

India – Time to Shine Again

20 August 2014

Mashreq Country Research





Table 1: Country Snapshot

Social		
Region		Asia-Pacific
Area	Sq. Km.	3,287,590
Population	Mn	1,237
Urban Population	%	31.66
Urban Population Growth	%	2.3
Capital		Delhi
Largest City		Mumbai
Official languages		Hindi, English
Political		
Set-up*	Federal Union	29 states, 9 union territories
Constitution		Parliamentary Democracy
Number of political parties		6 national parties
Political party in power		Bharatiya Janata Party
Prime Minister		Narendra Modi
President		Pranab Mukherjee
Economic		
Currency		Indian Rupee (INR)
Implied PPP conversion rate		22.33
Current Conversion Rate	INR/USD (Aug 11)	0.1634
GDP (2013)	USD bn	1,870.65
GDP/Capita (2013)	USD	1,504.54
Unemployment	%	3.7%
Current inflation	%	7.31%

Source: World Bank, Trading economics, IMF; **Note:** Urban population and growth thereof corresponds to 2012 and 2010, respectively.

Chart 1: Economic growth (%)

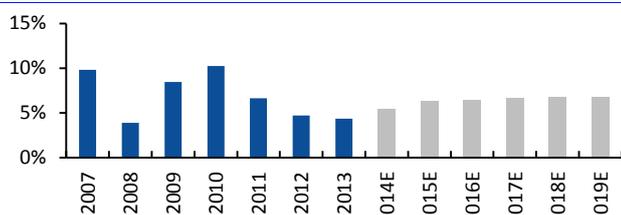
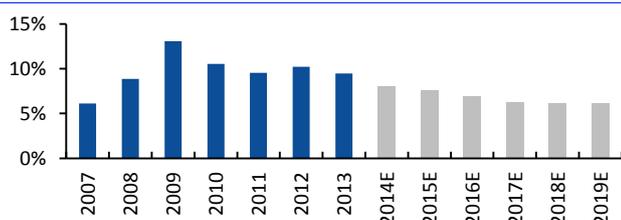


Chart 2: Inflation (%)



Source: IMF World Economic Outlook, April 2014

- The BJP-led NDA was voted into office on May 16 with a majority of 336 (out of 543) seats. After a prolonged period of policy inaction, the new government was expected to take swift decisions. The NDA delivered on that. In its first month in office, it streamlined the government and consolidated powers under the PMO to fast-track governance. It unveiled anti-inflationary measures and formed a special team to curtail the flow of black money.
- The UPA failed miserably in its second term. A large number of corruption scams and delays in decision-making and policy implementation marked the end of its decade-long run. The economy stagnated and the industrial sector slowed, even as inflation remained stubbornly high. GDP growth slipped to an average of 6.9% over the five years from 2009 to 2014.
- Markets welcomed the NDA government's maiden budget for FY15 (ending March 31, 2015) as it set the tone for achieving a higher growth trajectory, greater job creation and attracting investments, while restoring fiscal discipline.
- The prospect of a stable government after three decades pushed equity markets to record highs. Benchmark Sensex registered 24% returns in 1H14, the highest among major emerging and developed economies.

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India's 2014 Elections – A Sweeping Mandate for Change

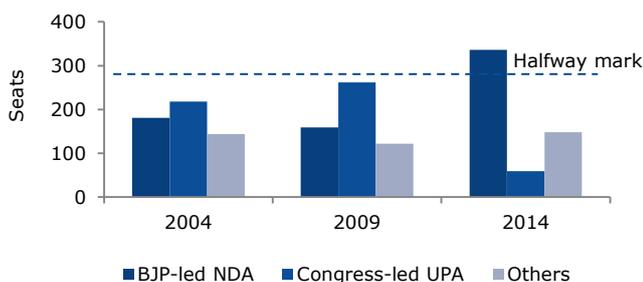
An Unprecedented victory for the Bharatiya Janata Party (BJP)

BJP registered a sweeping victory in 2014 Lok Sabha elections

The Bharatiya Janata Party (BJP) achieved a historic win in the 16th Lok Sabha elections, held over April and May 2014. The party won a clear majority, with 282 seats. The victory is the biggest since 1984, when Congress under Rajiv Gandhi won 414 seats shortly after the assassination of then Prime Minister (and his mother) Mrs. Indira Gandhi. Market sources say that the nationwide sympathy helped Rajiv Gandhi win with a two-thirds majority. This year, the BJP's 28-party coalition National Democratic Alliance (NDA) secured 336 in the 543-seated Lok Sabha. After years of wobbly coalition governments, the large number would enable the BJP to lead a stable government at the center. In contrast, Congress (which governed India for a total of 49 years out of 67 years of independence and successively since 2004), was nearly decimated. The party won 44 seats on its own and 59 seats along with its coalition United Progressive Alliance (UPA).

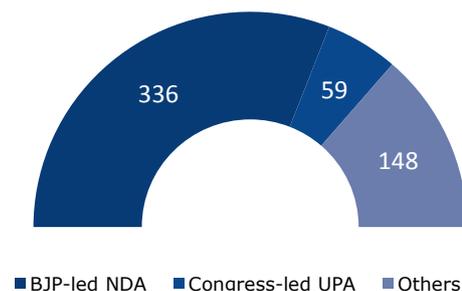
State wise, the BJP consolidated its position and completely shut the Congress out of western states of Gujarat and Rajasthan. The party recorded large-margin victories in northern states of Delhi, Madhya Pradesh, and Uttarakhand, and received strong support in crucial states in western, central and southern parts of the country such as Maharashtra, Karnataka, Bihar, and, notably, Uttar Pradesh, which has the largest number of Members of Parliament at 80. The BJP also increased its vote share in states where it did not have a substantial presence, with 22% in Odisha, 17% in West Bengal, and over 10% in Kerala.

Chart 3: Party-wise Lok Sabha seats over three terms



Source: Mashreq

Chart 4: BJP-led NDA won a clear majority in 2014



Source: Mashreq

...and near end of the Congress dynasty

A good run in the first term...

The UPA government came to power in 2004 under the aegis of Prime Minister Dr. Manmohan Singh. Dr. Singh earlier served as India's Finance Minister between 1991-96 and orchestrated the liberalization phase, which opened up a host of opportunities for the country. The ruling party's performance in the first term was satisfactory as the GDP averaged a strong 8.1% over the five years from 2004 to 2009. The UPA won the second term due to strong support from the country's poor, who had benefited through various welfare schemes including the INR650 billion (USD10.6 billion)¹ farm loan waiver announced in February 2008 and the Mahatma Gandhi National Rural Employment Guarantee (NREGA) scheme launched in 2006. Additionally, the Right to Information (RTI) act earned the party the votes of the middle class. A lack of workable alternatives also contributed to the UPA's re-election for a second term.

...cut short by non-performance in the second term

A large number of corruption scams related to 2G spectrum, coal block allocation and delays in decision-making and policy implementation during the second term marked the end of UPA's dream run. Between 2009-14, the UPA government spent large sums of money in the form of subsidies as a populist move to garner votes from the public, instead of spending it on completion of big projects at hand. Inflation remained stubbornly high (averaged 10.6% over 2009-13) and strained household budgets, while the slowdown in the industrial sector resulted in insufficient jobs being created for the growing workforce. As a result, GDP growth declined and averaged 6.9% during 2009 to 2014.

UPA won the second term on the back of its satisfactory performance in the first

However, it failed miserably in its second term

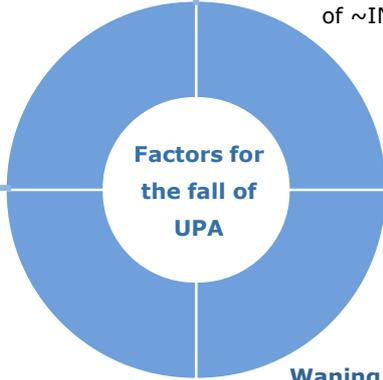
¹ Using an exchange rate of INR1 = USD0.01634, as of August 11, 2014

Chart 5: Major factors that contributed to the downfall of Congress in the second term
High profile corruption and scams

- Irregularities in the of 2G spectrum allocation, in which CAG* estimated a notional loss to the exchequer of INR1.76 trillion (USD28.8 billion)
- Unlawful activity in the allotment of coal blocks, which the CAG calculated at INR1.86 trillion (USD30.4 billion)
- 2010 Commonwealth Games funds misappropriation worth about INR700 billion (USD11.5 billion)
- Violation of rules in the allotment of Adarsh Housing Society apartments in Mumbai

Policy and bureaucratic paralysis

- Environment of suspicion and a lack of political consensus on major reforms
- Environmental and other regulatory approvals, land acquisition and funding issues led to delayed project implementation and rising project costs
- As per Ministry of Statistics and Programme Implementation, around 301 central projects were delayed, each at an investment of more than INR1.5 billion (USD25 million). This resulted in cost overruns of ~INR1.74 trillion (USD28.4 billion).



Factors for the fall of UPA

Weakening federal structure

- State governments expressed their displeasure at excessive centralization of powers. Nine states refused the proposal for setting up of a central National Counter Terrorism Centre (NCTC), an anti-terrorism unit, which provides real-time intelligence inputs for responding to terrorism
- The central government was also accused of raising obstacles in the funding of states' development schemes.

Waning economic indicators

- The economy grew at 4.7% in the full year ended March 2014, the lowest growth level in 10 years and the second straight year of sub-5% expansion
- Growth remained subdued largely due to a slowdown in the manufacturing sector. Inflation remained in near double-digit figures consistently for the past two years, negatively impacting consumer spending as well as savings. The fiscal and current account deficits also tested multi-year highs.

Source: Mashreq; *CAG– Comptroller and Auditor General of India

Given the UPA's abysmal record of governance, the party's loss in the general elections is not surprising. However, the magnitude of the defeat is astounding. BJP's landslide victory was primarily driven by high voter expectations from the party's prime ministerial candidate Narendra Modi. Mr. Modi served as the Chief Minister of the western state of Gujarat for three consecutive terms after taking office in 2001.

With elections over, BJP government seems to be standing at crossroads

The NDA government won this election on the promise of development. The ability to bring about positive change, while achieving set targets for fiscal deficit and economic growth, will be a key test for the NDA government. Investors have high hopes that the new government would be more likely to promote economic reforms, particularly as Mr. Modi ran his campaign on the basis of his reputation for being business-friendly. With the landslide victory, the party has the mandate to enact long-needed reforms to do away with red tape, boost business investment and revive economic growth, without unnecessary impediments by coalition partners.

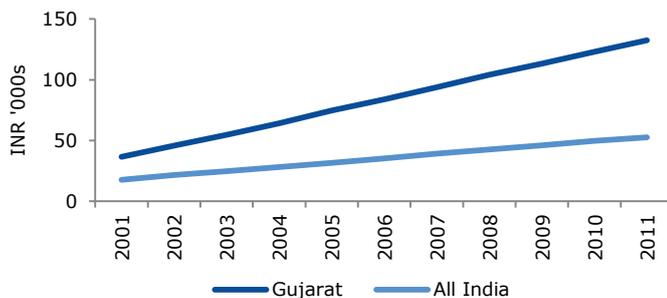
PM Narendra Modi's party won the elections on promises of good times

The state of Gujarat flourished under Mr. Modi's administration

The track record is encouraging

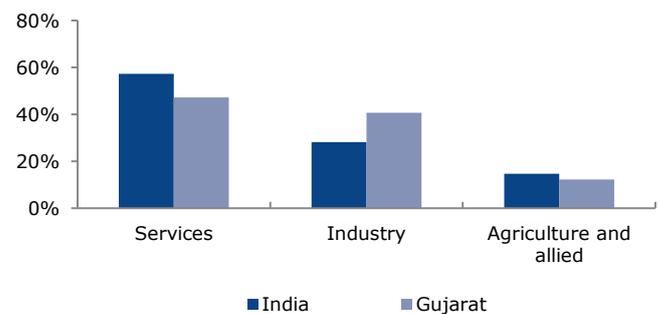
Mr. Modi's track record in Gujarat over three terms is reflected in the state's GDP per capita, which has been rising well over the national average. Gujarat makes up 5% of India's population but over 7% of its GDP. Its urbanisation rate of 42% is also much higher than the national figure of 31%. The highlight of the state's performance is that GDP growth is balanced across all sectors, including manufacturing, agriculture and services. Higher growth has resulted from various initiatives, including creating a favourable business environment, easily navigable bureaucracy, improving infrastructure and persistent marketing of the state's strengths. These initiatives, along with substantial tax breaks, has attracted investments in large numbers from domestic as well as international firms.

Chart 6: GDP per capita comparison- Gujarat and India



Source: Government of Gujarat

Chart 7: GDP distribution is well-balanced in Gujarat



Source: Government of Gujarat

As an example, Gujarat's agricultural income climbed up to INR960 billion (USD15.7 billion) from INR147 billion (USD2.4 billion) a decade ago. The state has witnessed rapid growth in its manufacturing sector and is all set to become one of Asia's largest auto-hubs. It has also made substantial progress in power generation and distribution over the last ten years. Total installed power capacity rose from ~9,000 Mw in 2003-04 to 23,887 Mw in March 2013. The state was able to lower transmission and distribution losses from 35% in 2003 to 15% in 2013, making it one of the few power surplus states in India. The biennial 'Vibrant Gujarat' summit from 2003 has also added value. The first edition saw the signing of 76 memorandums of understanding (MoUs), worth ~INR660 billion (USD10.8 billion), while the fifth edition in 2011 witnessed the signing of 8,380 MoUs, with investment proposals worth nearly ~INR21,000 billion (USD343 billion).

