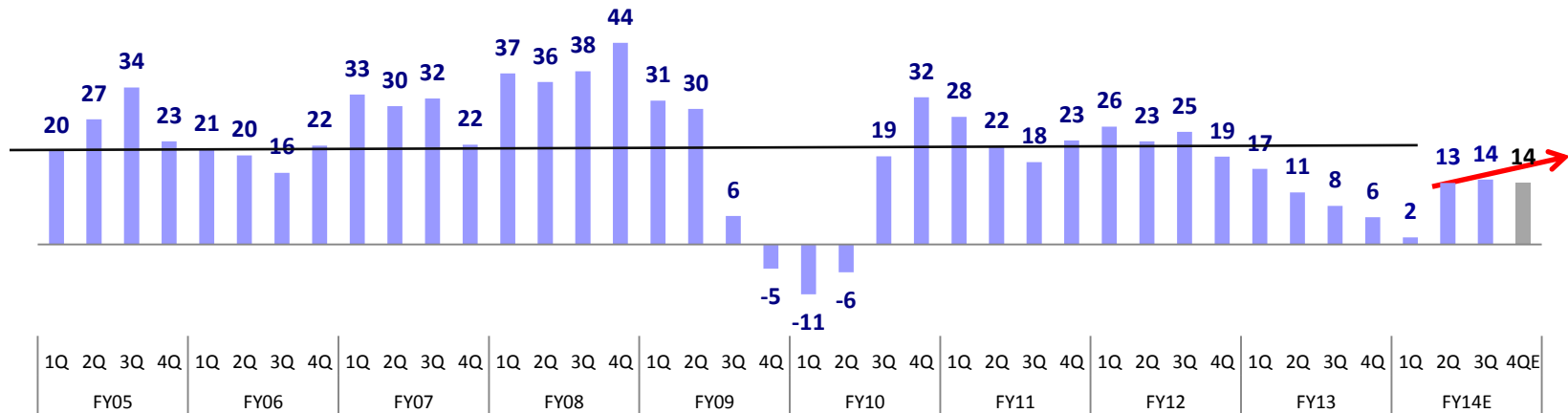
We expect cyclical bottom in GDP growth rates



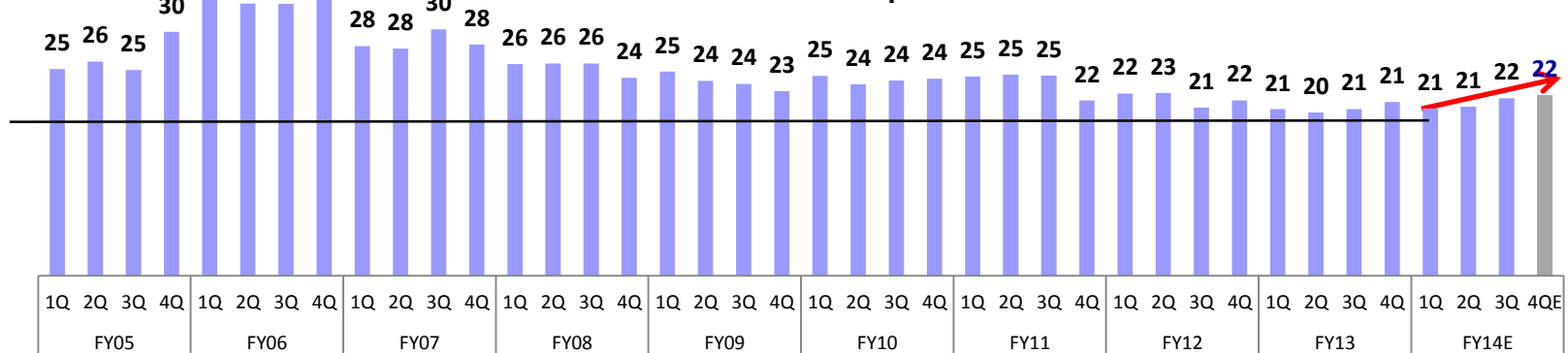
Since '91 India's growth has averaged 6.6%. We believe **GDP growth has bottomed out in 2014**

