

February 17, 2015

BSE-30: 29,136

All is well except for earnings and valuations. 3QFY15 results were disappointing and underlying trends in volumes and NPLs showed no signs of recovery. We see downside risks to our FY2016 estimates with both volume and profitability likely to disappoint. The market looks expensive, as India's improved macro position is yet to translate into earnings. The upcoming budget and budget session will be critical given that oil prices have moved up sharply in the past few weeks.

5.8% decline in net profits of BSE-30 Index; 5.1% decline in Nifty-50 Index's net profits

3QFY15 adjusted net profits of the BSE-30 Index and Nifty-50 Index declined 5.8% and 5.1% yoy. Reported results were boosted by extraordinary gains in NTPC and Tata Steel and would have been even worse otherwise. PSU banks and cement disappointed the most while IT was the only sector with consistent outperformance. 3QFY15 EBITDA of BSE-30 Index and Nifty-50 Index declined 6% and 3.2% (6.4% and 5.5% below our estimates).

Risks to FY2016 earnings estimates have increased post 3QFY15 results

We see downside risks to our current FY2016E net profits for the BSE-30 Index and Nifty-50 Index (+18.3% and +17.1%). Macro factors and especially the level of interest rates and oil prices will play a role undoubtedly for sectors such as banks and energy. However, our volume and profitability assumptions for certain domestic cyclical sectors such as automobiles, cement and industrials may be at risk without a meaningful pick-up in economic activity. Underlying trends in volume growth and NPLs were quite weak in 3QFY15 too.

Macro factors supporting market currently in the absence of earnings improvement

In our view, (1) India's improved macro position (low CAD, declining GFD/GDP and reasonable inflation), (2) supportive global liquidity and (3) ongoing reforms and expectations of further reforms are supporting the market's current high valuations in the absence of earnings recovery. Any negative surprise in one or more of the abovementioned factors may lead to a correction in the market given the absence of earnings support.

Budget and budget session will be important in the short term; macro will play a role too

Given the market's heightened expectations from the budget and five important economic bills before the parliament, the budget session of the parliament is likely to set the tone for the market for the next few months. Also, the level of global oil prices will influence India's macroeconomic variables and in turn, the fiscal and monetary policy actions of the government and the RBI, respectively. Both have potential to disappoint negatively versus expectations.

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Sanjeev Prasad
sanjeev.prasad@kotak.com
Mumbai: +91-22-4336-0830

Akhilesh Tilotia, CFA
akhilesh.tilotia@kotak.com
Mumbai: +91-22-4336-0897

Sunita Baldawa
sunita.baldawa@kotak.com
Mumbai: +91-22-4336-0896

Kotak Institutional Equities
Research

Important disclosures appear
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The prices in this report are based on the market close of February 16, 2015.

3QFY15 RESULTS OVERVIEW: WAIT FOR GROWTH GETS LONGER

Net profits of BSE-30 companies declined for the first time since 1QFY14 led by the automobiles, banking, energy and industrials sectors. Banks' slippages and NPLs remained high, volume growth was patchy across all domestic sectors and order booking of industrial companies showed no improvement. Our FY2015 earnings estimates continued their downward trajectory with full-year profit growth now down to 4.4% only. We expect FY2016 and FY2017 net profits of the BSE-30 Index to grow 18.3% and 17.9%, respectively, but see downside risks to our estimates.

Key takeaways from 3QFY15 results—wait for growth gets longer

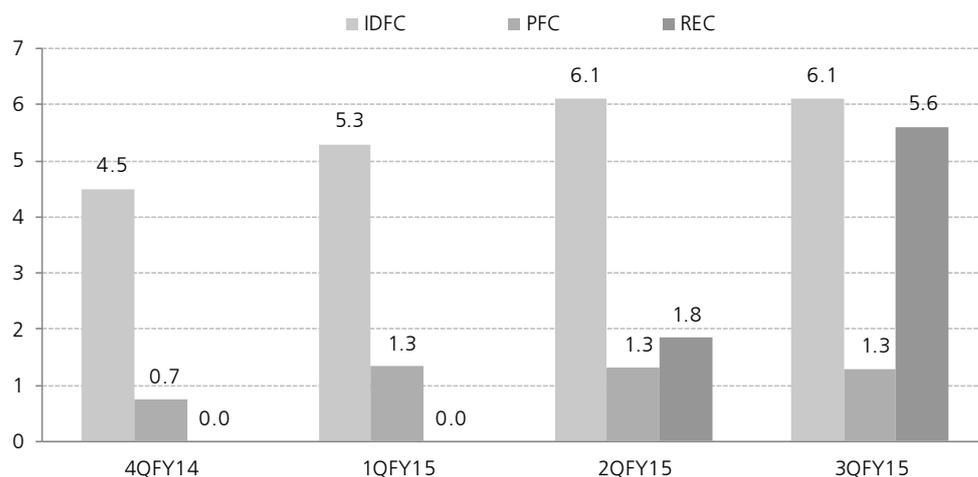
- ▶ **Bank slippages and NPL positions remain grim.** Public sector banks continued to report high fresh slippages and more worryingly, high slippages in their restructured loans portfolio and were joined by their private sector counterparts such as ICICI Bank (see Exhibit 1). As we have highlighted several times before, we expect further deterioration in NPLs, particularly in the power, steel and telecom sectors. The RBI's requirement for non-banking finance companies such as PFC and REC to recognize their restructured loans results in higher restructured loans in their quarterly numbers (see Exhibit 2).

Exhibit 1: Public sector banks continued to report high fresh slippages, as did some of their private sector counterparts
Trend in gross NPLs, net NPLs and slippages, 3QFY14-3QFY15