Yet, some critical near-term challenges remain

Despite Mr. Modi's remarkable performance at the state level, the BJP government is expected to face some critical challenges. Some of the major tasks related to the state of the economy and expectations of the financial markets are:

- (i) Resurrecting the growth rate and curtailing food inflation;
- (ii) Bringing down the current and fiscal account deficit;
- (iii) Repealing outdated laws to improve the 'Ease of Doing Business';
- (iv) Accelerating clearances of stalled infrastructure projects;
- (v) Increasing FDI flow and investor confidence;
- (vi) Reforming the Indian banking sector; and
- (vii) Tackling terrorism.

Further, although the NDA has a vast majority in the Lok Sabha, it does not have a majority in the Rajya Sabha (the upper house of Parliament). This may limit the government's ability to pursue reforms that require legislative action, and highlights the need for the government to build consensus with the opposition.

Nonetheless, whether the NDA government is able to repeat its Gujarat performance at the Center remains to be seen

A glimpse of the NDA government’s 30 days in power

The NDA’s first 30 days demonstrate the PMO’s hands-on approach to governance

It is still early days to judge the performance of the government. However, the larger trend indicates that the Prime Minister’s Office (PMO) is showing an extremely hands-on approach to governance. This approach is helping speed-up decision making by avoiding inter-ministerial deadlock.

Table 2: NDA’s 30-day report card

IMPROVEMENT AREA	STEP(S) TAKEN	IMMEDIATE EFFECT	OUTCOME
<p>Streamlining the government and consolidation of power under the PMO, in line with the NDA's slogan "Minimum government, maximum governance".</p>	<ul style="list-style-type: none"> The new government has a focused cabinet. The current council of ministers has only 45 members, including 23 cabinet members. This is in stark contrast with the UPA government which had 78 ministers. The government has scrapped 19 Group of Ministers (GoM) and eight Empowered Group of Ministers (EGoM). GoM and EGoM were constituted in order to resolve complex issues through exchange of ideas between inter-ministerial groups. However, the groups did not function as expected and led to unnecessary delays and indecision on project clearances. 	<ul style="list-style-type: none"> The streamlining of government and scrapping of GoM and EGoM would enable ministers and officers to take decisions on pending matters directly. The government cleared seven projects worth INR210 billion (USD3.4 billion) in its first 30 days. These projects were on hold mainly due to environmental and financial discrepancies. Additionally, the ministry of road transport approved road projects worth INR400 billion (USD6.5 billion). 	<ul style="list-style-type: none"> Flatter decision-making structures would eliminate bureaucratic hassles and fast track governance. Faster approvals of projects would accelerate infrastructural development in the country. Large-scale project implementation would, in turn, help revive the private investment cycle.
<p>Enhancing international relations to strengthen regional cooperation</p>	<ul style="list-style-type: none"> The new PM invited leaders of all South Asian Association Regional Corporation (SAARC) countries for his swearing-in ceremony. Mr. Modi discussed India’s concerns over terrorism with Pakistan's PM Nawaz Sharif, and urged him to crack down on militants and expedite trial of 2008 Mumbai attack suspects. Mr. Modi, in his first BRICS summit, gave a major push to the establishment of the New Development Bank and a USD100 billion contingency reserve arrangement to meet short-term liquidity pressures. 	<ul style="list-style-type: none"> The attendance of all seven countries in the PM's swearing-in ceremony was a major step forward in strengthening of India's relations with SAARC countries. Leaders of India and Pakistan decided that their foreign secretaries would discuss a way forward on diplomatic talks, which have been suspended since January 2013. Success of the proposed BRICS development bank and contingency reserve is expected to elevate the BRICS countries’ standing in the world. 	<ul style="list-style-type: none"> The PM’s invite to SAARC leaders for his swearing-in ceremony was a diplomatic move that eased investor concerns regarding the secular stance of the BJP. While potential diplomatic talks between India and Pakistan appear to be a step in the right direction, a definite outcome is unlikely over the near- to medium-term. The New Development Bank would act as an additional source of funding for India’s infrastructure requirements.

IMPROVEMENT AREA	STEP(S) TAKEN	IMMEDIATE EFFECT	OUTCOME
Tracking black money	<ul style="list-style-type: none"> The government has announced the formation of a Special Investigation Team (SIT) to track black money of Indians parked abroad. The SIT has been formed under retired Supreme Court judge MB Shah. 	<ul style="list-style-type: none"> The SIT plans to draw a detailed action plan to restrict generation of black money and create an institutional structure for it. In a 2011 report, BJP had estimated India's black economy to range between USD500 billion and USD1.4 trillion. 	<ul style="list-style-type: none"> The Swiss government's cooperation in tracking black money could provide significant help to the Indian government in its efforts to eliminate corruption. However, the success of the SIT largely depends on the government's ability to implement the plan.
Unveiling anti-inflationary measures	<ul style="list-style-type: none"> The government delisted fruits and vegetables from the ancient Agricultural Produce Market Committee (APMC) act. 	<ul style="list-style-type: none"> The move would allow farmers to sell their produce in the open market and reduces their dependence on middlemen. 	<ul style="list-style-type: none"> The delisting would allow the government to limit price increases in fresh agricultural produce.

Table 3: Steps planned by the government

IMPROVEMENT AREA	STEP(S) PLANNED	IMMEDIATE EFFECT	OUTCOME
Amending the Land Reforms Act, blamed for stalling the process of land acquisition and industrialization	<ul style="list-style-type: none"> Several states have asked the PMO to relax norms to acquire land for projects. The states want to remove a requirement to get landholders' consent in the case of public private partnership (PPP) projects, and reduce the threshold to 50% of landowners from the existing 80% for private acquisition. 	<ul style="list-style-type: none"> The step, if approved, would make land acquisitions easier. Corporates believe the 80% consent clause makes it impractical to win acquisition approvals. As a case in point, no major sale of land has been recorded after the law came into force in January 2014. 	<ul style="list-style-type: none"> The step would enhance 'ease of doing business' in India. This would improve investor confidence and boost foreign investment in the country.
Modifying archaic labor laws, responsible for thwarting job creation	<ul style="list-style-type: none"> The ministry of labor is proposing changes to four major laws, namely, the Factories Act, the Minimum Wages Act, the Industrial Disputes Act and the Contract Labor Act. The proposed changes include improved safety of workers, higher provision of overtime and relaxing the rules of female participation in some sectors. 	<ul style="list-style-type: none"> The proposals, if approved, are likely to generate higher employment opportunities by attracting fresh investments. Although the changes would be aimed at striking a balance between growth and welfare of workers, industrial and trade bodies may show some resistance at the outset. 	<ul style="list-style-type: none"> Amendments in the labor laws would be a positive for attracting investments in India's manufacturing sector. The move would not only increase the number of jobs, but also lift labor productivity.

Source: Mashreq

The FM presented a roadmap for economic recovery in the term's first budget

Beyond the 30 days: The Union Budget of 2014-15

Finance Minister (FM) Arun Jaitley unveiled his maiden budget on July 10, 2014. The government had less than 45 days to prepare for it and hence, the FM chose to present a working budget as an interim measure. The FM outlined his broad objectives of reducing the nation's fiscal deficit, lowering inflation, curtailing the current account deficit and reviving GDP growth to 7-8% in the next 3-4 years. Mr. Jaitley indicated that the current budget is part of the roadmap towards achieving these goals. The budget focuses on fiscal prudence to contain deficit and provides incentives for infrastructure projects and capital investment.

Fiscal deficit: The budget has set the fiscal deficit target at 4.1% of GDP for FY15, down from 4.6% in FY14. The target appears steep, but the new government has decided to accept it as a challenge. It aims to achieve this through a sharp increase in revenues, especially in indirect taxes and disinvestment proceeds. The fiscal deficit is expected to reduce further to 3.6% in FY16 and 3.0% in FY17. Much of the government's ability to meet its aggressive fiscal deficit targets will depend on growth in revenues during second half of the year. The targets appear hard to achieve as India's tax-to-GDP ratio has been on a downtrend and appears unlikely to pick up soon. It has fallen from 12.5% in 2007-08 to 10.2% at present. In such a situation, the government would have to resort to stringent cost cutting measures to achieve the set target.

GDP growth: The government targets real GDP growth of 5.4-5.9% in FY15. However, downside risks exist due to the weak monsoon season. It pegged GDP growth at over 6% in FY16 and 7-8% in the next 3-4 years.

Table 4: Union Budget 2014-15 – Key policy announcements

PARAMETER	INITIATIVES	RESULT
Stimulating the economy	<ul style="list-style-type: none"> The budget proposed to overhaul the subsidy regime, including food and petroleum subsidies. 	↓ Lower expenditure
	<ul style="list-style-type: none"> It reiterated the government's pledge to implement the goods and services tax (GST) within this year. The GST would unify the Indian market and is expected to boost GDP by up to 2 percentage points. 	↑ Tax revenues
	<ul style="list-style-type: none"> The government resolved to tackle elevated food prices by setting up a Price Stabilization Fund and working with states in re-orienting Agricultural Produce Market Committee (APMC) Act. 	↓ Inflation
	<ul style="list-style-type: none"> The budget aims to boost revenues by targeting divestment of USD10.4 billion in FY15. The amount is ambitious relative to divestment figures of ~USD4.2 billion in both FY13 and FY14. 	↑ Revenues from sale of assets
Building public infrastructure	<ul style="list-style-type: none"> The government proposed setting aside USD1.2 billion in FY15 to develop 100 smart cities. The cities would be developed as satellite towns of larger cities by modernizing the existing mid-sized cities. They would help accommodate the growing number of people wanting to migrate from the rural areas to the cities. 	↓ Regional disparity
	<ul style="list-style-type: none"> A new entity 3P India would be set up to strengthen the public-private partnership (PPP) framework. Innovative funding mechanisms like infra bonds for banks and Infrastructure 	↑ Funding techniques; PPPs
	<ul style="list-style-type: none"> Six asset reconstruction companies would be created, of which two would be committed to cleaning up bad debt in the power and roads sectors. 	↓ Bad debts
	<ul style="list-style-type: none"> The budget proposed sixteen new port projects and a scheme for development of new airports in Tier I and Tier II cities. 	↑ Improve regional connectivity
	<ul style="list-style-type: none"> It sought to address the unavailability of long-term infrastructure financing by creating Infrastructure Investment Trusts and a 5:25 structure which allows a bank to loan money to a developer for 25 years, with an option of rewriting the terms of the loan or transferring it to another bank after five years. The 5:25 structure makes it viable for banks to fund infrastructure 	↑ Bank funding to infrastructural projects

PARAMETER	INITIATIVES	RESULT
Improving business conditions and encouraging entrepreneurs	<ul style="list-style-type: none"> The finance minister assured corporates that no retrospective amendment to the law would be made to create fresh demands. 	↑ Faith in tax framework
	<ul style="list-style-type: none"> The budget announced changes in the approach to transfer pricing and advance rulings. 	↓ Tax disputes
	<ul style="list-style-type: none"> The budget unveiled an eBiz platform of all Central Government Department and Ministries to create a business and investor friendly ecosystem. The platform would make all business and investment related clearances and compliances available on a 24x7 single portal, with an integrated payment gateway. 	↓ Clearance times; bureaucratic hassles
	<ul style="list-style-type: none"> The finance minister set aside INR2 billion (USD32.7 million) to establish a technology centre network that will promote innovation and entrepreneurship in agri-businesses. Another INR1 billion (USD16.3 million) was set aside for a rural entrepreneurship scheme, while INR2 billion was reserved for developing young entrepreneurs from underprivileged 	↑ Entrepreneurial growth
	<ul style="list-style-type: none"> The creation of a risk capital fund with INR100 billion (USD1.6 billion) corpus for equity, quasi-equity and other risk capital for small companies was announced. 	↑ SME growth
Attracting foreign investors	<ul style="list-style-type: none"> The composite cap of FDI in defense manufacturing and insurance was raised from 26% to 49% with full Indian management and control. 	↑ Foreign investment; funding to defence and insurance sectors
	<ul style="list-style-type: none"> To encourage FDI participation in the development of smart cities, the condition for built up area reduced from 50,000 square meters to 20,000 square meters and minimum capitalization norms reduced from USD10 million to USD5 million, with a lock-in period of three years. 	↑ Foreign investment; funding to infrastructural projects

Source: Mashreq

Meanwhile, the budget discussion did not impact the country's sovereign credit rating. Ratings agency Standard & Poor's stated the budget would be positive to the country's credit fundamentals as long as fiscal debt and interest ratios are expected to continue to improve. However, any rating action would only occur when the measures are implemented and the change becomes measurable, particularly with respect to meeting the fiscal deficit target. Nonetheless, the extent to which various measures would be implemented and their impact on deficit targets remains to be seen.

Speedy Reforms are Critical for Economic Growth Revival

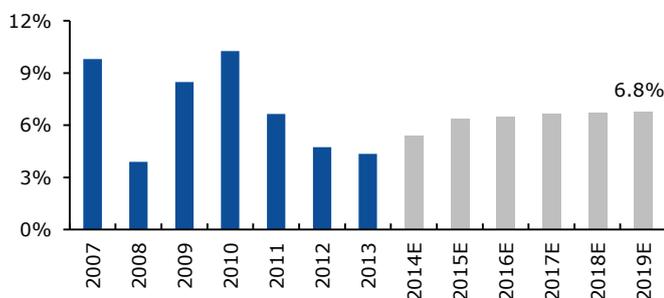
How India stumbled and what lies ahead for the NDA government

India's economy grew at a near decade-low 4.7% in FY14

India's GDP growth slowed dramatically between 2010 and 2014. The economy grew at a decade-low rate of 4.5% in FY13 and 4.7% in FY14, compared with a decade high of 9.6% in FY10. Global factors are partially responsible for falling exports and decelerating investments. However, the IMF believes that about two-thirds of the slowdown can be attributed to domestic elements. These include supply bottlenecks, delayed or stalled project approvals and implementation, and increased policy uncertainty. The impact of these factors was initially limited to infrastructure and corporate investments. However, it slowly spread across sectors.

