

### Thematic research: Markets under possible NDA regime...

The Bharatiya Janata Party (BJP)-led National Democratic Alliance (NDA) is tipped to form the next government with many exit polls projecting a clear majority for the coalition in the just-concluded Lok Sabha elections. The projections suggest that the BJP is set to record its best-ever performance, with some polls giving it well over 200 seats. In contrast, the Congress is headed for its worst-ever showing in a Lok Sabha election with a tally of less than 100 seats, the exit polls said. Four channels — NewsX, India TV, ABP News and CNN-IBN — put the NDA well past the halfway mark of 272. NewsX and India TV projected 289 seats for the NDA while ABP News gave it 281 seats. The CNN-IBN tally for the NDA was in the 279-282 range. The India Today Group post-poll survey was a bit more conservative, putting the NDA figure in the range of 261-283, which is within striking distance of forming a government even if the coalition scores on the lower side. Times Now put the NDA number much lower at 249. Most of the polls showed the United Progressive Alliance getting between 101 and 148 seats. NewsX gave the UPA 101 seats, India TV 107 seats, ABP News 97 and CNN-IBN 92-102. 'Others', including regional parties and the Left Front, were projected to get between 146 and 156 seats. The exit polls predicted the BJP drawing a blank in Tamil Nadu and Kerala, but in north India a Narendra Modi wave was set to sweep aside regional heavyweights like the Samajwadi Party and the Bahujan Samaj Party in Uttar Pradesh and the Rashtriya Janata Dal (RJD) in Bihar. The BJP's biggest gains are in Uttar Pradesh where at least two surveys have predicted the party to win 54 seats, three short of its all-time high of 57 in 1998. Likewise in Bihar, the exit poll results dismissed any chance of the RJD's resurgence, giving a clear lead to the NDA. In its maiden election, the Aam Aadmi Party is tipped to pick up an average of five seats and an all-India vote share of about four per cent.

Before we start contemplating the possible effect of BJP forming a government at the centre after 2014 General Election, let's recap in short the current state of the economy.

Over the last 10 years, India has flirted with Centre-Left economic policies with large scale enactment of Entitlement programs and other welfare economic policies on one hand, and creeping privatization of PSU companies through sale of equity in open market on the other hand. There has been a clear departure from previous experiments of investment promotion and job creation to sale of government holdings to private companies. As a result, we have moved from low fiscal deficit level of 2.54% achieved in 2007-08 to a high 4.1% (after adding off balance sheet items and items for which money has not be disbursed by Government, the actual fiscal deficit would be much higher. Also note that FRBM Act mandates a fiscal deficit target of 3% to ensure sustainable growth parameters).

The high fiscal deficit of 4.1%, high and sticky Consumer Price Inflation of 8%+ for over the last 5 years, now has greatly impacted the structure of the Indian economy. On one side, we are seeing increasing wage pressure and low consumption rates set in, and on the other hand, job creation has been the slowest over last 15 years led by low investment rate, slowdown in service sector growth and manufacturing sector growth. To put this simply, there is more gloom in the economic environment than bloom to speak about.

#### **We believe the following sectors would benefit under NDA government -**

**Infrastructure:** We believe that Infrastructure esp. Roads would continue to be thrust areas of the new government going in to future. A major requirement for it would be streamlining land acquisition, NHAI tendering process, development of a national fund to finance road development.

**Power:** One of the major achievements of the Gujarat government has been on the power front with many out of the box solutions like separate transmission line for farms leading to substantial improvement in Power scenario of Gujarat. As of June 2013, 100% of Gujarat's villages have electricity connection for 24hr power through the Jyotigram Yojana. During this period Gujarat moved from a power deficit state to a power surplus state. It is likely that BJP would try and make this as one



of its major poll promises to electorate. Based on recent news reports, it likely that BJP would focus on a vision of achieving 24\*7 electricity supply not only to urban areas but also in rural areas by 2020. This, we believe would be key policies of BJP government given the fact that Power deficit is becoming a major constraint towards ensuring a sustainable growth in future.