Sales and Margins – Slow Recovery has begun

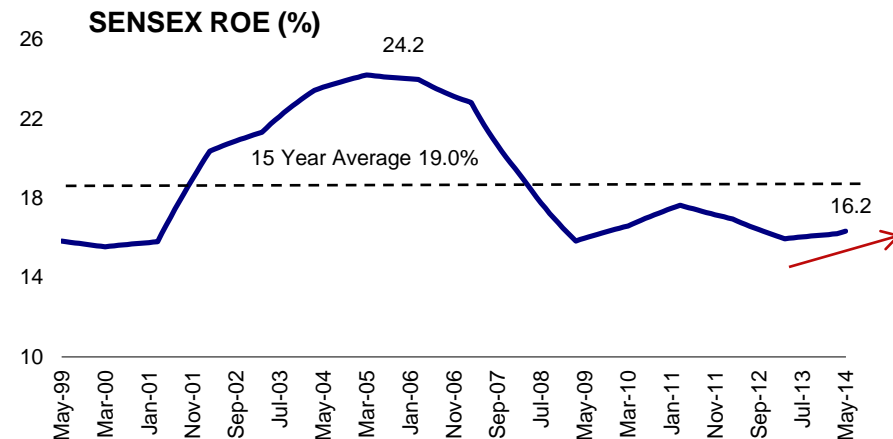
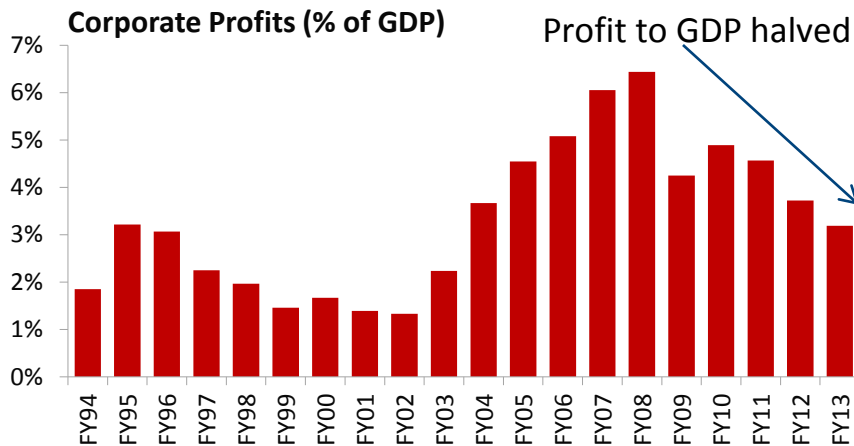
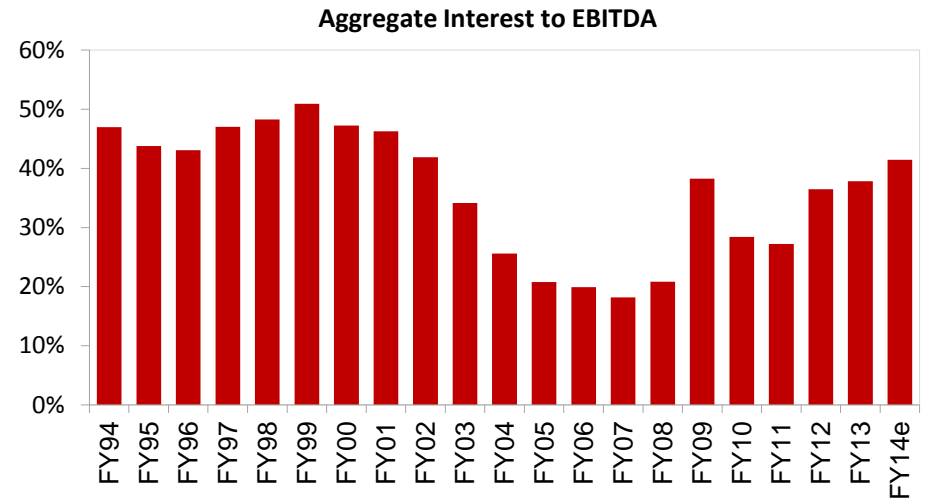
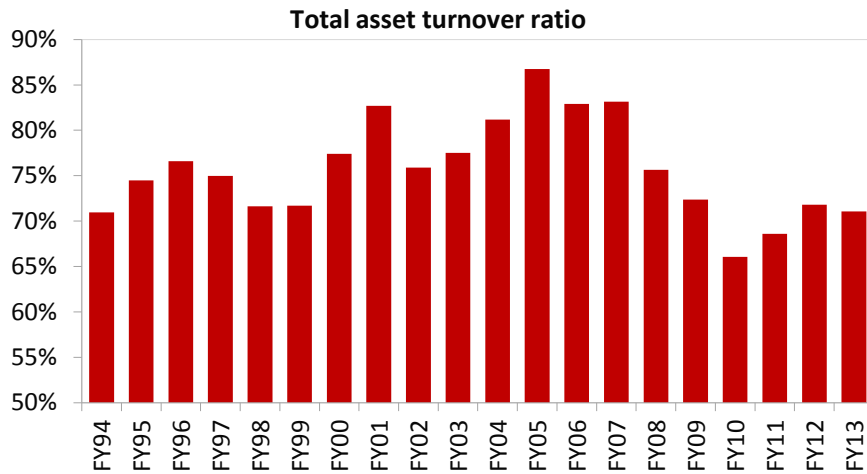
Sales growth for
SENSEX Companies