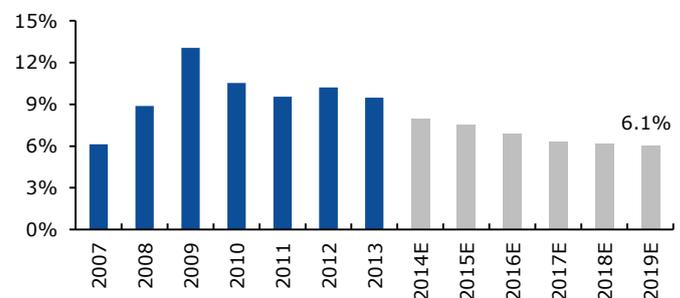
Along with slowing growth, India is also battling spiralling inflation. Over the last two years, India's CPI averaged ~10%, far higher than the 4% (+/-2%) target proposed by the RBI. Prices rose primarily due to market inefficiencies and supply-side constraints, rather than strong demand. Improper food storage and distribution system coupled with rising crude oil prices also contributed to the rise in prices. Elevated prices and a slowing economy weighed on household budgets and company performances, hurting consumer demand as well as corporate investments.

Chart 8: GDP growth has slowed since 2010



Source: IMF World Economic Outlook (WEO), April 2014

Chart 9: Inflation has remained oddly high

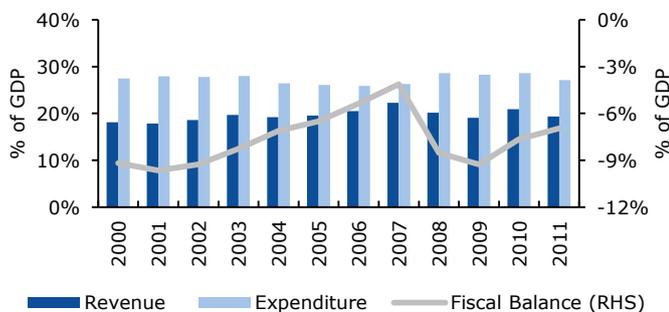


Source: IMF World Economic Outlook (WEO), April 2014

UPA's slow reaction to withdrawal of stimulus upset the economic balance

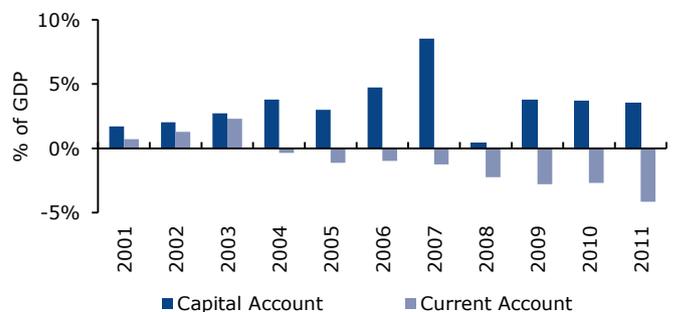
Deterioration in India's economic health reflected macroeconomic as well as structural weaknesses. The UPA government, in FY09, took steps to revive domestic demand through expansionary fiscal measures, which helped India come back on track after the global economic crisis. However, UPA's unhurried reaction to withdrawal of stimulus hurt economic balance. Government spending on social programmes, especially NREGA, strained fiscal conditions. The fiscal deficit widened from 4% of the GDP in FY08 to 7% in FY12. A consistently high deficit led to higher interest rates for the private sector. It also restrained the government from implementing any additional stimulus measures when growth slowed down again.

Chart 10: Revenue, spend and fiscal deficit



Source: IMF World Economic Outlook (WEO), April 2014

Chart 11: Current and capital account

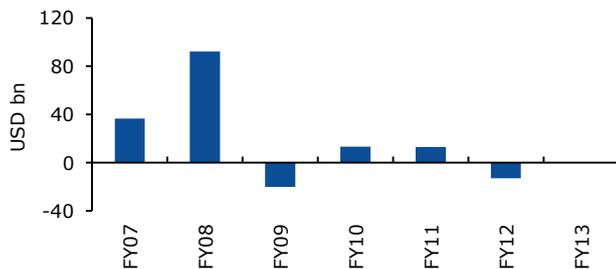


Source: IMF World Economic Outlook (WEO), April 2014

The delay in stimulus withdrawal also led to spiralling inflation, which prompted monetary policy tightening and adversely impacted aggregate demand. It also dampened gross private investment and savings. Total savings declined from 36.8% in FY08 to 32.3% in FY11. The 4.5 percentage point (of GDP) fall exceeded the 3 percentage point (of GDP) decline in gross investment during the same period and resulted in sharp growth in India's current account deficit.

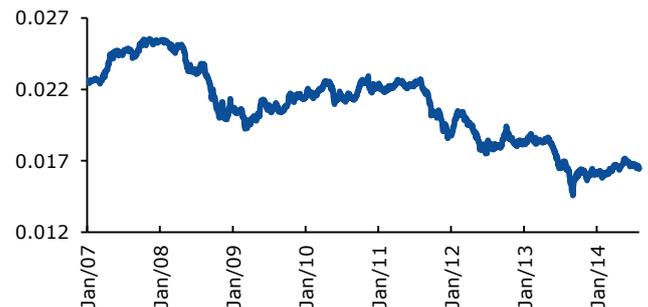
The high level of current account deficit slowed down capital inflows and resulted in currency depreciation. The unfavourable external environment, led by a probable easing of stimulus in the US and weak economic growth in Eurozone, exacerbated the situation. The possibility of a pullback in stimulus in the US led to a capital flight from emerging nations to the US, while fragile economic growth in the Eurozone bloc weighed on India's exports, upsetting the economic balance further.

Chart 12: Balance of payments



Source: IMF World Economic Outlook (WEO), April 2014

Chart 13: INRUSD



Source: Bloomberg

UPA took some steps in the positive direction

Towards the end of its term, the Congress-led UPA government made some moves to improve the deteriorating economic situation. However, the steps were too little and came too late. Current account deficit was brought under control, foreign exchange reserves were rebuilt, the rupee stabilized and the overall balance of payments improved. On the flip side, the economy continued to register subdued growth and inflationary pressures persisted, driven by high commodity prices and structural demand and supply imbalances.

BJP's chance to bring the Indian economy back on track

The 2014 national elections were an important checkpoint along the path to restoring India's economic growth. The outcome of the elections has boosted investor sentiment. However, the immediate situation remains fragile. IMF expects a gradual recovery in GDP growth to 6.7% by 2019, while CPI is expected to moderate to 6.1% over the next five years. Performance in the current year may be hampered by the possibility of El-Nino, which would hurt agricultural output and impact GDP growth and inflation. Nonetheless, the NDA's victory has renewed hopes for faster structural reforms and healthier investment climate. This is expected to support growth over the coming years.

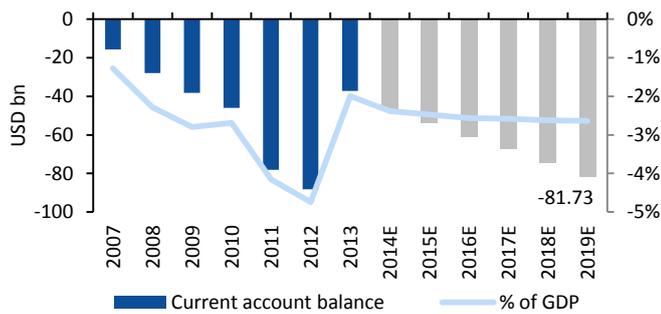
Twin deficits have been on the mend...

The current account deficit was brought under control

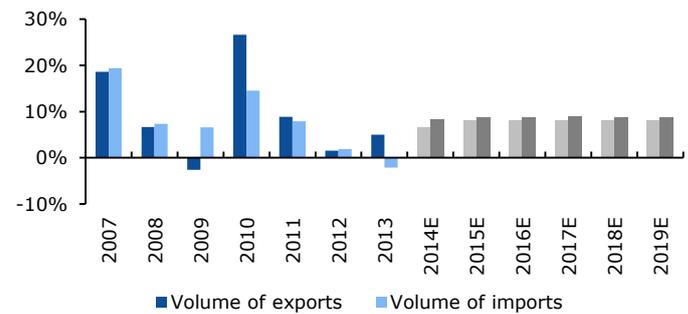
India's current account deficit shrunk to USD32 billion (1.7% of GDP) in FY14 from USD88 billion (4.7% of GDP) in FY13. The drop was driven by administrative measures to constrict gold imports, in addition to a significant improvement in exports and robust remittances flows. Import duty on gold was incrementally raised from 4% to 10% and various restrictions were imposed on agencies and trading houses. Non-oil non-gold imports also slipped as a result of weak domestic demand. Additionally, India's exports recovered despite a fall in growth of global trade. Merchandise exports grew 6.3% to USD326 billion.

The government expects India's current account deficit to increase slightly to USD45 billion (2.1% of GDP) in FY15. This is likely to be fully financed by stable sources of capital flows.

India has also been able to rebuild the reserves it spent on the rupee's defence in July and August 2013, primarily due to the attractive swap offered to banks for non-resident deposits.

Chart 14: India's current account deficit

Source: IMF World Economic Outlook (WEO), April 2014

Chart 15: Growth in trade volume of goods & services

Source: IMF World Economic Outlook (WEO), April 2014

The government has a tough fiscal deficit target

On the fiscal account front, India achieved its deficit target of 4.6% of GDP in FY14. The target was met primarily by way of reducing current expenditure, which is unsustainable over the longer term. Revenues were raised through an increase of USD5 billion each in FII investment limits in government securities and corporate bonds. Tax rate for foreign investors earned on interest income on debt was also lowered to 5% for a two-year period.

For FY15, the preceding FM had set a target of limiting the fiscal deficit to 4.1% of GDP in an interim budget before the elections. Economists reckon the goal is unrealistic, as the outgoing government left large amounts of unpaid bills to state oil companies, that have reduced the effective fiscal budget for FY15. However, the NDA government has decided to pursue the challenge. Towards this end, the budget report recommended tackling subsidies to lower spending, while broadening the tax base. Some of the proposals include:

- (i) Raising overall revenue of INR11,900 billion (USD194.5 billion) in the current year, up from the previous government's estimate of Rs11,700 billion (USD191.2 billion);
- (ii) Raising India's tax collection, currently lower than 9% of GDP. This is about 25% of the average tax collection in the OECD group of developed nations;
- (iii) Raising INR634 billion (USD10.4 billion) from selling government stakes, compared with INR569 billion (USD9.3 billion) in the interim budget;
- (iv) Retaining the target for subsidy spending set by the previous government at about INR2,600 billion (USD42.5 billion) for the current fiscal year;
- (v) Raising plan expenditure, which includes funds for creating roads and ports, to INR5,750 billion (USD94.0 billion) from INR5,550 billion (USD90.7 billion) projected in the interim budget; and
- (vi) Revamping food and fuel subsidies to make them more targeted while still providing protection for the marginalized and poor. A commission would be set up to ensure that the government spends its money efficiently.

Further, the FM Arun Jaitley also pledged to lower the fiscal deficit to 3.6% of GDP by FY16 and 3% by FY17 to meet the original target of 3% set by the Fiscal Responsibility and Budget Management Act.

...and inflationary pressures are easing, yet risks remain

Inflation has edged lower, but remains above the central bank's target

Lately, stubbornly high inflation has been showing signs of easing mainly on account of a decline in prices of food items. However, it remains beyond the RBI's comfort zone. The CPI rose at a rate of 7.31% y/y in June, the slowest since the series started in January 2012, while the WPI increased 5.43% y/y, slower than the 6.01% y/y rise recorded in May. However, inflation in fuel and power items remained high due to the rationalization of electricity tariff in many states and the revised policy of allowing greater pass-through in diesel prices. Food prices fell due to some steps taken by the NDA:

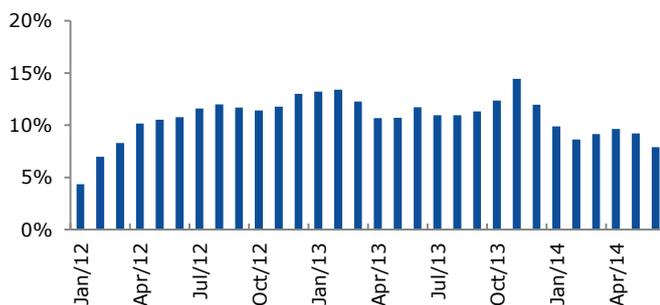
- (i) Cracking down on hoarders to maintain food prices;
- (ii) Imposing minimum export price (MEP) on the export of staples in order to increase domestic availability;
- (iii) Delisting fruits and vegetables from APMC so that they are released into the open market;

While these measures had an direct impact on reducing food inflation, the government plans to take additional steps to tackle inflation over the medium to longer term. These include:

- (i) Investing heavily in rural roads, warehouses and cold-storages to minimise damage and wastage of perishable goods;
- (ii) Setting up a 'Price Stabilisation Fund' to mitigate the impact of steep price rises on consumers in emergency situations. State food ministers have given their in-principle consent for the setting up the fund;
- (iii) Adopting penalizing administrative measures, such as making hoarding a non-bailable offence, in a concentrated effort to eliminate black marketers and hoarders; and
- (iv) Leveraging technology to map crop production pan-India and transmitting real-time data on prices, production and markets.