**PSUs:** During the last NDA government at centre, we saw major disinvestment of PSU companies. Modi government in Gujarat pursued a different track of decentralised administration of Gujarat PSU with more autonomy to take operational decisions with government looking at only big picture investment decisions. We believe a similar experiment would be hallmark of the NDA government towards PSU. Decentralisation would be seen in PSU manufacturing units and banks wherein they can enjoy more autonomy in their operational decision, with Maharatnas even having some level investment autonomy. Loss making PSU could have an opportunity to restructure them and become efficient or seek a strategic investment (similar to like HZL, BALCO).

Strong Liability franchises like SBI, PNB and BoB could go for raising money from open market, some of the smaller banks with weak balance sheets would be merged with larger stronger PSU Banks while some of the smaller banks with regional presence with relatively strong balance sheet and capital adequacy ratio can expect budgetary support.

It is important to note that RBI is also looking for means & ways for developing a much more fool proof method of NPA recognition, restructuring of stressed assets in genuine cases and legal action to recover bank assets from wilful defaulters. The 2008 financial crisis and global experience of bad assets in banking sector and its impact on the overall economy has ensured that this would be the priority of any Central Banker. The recent case of United Bank of India will only hasten the process at regulatory level. RBI under Raghuram Rajan, wants to go one step ahead as he has repeatedly stressed development of early warning mechanisms for NPA so that Banks and RBI can take proactive steps to contain the fallout. We believe RBI under Raghuram Rajan, would play a key role in helping Government develop key policies in banking sector.

PSU stocks have underperformed in the last five years due to low growth, policy paralysis, and disinvestments. But, a BJP-led NDA government at the Centre - which seems likely going by opinion polls - could result in a re-rating of the stocks because the alliance's prime ministerial candidate Narendra Modi has said he believes the PSUs can be improved by empowering their management. To buttress his claim, he has often cited the success his government in Gujarat has had in turning around several loss-making PSUs in the state.

For example, Gujarat State Fertilizer Company (GSFC) was a loss-making entity in FY03. Modi gave a free hand to its top management. Since FY03, its sales have grown at 12% CAGR and it made a profit of 520 crore in FY13 against a loss of 391 crore in FY03. The company has a return on equity of 15% now.

The six major listed Gujarat PSUs (GMDC, GSPL, GSFC, GALK, GIPL and GNVFC) have grown net profits by 13% CAGR over the last five years and 19% CAGR over the last 10 years. A look into the financials and stock performances of Gujarat PSUs suggest better days ahead for central PSUs. Following are some companies that could see a turnaround and value creation in the next five years. The inexpensive valuations of these stocks can also work in their favour.

### **Engineering companies**

**BEML and BEL:** BEML - which provides machinery for mining and construction, and railways - will benefit from the pick-up in mining and construction activities. The company has been making losses for two years.



With NDA's focus on infrastructure, the company could see a potential turnaround.

Another area where Modi has been vocal about is the reforms in defence. This could be a positive for Bharat Electronics, which manufactures advanced electronic products for armed forces.

The company's profits have grown at less than 1% between FY08 and FY13.

### **Oil Marketing Companies**

HPCL, BPCL, IOC: Some of the key policies or reforms that are likely to happen under a new, stable government are decontrolling diesel prices, introducing a market-driven pricing mechanism for natural gas and setting a transparent policy for subsidy sharing with upstream companies.

Any steps by the new government to achieve this will benefit PSU oil marketing companies such as HPCL, BPCL and IOCL, which have seen a sharp drop in earnings and profitability, despite strong growth in revenues over the last 10 years.

### **Power Financing Companies**

PFC and REC: PFC and REC are expected to see pick up in disbursements with new investments in power generation. Gujarat has been the only power surplus state and its state electricity boards have the best financial health. Going by this, the state of the Indian power industry could undergo major revival. This will, in turn, boost lending of power finance companies that are currently seeing a lull in new disbursements.



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