| | Gross NPLs (%) | | | | | Net NPLs (%) | | | | | Slippages (%) | | | | |
|---------------------------|----------------|------------|------------|------------|------------|--------------|------------|------------|------------|------------|---------------|--------|--------|--------|--------|
| | 3QFY14 | 4QFY14 | 1QFY15 | 2QFY15 | 3QFY15 | 3QFY14 | 4QFY14 | 1QFY15 | 2QFY15 | 3QFY15 | 3QFY14 | 4QFY14 | 1QFY15 | 2QFY15 | 3QFY15 |
| Public banks | | | | | | | | | | | | | | | |
| Allahabad Bank | 5.5 | 5.7 | 5.5 | 5.4 | 5.5 | 4.2 | 4.2 | 3.9 | 3.5 | 3.9 | 4.4 | 4.9 | 3.5 | 3.8 | 3.0 |
| Andhra Bank | 5.6 | 5.3 | 6.0 | 6.0 | 6.0 | 3.7 | 3.1 | 3.9 | 3.9 | 3.7 | 2.8 | 2.0 | 7.8 | 3.4 | 3.1 |
| Bank of Baroda | 3.3 | 2.9 | 3.1 | 3.3 | 3.9 | 1.9 | 1.5 | 1.6 | 1.7 | 2.1 | 1.8 | 1.5 | 2.0 | 1.9 | 3.0 |
| Bank of India | 2.8 | 3.2 | 3.3 | 3.5 | 4.1 | 1.8 | 2.0 | 2.1 | 2.3 | 2.5 | 2.1 | 4.0 | 4.0 | 3.1 | 3.4 |
| Canara Bank | 2.8 | 2.5 | 2.7 | 2.9 | 3.4 | 2.4 | 2.0 | 2.0 | 2.3 | 2.4 | 3.0 | 3.0 | 3.4 | 4.2 | 2.9 |
| Corporation Bank | 3.1 | 3.4 | 4.0 | 4.5 | 4.9 | 2.2 | 2.3 | 2.7 | 2.9 | 3.3 | 1.2 | 3.7 | 3.8 | 2.3 | 3.2 |
| Indian Overseas Bank | 5.3 | 5.0 | 5.8 | 7.4 | 8.1 | 3.2 | 3.2 | 3.9 | 5.2 | 5.5 | 3.7 | 5.2 | 5.9 | 10.2 | 5.0 |
| Oriental Bank of Commerce | 3.9 | 4.0 | 4.3 | 4.7 | 5.4 | 2.9 | 2.8 | 3.1 | 3.3 | 3.7 | 3.2 | 3.6 | 4.1 | 2.8 | 3.8 |
| Punjab National Bank | 5.0 | 5.3 | 5.5 | 5.7 | 6.0 | 2.8 | 2.9 | 3.0 | 3.3 | 3.8 | 1.9 | 5.5 | 3.4 | 4.6 | 5.8 |
| State Bank of India | 5.7 | 5.0 | 4.9 | 4.9 | 4.9 | 3.2 | 2.6 | 2.7 | 2.7 | 2.8 | 4.1 | 2.8 | 3.3 | 2.6 | 2.3 |
| Union Bank of India | 3.9 | 4.1 | 4.3 | 4.7 | 5.1 | 2.3 | 2.3 | 2.5 | 2.7 | 3.0 | 2.1 | 2.1 | 2.2 | 3.3 | 2.8 |
| Old private banks | | | | | | | | | | | | | | | |
| City Union Bank | 1.7 | 1.8 | 1.9 | 2.0 | 2.1 | 0.9 | 1.2 | 1.3 | 1.3 | 1.3 | 2.3 | 4.5 | 9.2 | 2.1 | 1.5 |
| DCB Bank | 2.8 | 1.7 | 1.8 | 1.9 | 1.9 | 0.8 | 0.9 | 1.0 | 1.1 | 1.0 | 1.4 | 1.5 | 1.2 | 2.0 | 1.0 |
| Federal Bank | 2.8 | 2.5 | 2.2 | 2.1 | 2.2 | 0.9 | 0.7 | 0.7 | 0.7 | 0.7 | 1.4 | 1.9 | 2.1 | 1.6 | 1.9 |
| Karur Vysya Bank | 1.5 | 0.8 | 1.3 | 1.4 | 1.9 | 0.5 | 0.4 | 0.5 | 0.6 | 0.7 | 0.4 | 0.9 | 2.4 | 1.8 | 2.6 |
| J&K Bank | 1.7 | 1.7 | 4.2 | 4.7 | 5.8 | 0.2 | 0.2 | 2.2 | 2.5 | 3.2 | 1.4 | 0.6 | 10.0 | 3.3 | 5.1 |
| New private banks | | | | | | | | | | | | | | | |
| Axis Bank | 1.3 | 1.2 | 1.3 | 1.3 | 1.3 | 0.4 | 0.4 | 0.4 | 0.4 | 0.4 | 1.2 | 0.6 | 1.1 | 1.6 | 1.2 |
| HDFC Bank | 1.0 | 1.0 | 1.1 | 1.0 | 1.0 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 | — | — | — | — | — |
| ICICI Bank | 3.1 | 3.1 | 3.2 | 3.2 | 3.5 | 0.9 | 1.0 | 1.0 | 1.1 | 1.3 | 1.5 | 1.5 | 1.4 | 1.9 | 2.5 |
| IndusInd Bank | 1.2 | 1.1 | 1.1 | 1.1 | 1.1 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 | 0.9 | 0.6 | 0.8 | 0.0 | 0.2 |
| Yes Bank | 0.4 | 0.3 | 0.3 | 0.4 | 0.4 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | — | — | — | — | — |
| Total | 3.8 | 3.6 | 3.8 | 3.9 | 4.2 | 2.2 | 2.0 | 2.1 | 2.2 | 2.4 | | | | | |
| Public banks | 4.5 | 4.3 | 4.4 | 4.6 | 4.9 | 2.7 | 2.4 | 2.6 | 2.7 | 2.9 | | | | | |
| Private banks | 1.8 | 1.7 | 1.9 | 1.9 | 2.0 | 0.5 | 0.5 | 0.6 | 0.7 | 0.7 | | | | | |

Source: Companies, Kotak Institutional Equities

Exhibit 2: Steep increase in restructured loans of IDFC, PFC and REC
Restructured loans for IDFC, PFC and REC, 4QFY14-3QFY15 (%)



Source: Companies, Kotak Institutional Equities

In addition, credit off-take has slowed to multi-quarter lows again thereby belying the expectation that a sharp increase in the loan book will, at least optically, reduce the NPLs as a proportion of loans. Exhibit 3 shows yoy credit growth for the banks under our coverage as well as total credit growth for the past few quarters. A few banks, mostly private, showed strong growth but credit growth for the banking system declined to 10.5% yoy in the month of December 2014. A pick-up in investment may result in higher credit growth after 3-4 quarters.

Exhibit 3: Credit growth for the banking system has declined in past few quarters
Yoy growth in loans for companies under KIE universe, March fiscal year-ends, 2013-15 (%)

| | 3QFY13 | 4QFY13 | 1QFY14 | 2QFY14 | 3QFY14 | 4QFY14 | 1QFY15 | 2QFY15 | 3QFY15 |
|---------------------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Public banks | | | | | | | | | |
| Bank of Baroda | 14.8 | 14.2 | 12.4 | 16.3 | 17.7 | 21.0 | 18.8 | 13.5 | 11.7 |
| Bank of India | 20.3 | 16.5 | 17.1 | 29.4 | 27.2 | 28.4 | 23.3 | 18.5 | 15.1 |
| Canara Bank | 0.3 | 4.2 | 10.8 | 30.3 | 31.8 | 24.3 | 21.2 | 10.6 | 8.5 |
| Oriental Bank of Commerce | 11.7 | 16.3 | 12.4 | 9.2 | 8.4 | 8.1 | 8.1 | 8.1 | 5.5 |
| Punjab National Bank | 13.2 | 5.1 | 3.6 | 6.5 | 9.7 | 13.1 | 13.9 | 13.8 | 11.1 |
| State Bank of India | 15.6 | 20.5 | 15.7 | 19.1 | 17.4 | 15.7 | 13.0 | 9.6 | 7.4 |
| Union Bank of India | 21.6 | 17.1 | 16.5 | 25.5 | 19.9 | 10.6 | 18.1 | 10.3 | 8.9 |
| Old private banks | | | | | | | | | |
| City Union Bank | 31.6 | 25.6 | 20.5 | 16.8 | 9.0 | 5.6 | 5.0 | 7.7 | 7.2 |
| DCB Bank | 20.6 | 24.6 | 18.8 | 17.8 | 23.4 | 23.6 | 28.1 | 31.7 | 28.9 |
| Federal Bank | 18.9 | 16.8 | 8.5 | 16.3 | 5.4 | (1.5) | 9.1 | 14.8 | 15.3 |
| Karur Vysya Bank | 22.6 | 22.7 | 25.8 | 24.3 | 21.2 | 15.2 | 11.9 | 11.3 | 8.0 |
| J&K Bank | 19.9 | 18.5 | 21.1 | 20.0 | 21.5 | 18.3 | 13.6 | 9.6 | 2.4 |
| New private banks | | | | | | | | | |
| Axis Bank | 20.7 | 16.0 | 15.8 | 16.9 | 17.8 | 16.8 | 16.3 | 20.3 | 23.2 |
| HDFC Bank | 24.3 | 22.7 | 21.2 | 16.0 | 22.9 | 26.4 | 20.7 | 21.8 | 17.0 |
| ICICI Bank | 16.5 | 14.4 | 12.3 | 15.5 | 16.0 | 16.7 | 15.2 | 13.8 | 12.8 |
| Yes Bank | 22.3 | 23.7 | 24.3 | 13.6 | 14.7 | 18.4 | 23.2 | 30.0 | 32.4 |
| IndusInd Bank | 30.8 | 26.4 | 27.3 | 24.2 | 23.7 | 24.3 | 23.7 | 22.4 | 21.7 |
| Public sector | 14.4 | 15.0 | 13.3 | 19.3 | 18.7 | 17.5 | 16.0 | 11.7 | 9.5 |
| Private sector | 20.9 | 18.5 | 17.2 | 16.7 | 18.3 | 18.6 | 17.1 | 18.2 | 16.9 |
| Total | 16.1 | 15.9 | 14.3 | 18.6 | 18.6 | 17.8 | 16.3 | 13.5 | 11.5 |

Source: Companies, Kotak Institutional Equities

- ▶ **Consumption continues to be patchy, with a few pockets of strength.** Consumer staples' volume growth seems to have stabilized at low levels (same as in the last quarter), even though trends were mixed. In the case of consumer discretionary products, Asian Paints, which had delivered solid growth in 1QFY15 and 2QFY15 (11% and 12% yoy volume growth, respectively), showed a sharp slowdown to 3% yoy volume growth. Volume growth and SSG parameters for all companies under coverage were positive except for ITC, which saw a sharp estimated fall of 14% in cigarette volumes. Exhibit 4 shows the trends in volume growth for the major companies under our coverage over the past several quarters.