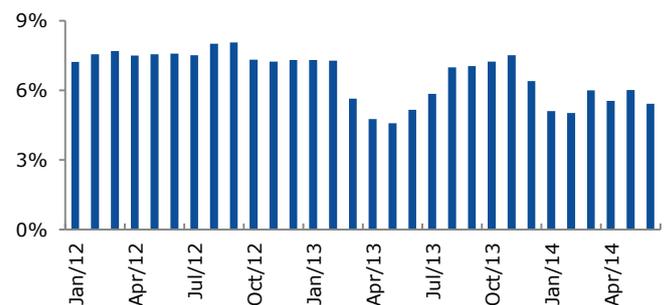
On the whole, the government aims to focus on supply-side issues to rein in inflation, as against using monetary policy and raising interest rates. The government is positive that it would effectively address the inflation issue through this set of short and long-term measures.

Chart 16: CPI for food, beverages & tobacco (y/y)



Source: Bloomberg

Chart 17: WPI (y/y)



Source: Bloomberg

RBI- Curtailing inflation remains the top priority

India's growth vs. inflation dilemma

Managing the growth-inflation trade-off remains a particularly challenging task for emerging economies like India due to the following factors:

- Supply shocks, especially in food and fuel sectors, are the major drivers of inflation.
- The most effective way of tackling poverty in an economy like India is growth. On the other hand, increasing inflation is a regressive tax that impacts the poor population.

Given the situation, the RBI has firmly stated that its primary focus would be on curtailing inflation, instead of boosting growth.

Plan of action

Governor Raghuram Rajan has repeatedly ignored demands from top politicians and industrialists for a rate cut to revive growth, citing that inflation is a bigger enemy. CPI had surged to 11.2% in November 2013 before three interest rate hikes helped bring it down to 7.3% in June. The central bank aims to lower inflation, even if it means keeping interest rates high.

The BJP has promised conditional support to the RBI to bring retail inflation down to 6% by 2016.

Manufacturing activity is slowly turning the corner

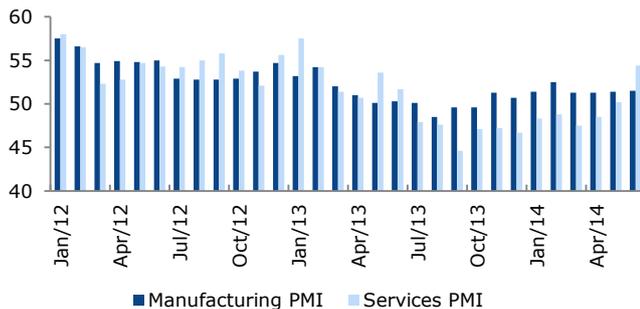
Manufacturing sector is slowly recovering

The share of manufacturing in India's GDP has remained at ~15% for more than a decade. The past two years were particularly challenging, as UPA's governance policies sapped business and investor confidence and weakened domestic demand. The manufacturing sector contracted 0.7% in FY14 after expanding just 1.0% in FY13. On a relative basis, China's contribution to world manufacturing stood at 22.4% in 2012 while India's share stood at a mere 2%. However, optimism in India is gradually returning on hopes the new government would work towards removing the bottlenecks that have been holding the sector back. Some of the initiatives announced in the recent budget statement are expected to aid growth in the sector:

- (i) Relaxation in foreign investment restrictions in insurance and defense sectors from 26% to 49%;
- (ii) Tax breaks to the power sector; and
- (iii) Overhaul in government subsidies and a better-than-expected fiscal deficit target would restore investor confidence.

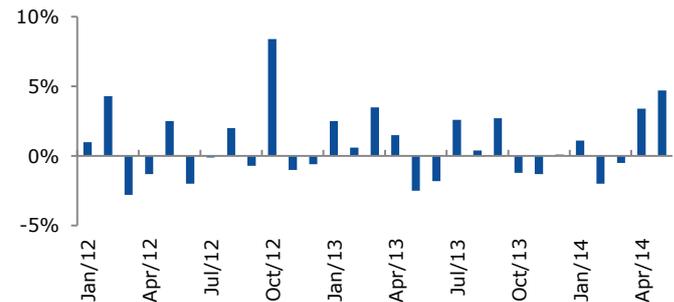
In recent months, a few economic indicators have registered improvement in manufacturing activity and business confidence. HSBC's manufacturing PMI showed activity levels rose in May and June. Exports increased more than 10% for the first time in eight months in May while output of infrastructure industries also showed expansion. Further, industrial production grew 4.7% in May. This is the highest rate of growth since October 2012 and significantly exceeds estimates of a 3.8% rise.

Chart 18: HSBC manufacturing and services PMI



Source: Bloomberg

Chart 19: Growth in industrial production



Source: Bloomberg

Economy is expected to recover gradually as the new government addresses structural constraints

Overall, India is poised to recover from sub-5% levels in FY15

According to the NDA government's first economic survey, India is expected to grow 5.4-5.9% in FY15. **The economy is projected to take at least a couple of years to expand beyond an annual rate of 7-8% as this would require restoration of domestic macroeconomic stability and higher economic efficiency.** To achieve this, the government would have to persistently focus on fiscal consolidation and removal of structural constraints.

For the current year, institutional reforms (which would help speed up implementation of large projects) and a stronger-than-expected recovery in advanced economies would support growth in the Indian economy. However, the play out of certain factors would result in growth leaning towards the lower side of the 5.4-5.9% range. These factors include:

- (i) Initiatives to revive the investment cycle, including faster project clearances and incentives provided to the industry, would take longer to show results;
- (ii) High inflation levels may limit the RBI's room to reduce policy rates;
- (iii) Subdued growth outlook in some economies, especially top trading partner China; and
- (iv) Expectation of a shortfall in monsoon rains.

Nonetheless, the improved post-election business sentiment is widely expected to offset some of the negative impact of these factors.

The IMF's World Economic Outlook (WEO) update in July downgraded its previously forecast expansion for the global economy in 2014. The revision was driven by slower growth in the US, Russia and some developing economies. However, IMF retained its GDP forecast for India at 5.4% for FY15 and 6.4% for FY16.

Markets Rallied on Growing Optimism

Equity markets scale record highs

Indian equities posted the best performance in 1H14 among major emerging and developed nations

Indian stock markets have witnessed bumper returns over the past one year. The Sensex posted the highest returns in 1H14 (+26.3%) among major developed and emerging market indices worldwide. This compares with a 4.5% increase in the MSCI World index over the same period. The fresh highs in the Sensex came amid optimism the country's newly elected government would implement sweeping economic reforms and stimulate investments. Continued inflows from FIIs and positive cues from global equity markets also supported gains. FIIs pumped in more than USD20 billion into the Indian market in 1H14, with net equity inflows totaling USD9.96 billion (INR598 billion). This compares with net inflows of USD10.2 billion (INR622.9 billion) over the full-year 2013.

The first spurt of positivity in Indian markets came with the appointment of former IMF chief economist Raghuram Rajan as the governor of RBI in September 2013. He turned the central bank's focus towards bringing down inflation to improve investor confidence and raised interest rates by a total of 75 bps after taking the RBI's helm. While Mr. Rajan's appointment marked the beginning of the rally in Sensex, anticipation of BJP's victory took over as the primary reason since the beginning of 2014. Overall, the stock market performance reflected an outstanding recovery after a long period of economic slowdown.

Table 5: The Indian market has outperformed major emerging and developed markets over the last one year

Indices	YTD	Price Performance %			1-Yr Forward P/E
		1 Yr	2 Yr	3 Yr	
MSCI World	4.76%	15.22%	38.78%	33.24%	15.69
BSE Sensex	21.20%	37.00%	47.40%	48.30%	16.51
Shanghai Composite	3.08%	9.40%	3.69%	-19.26%	8.68
Hang Seng	6.12%	13.02%	24.93%	10.21%	11.38
Nikkei 225	-3.96%	14.47%	79.94%	59.12%	17.52
Bovespa	10.43%	17.92%	1.39%	-3.31%	11.78
JSE All Share	11.92%	25.37%	49.64%	65.89%	15.15
S&P 500	6.58%	16.87%	42.83%	52.45%	16.11
FTSE 100	0.36%	2.30%	20.20%	16.48%	13.99
DAX	0.43%	15.92%	41.66%	34.01%	13.05
CAC 40	0.38%	8.00%	31.01%	17.46%	14.88

Source: Bloomberg; As of August 08, 2014

Of the 30 companies listed on the BSE Sensex, all but one have seen positive returns since the beginning of the year. Over the last one year, all the constituents of the index delivered positive returns with an average increase of 50.4%.

Table 6: Sensex constituents and their returns

Company	Market Cap. (USD m)	YTD (%)	1 Yr (%)	2 Yr (%)	P/E (x)	P/B (x)
Tata Consultancy Services	79,841	13.7%	32.1%	101.0%	23.8x	8.7x
Oil & Natural Gas Corp.	55,219	38.5%	49.6%	42.1%	12.9x	2.0x
Reliance Industries Ltd.	51,965	10.5%	17.6%	25.9%	12.9x	1.5x
ITC Ltd.	44,802	7.6%	4.8%	34.0%	30.7x	10.1x
Coal India Ltd.	36,967	25.2%	41.4%	5.7%	15.2x	5.4x
Infosys Ltd.	33,391	0.6%	17.4%	58.2%	18.0x	4.2x
HDFC Bank Ltd.	31,757	21.9%	33.3%	35.2%	22.2x	4.4x
State Bank of India Ltd.	29,456	37.9%	48.4%	20.7%	11.8x	1.2x
ICICI Bank Ltd.	27,212	31.5%	66.8%	51.5%	15.2x	2.2x

Company	Market Cap. (USD m)	YTD (%)	1 Yr (%)	2 Yr (%)	P/E (x)	P/B (x)
HDFC Ltd.	26,382	29.2%	36.6%	44.5%	20.1x	4.3x
Sun Pharma Industries	25,589	33.7%	41.0%	126.1%	48.4x	8.3x
Hindustan Unilever Ltd.	24,899	23.0%	15.4%	50.2%	38.5x	43.0x
Bharti Airtel	23,899	10.8%	13.3%	23.5%	45.9x	2.4x
Larsen & Toubro	22,377	38.5%	86.3%	58.1%	28.0x	3.6x
Wipro Ltd.	22,124	-1.2%	22.5%	79.2%	16.3x	3.7x
Tata Motors Ltd.	21,976	17.4%	53.7%	93.0%	11.9x	2.2x
NTPC Ltd.	18,832	2.8%	4.4%	-15.0%	10.2x	1.3x
Axis Bank Ltd.	14,692	46.6%	74.8%	79.2%	14.2x	2.3x
Sesa Sterlite Ltd.	13,911	41.0%	127.6%	55.2%	13.4x	1.2x
Maruti Suzuki	12,954	50.2%	98.9%	132.9%	28.0x	3.7x
Mahindra & Mahindra	12,431	32.3%	46.3%	79.7%	15.6x	3.1x
Bajaj Auto Ltd.	10,087	12.0%	18.3%	30.7%	18.2x	6.1x
Bharat Heavy Electricals	9,132	30.5%	105.0%	0.7%	16.1x	1.7x
Gail India Ltd.	8,695	22.4%	38.3%	14.6%	11.1x	1.6x
Tata Steel Ltd.	8,694	31.0%	180.4%	37.5%	15.9x	1.3x
Hero Motocorp Ltd.	8,437	25.8%	41.3%	31.9%	24.7x	9.3x
Dr. Reddy's Laboratories Ltd.	7,617	8.7%	25.3%	66.2%	21.7x	5.1x
Hindalco Industries	6,438	54.2%	121.0%	60.1%	17.3x	1.0x
Cipla Ltd.	5,687	8.5%	11.1%	23.8%	25.1x	3.5x
Tata Power Co.	4,211	7.7%	37.7%	1.2%	-	2.0x

Source: Bloomberg; As of August 08, 2014

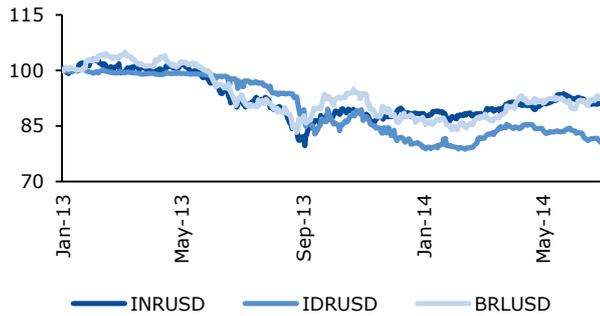
The rupee has recovered from last year's record lows

The Indian rupee remains steady

The Indian rupee has stabilized after witnessing steep depreciation between June and August 2013. The decline was led by FIIs pulling out capital from emerging markets with larger current account deficits, after the US Fed stated it may consider reducing its monthly bond-buying programme of USD85 billion. The Indian government and the RBI responded swiftly by taking a spate of measures to reduce the current account deficit and rebuild investor confidence. In addition to restrictions on non-essential imports such as gold, the central bank announced steps to attract foreign capital, including higher limits for exporters to re-book cancelled forward exchange contracts and a window to swap foreign currency deposits. The subsequent narrowing of the current account deficit reduced downward pressure on the Indian currency. It averaged INR61 at the end of the fiscal year (in March 2014) and has since remained range bound and stable. On YTD basis in 2014, the currency has gained 1.8%.

