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MANAGEMENT SERVICES

NEWSLETTER JULY 2017

"As we write this newsletter markets are hitting new highs, sentiments continue to be buoyant and we are through with the timely implementation of GST- the biggest economic reform in indirect taxation in independent India. Domestic Institutional Investors are continuously receiving inflows through Systematic Investment Plans (SIP) of around Rs 4800 to 5000 crores per month lending strong support to the indices and cushioning any significant corrections. Inflation has been under control and RBI is expected to ease interest rates in their meeting in August 2017. Progress of monsoons has been normal till now barring Southern India which has a deficit of 11% till now. Sowing has seen a 9% jump YoY and till now is showing good trends."

1 GST ROLLOUT HAS BEEN SMOOTH; BUSINESSES WILL TAKE A COUPLE OF QUARTERS TO ADJUST

Implementation of GST has been hassle free with removal of barriers on various state borders ensuring smooth transport of goods carriers and businesses have re-jigged their logistical and manufacturing set-ups to optimize their costs and leverage on scalable operations. Pre-GST clearance sales kept the cash registers ringing for most companies in sectors such as retailing, FMCG, branded apparels, automobiles and consumer durables in the month of June. As we start the July-September quarter channel inventory is at bare minimum. We expect the tax arbitrage that sustained many unorganized sector players to narrow substantially verses players in the organized sector leading to market share gains by organized sector players and pressure on the profitability of unorganized sector players. The general business uncertainty around the extent of input tax credit due to confusion over various product categories could moderately impact GDP in the near term. However, the channel is expected to refill stocks gradually starting from July-August and gather pace as we go into the festival season in September. According to our interactions, most organized players are GST-ready and their dealer network too is GST compliant. However, the inventory adjustment to attain normal levels will take a couple of quarters.

2 GOOD SPATIAL DISTRIBUTION OF MONSOON HOLDS THE KEY

Monsoon has arrived on time and has seen normal rainfall till date. Overall rural consumption gets a boost due to rising farm and non-farm wages. Sales of companies in sectors of automobiles, FMCG, home Improvement like paints/plywood/ceramics, fertilizer pesticides, seeds, tractor companies would get positively impacted.

3 INDIAN MACROECONOMIC FACTORS HAVE IMPROVED

Earnings growth of Indian corporate which has been tepid over the last 3-4 years is likely to take-off over the next 2 yrs due to pick-up aggregate demand as a result of rising capacity utilization, sustained momentum in government's spend on infrastructure, benign inflation & interest rates continuing to support consumption-led growth. Furthur, tax buoyancy is expected to improve post demonetization and GST roll-out strengthening the fiscal position. We are hopeful of earnings growth in double digits over FY17-FY19 after a lull of almost 4 years.

4 CORPORATE EARNINGS DRIVEN BY AUTO, METALS, FMCG AND PRIVATE SECTOR BANKS

FMCG, Auto and Private sector banks continue to deliver strong earnings growth driven by buoyant consumer demand. Metals continue to show strong improvement in capacity utilization and stable prices reversing fortunes for the Steel companies. According to various estimates, anti-dumping duties imposed on Chinese steel products is expected to jack-up the capacity utilization of Indian steel companies from 78% to 90% over the next two years which may bode well for the sector. Export oriented sectors including Information technology and pharmaceuticals continue to struggle with strong rupee and tepid demand in their primary markets like the US and Europe. Pharmaceuticals sector has been hit hard due to continued pricing pressure and tightening regulatory concerns from drug regulators in the US & Europe. Information technology sector is clearly struggling with twin issues of single digit revenue growth and margin pressure. OMC's have had a windfall in FY17 due to inventory gains and we don't expect that to recur in FY18.

5 INFLATION UNDER CONTROL, RATE CUTS IMMINENT GOING FORWARD

Stable commodity prices and constructive government policies have kept domestic inflation under control. Further, normal monsoon will keep food price inflation under check. However, a spate of announcements by various State governments like Uttar Pradesh, Maharashtra and Punjab to waive off farm loans has prompted RBI to sound an alarm about fiscal deterioration and an issue of moral hazard (i.e. a series of such waivers brings about an adverse behavioral change among borrowers who are used to paying on time). RBI can still sound hawkish by citing pressure on government finances due to implementation of recommendations of states' own pay commissions, farm loan waiver in some states and revenue uncertainty on account of the implementation of GST. In our view, a 0.25% cut in Repo rate in the monetary policy meeting scheduled in August 2017 looks almost certain and there is an outlier chance of a 0.5% rate cut.

OUTLOOK AND VIEW

India's GDP is expected to grow by 7-8% CAGR over the next few years buoyed by strong consumption growth and spending by central and state governments on public infrastructure. This coupled with benign inflation trend, controlled deficit situation and improving productivity in the economy prepares a favorable ground for sustainable earnings growth which should support valuations going forward. Further, we are very bullish on GST implementation as it will be a game changer for tax compliant businesses and help them gain market share. Slack in private sector capex should gradually reverse as banks work towards faster resolution of NPA issues. From an investor's perspective, our Multi-Growth Strategy is ideally placed to deliver superior returns with core exposure to large-caps and prudent risk-taking in mid/small cap space. We expect some hiccups over the next few months but we believe it will be temporary and the bounce back will be strong.

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