Exhibit 4: Consumer companies have reported weak volume growth in 3QFY15

Volume growth of consumer companies, 3QFY13-3QFY15 (% , yoy)

| | 3QFY13 | 4QFY13 | 1QFY14 | 2QFY14 | 3QFY14 | 4QFY14 | 1QFY15 | 2QFY15 | 3QFY15 |
|------------------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| Volume growth | | | | | | | | | |
| Staples | | | | | | | | | |
| Bajaj Corp. - Almond Drop Hair Oil | 23.4 | 20.6 | 19.1 | 15.9 | (1.5) | (10.4) | (1.0) | 4.0 | 19.2 |
| Colgate - Overall | 7.0 | 12.0 | 9.0 | 10.0 | 10.0 | 7.0 | 5.0 | 7.0 | 5.0 |
| Colgate - Toothpaste | 8.0 | 11.0 | 11.0 | 9.0 | 11.0 | 7.0 | 5.0 | 7.0 | 5.0 |
| Dabur - Domestic | 9.5 | 12.0 | 9.0 | 10.7 | 9.0 | 9.2 | 8.3 | 8.7 | 7.4 |
| Emami - Domestic | 16.0 | 13.0 | 6.0 | 6.0 | 2.5 | (5.0) | 12.5 | 11.0 | 10.0 |
| GSK Consumer | 8.0 | 8.0 | 7.0 | 10.0 | 11.0 | 7.0 | 3.0 | 2.0 | 5.0 |
| GCPL - Soaps | 2.0 | 4.0 | 7.0 | 4.0 | 6.0 | (4.0) | (3.0) | 4.0 | 4.0 |
| HUL (FMCG business) | 5.0 | 6.0 | 4.0 | 5.0 | 4.0 | 3.0 | 6.0 | 5.0 | 3.0 |
| Marico - Domestic | 15.0 | 14.0 | 10.0 | 4.0 | 3.0 | 6.0 | 6.5 | 8.0 | 5.0 |
| Marico - Parachute | 6.0 | 5.0 | 4.0 | 1.0 | 2.0 | 10.0 | 6.0 | 7.0 | 8.0 |
| Marico - Saffola | 4.0 | 5.0 | 10.0 | 7.0 | 9.0 | 11.0 | 10.0 | 9.5 | 3.0 |
| Marico - Value-added hair oils | 30.0 | 24.0 | 16.0 | 15.0 | 8.0 | 5.0 | 11.0 | 13.0 | 10.0 |
| Nestle | — | 1.0 | 3.0 | 4.0 | (1.0) | (2.0) | 2.0 | 1.0 | 2.0 |
| Discretionary | | | | | | | | | |
| Asian Paints | 14.0 | 3.0 | 10.0 | 13.0 | 7.0 | 15.0 | 11.0 | 12.0 | 3.0 |
| ITC - Cigarettes | 1.5 | 3.0 | (2.0) | (4.0) | (2.5) | (3.0) | (2.5) | (4.0) | (14.0) |
| Jubilant Foodworks - SSG | 16.1 | 7.7 | 6.3 | 6.6 | (2.6) | (3.4) | (2.4) | (5.3) | 1.9 |
| Titan - Jewelry | 13.0 | 9.0 | 67.0 | (4.0) | (21.0) | (2.0) | (24.0) | 75.0 | 25.0 |

Source: Companies, Kotak Institutional Equities

Automobiles showed some strength in 3QFY15, driven by lower fuel prices and the expectation of the end of the excise cuts. Exhibit 5 shows the quarterly volumes of various automobile segments. Scooters continued their smart run (volumes up 27.7% yoy until FYTD December 2014) even as motorcycles volumes grew only 5.5%. FYTD passenger car volumes are also up only 5%. CV volumes continue to decline despite a low base, underscoring the problem of low capacity utilization in the road freight industry. Tractor volumes declined sharply this quarter (weak in January 2015 too) pulling down the FYTD growth into negative territory, reflecting a likely decline in farm incomes from lower crop prices.

Exhibit 5: Automobile companies showed good volumes in 3QFY15

Domestic volumes of select companies in auto sector, March fiscal year-ends, 3QFY13-3QFY15

| | 3QFY13 | 4QFY13 | 1QFY14 | 2QFY14 | 3QFY14 | 4QFY14 | 1QFY15 | 2QFY15 | 3QFY15 |
|---------------------------------------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|
| Domestic sales volumes (units) | | | | | | | | | |
| Ashok Leyland | 20,959 | 32,416 | 19,387 | 20,981 | 16,042 | 22,700 | 17,379 | 25,379 | 25,397 |
| Bajaj Auto | | | | | | | | | |
| Two wheelers | 687,351 | 556,147 | 571,655 | 506,472 | 527,181 | 493,922 | 490,841 | 461,651 | 438,849 |
| Three wheelers | 64,168 | 60,079 | 45,057 | 53,828 | 44,003 | 44,024 | 55,622 | 74,838 | 55,257 |
| Eicher Motors | | | | | | | | | |
| Two wheelers | 31,116 | 33,933 | 38,706 | 47,101 | 54,125 | 62,827 | 72,209 | 80,457 | 80,887 |
| Commercial vehicles | 10,846 | 11,936 | 10,344 | 8,033 | 6,937 | 8,692 | 9,329 | 8,296 | 7,729 |
| Hero Motocorp | 1,530,122 | 1,488,167 | 1,527,980 | 1,383,127 | 1,649,391 | 1,554,699 | 1,678,476 | 1,688,471 | 1,578,321 |
| Maruti Suzuki | 268,957 | 308,871 | 245,346 | 241,562 | 268,185 | 298,596 | 270,643 | 287,687 | 295,202 |
| M&M (passenger vehicles) | 74,297 | 75,823 | 60,224 | 50,267 | 56,131 | 62,533 | 53,013 | 48,741 | 50,330 |
| Tata Motors | | | | | | | | | |
| Commercial vehicles | 111,031 | 118,546 | 89,055 | 82,771 | 71,334 | 74,727 | 66,590 | 92,069 | 72,866 |
| Passenger vehicles | 81,167 | 66,396 | 52,682 | 55,095 | 47,794 | 43,241 | 33,157 | 34,551 | 40,906 |
| Yoy change (%) | | | | | | | | | |
| Ashok Leyland | 4.3 | 2.7 | (21.1) | (24.4) | (23.5) | (30.0) | (10.4) | 21.0 | 58.3 |
| Bajaj Auto | | | | | | | | | |
| Two wheelers | 7.0 | (9.8) | (7.6) | (15.9) | (23.3) | (11.2) | (14.1) | (8.8) | (16.8) |
| Three wheelers | 23.1 | 12.9 | 0.5 | (5.6) | (31.4) | (26.7) | 23.4 | 39.0 | 25.6 |
| Eicher Motors | | | | | | | | | |
| Two wheelers | 70.3 | 46.6 | 46.5 | 61.1 | 73.9 | 85.2 | 86.6 | 70.8 | 49.4 |
| Commercial vehicles | (9.3) | (11.7) | (7.3) | (21.5) | (36.0) | (27.2) | (9.8) | 3.3 | 11.4 |
| Hero Motocorp | (0.8) | (2.8) | (4.2) | 6.5 | 7.8 | 4.5 | 9.8 | 22.1 | (4.3) |
| Maruti Suzuki | 27.0 | (3.9) | (6.8) | 15.1 | (0.3) | (3.3) | 10.3 | 19.1 | 10.1 |
| Mahindra & Mahindra | 32.9 | 19.4 | (2.1) | (25.7) | (24.5) | (17.5) | (12.0) | (3.0) | (10.3) |
| Tata Motors | | | | | | | | | |
| Commercial vehicles | (10.1) | (22.0) | (10.9) | (28.2) | (35.8) | (37.0) | (25.2) | 11.2 | 2.1 |
| Passenger vehicles | (15.2) | (46.6) | (30.5) | (39.5) | (41.1) | (34.9) | (37.1) | (37.3) | (14.4) |

Source: SIAM, Kotak Institutional Equities

Cement volume showed moderate growth (see Exhibit 6). However, the numbers are inflated by UTCM's volumes, which include contribution from cement plants acquired from JPA. In reality, cement demand is weak reflecting low construction activity. Shree Cement continued with its industry-beating volume growth (even though its rate of volume growth has declined) in a scenario where all the other companies struggled to grow volumes or move beyond single-digit growth. Industrial and construction activity has not yet picked up belying expectations of a quick turnaround in the economy post the formation of a new stable government in May 2014.