EBITDA Margin (%) for
SENSEX Companies

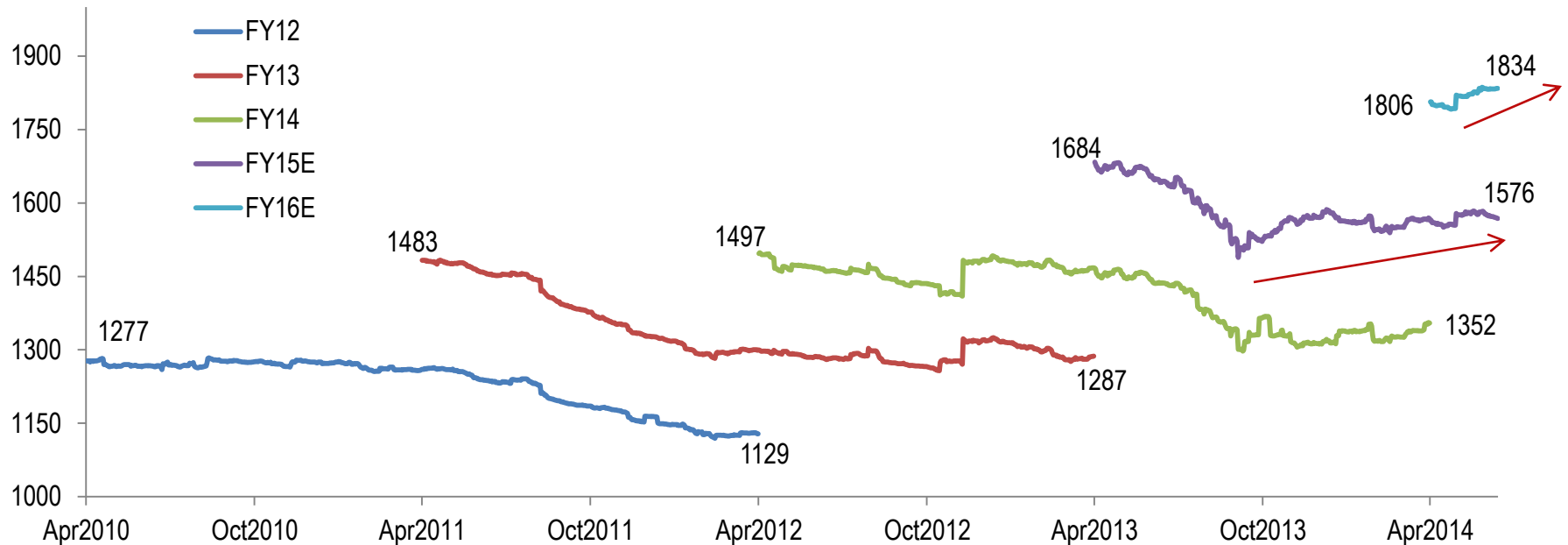


Profitability at cyclical lows .. Margins and Interest costs are key drivers of profits