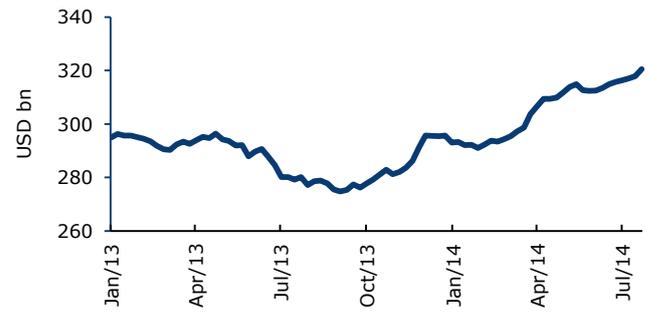
The positive developments on the external account front have led to optimism that the Indian economy is better prepared to tackle the challenges of stimulus reversals globally, including tapering of quantitative easing in the US. India's Economic Survey forecasts that the rupee will likely remain steady in coming months due to support from encouraging policy actions and rising capital inflows. However, the RBI may not willingly accept a significant appreciation in the currency as a weak rupee makes exports more competitive. ~40% of the companies that form the Sensex gain from a weaker rupee.

Chart 20: Performance of emerging market currencies



Source: Bloomberg

Chart 21: India's forex reserves



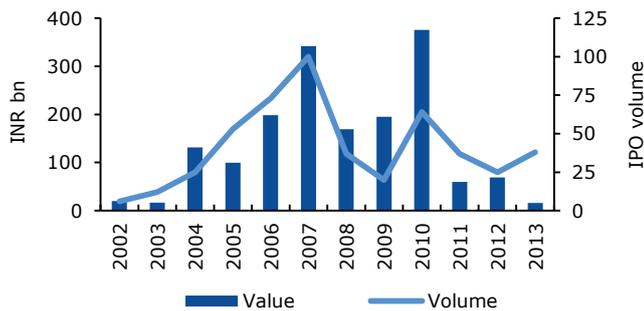
Source: Bloomberg

Fund raising was relatively subdued in 1H14..

Capital raising, although at low levels currently, is expected to pick up pace

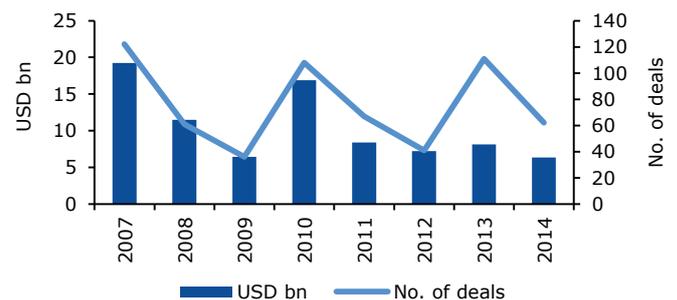
Capital raising picked up slightly in 1H14 after a dry 2H13. However, activity remained low when compared to 1H13. Equity and equity-linked issuances fell to a four-year low of USD5.4 billion in 1H14, down nearly 29% from the corresponding period last year. Funds raised via IPOs plunged ~70% y/y to USD81.5 million, while proceeds from follow-on public offerings (FPOs) fell 27.1% y/y to USD5.3 billion. In addition to the drop in equity fund raising, bond issuances slipped 42% y/y from the record USD36.2 billion in 1H13 to USD21 billion in 1H14. Indian corporates raised USD6.3 billion through dollar-denominated bond in 1H14, down 35.2% y/y, after the best-ever first half in 2013 when companies raised a combined USD9.7 billion.

Chart 22: Declining IPO volumes in India



Source: Prime Database

Chart 23: Total equity offerings (IPOs, FPOs etc.)



Source: Dealogic, The Wall Street Journal

..But activity will gain steam in 2H14

Nonetheless, capital raising activity is likely to see a spike in 2H14 as a resurgent corporate India seeks fresh capital to mend balance sheets and fund future growth. Investment banks estimate capital raising activity of up to INR1,200 billion (USD19.6 billion) in the next two years, of which about INR710 billion (USD11.6 billion) is expected to be raised in the next six months.

Table 7: Qualified Institutional Placements (QIPs) on the rise

QIP issues in FY14	Date of issue	INR m	USD m
Dhanlaxmi Bank	2-Apr-13	698.6	11.4
DEN Networks	6-May-13	2,711.4	44.3
ING Vysya Bank	25-Jun-13	8,809.4	143.9
Dhanlaxmi Bank	20-Dec-13	672.2	11.0
Hinduja Foundries	27-Jan-14	809.3	13.2
State Bank of India	28-Jan-14	80,316.5	1,312.4
Total		94,017.4	1,536.2

Source: Prime Database

FY15 QIP issues (April onwards)	Date of issue	INR m	USD m
SKS Microfinance	19-May-14	4,000.0	65.4
YES Bank	29-May-14	29,420.8	480.7
KSK Energy Ventures	2-Jun-14	400.0	6.5
Idea Cellular	5-Jun-14	30,000.0	490.2
Reliance Communications	25-Jun-14	48,000.0	784.3
Total		115,420.8	1,886.0

Source: Prime Database

A large number of companies are opting for QIPs to raise capital

While IPO volumes have remained passive, recent months have seen a rise in popularity of QIPs. QIPs allow listed companies to sell shares directly to institutions without making a public offer. An increasing number of companies attempting to mobilise capital in the near future are expected to raise funds through QIPs in a bid to lower the high cost of capital and strengthen balance sheets. In fact, total QIPs in the first three months of FY15, at INR125 billion (USD2.0 billion), already exceeded those in the entire FY14, at INR94 billion (USD1.5 billion). Lower cost, fewer regulatory approvals and shorter time duration to obtain funds are some of the reasons for corporates queueing up for QIPs.

Further, Indian companies have been increasingly tapping international bond markets for debt financing. Lower interest rates across developed markets, growing investor appetite for Indian bonds and an attempt to spread exposures across different currencies is boosting foreign currency denominated bond issuances in India.

Table 8: Foreign currency denominated debt issuances by Indian corporates/financials

Issuer Name	Rating	Currency	Issue size (m)	Coupon (%)	Maturity	Mid-price	YTM (%)	Z-Spread (bps)
ABJA Investment	BB-/BB+	USD	500	4.85	31-Jan-20	102.15	4.40	258.85
ABJA Investment	BB-/BB+	USD	1,000	5.95	31-Jul-24	100.63	5.87	339.50
Axis Bank Ltd./Dubai	BBB-/Baa2/BBB-	USD	350	5.25	30-Sep-15	103.98	1.63	130.11
Axis Bank Ltd./Dubai	BBB-/Baa2/BBB-	USD	500	4.75	02-May-16	104.43	2.08	156.37
Axis Bank Ltd./Dubai	BBB-/Baa2/BBB-	USD	750	5.13	05-Sep-17	105.35	3.26	218.56
Bank of Baroda/London	-/Baa3/BBB-	USD	350	4.75	07-Oct-15	103.35	1.75	142.01
Bank of Baroda/London	-/Baa3/BBB-	USD	500	5.00	24-Aug-16	105.52	2.18	153.95
Bank of Baroda/London	-/Baa3/BBB-	USD	1,000	4.88	23-Jul-19	105.13	3.73	203.70
Bank of Baroda/London	NR/Ba2/B+	USD	300	6.63	25-May-22	103.25	3.80	438.92
Bank of India/London	BBB-/Baa3/-	USD	750	4.75	30-Sep-15	103.35	1.70	137.54
Bank of India/London	BBB-/Baa3/-	USD	500	3.63	21-Sep-18	101.79	3.15	168.71
Bank of India/London	BBB-/Baa3/-	USD	500	6.25	16-Feb-21	111.11	4.27	226.70
Canara Bank/London	-/Baa3/BBB-	USD	500	5.25	18-Oct-18	106.93	3.45	197.72
Export-Import Bank of India	BBB-/Baa3/-	USD	500	4.00	07-Aug-17	104.73	2.34	128.72
Export-Import Bank of India	BBB-/Baa3/-	USD	500	3.88	02-Oct-19	102.40	3.36	160.85
Export-Import Bank of India	BBB-/Baa3/-	USD	750	4.00	14-Jan-23	100.01	4.00	165.11
HDFC Bank Ltd./Bahrain	BBB-/Baa2/-	USD	570	3.00	30-Nov-16	101.86	2.16	139.80
HDFC Bank Ltd./Bahrain	BBB-/Baa2/-	USD	500	3.00	06-Mar-18	100.47	2.86	157.99
ICICI Bank Ltd.	BB/Ba2/B+	USD	750	6.38	30-Apr-22	103.88	3.46	389.51

Issuer Name	Rating	Currency	Issue size (m)	Coupon (%)	Maturity	Mid-price	YTM (%)	Z-Spread (bps)
ICICI Bank Ltd.	BB/Baa3/-	USD	340	7.25	NA	99.75	3.71	665.16
ICICI Bank Ltd./Bahrain	BBB-/Baa2/-	USD	750	5.50	25-Mar-15	102.47	1.35	111.87
ICICI Bank Ltd./Dubai	BBB-/Baa2/-	USD	1,000	4.75	25-Nov-16	105.58	2.21	146.28
ICICI Bank Ltd./Dubai	BBB-/Baa2/BBB-	USD	1,000	4.70	21-Feb-18	105.62	3.00	174.36
ICICI Bank Ltd./Dubai	BBB-/Baa2/BBB-	USD	1,000	4.80	22-May-19	105.83	3.46	181.62
ICICI Bank Ltd./Hong Kong	BBB-/Baa2/-	USD	500	5.00	15-Jan-16	104.52	1.73	131.65
ICICI Bank Ltd./Hong Kong	BBB-/Baa2/BBB-	USD	1,000	5.75	16-Nov-20	109.58	4.00	203.35
IDBI Bank Ltd./DIFC Dubai	BB+/Baa3/BBB-	USD	350	4.75	05-Feb-16	103.42	2.36	191.73
IDBI Bank Ltd./DIFC Dubai	BB+/Baa3/BBB-	USD	500	4.38	26-Mar-18	102.67	3.58	229.11
IDBI Bank Ltd./DIFC Dubai	BB+/Baa3/BBB-	USD	500	3.75	25-Jan-19	99.47	3.88	231.34
IDBI Bank Ltd./DIFC Dubai	BB+/Baa3/BBB-	USD	300	5.00	25-Sep-19	104.08	4.10	237.37
Indian Overseas Bank/HK	BBB-/P/Baa3/-	USD	500	5.00	19-Oct-16	105.49	2.38	167.72
Indian Overseas Bank/HK	BBB-/Baa3/-	USD	500	4.63	21-Feb-18	103.84	3.45	219.83
Indian Railway Finance	BBB-/Baa3/BBB-	USD	300	3.42	10-Oct-17	102.86	2.46	133.74
Indian Railway Finance	BBB-/Baa3/BBB-	USD	500	3.92	26-Feb-19	103.08	3.18	158.90
State Bank of India	BB/B1/B	USD	400	6.44	NA	98.50	3.08	610.22
SBI London	BBB-/Baa3/BBB-	USD	850	4.50	23-Oct-14	100.61	1.07	88.28
SBI London	BBB-/Baa3/-	USD	1,000	4.50	27-Jul-15	102.90	1.38	109.63
SBI London	BBB-/Baa3/-	EUR	978	4.50	30-Nov-15	104.99	0.58	NA
SBI London	BBB-/Baa3/BBB-	USD	1,250	4.13	01-Aug-17	103.05	3.03	199.01
SBI London	BBB-/Baa3/BBB-	USD	1,000	3.25	18-Apr-18	100.88	2.99	167.35
SBI London	BBB-/Baa3/-	USD	750	3.62	17-Apr-19	101.27	3.32	169.38
SBI London	BBB-/Baa3/-	USD	500	4.88	17-Apr-24	102.90	4.50	202.65
Syndicate Bank/London	BBB-/Baa3/-	USD	500	4.75	06-Nov-16	104.69	2.56	183.04
Syndicate Bank/London	BBB-/Baa3/-	USD	500	4.13	12-Apr-18	102.28	3.45	214.65
Syndicate Bank/London	BBB-/Baa3/-	USD	400	3.88	04-Dec-19	100.21	3.83	203.98
Union Bank of India/HK	BBB-/Baa3/-	USD	350	4.63	22-Aug-17	103.57	3.37	230.18
Union Bank of India/HK	BBB-/Baa3/-	USD	350	3.63	25-Oct-18	101.53	3.23	173.53
Union Bank of India/HK	BBB-/Baa3/-	USD	350	4.50	28-Oct-19	103.24	3.80	204.67
Bharti Airtel Netherlands	BBB-/Baa3/BBB-	EUR	1,377	4.00	10-Dec-18	107.29	2.21	171.46
Bharti Airtel Netherlands	BBB-/Baa3/BBB-	EUR	1,027	3.38	20-May-21	103.02	2.88	207.95
Bharti Airtel Netherlands	BBB-/Baa3/BBB-	USD	1,500	5.13	11-Mar-23	104.39	4.50	216.19
Bharti Airtel Netherlands	BBB-/Baa3/BBB-	USD	1,000	5.35	20-May-24	105.74	4.61	213.95
Indian Oil Corp Ltd.	-/Baa3/BBB-	USD	500	4.75	22-Jan-15	101.45	1.31	109.50
Indian Oil Corp Ltd.	-/Baa3/BBB-	USD	500	5.63	02-Aug-21	106.83	4.47	237.50
Indian Oil Corp Ltd.	-/Baa3/BBB-	USD	500	5.75	01-Aug-23	106.69	4.82	244.70
Oil India Ltd.	-/Baa2/BBB-	USD	500	3.88	17-Apr-19	102.44	3.30	167.65
Oil India Ltd.	-/Baa2/BBB-	USD	500	5.38	17-Apr-24	105.10	4.71	225.02