Exhibit 6: Cement volumes weak; UTCM's volumes boosted by acquisitions of JPA's plants

Volume trends for cement companies under KIE coverage, 3QFY14-3QFY15

| | 2QFY13 | 3QFY13 | 4QFY13 | 1QFY14 | 2QFY14 | 3QFY14 | 4QFY14 | 1QFY15 | 2QFY15 | 3QFY15 |
|--------------------------------|-------------|--------------|--------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Yoy volume growth (%) | | | | | | | | | | |
| ACC | (4.6) | (0.7) | (4.5) | 1.2 | 2.0 | (1.0) | 0.9 | 3.8 | 1.4 | (1.5) |
| Ambuja Cements | 0.7 | (11.9) | (1.5) | (2.9) | 2.1 | 6.3 | 1.7 | 7.6 | (4.5) | 3.4 |
| India Cements | 2.3 | 10.5 | 6.5 | 11.3 | (1.7) | (5.0) | (10.8) | (3.4) | (3.6) | (8.2) |
| Shree Cement | 22.4 | 5.2 | (6.2) | (5.9) | 5.2 | 14.7 | 17.8 | 17.3 | 21.2 | 10.9 |
| UltraTech Cement | (2.2) | (1.5) | (3.6) | 1.4 | 1.8 | (1.7) | 9.4 | 16.1 | 12.3 | 13.2 |
| Total volume growth (%) | 0.7 | (1.8) | (2.8) | 0.4 | 2.0 | 1.6 | 5.1 | 9.9 | 6.2 | 5.9 |
| Volumes (mn tons) | | | | | | | | | | |
| ACC | 5.4 | 5.9 | 6.4 | 6.1 | 5.5 | 5.9 | 6.5 | 6.4 | 5.6 | 5.8 |
| Ambuja Cements | 4.8 | 5.1 | 6.0 | 5.4 | 4.9 | 5.4 | 6.1 | 5.8 | 4.7 | 5.6 |
| India Cements | 2.5 | 2.4 | 2.8 | 2.6 | 2.4 | 2.3 | 2.5 | 2.6 | 2.4 | 2.1 |
| Shree Cement | 3.0 | 3.0 | 3.3 | 3.2 | 3.2 | 3.4 | 3.8 | 3.7 | 3.9 | 3.8 |
| UltraTech Cement | 9.1 | 9.9 | 11.1 | 10.1 | 9.2 | 9.7 | 12.2 | 11.7 | 10.4 | 11.0 |
| Total | 24.8 | 26.2 | 29.5 | 27.4 | 25.3 | 26.7 | 31.0 | 30.1 | 26.9 | 28.2 |

Source: Companies, Kotak Institutional Equities

We find the market's faith in the cement sector, as exemplified by its high valuations, remarkable in the context of current low volume growth and profitability of the cement sector. The valuations are all the more remarkable since they are expensive based on a sharp improvement in profitability over the next two years (see Exhibit 7 for our profitability and volume assumptions for the cement stocks under our coverage).

Exhibit 7: Valuations of cement stocks are expensive despite assuming a sharp improvement in profitability over the next two years
Cement comparative valuation, March fiscal year-ends, 2014-17E

| Company | EPS (Rs) | | | | P/E (X) | | | | EV/EBITDA (X) | | | | EV/ton of production (US\$) | | | |
|-----------------------|----------|-------|-------|-------|---------|--------|-------|-------|---------------|-------|-------|-------|-----------------------------|-------|-------|-------|
| | 2014 | 2015E | 2016E | 2017E | 2014 | 2015E | 2016E | 2017E | 2014 | 2015E | 2016E | 2017E | 2014 | 2015E | 2016E | 2017E |
| ACC | 46 | 46 | 63 | 85 | 35.1 | 35.3 | 25.5 | 19.0 | 20.4 | 23.0 | 13.6 | 10.2 | 191 | 195 | 176 | 162 |
| Ambuja Cements | 7 | 9 | 12 | 14 | 39.4 | 29.1 | 23.1 | 18.7 | 23.2 | 17.4 | 13.7 | 10.7 | 285 | 267 | 248 | 225 |
| Grasim Industries | 212 | 195 | 248 | 333 | 18.2 | 19.8 | 15.6 | 11.6 | 8.7 | 7.7 | 5.3 | 3.7 | NA | NA | NA | NA |
| India Cements | (2) | 3 | 7 | 10 | (45.4) | 38.2 | 14.2 | 10.7 | 11.3 | 8.8 | 6.8 | 5.4 | 111 | 112 | 102 | 93 |
| Jaiprakash Associates | (6) | (1) | 4 | 4 | (4.4) | (18.3) | 5.5 | 7.0 | 12.9 | 13.5 | 9.8 | 9.6 | NA | NA | NA | NA |
| Shree Cement | 236 | 207 | 350 | 474 | 46.9 | 53.5 | 31.6 | 23.4 | 27.6 | 24.8 | 16.6 | 12.6 | 408 | 367 | 334 | 282 |
| UltraTech Cement | 75 | 76 | 102 | 142 | 41.2 | 40.7 | 30.2 | 21.7 | 23.2 | 21.8 | 15.1 | 11.4 | 332 | 314 | 284 | 252 |

Source: Companies, Kotak Institutional Equities estimates

- **Investment will take time to recover.** Domestic revenues for industrial companies continued to be weak (see Exhibit 8 for domestic revenues of industrial companies under our coverage for the past 10 quarters). Companies continued to rely on offshore orders for their growth given subdued domestic order booking. We attribute the weakness in domestic revenues to (1) subdued investment activity in general and (2) slow execution in projects of companies with poor financials or in projects with underlying challenges such as land acquisition, fuel shortage and resource non-availability.

Exhibit 8: Domestic revenues for industrial companies continued to be weak
Domestic revenues for industrials companies under KIE coverage, 3QFY13-3QFY15 (Rs bn)

| | Domestic revenues (Rs bn) | | | | | | | | | | yoy growth (%) | | | | | | | | |
|-----------------|---------------------------|------------|------------|------------|------------|------------|------------|------------|------------|--|----------------|------------|-------------|------------|------------|------------|------------|------------|------------|
| | 3QFY13 | 4QFY13 | 1QFY14 | 2QFY14 | 3QFY14 | 4QFY14 | 1QFY15 | 2QFY15 | 3QFY15 | | 3QFY13 | 4QFY13 | 1QFY14 | 2QFY14 | 3QFY14 | 4QFY14 | 1QFY15 | 2QFY15 | 3QFY15 |
| ABB | 17 | 17 | 15 | 15 | 18 | 15 | 15 | 15 | 19 | | (5) | 10 | (6) | (1) | 6 | (7) | 3 | 3 | 1 |
| BHEL | 95 | 179 | 60 | 84 | 80 | 140 | 48 | 57 | 58 | | (5) | (2) | (24) | (15) | (16) | (22) | (20) | (32) | (28) |
| Crompton | 15 | 19 | 17 | 15 | 16 | 17 | 17 | 17 | 17 | | 10 | 7 | 12 | 7 | 4 | (10) | 0 | 12 | 8 |
| Cummins | 8 | 8 | 7 | 6 | 7 | 6 | 6 | 7 | 7 | | 30 | 18 | (9) | (18) | (13) | (26) | (16) | 12 | 1 |
| Larsen & Toubro | 106 | 153 | 80 | 97 | 120 | 164 | 88 | 107 | 132 | | (6) | 4 | (9) | 4 | 13 | 8 | 9 | 10 | 10 |
| Siemens | 21 | 25 | 22 | 28 | 20 | 23 | 20 | 20 | 19 | | (1) | (22) | (7) | (3) | (4) | (8) | (10) | (27) | (6) |
| Thermax | 9 | 12 | 7 | 9 | 9 | 12 | 7 | 10 | 10 | | (18) | (13) | (12) | (13) | (3) | (6) | (3) | 14 | 13 |
| Total | 272 | 413 | 209 | 253 | 271 | 377 | 201 | 233 | 262 | | (4) | (1) | (12) | (5) | (0) | (9) | (4) | (8) | (3) |

Notes:

(a) We have used historical share of exports to get domestic revenues of ABB, BHEL, Siemens and Thermax.

Source: Companies, Kotak Institutional Equities

Domestic order inflows increased sharply (see Exhibit 9), which suggests that investment recovery may gather momentum over the next 3-4 quarters. We would caution that L&T has stopped distinguishing between domestic and overseas order inflows in its disclosures and we have made some assumptions to arrive at its domestic order inflows. We note that L&T's reticence makes it difficult to get a grip on the state of the domestic industry; L&T's order inflows would provide a good sense given the company's presence in almost all segments of the industrials and infrastructure sectors.