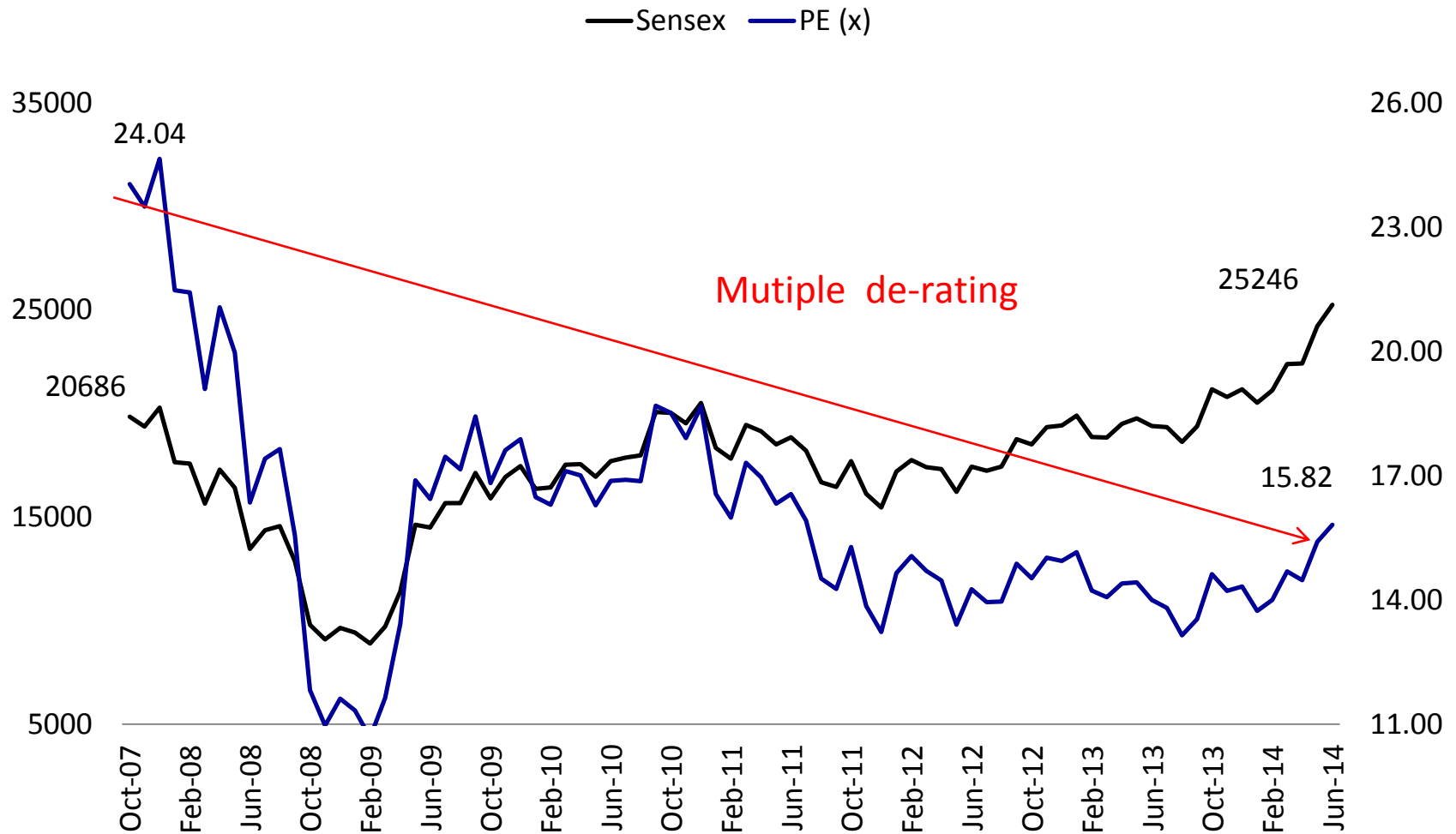
Source: Bloomberg, BSLAMC, IIFL & MOSL

Consensus expectations are still low

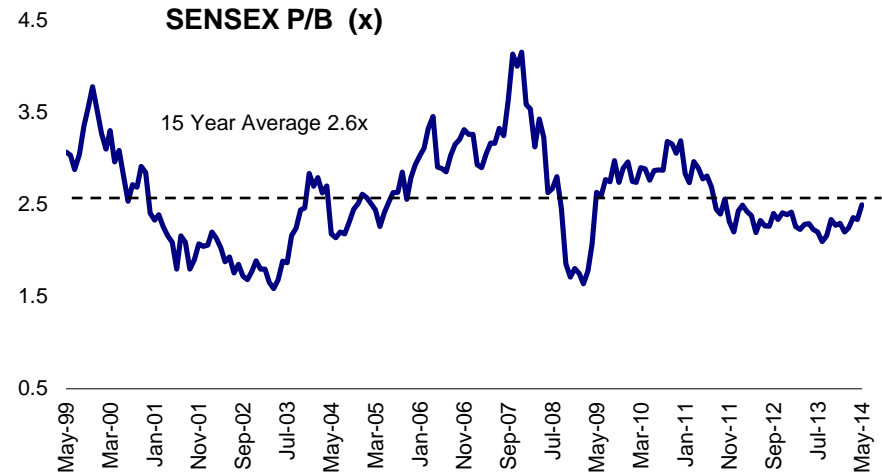
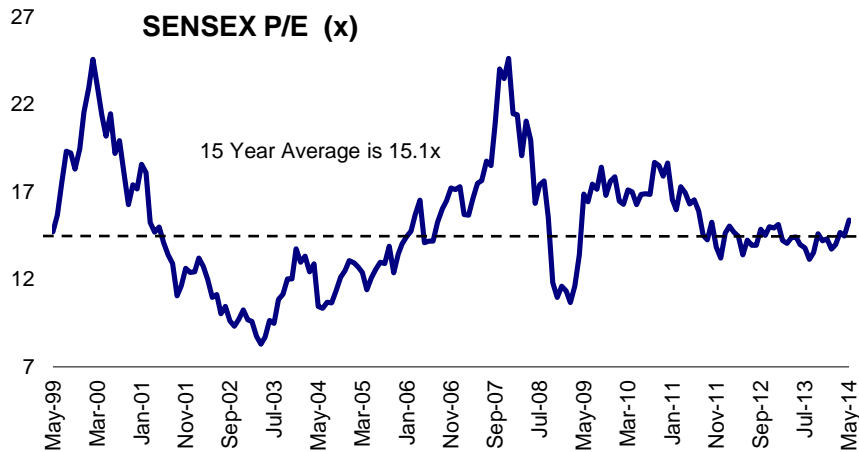


- Over the last four years we have seen an earning decline cycle. In FY12, FY13, FY14 we saw sharp cuts in Sensex earnings estimates.
- From Dec 2013 we saw consensus earning revision towards the positive side.