Issuer Name	Rating	Currency	Issue size (m)	Coupon (%)	Maturity	Mid-price	YTM (%)	Z-Spread (bps)
ONGC Videsh Ltd.	BBB-/Baa2/-	USD	300	2.50	07-May-18	99.02	2.78	143.26
ONGC Videsh Ltd.	BBB-/Baa2/-	USD	750	3.25	15-Jul-19	99.39	3.39	168.21
ONGC Videsh Ltd.	BBB-/Baa2/-	EUR	712	2.75	15-Jul-21	98.09	3.06	224.07
ONGC Videsh Ltd.	BBB-/Baa2/-	USD	500	3.75	07-May-23	95.18	4.42	203.09
ONGC Videsh Ltd.	BBB-/Baa2/-	USD	750	4.63	15-Jul-24	99.94	4.63	212.58
Reliance Holding USA Inc	BBB+/Baa2/-	USD	1,000	4.50	19-Oct-20	105.05	3.58	160.88
Reliance Holding USA Inc	BBB+/Baa2/-	USD	1,500	5.40	14-Feb-22	109.18	3.97	178.31
Reliance Holding USA Inc	BBB+/Baa2/-	USD	500	6.25	19-Oct-40	109.25	5.57	252.68
Reliance Industries Ltd.	BBB+/Baa2/-	USD	800	5.88	NA	97.13	6.07	299.78
Vedanta Resources Jersey	BB/-/-	USD	1,250	5.50	13-Jul-16	102.33	4.21	NA
Vedanta Resources PLC	BB/Baa3/WD	USD	750	6.75	07-Jun-16	104.88	3.91	335.96
Vedanta Resources PLC	BB/Baa3/WD	USD	750	9.50	18-Jul-18	116.25	4.89	353.00
Vedanta Resources PLC	BB/Baa3/WD	USD	1,200	6.00	31-Jan-19	103.38	5.14	358.99
Vedanta Resources PLC	BB/Baa3/WD	USD	900	8.25	07-Jun-21	112.76	5.94	392.07
Vedanta Resources PLC	BB/Baa3/WD	USD	500	7.13	31-May-23	105.75	6.26	394.73
NTPC Ltd.	BBB-/-/BBB-	USD	500	5.63	14-Jul-21	108.02	4.27	218.47
NTPC Ltd.	BBB-/-/BBB-	USD	500	4.75	03-Oct-22	102.36	4.40	211.04
Bharat Petroleum Corp Ltd.	-/Baa3/BBB-	USD	500	4.63	25-Oct-22	101.38	4.42	211.99
Jaiprakash Power Ventures	-/-/-	USD	200	5.00	13-Feb-15	107.78	12.25	NA
Power Grid Corp of India Ltd.	BBB-/-/BBB-	USD	500	3.88	17-Jan-23	96.54	4.37	202.20
Rural Electrification Corp Ltd.	-/Baa3/BBB-	USD	500	4.25	25-Jan-16	103.00	2.11	168.21
Larsen & Toubro Ltd.	-/-/-	USD	200	3.50	22-Oct-14	101.16	-3.05	NA
Rolta Americas LLC	BB-/-/BB-	USD	300	8.88	24-Jul-19	102.25	8.31	667.27
Rolta LLC	BB-/-/BB-	USD	200	10.75	16-May-18	108.00	8.21	693.08
Sesa Sterlite Ltd.	-/-/-	USD	500	5.00	31-Oct-14	82.75	109.73	NA
Suzlon Energy Ltd.	-/-/-	USD	547	3.25	16-Jul-19	NA	NA	NA
Tata Power Co Ltd.	-/-/-	USD	300	1.75	21-Nov-14	108.87	3.73	NA
Tata Steel Ltd.	-/-/-	USD	547	4.50	21-Nov-14	96.88	17.07	NA
TML Holdings Pte Ltd.	-/-/-	USD	300	5.75	07-May-21	102.25	5.35	329.89
Samvardhana Motherson	(P)BB+/-/-	EUR	680	4.13	15-Jul-21	97.72	4.51	370.84
AE-Rotor Holding BV	-/Baa3/-	USD	647	4.97	28-Mar-18	102.79	4.15	285.04
Ballarpur Int. Graphic Paper	-/-/-	USD	200	9.75	NA	84.00	12.03	1928.44
Greenko Dutch BV	B/-/B	USD	550	8.00	01-Aug-19	99.00	8.25	659.71
Bhira Investments Ltd.	-/-/-	USD	450	8.50	27-Apr-71	100.75	15.47	-1326.08

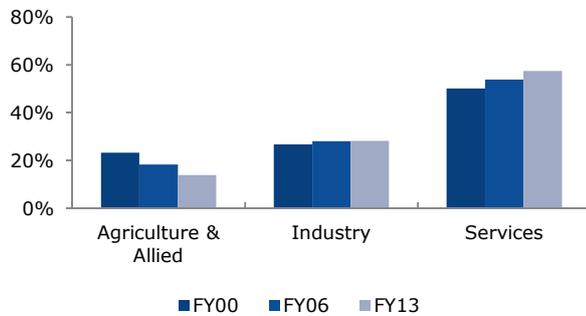
Source: Bloomberg

Key Sectors Driving Economic Growth

Services and Industry to remain key growth drivers

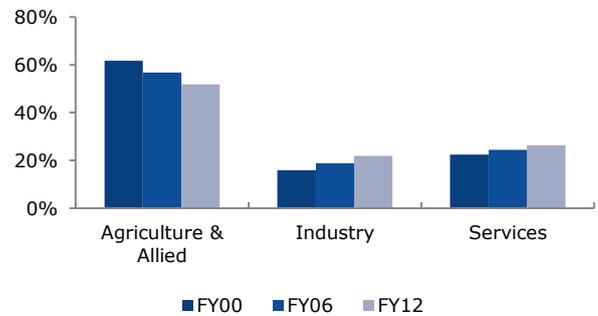
Although initially an agrarian economy, India has undergone radical changes in the last two decades. Growth over the past two decades is primarily attributed to development in the service and industry sectors. As of FY13, the agricultural, industry and services sector of the economy accounted for 14%, 26% and 60% of GDP, respectively.

Chart 24: Sector-wise contribution to GDP



Source: RBI

Chart 25: Sector-wise contribution to employment



Source: RBI

The contribution of agriculture to Indian GDP is decreasing

Agriculture plays an important, although decreasing, role in the Indian economy. Its contribution to GDP has steadily dropped from 30% in early 1990s to 14% in FY13 due to diversification and growth of the overall economy. However, the sector continues to be the largest employment source and a key driver of socio-economic development. It provides employment to ~51% of India's total workforce. The five-year plans also continue to lay special emphasis on agriculture and aim at steady improvements in application of modern agricultural practices and provision of agricultural credit and subsidies in order to sustain the growth in crop yield per unit area.

Industry sector's contribution to GDP in India is lower than that in other comparable developing countries

The industry sector's share of GDP has remained steady over the past two decades. The economic liberalisation in 1991 changed the sector's landscape. It brought in foreign players, eased trade restrictions and relaxed the rules governing FDI. The post-liberalisation era witnessed greater demand and production of consumer goods, even as the Indian private sector faced increasing domestic and foreign competition. The sector contributed 26% to GDP in FY13. This is lower than the industry sector's share in Thailand (36%), South Korea (31%) and China (30%). However, employment in the sector has increased from 16% of the overall workforce in 1990s to 22% in 2012.

The services sector has witnessed rapid growth in the last few years

India's services sector has made swift strides in the last few years and emerged as the biggest and fastest-growing sector of the economy. It contributes around 60% to India's GDP. The CAGR of services sector GDP at 8.5% for the period FY01-14 has also been higher than the 7.1% CAGR of overall GDP during the same period. In addition to GDP, the sector has also contributed substantially to foreign investment flows, trade flows and employment. It covers a wide array of activities, such as trading, transportation and communication, banking and finance, real estate and housing and healthcare and education, among others.

Growth Accelerators



Infrastructure

- The infrastructure sector, which includes electricity, telecom infrastructure, roads and bridges, railways, water supply and sanitation, ports, airports, and oil & gas, has been accorded priority status by the government of India. The central and state governments are working towards building infrastructural facilities that meet international norms.
- The government estimated that USD1 trillion would be spent on development of infrastructure over 2012 to 2017. Of this, the private sector's contribution is expected to be roughly 40%.
- High infrastructure spending is expected to provide counter-cyclical stimulus and revive economic growth.



Banking

- The RBI is carrying out reforms to strengthen the Indian banking system by encouraging increased competition in both the private and public sectors.
- Financial inclusion is a key priority of the Indian government. The authorities are aiming at ensuring access to banking and financial services at affordable costs to India's vast unbanked, disadvantaged and low-income groups.
- The banking sector is expected to create 2 million new jobs over the coming decade, helped by issuance of new bank licences and efforts towards expansion of financial services into rural areas.



Healthcare

- India's Planning Commission has allocated USD55 billion to health and family welfare in the 12th Five-year Plan, about three times the expenditure under the 11th Five-year Plan.
- Healthcare spending is estimated to grow 14% annually driven by rising incomes, government healthcare outlays and longer life expectancy.
- India is gaining popularity as a global destination for medical tourism due to substantially lower treatment costs. Currently, India receives more than 230,000 foreign patients a year.



Telecom/IT Services

- With over 900 million telephone connections, India is the world's second-largest telecom market. The government has devised policies to encourage further growth of the telecom industry and use it as an effective channel to increase inclusive growth.
- Market dynamics are undergoing a change as telecom operators devise innovative business models (such as sharing infrastructure) to boost margins.
- India is also one of the world's fastest-growing IT services markets. Its rise has been helped by its cost competitiveness and a growing talent pool.

Infrastructure – Helping Economic Revival

Sector Overview

India is going through a challenging period as GDP growth has slowed to a decade low. In this backdrop, high infrastructure expenditure, totaling about 10% of GDP, is expected to have a positive spiral effect on GDP growth. The government of India has announced plans to double infrastructure investments to USD1 trillion during the 12th Five-year Plan (FY12-17). Close to half of this is targeted to be achieved through private sector investment.

Growth Drivers

- **Ambitious infrastructure growth plans:** The Government of India has set a massive target for infrastructure development in India to boost the country's slowing economy. It plans to double investment in infrastructure from INR20.5 trillion (USD335 billion) to INR40.9 trillion (USD668 billion) at FY07 prices during the 12th Five-year Plan that stretches from 2012 to 2017.
- **Innovative funding techniques:** The government introduced several initiatives to increase funding in the latest Union Budget:
 - Banks would be allowed to raise long term funds for infra projects with minimum regulatory requirements. These funds will not attract standard rules like cash reserve ratio and statutory liquidity ratio.
 - India has emerged as the largest PPP market in the world with over 900 projects in various stages of development. The FM proposed setting up of an institution, called 3P India, with a corpus of INR5 billion (USD81.7 million) to provide support to mainstreaming PPPs. The 3P will work towards overhauling the way PPP projects are conceived, bid and executed in India.
 - The Union Budget proposed tax incentives for two new investment instruments — Real Estate Investment Trusts (REITs) and Infrastructure Investment Trusts (InvITs) — to help attract long term funds from foreign and domestic investors. The new investment products would be listed on stock exchanges like shares of any company and allow retail and institutional investors to buy or sell those securities.

Key Challenges

- **Project delays:** The government, in the past, has failed to meet set targets due to various issues, including:
 - Lengthy process of land acquisition
 - Receiving regulatory approvals and environmental clearances
 - Funding of projects

The delay caused due by these factors typically leads to cost overruns and results in heavy project backlogs. For instance, the Centre for Monitoring Indian Economy (CMIE) estimated that more than INR6 trillion (USD98 billion) worth of projects in India had been stalled as of March 31, 2014. At least INR1.8 trillion (USD29.4 billion) of these projects were road projects awaiting land and environmental clearances. In this backdrop, achieving the targets set in the 12th Plan appears to be a challenging task.

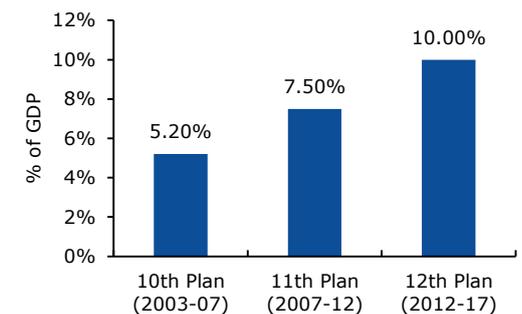
- **Investment funding gap:** Based on estimated funding flows from various sources and the incremental investment required, the Planning Commission stated that the 12th Plan would have a huge funding gap. It would need to channelize an additional private sector investment of about INR6.1 trillion (USD99.7 billion) over the Five-year Plan.