Exhibit 9: Industrial stocks reported a strong improvement in order booking in 3QFY15; but growth is still patchy

Order inflows for industrials companies under KIE coverage, 3QFY13-3QFY15 (Rs bn)

| | Order inflows (Rs bn) | | | | | | | | | yoy growth (%) | | | | | | | | |
|----------------------------|-----------------------|--------|--------|--------|--------|--------|--------|--------|--------|----------------|--------|--------|--------|--------|--------|--------|--------|--------|
| | 3QFY13 | 4QFY13 | 1QFY14 | 2QFY14 | 3QFY14 | 4QFY14 | 1QFY15 | 2QFY15 | 3QFY15 | 3QFY13 | 4QFY13 | 1QFY14 | 2QFY14 | 3QFY14 | 4QFY14 | 1QFY15 | 2QFY15 | 3QFY15 |
| ABB | 16 | 15 | 17 | 17 | 18 | 20 | 20 | 14 | 25 | (28) | (6) | (15) | 3 | 11 | 30 | 16 | (18) | 41 |
| BHEL | 14 | 208 | 15 | 30 | 68 | 163 | 11 | 123 | 61 | 45 | 205 | (74) | (5) | 369 | (22) | (23) | 311 | (10) |
| Crompton (domestic) | 6 | 4 | 9 | 3 | 6 | 10 | 7 | 6 | 7 | NA | (36) | 95 | (51) | 14 | 151 | (21) | 103 | 4 |
| Larsen & Toubro (domestic) | 137 | 223 | 216 | 151 | 105 | 159 | 130 | 269 | 216 | NA | 36 | 31 | 4 | (23) | (29) | (40) | 78 | 106 |
| Siemens | 20 | 28 | 26 | 26 | 20 | 26 | 27 | 30 | 21 | (30) | 56 | (3) | (8) | 1 | (7) | 5 | 13 | 5 |
| Thermax | 13 | 12 | 21 | 8 | 14 | 11 | 7 | 11 | 12 | 118 | 43 | 69 | (34) | 6 | (1) | (69) | 33 | (10) |
| Voltas | 9 | 4 | 8 | 12 | 2 | 3 | 8 | 4 | 7 | (40) | (17) | 86 | 252 | (72) | (14) | (1) | (65) | 171 |
| Total | 214 | 493 | 312 | 248 | 233 | 392 | 210 | 455 | 348 | 165 | 73 | 8 | 2 | 9 | (20) | (33) | 84 | 50 |

Notes:

(a) We have used domestic order inflows for Crompton and L&T, for the rest of the companies, we have used total order inflows.

(b) We have adjusted LT's order inflows by removing the order booking pertaining to the hydrocarbons segment for FY2012 and FY2013. Order inflows may show positive bias (on lack of standalone data).

Source: Companies, Kotak Institutional Equities

High valuations of stocks (see Exhibit 10) reflect the market's confidence in a recovery in revenues and profits in the medium term. We do not dispute the medium-term potential of investment in India but suspect that revenues will continue to be weak for the next few quarters. The confidence of companies expecting a recovery in FY2015 seems to have waned with many companies now painting a more muted outlook for the next few quarters. Even as the profit growth of the companies in industrials sector under our coverage is expected to fall by 19.4% in FY2015, we expect a sharp recovery in FY2016 and FY2017 with profit growth estimated to be 48% and 34%, respectively.

Exhibit 10: Valuation are quite stiff even after factoring a significant recovery in their earnings

Valuation summary of industrials stocks under KIE coverage, March fiscal year-ends, 2015-17E

| Company | EPS (Rs) | | | EPS growth (%) | | | PER (X) | | | EV/EBITDA (X) | | | Price/BV (X) | | |
|------------------------------|----------|-------|-------|----------------|--------|-------|---------|-------|-------|---------------|-------|-------|--------------|-------|-------|
| | 2015E | 2016E | 2017E | 2015E | 2016E | 2017E | 2015E | 2016E | 2017E | 2015E | 2016E | 2017E | 2015E | 2016E | 2017E |
| ABB | 11.6 | 24.0 | 32.2 | 38.6 | 107.4 | 34.3 | 124.6 | 60.1 | 44.7 | 66.5 | 38.0 | 29.9 | 10.8 | 9.4 | 7.9 |
| Bharat Heavy Electricals | 7.3 | 11.8 | 15.7 | (48.2) | 61.7 | 32.7 | 35.5 | 21.9 | 16.5 | 23.5 | 12.5 | 7.7 | 1.9 | 1.7 | 1.6 |
| Crompton Greaves | 3.9 | 7.7 | 11.8 | (0.4) | 99.4 | 52.3 | 44.2 | 22.2 | 14.6 | 17.7 | 12.7 | 9.5 | 2.7 | 2.4 | 2.1 |
| Cummins India | 28.2 | 31.4 | 39.1 | 30.7 | 11.1 | 24.7 | 31.8 | 28.7 | 23.0 | 32.5 | 25.5 | 20.4 | 8.9 | 8.2 | 7.4 |
| Kalpataru Power Transmission | 8.5 | 7.5 | 12.7 | 6.8 | (11.7) | 69.7 | 27.4 | 31.0 | 18.3 | 9.6 | 8.1 | 6.8 | 1.6 | 1.6 | 1.5 |
| KEC International | 5.7 | 5.9 | 10.4 | 71.7 | 3.4 | 77.7 | 14.8 | 14.3 | 8.1 | 9.4 | 6.9 | 5.3 | 1.5 | 1.4 | 1.2 |
| Larsen & Toubro | 37.5 | 55.8 | 76.4 | (23.0) | 49.0 | 36.9 | 44.0 | 29.5 | 21.6 | 21.4 | 16.3 | 13.9 | 4.0 | 3.6 | 3.2 |
| Siemens | 17.2 | 23.2 | 28.7 | 177.4 | 35.3 | 23.6 | 71.8 | 53.1 | 42.9 | 41.0 | 31.1 | 25.2 | 9.1 | 8.2 | 7.3 |
| Thermax | 23.5 | 32.1 | 38.8 | 14.0 | 36.3 | 21.1 | 51.2 | 37.6 | 31.0 | 34.2 | 25.0 | 20.5 | 6.5 | 5.8 | 5.2 |
| Voltas | 8.7 | 12.0 | 14.2 | 16.9 | 38.4 | 18.6 | 28.7 | 20.8 | 17.5 | 23.6 | 15.4 | 12.6 | 4.1 | 3.6 | 3.2 |

Source: Companies, Kotak Institutional Equities estimates

Earnings focus shifts to FY2016; FY2015 growth down to low single digits

Our earnings estimates for the market for FY2015 declined further post the 3QFY15 results. We now expect 4.4% growth for the BSE-30 Index's net profits, significantly lower than 15.6% at the start of the financial year. Exhibit 11 shows our estimate of the yoy changes in net profits of the BSE-30 Index broken down by sector. However, our FY2016 and FY2017 earnings estimates are largely unchanged, which raises risks of further downgrades as we head into FY2016 given weak underlying trends in the economy. For now, we expect FY2016 and FY2017 net profits of the BSE-30 Index to grow 18.3% and 17.9% and discuss the same in more detail in the final section of the report.

Exhibit 11: We now expect 4.4% growth for the BSE-30 Index's net profits, lower than 15.6% at the start of the financial year
Earnings growth of BSE-30 Index sectors, March fiscal year-end, 2015-17E (%)