- Historically, analyst estimates for earning growth tend to lag in accelerating GDP growth environment. Over the course of the next few years we expect upwards revision in estimates.

Markets at all time High.. Where are Valuations



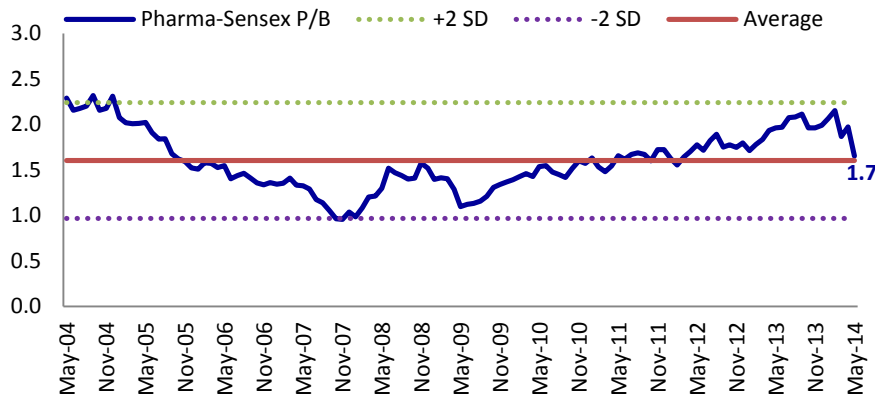
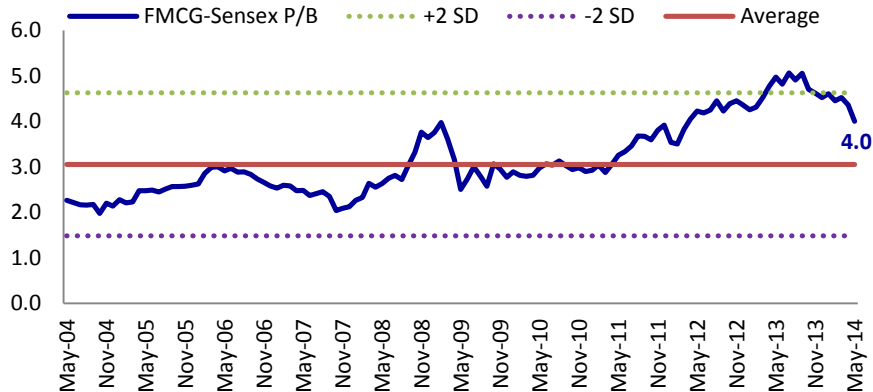
Market valuations are still reasonable