Table 9: Key sector Statistics

Contribution to GDP (FY12-17E)	10%
Projected investment FY12-17 (USD)	1tn
Est. Private Sector Contribution	40%
Growth in value of roads and bridges	17.4%
Growth in capacity of ports	12.3%

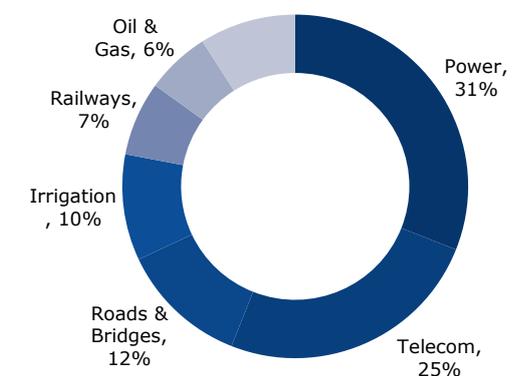
Source: IBEF

Chart 26: Infrastructure investment



Source: Planning Commission

Chart 27: Investments in 12th Plan



Source: Planning Commission

Chart 28: Private and public investment



Source: Planning Commission

Chart 29: Sector outperformers

- The CNX Infrastructure index posted one-year return of 45.4% and YTD return of 25.4% as on August 14, 2014.
- The top three companies in the index, namely, IRB Infrastructure, Adani Ports and SEZ, and Reliance Infrastructure, beat the sector index.
- IRB Infrastructure, Adani Ports and SEZ, and Reliance Infrastructure posted one-year returns of 246.9%, 88.0% and 100.0%, respectively, over the last one year. Meanwhile, the YTD returns for the three companies stood at 175.2%, 71.6% and 64.4%, respectively.

Source: Bloomberg

Table 10: Du Pont Analysis (FY13)

	Net Profit Margin (%)	Total Asset Turnover	Leverage Ratio	ROE (%)	Adjusted ROE (%)	Payout Ratio
IRB Infrastructure	15.10	0.31	3.94	18.21	17.63	23.88
Adani Ports and SEZ	45.38	0.15	4.19	27.45	22.62	13.03
Reliance Infrastructure	14.49	0.24	2.54	7.54	7.48	8.68

Source: Bloomberg

Banking – Undergoing a Tectonic Change

Sector Overview

India's banking assets account for 63% of the nation's financial assets. The banking sector plays a key role in economic and financial growth of the country. The RBI is working on expanding the industry through financial inclusion and priority sector lending. With focus on improving the operational performance of banks through various reforms, the sector appears to be on an upward growth trajectory.

Growth Drivers

- **Healthy asset growth:** Over the six years from FY07 to FY13, total assets of commercial banks grew at a CAGR of 18.4%. Total credit disbursed by scheduled commercial banks grew at a CAGR of 23% during FY07-13 while total deposits of scheduled commercial banks grew at a CAGR of 21% during FY07-13.
- **Rise in NPAs on subdued economic activity:** The asset quality of commercial banks, particularly public sector banks, worsened over the last two years due to significantly higher interest rates coupled with an industrial contraction. Net NPA ratio of commercial banks grew from 0.97% in FY11 to 1.68% in FY13. Public banks bear 90% of India's NPAs due to pressure to lend to priority sectors.
- **Banking Reforms:** The recent budget session drove expectations of anticipated reforms in public sector banks.
 - The FM estimated that public sector banks would need INR2.4 trillion (USD39.2 billion) of capital by 2018 to comply with Basel III international regulatory norms. In order to raise additional resources, the government would lower its stake in public sector banks by selling shares to retail investors in a phased manner.
 - The government also announced plans to give greater independence to public sector banks, which form a major portion (~73%) of the Indian banking industry's assets.
 - Further, it announced plans to set up six new debt recovery tribunals in Chandigarh, Bangalore, Ernakulam, Dehradun, Siliguri and Hyderabad in order to tackle rising non-performing assets in public sector banks.
- **Financial inclusion to play a key role in the near future:** As per the latest census, the percentage of households availing banking services in India stood at 59% in 2011. The unbanked population mainly belongs to rural areas or low income groups. Thus, in recent years, the RBI, along with the government, have increased their focus on providing formal banking services to this set of households.
- **Capital injection:** The government allocated INR112 billion (USD1.8 billion) for capital injection into public sector banks in its interim budget in February 2014. The infusion is expected to help banks boost lending amid a rise in NPAs.

Key Challenges

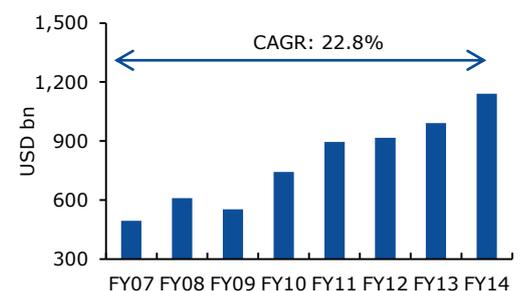
- **Asset quality to remain weak in FY15:** The weakness in banks' asset quality is likely to persist in FY15 as economic recovery is still tepid. However, regulatory measures are driving banks to increase loan loss reserves on restructured loans. This is expected to boost the total loan loss reserves of the system to nearly 70% of gross NPAs (from the current level of 63%), according to Fitch's India Ratings & Research.
- **Competition set to intensify:** In August 2011, the RBI prepared guidelines for licensing of new banks in the private sector. The central bank processed applications after an almost decade-long break, and granted banking licenses to IDFC (an infrastructure finance group) and Bandhan Financial Services (a microfinance group). RBI is also considering introducing separate licenses to restrict bank operations in particular geographies and product ranges. This is expected to allow banks to adapt to local needs.

Table 11: Key sector Statistics

Deposits to GDP (FY13)	67%
Credit to GDP (FY13)	53%
Total assets to GDP	100.2%
Unbanked population	41%
No. of scheduled commercial banks	157
Banking assets (USD tn)	1.8tn
Banking deposits (USD tn)	1.4tn

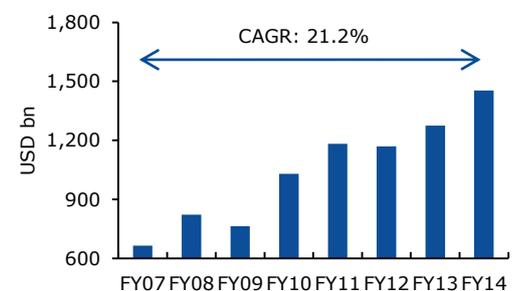
Source: RBI

Chart 30: Growth in credit off-take



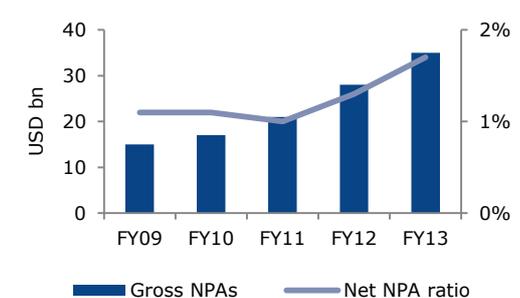
Source: IBEF

Chart 31: Growth in deposits

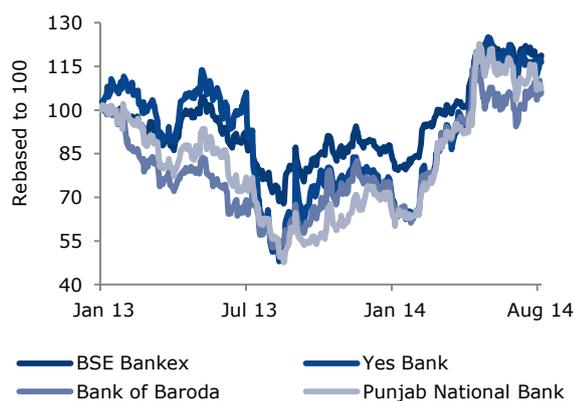


Source: IBEF

Chart 32: Gross NPAs and net NPA ratio



Source: RBI

Chart 33: Sector outperformers

Source: Bloomberg

- The BSE Bankex posted one-year return of 51.2% and YTD return of 33.0% as on August 14, 2014.
- The top three companies in the index were Yes Bank, Bank of Baroda and Punjab National Bank. While Bank of Baroda and Punjab National Bank are public sector banks, Yes Bank is a private sector bank founded in 2004.
- Yes Bank, Bank of Baroda and Punjab National Bank posted one-year returns of 88.3%, 73.0% and 72.2%, respectively, over the last one year. Meanwhile, the YTD returns for the three banks stood at 48.2%, 40.4% and 47.8%, respectively.

Table 12: Du Pont Analysis (FY13)

	Net Profit Margin (%)	Total Asset Turnover	Leverage Ratio	ROE (%)	Adjusted ROE (%)	Payout Ratio
Yes Bank	37.41	0.11	16.10	24.94	-	17.91
Bank of Baroda	29.17	0.08	16.45	15.55	20.26	22.06
Punjab National Bank	25.76	0.10	15.19	15.55	20.52	19.26

Source: Bloomberg

Healthcare – Riding the Growth Wave

Sector Overview

Healthcare has emerged as one of the largest service sectors in India with estimated revenues of around USD30 billion constituting 5% of GDP. India's healthcare industry is expected to post double-digit growth driven by efforts by the public as well as private players to improve access to quality healthcare in the country.

Growth Drivers

- **High growth potential:** India stands well behind its counterparts on key healthcare parameters. However, growth is picking up due to greater disposable incomes, increasing lifestyle related health issues, affordable treatment costs, rising penetration of health insurance and government initiatives. The healthcare industry is expected to grow at a CAGR of 15% and is poised to reach USD250 billion by 2020, according to a PwC survey.

	India	China	Sri Lanka	Thailand
Per capita expenditure on health (\$)	43	240	85	265
Spending on healthcare (% GDP)	1.2%	2.7%	1.5%	3.0%
Out-of-pocket spending (%)	69%	44%	55%	25%

Source: PwC

- **Government initiatives:** The Indian government has set a long-term vision of achieving universal health coverage. The Planning Commission has allocated USD55 billion under the 12th Five-year Plan to the Ministry of Health and Family Welfare, about three times the actual outlay under the 11th Plan.

The government also made some key proposals to enhance access to healthcare facilities in the recent Union Budget. These include raising the FDI limit in medical insurance business to 49%; introduction of four new medical institutions similar to All India Institute of Medical Sciences (AIIMS); and establishment of biotech clusters to develop innovative technologies for healthcare.

- **Growth in health insurance:** Although less than 15% of India's population is currently covered by health insurance (including government-sponsored schemes), the sector is gradually picking up. Health insurance premium grew at a CAGR of 32% over FY05-13.
- **Rise in medical tourism:** India has positioned itself as a relatively inexpensive destination for medical treatment compared with the US and Europe. The size of the medical tourism industry in India is estimated at USD3 billion, with tourist arrivals estimated at 230,000. This is expected to reach USD6 billion by 2018, with the number of people arriving in the country set to double over the next four years.

Key Challenges

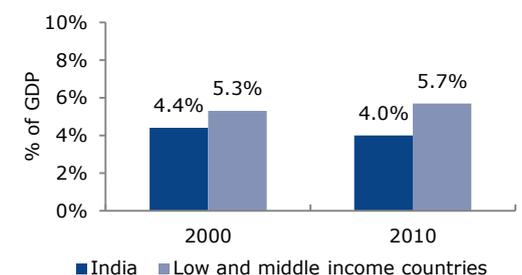
- **Shortage of workforce and infrastructure:** India has 1.7 trained doctors and nurses per 1,000 people, compared to the WHO recommended guideline of 2.5. Bed density of 0.67 per 1,000 is also well below the WHO benchmark of 3.5.
- **Poor public healthcare facilities:** Treatment in public facilities in India is inexpensive; albeit of poor quality. As a result, only 22% of the population in rural areas and 19% in urban areas use government facilities for out-patient care. The rate is low for in-patient care as well, at 42% in rural areas and 38% in urban areas.
- **Concentrated healthcare infrastructure:** 70% of the healthcare infrastructure in India is focused in the top 20 cities, which enjoy hospitals with world-class facilities and services.

Table 13: Key sector Statistics

Contribution to GDP (FY13)	5.0%
Total healthcare expenditure (USD)	90.4bn
Government's share in health exp.	33.1%
Per capita health expenditure (USD)	43
Physicians per 1,000 population	1.7
Hospital beds per 1,000 population	0.7
Health insurance penetration	~15%

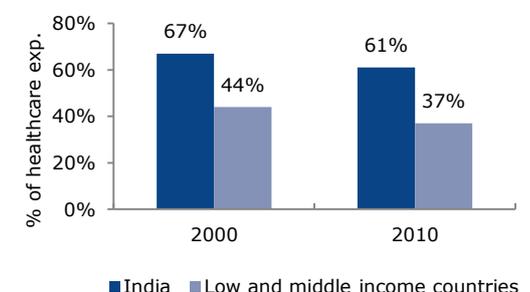
Source: McKinsey & Company, CII

Chart 34: Total healthcare spending



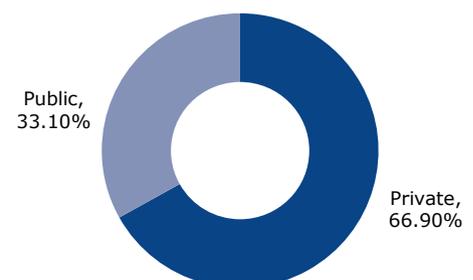
Source: McKinsey & Company, CII

Chart 35: Out-of-pocket spend

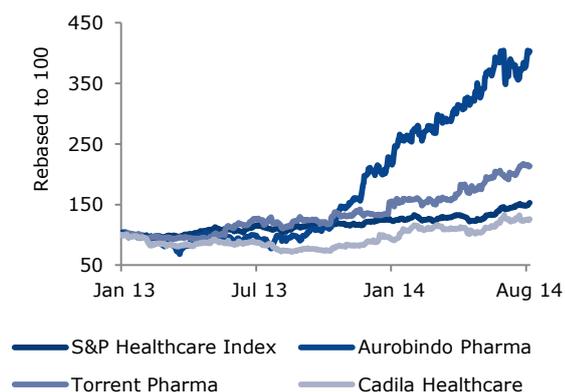


Source: McKinsey & Company, CII

Chart 36: Share of healthcare spend



Source: Business Standard

Chart 37: Sector outperformers

Source: Bloomberg

- The S&P BSE Healthcare index posted one-year return of 37.2% and YTD return of 25.5% as on August 14, 2014.
- The top three companies in the index were Aurobindo Pharma Ltd., Torrent Pharmaceuticals Ltd. and Cadila Healthcare Ltd. All the three stocks outperformed the sector index by a big margin.
- Aurobindo Pharma, Torrent Pharmaceuticals and Cadila Healthcare posted one-year returns of 3.6.3%, 75.7% and 63.5%, respectively, over the last one year. Meanwhile, the YTD returns for the three companies stood at 96.1%, 59.8% and 38.2%, respectively.