| | Mar-14 | Apr-14 | May-14 | Jun-14 | Jul-14 | Aug-14 | Sep-14 | Oct-14 | Nov-14 | Dec-14 | Jan-15 | Current |
|---------------------------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| 2015E | | | | | | | | | | | | |
| Automobiles | 18 | 18 | 5 | 5 | 0 | 0 | 5 | 6 | 10 | 10 | 10 | 7 |
| Banking | 15 | 18 | 21 | 21 | 21 | 21 | 20 | 20 | 19 | 20 | 21 | 20 |
| Consumers | 15 | 15 | 16 | 16 | 13 | 13 | 13 | 15 | 15 | 15 | 13 | 13 |
| Energy | 17 | 12 | 11 | 11 | 16 | 16 | 14 | 12 | 8 | 6 | (5) | (9) |
| Industrials | (6) | (3) | 6 | 6 | (7) | (7) | (11) | (11) | (17) | (17) | (17) | (34) |
| Metals & Mining | 13 | 17 | 18 | 18 | 24 | 24 | 25 | 20 | 7 | 5 | 3 | (4) |
| Pharmaceuticals | 16 | 16 | 16 | 16 | 5 | 5 | 12 | 9 | 8 | 9 | 10 | 8 |
| Technology | 20 | 14 | 11 | 11 | 13 | 13 | 14 | 12 | 12 | 12 | 11 | 11 |
| Telecom | 70 | 70 | 47 | 47 | 70 | 70 | 70 | 86 | 86 | 86 | 86 | 80 |
| Utilities | (3) | (3) | (6) | (6) | (3) | (3) | (12) | (13) | (17) | (17) | (4) | (9) |
| BSE-30 Index | 15.6 | 14.6 | 12.6 | 12.6 | 14.0 | 14.0 | 13.8 | 12.8 | 10.1 | 9.7 | 7.7 | 4.4 |
| BSE-30 Index (ex-energy) | 15.1 | 15.3 | 13.0 | 13.0 | 13.3 | 13.3 | 13.7 | 13.0 | 10.9 | 10.7 | 11.3 | 8.3 |
| 2016E | | | | | | | | | | | | |
| Automobiles | 19 | 19 | 28 | 28 | 33 | 33 | 30 | 29 | 31 | 33 | 33 | 29 |
| Banking | 15 | 15 | 16 | 16 | 17 | 17 | 17 | 17 | 17 | 17 | 16 | 19 |
| Consumers | 12 | 12 | 13 | 13 | 15 | 15 | 15 | 16 | 16 | 17 | 15 | 15 |
| Energy | 7 | 6 | 8 | 8 | 8 | 8 | 16 | 16 | 16 | 15 | 10 | 14 |
| Industrials | 19 | 17 | 24 | 24 | 43 | 43 | 40 | 40 | 33 | 33 | 33 | 53 |
| Metals & Mining | 16 | 13 | 8 | 8 | 5 | 5 | 7 | 9 | 12 | 11 | 19 | 19 |
| Pharmaceuticals | 8 | 8 | 8 | 8 | 11 | 11 | 14 | 14 | 15 | 13 | 12 | 15 |
| Technology | 10 | 11 | 10 | 10 | 10 | 10 | 15 | 14 | 14 | 16 | 13 | 13 |
| Telecom | 47 | 47 | 33 | 33 | 18 | 18 | 18 | 10 | 10 | 10 | 10 | 4 |
| Utilities | 5 | 5 | 6 | 6 | 7 | 7 | 18 | 30 | 30 | 30 | 14 | 19 |
| BSE-30 Index | 12.7 | 12.5 | 13.3 | 13.3 | 13.7 | 13.7 | 17.1 | 17.3 | 17.8 | 18.2 | 16.6 | 18.3 |
| BSE-30 Index (ex-energy) | 14.6 | 14.4 | 15.0 | 15.0 | 15.5 | 15.5 | 17.4 | 17.7 | 18.4 | 19.0 | 18.2 | 19.2 |
| 2017E | | | | | | | | | | | | |
| Automobiles | | | | | | | | 21 | 19 | 18 | 19 | 26 |
| Banking | | | | | | | | 17 | 18 | 18 | 19 | 17 |
| Consumers | | | | | | | | 15 | 15 | 15 | 13 | 13 |
| Energy | | | | | | | | 8 | 9 | 17 | 18 | 19 |
| Industrials | | | | | | | | 40 | 28 | 28 | 28 | 35 |
| Metals & Mining | | | | | | | | 5 | (2) | 1 | 3 | 8 |
| Pharmaceuticals | | | | | | | | 17 | 15 | 15 | 15 | 16 |
| Technology | | | | | | | | 14 | 14 | 18 | 18 | 18 |
| Telecom | | | | | | | | 24 | 24 | 24 | 24 | 14 |
| Utilities | | | | | | | | 15 | 15 | 15 | 16 | 16 |
| BSE-30 Index | | | | | | | | 14.4 | 13.2 | 16.1 | 16.6 | 17.9 |
| BSE-30 Index (ex-energy) | | | | | | | | 16.3 | 14.5 | 15.9 | 16.2 | 17.6 |

Source: Kotak Institutional Equities estimates

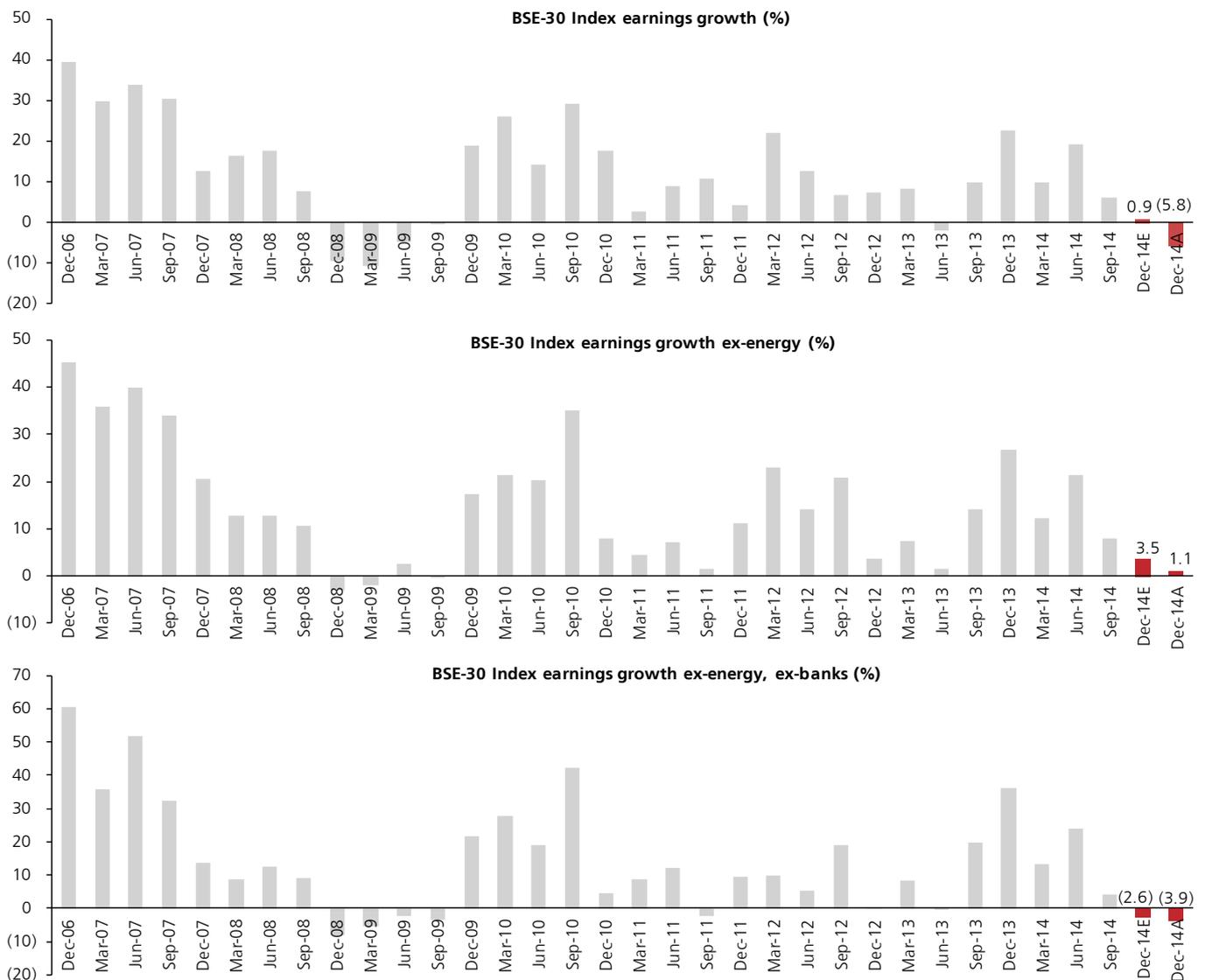
3QFY15 RESULTS ANALYSIS: A DISAPPOINTING QUARTER

3QFY15 net profits of the KIE universe were below our expectations, with nine sectors (out of 16 KIE covered sectors) reporting results well below expectations and only one large sector (technology) reporting results above expectations. Adjusted net profits of the KIE universe declined 2.3% yoy against our expectations of 7.9% yoy increase. On an ex-energy basis, net profits of KIE universe were 4.2% below our expectations and grew 5% yoy and 2.1% qoq. We have cut our free-float EPS estimates of the BSE-30 Index to ₹1,676 in 2016 and ₹1,996 in 2017 from ₹1,740 in 2016 and ₹2,060 in 2017 at the start of the results season.

3QFY15 results: Net profits of the BSE-30 Index 6.8% below our estimates

Exhibit 12 presents the quarterly trend in earnings growth of the BSE-30 Index. Adjusted net profits of the BSE-30 Index declined 5.8% yoy, 6.8% below our expectations. Results were generally weak versus expectations with net profits of most companies in the BSE-30 Index being below expectations. Numbers would have been weaker removing NTPC's ₹6.6 bn tax credit. We note that as many as 15 companies missed our EBITDA estimates out of 25 non-financial companies in the BSE-30 Index.