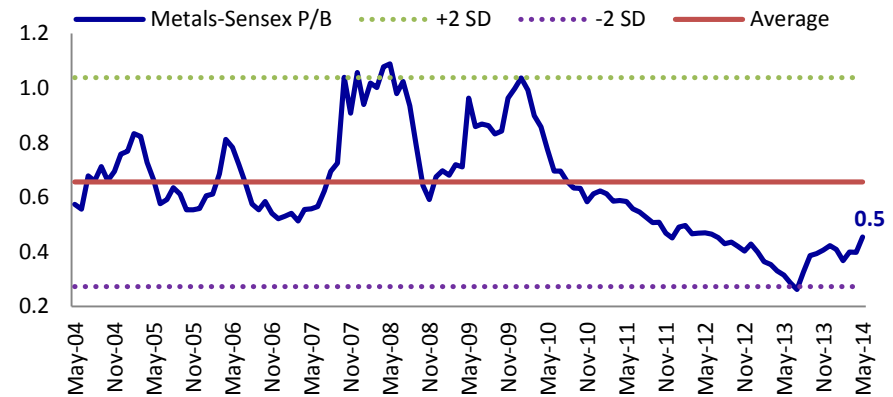
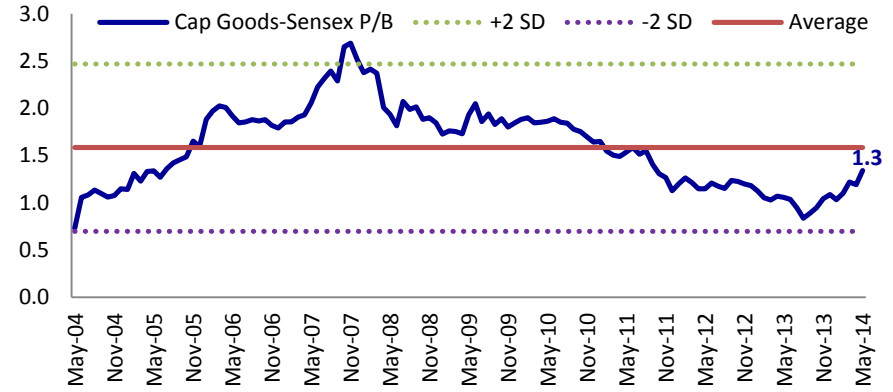
- Valuations are slightly above the Long term averages of 15.1x. Currently Sensex trades at 15.8x 1 Year forward PE.
- Even as indices are trading near all-time high levels, valuation parameters are comfortably below the 2008 highs.
- The current PE are on moderate earnings growth estimates. As earning upgrades cycle sets in on visibility in reform process, valuations will provide further comfort.

Opportunities in valuation gaps, cyclical more headroom..