Table 14: Du Pont Analysis (FY13)

	Net Profit Margin (%)	Total Asset Turnover	Leverage Ratio	ROE (%)	Adjusted ROE (%)	Payout Ratio
Aurobindo Pharma Ltd.	14.59	0.86	2.73	11.88	17.58	14.86
Torrent Pharmaceuticals Ltd.	16.45	0.89	2.62	35.96	32.23	45.06
Cadila Healthcare Ltd.	10.62	0.89	2.49	23.63	30.51	23.50

Source: Bloomberg

IT & ITes – Driven By a Fast Growing Digital Economy

Sector Overview

India's IT & ITes industry is primarily made up of four sub-components: IT services, business process management (BPM), software products & engineering services, and hardware. The industry has a total market size of USD118 billion as of FY14 and grew at a GAGR of 13.3% between FY08-14, as per National Association of Software and Services Companies (NASSCOM). It is one of the largest employment generators in the organized sector, directly employing almost 3.1 million persons and indirectly employing around 8.9 million as of FY14.

Growth Drivers

- Cloud computing/software-as-a-service (SaaS):** SaaS is an inexpensive yet sophisticated data analyzing tool, wherein data/software is hosted centrally on a cloud and can be accessed through a web browser. It is being used by firms to manage large volumes of data in an inexpensive manner. As per NASSCOM, growing popularity of cloud computing and SaaS will increase India's IT-BPO exports by 12-14% to USD84-87 billion in FY14.
- Mobile internet gives rise to multi-channel commerce:** With increasing penetration of smartphones (about 10% in FY13) and tablets, companies are focusing on multi-channel commerce strategies to reach out to its customers. This is expected to increase domestic demand for IT & ITes services from Indian corporates to tap the growing market. As per Internet and Mobile Association of India (IAMAI), 17 million out of 121 million internet users in India have shopped online. This number is expected to grow three-fold by 2015 due to increasing internet penetration and rising affordability of PCs and smartphones.
- Increasing foreign investments:** India's IT & ITes sector has been able to attract significant foreign investments. Between April 2000 and February 2014, the sector attracted foreign investments to the tune of USD9.89 billion.
- Increasing technology adoption:** Rising technology adoption in India's domestic market, particularly within the government and the small and medium business (SMB) sectors, is expected to drive growth in the IT services sector within India in the coming years.
- Government initiatives:** The 12th Five-year Plan aims to increase the IT & ITes sector's contribution to development and growth, particularly in terms of investment, exports, employment, and contribution to GDP. The plan also targets retaining India's leadership position as a global IT-BPO destination as well as consolidating and growing in mature as well as emerging markets.

Key Challenges

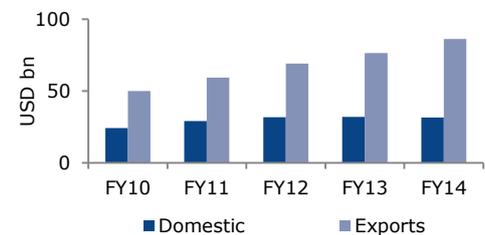
- Skill gap:** The shortage of suitably skilled labor is emerging as a challenge to growth in the IT & ITes sector. According to NASSCOM, over 3 million students are added to the Indian workforce annually. However, only 25% of technical graduates and 10-15% of other graduates are considered employable.
- Growing competition from developing countries:** India's IT & ITes sector is facing competition from several developing countries. Although the EU, India, and the US hold the largest share in exports of information services, new competitors such as China, Israel, and the Philippines have recently emerged. Between 2005 and 2011, information services grew at an average annual rate of 69% in the Philippines, 28% in Sri Lanka, 59% in Ukraine, 27% in the Russian Federation, 37% in Argentina, and 35% in Costa Rica. Actual export revenues for these countries are relatively low. However, average annual growth significantly exceeds average growth in the sector in India and may increase competitive pressure over the long term.

Table 15: Key sector Statistics

Contribution to GDP	8.1%
Contribution to India's exports	23-25%
Contribution to services exports	38%
Contribution to FDI	7%
Revenue by segments (USD bn):	
IT services	63.7
BPM	23.6
Software products and services	17.7
Hardware	13.0

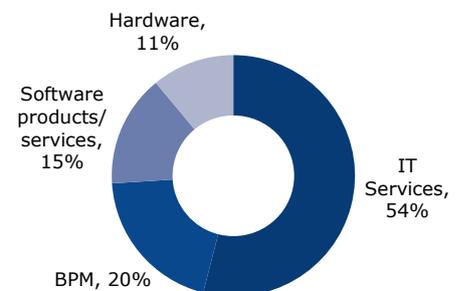
Source: NASSCOM

Chart 38: IT & ITes Sector revenues



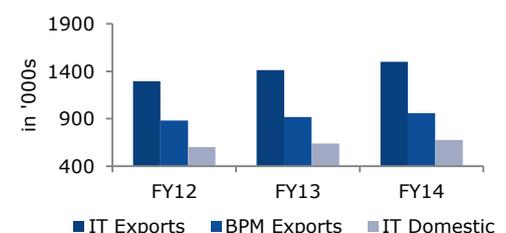
Source: NASSCOM

Chart 39: Segment revenues (FY14)



Source: NASSCOM

Chart 40: Direct employment



Source: NASSCOM

Chart 41: Sector outperformers

Source: Bloomberg

- The S&P BSE IT index posted one-year return of 29.7% and YTD return of 8.8% as on August 14, 2014.
- The top three companies in the index, namely, Persistent Systems Ltd., Mindtree Ltd. and HCL Technologies Ltd. outperformed the sector index significantly.
- Persistent Systems, Mindtree and HCL posted one-year returns of 123.2%, 103.9% and 69.9%, respectively, over the last one year. Meanwhile, the YTD returns for the three companies stood at 24.8%, 33.8% and 22.9%, respectively.

Table 16: Du Pont Analysis (FY13)

	Net Profit Margin (%)	Total Asset Turnover	Leverage Ratio	Adjusted ROE (%)	5 Yr. Adj. ROE (%)	Payout Ratio
Persistent Systems Ltd.	14.49	1.13	1.23	20.19	20.29	19.19
Mindtree Ltd.	13.67	1.55	1.30	27.53	22.26	15.45
HCL Technologies Ltd.	15.79	1.26	1.77	35.13	27.56	20.68

Source: Bloomberg

Telecom – At an Inflection Point

Sector Overview

The Indian telecom sector is the second largest in the world after China, with a subscriber base of over 900 million as of FY13. It ranks fifth in terms of the number of smartphone users with an estimated base of 67 million users in 2013. Further, the number of subscribers accessing internet through mobile devices touched 176.50 million in 2013 as a result of growing smartphone penetration.

Growth Drivers

- Data services gaining pace:** Demand for data services is growing rapidly in India. According to Nokia Siemens Networks' MBit index study, total mobile data usage rose 87% y/y in 2013. Data traffic generated by 2G and 3G services grew 66% and 196%, respectively. As a result, 3G's share in mobile data rose from 33% in 2012 to 43% in 2013.
- Rising smartphone adoption:** Smartphone penetration in India stood at just 10% in 2013. However, penetration is witnessing significant growth in the country's urban parts. According to Nielsen Mobile Insights, the share of smartphones in the mobile market of urban India doubled from 9% in 2012 to 17% in 2013. Further, Ericsson estimates that overall penetration would rise to 45% by 2020, driven by availability of affordable smartphones as well as low-cost data connectivity options.
- Technological upgrades:** Telecom operators are increasingly looking at ramping up existing technologies. Leading telecom operator Bharti Airtel has already launched 4G services in select cities, while Reliance Jio Infocomm is planning to launch it commercially in 2015.
- Lowering costs through innovative business models:** A growing trend in the sector is sharing of passive infrastructure (such as antennas and mast) by network operators. This is helping companies lower operating as well as capital expenditure. Companies are now exploring opportunities to share active electronic infrastructure.
- Government initiatives:** India's National Telecom Policy (NTP) targets 100% tele-density and 600 million broadband connections by 2020. This is expected to translate into demand for an additional 400,000 base stations and 50,000 towers at an investment of INR500 billion (USD8.2 billion). The NTP is visualizing doubling the current telecom capacity and increasing its reach to 95+% of India while providing broadband level of internet capability.

Key Challenges

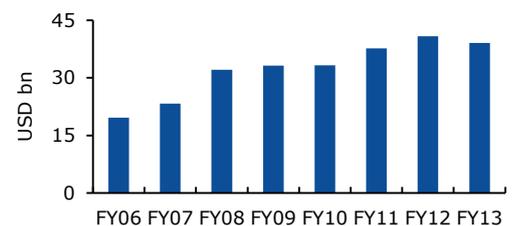
- Spectrum availability and high capital requirements:** One of the telecom industry's major challenges is the availability of new spectrum to meet the rising demand for data usage. India is a largely wireless economy and the launch and adoption of broadband would largely be driven through mobile broadband. The rising use of m-governance, m-banking, and m-entertainment is expected to increase traffic. To address this issue, the government needs to clearly identify and allocate new spectrum bands. The roadmap would also help companies plan for heavy investments in infrastructure.
- Considerable financial and operational pressure:** The telecom industry is impeded by substantial financial and operational pressure. Taxes and levies in the sector amount to 30% of telecom companies' revenues vis-à-vis about 5% in other Asia-Pacific countries. Moreover, in terms of telecom infrastructure investments, India accounted for just 11% of total investments in Asia-Pacific relative to China which received almost 50% of investments in FY13.

Table 17: Key sector Statistics

Contribution to GDP (FY13)	3.0%
Contribution to FDI (FY13)	1.35%
Telecom subscriber base (June '13)	903m
Mobile subscribers (% of total)	96.7%
Smartphone user base	40m
Wire-line broadband subscriber base	22m
Tele-density	73.3%

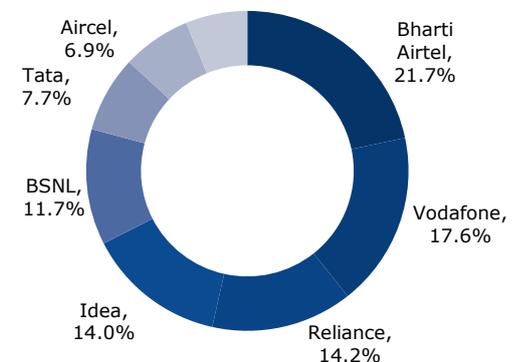
Source: TRAI

Chart 42: Telecom sector revenues



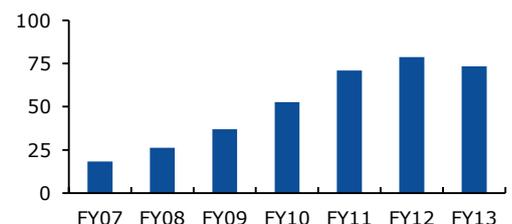
Source: IBEF

Chart 43: Wireless market share in India

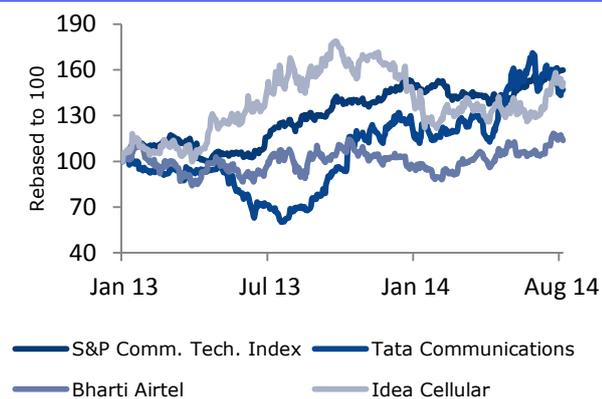


Source: IBEF

Chart 44: India's tele-density



Source: IBEF

Chart 45: Sector outperformers

Source: Bloomberg

- The S&P BSE Communication Technologies index registered one-year return of 25.6% and YTD return of 8.8% as on August 14, 2014.
- The top three companies in the index were Tata Communications, Bharti Airtel and Idea Cellular.
- Tata Communications and Bharti Airtel posted one-year returns of 113.0% and 6.4%, respectively. Idea Cellular declined 9.6% in the last one year. However, the stock generated returns of 51.6% as compared to its January 2013 level.

Table 18: Du Pont Analysis (FY13)

	Net Profit Margin (%)	Total Asset Turnover	Leverage Ratio	ROE (%)	Adjusted ROE (%)	Payout Ratio
Tata Communications	-3.62	0.75	12.46	-39.25	-18.57	-
Bharti Airtel	2.96	0.49	3.13	4.51	16.50	16.69
Idea Cellular	4.51	0.65	2.52	7.39	7.79	9.84

Source: Bloomberg

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