Exhibit 12: 3QFY15 adjusted net profits of the BSE-30 Index declined 5.8% versus our expectations of a 0.9% increase
Adjusted net income growth of BSE-30 Index (%)



Source: Kotak Institutional Equities estimates

- **Net profits below expectations.** Exhibit 13 compares 3QFY15 adjusted net profits of the BSE-30 Index with 3QFY14, 2QFY15 and 3QFY15E adjusted net profits. We note that 3QFY15 net profits benefited from a weaker exchange rate on a yoy basis. We note that the average ₹/US\$ exchange rate was ₹61.9/US\$ in 3QFY15 versus ₹55.9/US\$ in 3QFY14 and ₹60.6/US\$ in 2QFY15.

Exhibit 13: 3QFY15 results were well below our estimates

Comparison of 3QFY15 net income of BSE-30 stocks, actual versus expected (Rs bn)

| Company | Adjusted net income (Rs bn) | | | | Change (%) A versus E | Growth (%) | |
|---------------------------------|-----------------------------|------------|------------|------------|--------------------------|--------------|------------|
| | Dec-13 | Sep-14 | Dec-14A | Dec-14E | | yoy | qoq |
| Bajaj Auto | 9.0 | 8.5 | 8.6 | 7.1 | 21 | (5) | 1 |
| Hero Motocorp | 5.2 | 7.6 | 5.8 | 7.3 | (20) | 11 | (24) |
| Mahindra & Mahindra | 10.0 | 9.7 | 6.7 | 6.0 | 10 | (33) | (31) |
| Maruti Suzuki | 6.8 | 8.6 | 8.0 | 8.8 | (9) | 18 | (7) |
| Tata Motors | 49.0 | 32.6 | 40.3 | 48.9 | (18) | (18) | 24 |
| Axis Bank | 16.0 | 16.1 | 19.0 | 18.7 | 2 | 18 | 18 |
| HDFC | 12.8 | 13.6 | 14.3 | 13.4 | 6 | 12 | 5 |
| HDFC Bank | 23.3 | 23.8 | 27.9 | 28.6 | (2) | 20 | 17 |
| ICICI Bank | 25.3 | 27.1 | 28.9 | 29.8 | (3) | 14 | 7 |
| State Bank of India | 22.4 | 31.0 | 29.1 | 35.9 | (19) | 30 | (6) |
| Hindustan Unilever | 9.5 | 9.6 | 9.6 | 11.0 | (13) | 0 | (0) |
| ITC | 23.9 | 24.3 | 26.3 | 26.3 | 0 | 10 | 9 |
| GAIL (India) | 16.8 | 13.0 | 5.6 | 7.0 | (21) | (67) | (57) |
| Oil & Natural Gas Corporation | 71.3 | 54.4 | 35.7 | 61.3 | (42) | (50) | (34) |
| Reliance Industries | 55.1 | 57.4 | 50.9 | 53.8 | (5) | (8) | (11) |
| Bharat Heavy Electricals | 6.9 | 1.2 | 6.5 | 6.3 | 2 | (7) | 418 |
| Larsen & Toubro | 6.9 | 8.6 | 8.6 | 11.9 | (27) | 26 | 0 |
| Coal India | 39.1 | 21.9 | 32.8 | 36.7 | (11) | (16) | 50 |
| Hindalco Industries | 3.3 | 3.8 | 3.6 | 5.1 | (29) | 8 | (6) |
| Sesa Sterlite | 18.4 | 16.6 | 15.9 | 15.0 | 6 | (14) | (4) |
| Tata Steel | 5.0 | 4.5 | (1.4) | (1.1) | (27) | (128) | (132) |
| Cipla | 2.6 | 3.0 | 3.3 | 3.7 | (12) | 28 | 10 |
| Dr Reddy's Laboratories | 5.7 | 5.7 | 6.3 | 5.1 | 23 | 10 | 9 |
| Sun Pharmaceuticals | 15.3 | 15.7 | 14.3 | 15.9 | (10) | (7) | (9) |
| Infosys | 28.8 | 31.0 | 32.5 | 31.0 | 5 | 13 | 5 |
| TCS | 51.8 | 52.9 | 54.4 | 54.1 | 1 | 5 | 3 |
| Wipro | 20.1 | 20.8 | 21.9 | 21.1 | 4 | 9 | 5 |
| Bharti Airtel | 8.3 | 15.4 | 17.3 | 11.6 | 49 | 108 | 12 |
| NTPC | 28.6 | 20.7 | 30.7 | 24.1 | 27 | 7 | 48 |
| Tata Power | 3.2 | 3.5 | 2.3 | 2.6 | (14) | (28) | (36) |
| BSE-30 Index | 601 | 563 | 566 | 607 | (6.8) | (5.8) | 0.5 |
| BSE-30 Index (ex-energy) | 457 | 438 | 474 | 485 | (2.4) | 3.5 | 8.1 |

Source: Companies, Kotak Institutional Equities estimates

Among the BSE-30 stocks, several stocks reported weak numbers at the EBITDA and net income level—(1) GAIL (lower profitability of the gas-trading segment and lower other income), (2) Hero Motocorp (higher-than-expected staff costs and other expenses), (3) ICICI Bank (high loan-loss provisions), (4) L&T (large losses in hydrocarbon segment and lower-than-expected revenues in the standalone operations), (5) MSIL (lower other income and a one-time payment related to excise-duty provisions), (6) ONGC (higher-than-expected subsidies and DD&A expenses), (7) RIL (adventitious/inventory losses due to sharp decline in crude prices), (8) Sun Pharmaceuticals (meaningful miss in revenues due to weak sales across geographies) and (9) TTMT (impacted by one-time provisions).

On the other hand, (1) Bajaj Auto (higher-than-expected revenues and lower-than-expected expenses), (2) Bharti (lower-than-expected depreciation and net finance costs), and (3) NTPC (earnings outperformance is primarily because of a tax reversal) surprised positively at the net income level.

- ▶ Reported net income of the BSE-30 Index declined 5.2% yoy. Exhibit 14 shows the reported net income of the BSE-30 Index for 3QFY15, 2QFY15 and 3QFY14. Several companies had large extraordinary items in 3QFY15.

Exhibit 14: Reported net income of the BSE-30 Index declined 5.2% yoy in 3QFY15
Comparison of 3QFY15 reported net income of BSE-30 stocks (Rs bn)

| Company | Reported net income (Rs bn) | | | Growth (%) | |
|---------------------------------|-----------------------------|------------|------------|--------------|------------|
| | Dec-13 | Sep-14 | Dec-14 | yoy | qoq |
| Bajaj Auto | 9.0 | 5.9 | 8.6 | (5) | 46 |
| Hero Motocorp | 5.2 | 7.6 | 5.8 | 11 | (24) |
| Mahindra & Mahindra | 10.0 | 9.7 | 9.7 | (3) | (1) |
| Maruti Suzuki | 6.8 | 8.6 | 8.0 | 18 | (7) |
| Tata Motors | 48.0 | 32.9 | 35.8 | (25) | 9 |
| Axis Bank | 16.0 | 16.1 | 19.0 | 18 | 18 |
| HDFC | 12.8 | 13.6 | 14.3 | 12 | 5 |
| HDFC Bank | 23.3 | 23.8 | 27.9 | 20 | 17 |
| ICICI Bank | 25.3 | 27.1 | 28.9 | 14 | 7 |
| State Bank of India | 22.4 | 31.0 | 29.1 | 30 | (6) |
| Hindustan Unilever | 10.6 | 9.9 | 12.5 | 18 | 27 |
| ITC | 23.9 | 24.3 | 26.3 | 10 | 9 |
| GAIL (India) | 16.8 | 13.0 | 6.0 | (64) | (54) |
| Oil & Natural Gas Corporation | 71.3 | 54.4 | 35.7 | (50) | (34) |
| Reliance Industries | 55.1 | 57.4 | 50.9 | (8) | (11) |
| Bharat Heavy Electricals | 6.9 | 1.2 | 6.5 | (7) | 418 |
| Larsen & Toubro | 7.5 | 8.4 | 9.6 | 27 | 14 |
| Coal India | 38.9 | 21.9 | 32.6 | (16) | 49 |
| Hindalco Industries | 3.3 | 0.8 | 3.6 | 8 | 357 |
| Sesa Sterlite | 18.7 | 16.2 | 15.9 | (15) | (2) |
| Tata Steel | 5.0 | 12.5 | 1.6 | (69) | (87) |
| Cipla | 2.6 | 3.0 | 3.3 | 25 | 8 |
| Dr Reddy's Laboratories | 6.2 | 5.7 | 5.7 | (7) | 0 |
| Sun Pharmaceuticals | 15.3 | 15.7 | 14.3 | (7) | (9) |
| Infosys | 28.8 | 31.0 | 32.5 | 13 | 5 |
| TCS | 51.8 | 52.9 | 54.4 | 5 | 3 |
| Wipro | 20.1 | 20.8 | 21.9 | 9 | 5 |
| Bharti Airtel | 6.1 | 13.8 | 14.4 | 135 | 4 |
| NTPC | 28.6 | 20.7 | 30.7 | 7 | 48 |
| Tata Power | 2.5 | 3.1 | 2.3 | (7) | (23) |
| BSE-30 Index | 599 | 563 | 568 | (5.2) | 0.8 |
| BSE-30 Index (ex-energy) | 456 | 438 | 475 | 4.2 | 8.4 |