Defensives vs Sensex P/B



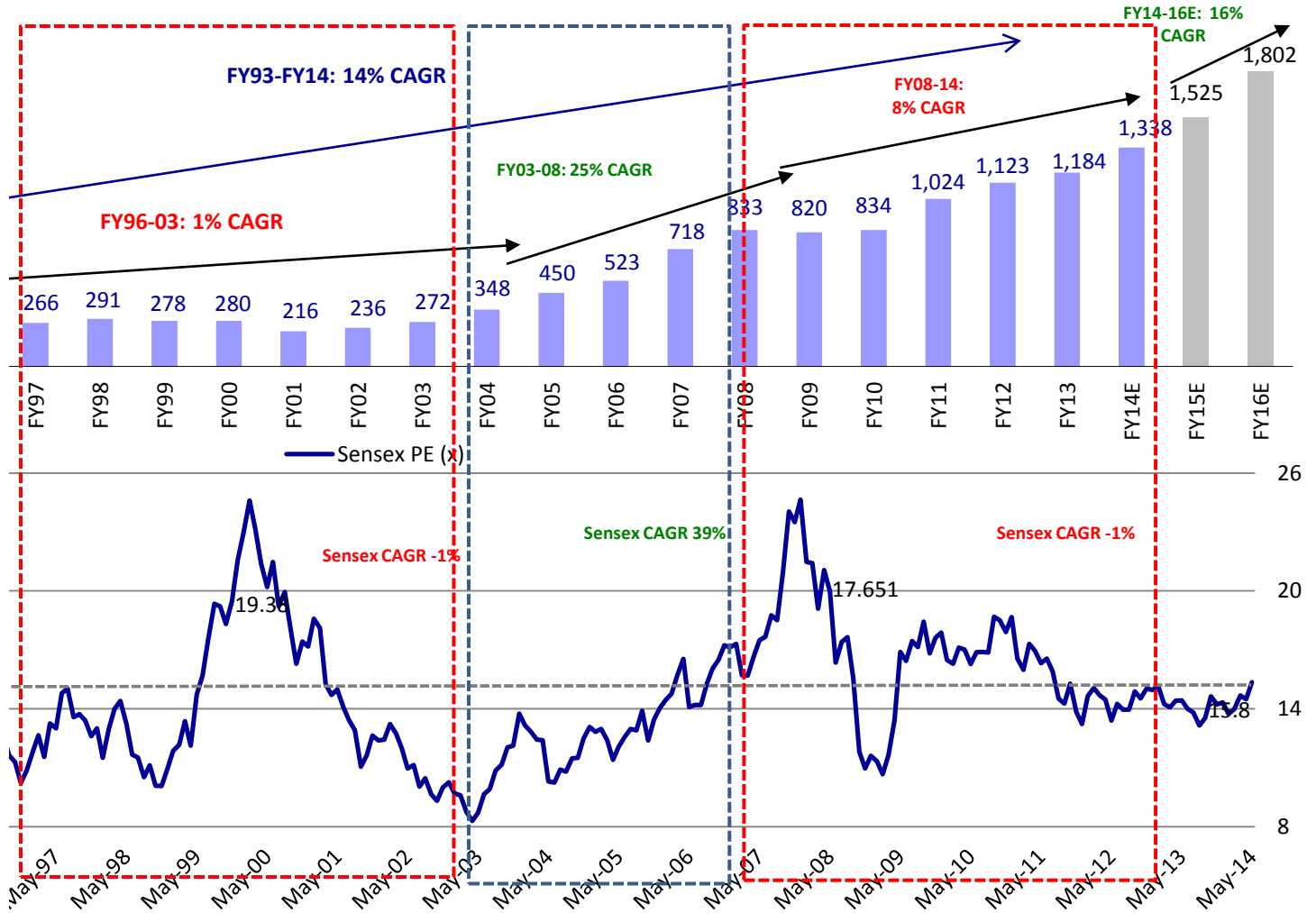
Cyclicals vs Sensex P/B



Cyclical sectors trading below their LT average levels makes a compelling case for mean reversion as outlook improves.

Sensex Historical Earnings Growth

Correlation
of
Earning
growth
and
PE Re-rating



Equity markets have rallied on decisive election outcome leading to hopes of improving pace and quality of economic recovery.

- A pro-reform government coupled with decisive leadership will accelerate the reforms and growth process.
- The depressed corporate profitability will improve over the next 3 to 5 of years as the economy sees a cyclical uptick, clocking CAGR of 18% - driven by higher revenues, operating leverage and interest costs savings.
- Even post the sharp run up- Sensex trades at 1year forward PE of 16.8x. Earning upgrades cycle on visibility in reform process will provide further support to market and valuations.
- We expect cyclical recovery in economy with average GDP growth of 6% over the next 5years with exit GDP of 7.5 to 8%. - equity returns will be driven both by earning growth and valuation re-rating providing investor a good investment opportunity.
- In the current scenario, equity investments provide a compelling case over other asset classes. Indian investors should increase their equity allocations and benefit from Indian growth story.

Thank You

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