Source: Companies, Kotak Institutional Equities

- Bharti Airtel reported an extraordinary loss of ₹2.9 bn due to the reinstatement impact of certain foreign currency liabilities in Nigeria and restructuring activities in a few countries.
- Dr Reddy's net income was impacted by impairment charges of ₹534 mn during the quarter.
- GAIL accounted a non-recurring gain of ₹628 mn on sale of CNG business to Vadodara Gas.
- HUL had an extraordinary gain of ₹2.9 bn pertaining to sale of surplus properties.
- M&M had an extraordinary income of ₹3 bn arising from merger of Mahindra Engineering Services with M&M.
- Tata Motors made a one-time provision of ₹6.5 bn, related to write-offs of investments in the Singur plant and on receivables.
- Tata Steel's Europe operations benefited from ₹3 bn of lower pension obligations following the conclusion of negotiations with its Dutch trade unions.

Adjusted EBITDA of the BSE-30 Index was 6.4% below expectation and declined 6% yoy. Exhibit 15 compares 3QFY15 EBITDA of the BSE-30 Index with 3QFY14, 2QFY15 and 3QFY15E EBITDA. Many companies missed our EBITDA estimates by a wide margin with as many as 13 companies in the BSE-30 Index falling short by over 5%. We note that Tata Steel's reported EBITDA included net one-off gain of ₹3 bn in Europe.

Exhibit 15: Many companies in the BSE-30 Index missed our EBITDA estimates
Comparison of 3QFY15 EBITDA of BSE-30 stocks, actual versus expected (Rs bn)

| Company | Adjusted EBITDA (Rs bn) | | | | Change (%) A versus E | Growth (%) | |
|---------------------------------|-------------------------|------------|------------|------------|--------------------------|--------------|------------|
| | Dec-13 | Sep-14 | Dec-14A | Dec-14E | | yoy | qoq |
| Bajaj Auto | 11.4 | 11.3 | 12.3 | 9.7 | 26 | 8 | 9 |
| Hero Motocorp | 6.8 | 9.3 | 8.2 | 9.4 | (13) | 20 | (12) |
| Mahindra & Mahindra | 15.3 | 11.0 | 10.8 | 10.4 | 4 | (30) | (2) |
| Maruti Suzuki | 13.5 | 15.2 | 15.9 | 16.0 | (0) | 18 | 5 |
| Tata Motors | 99.5 | 95.7 | 103.6 | 112.6 | (8) | 4 | 8 |
| Hindustan Unilever | 12.3 | 12.4 | 13.3 | 14.3 | (7) | 9 | 7 |
| ITC | 32.8 | 34.9 | 34.6 | 37.1 | (7) | 5 | (1) |
| GAIL (India) | 22.9 | 20.2 | 9.9 | 11.0 | (11) | (57) | (51) |
| Oil & Natural Gas Corporation | 134.6 | 109.4 | 96.1 | 129.4 | (26) | (29) | (12) |
| Reliance Industries | 76.2 | 82.4 | 72.1 | 79.9 | (10) | (5) | (12) |
| Bharat Heavy Electricals | 8.1 | 1.8 | 7.8 | 7.7 | 1 | (4) | 346 |
| Larsen & Toubro | 26.3 | 23.3 | 28.9 | 31.1 | (7) | 10 | 24 |
| Coal India | 41.0 | 20.7 | 34.8 | 39.4 | (12) | (15) | 68 |
| Hindalco Industries | 6.3 | 9.0 | 9.2 | 11.1 | (17) | 47 | 3 |
| Sesa Sterlite | 64.9 | 63.3 | 61.5 | 59.3 | 4 | (5) | (3) |
| Tata Steel | 40.1 | 36.4 | 27.8 | 28.0 | (1) | (31) | (24) |
| Cipla | 4.4 | 5.6 | 5.5 | 6.5 | (15) | 26 | (1) |
| Dr Reddy's Laboratories | 9.8 | 8.2 | 9.5 | 7.9 | 20 | (3) | 16 |
| Sun Pharmaceuticals | 19.8 | 21.8 | 19.3 | 22.0 | (12) | (2) | (12) |
| Infosys | 36.2 | 37.7 | 39.5 | 39.0 | 1 | 9 | 5 |
| TCS | 66.9 | 68.1 | 70.5 | 70.1 | 1 | 5 | 4 |
| Wipro | 26.5 | 26.1 | 27.7 | 27.0 | 3 | 4 | 6 |
| Bharti Airtel | 70.9 | 75.8 | 77.8 | 77.5 | 0 | 10 | 3 |
| NTPC | 46.3 | 30.9 | 45.4 | 43.2 | 5 | (2) | 47 |
| Tata Power | 6.0 | 4.0 | 2.9 | 3.5 | (16) | (52) | (28) |
| BSE-30 Index | 899 | 834 | 845 | 903 | (6.4) | (6.0) | 1.2 |
| BSE-30 Index (ex Energy) | 665 | 622 | 667 | 683 | (2.3) | 0.3 | 7.1 |

Source: Companies, Kotak Institutional Equities

Exhibit 16 compares reported EBITDA and net income of the BSE-30 Index with adjusted EBITDA and net income. We remove extraordinary items, such as prior-period items, while computing adjusted EBITDA and net income (adjusted for tax impact) but do not remove additional branding costs or foreign currency-related gains or losses. In our view, these represent the normal costs of doing business and global accounting practices also advocate recognition of foreign currency-related gains or losses in profit and loss statements on a consistent basis.

Exhibit 16: Many cases of one-off items in 3QFY15

Adjusted and reported EBITDA and net income of the BSE-30 stocks, 3QFY15 (Rs mn)

| Company | Sector | EBITDA | | | Net income | | |
|-------------------------------|-----------------|----------|----------|------------|------------|----------|------------|
| | | Adjusted | Reported | Difference | Adjusted | Reported | Difference |
| Bajaj Auto | Automobiles | 12,269 | 12,269 | — | 8,612 | 8,612 | — |
| Hero Motocorp | Automobiles | 8,218 | 8,218 | — | 5,830 | 5,830 | — |
| Mahindra & Mahindra | Automobiles | 10,797 | 10,797 | — | 6,674 | 9,666 | 2,991 |
| Maruti Suzuki | Automobiles | 15,926 | 15,926 | — | 8,022 | 8,022 | — |
| Tata Motors | Automobiles | 103,636 | 103,636 | — | 40,346 | 35,807 | (4,539) |
| Axis Bank | Banking | 33,146 | 33,146 | — | 18,998 | 18,998 | — |
| HDFC | Banking | 20,655 | 20,655 | — | 14,265 | 14,265 | — |
| HDFC Bank | Banking | 47,786 | 47,786 | — | 27,945 | 27,945 | — |
| ICICI Bank | Banking | 50,370 | 50,370 | — | 28,890 | 28,890 | — |
| State Bank of India | Banking | 89,281 | 89,281 | — | 29,137 | 29,137 | — |
| Hindustan Unilever | Consumers | 13,315 | 13,315 | — | 9,553 | 12,522 | 2,969 |
| ITC | Consumers | 34,642 | 34,642 | — | 26,350 | 26,350 | — |
| GAIL (India) | Energy | 9,857 | 9,857 | — | 5,596 | 6,041 | 445 |
| Oil & Natural Gas Corporation | Energy | 96,051 | 96,051 | — | 35,712 | 35,712 | — |
| Reliance Industries | Energy | 72,080 | 72,080 | — | 50,850 | 50,850 | — |
| Bharat Heavy Electricals | Industrials | 7,817 | 7,817 | — | 6,472 | 6,472 | — |
| Larsen & Toubro | Industrials | 28,900 | 28,900 | — | 8,648 | 9,559 | 911 |
| Coal India | Metals & Mining | 34,800 | 34,800 | — | 32,795 | 32,625 | (170) |
| Hindalco Industries | Metals & Mining | 9,233 | 9,233 | — | 3,593 | 3,593 | — |
| Sesa Sterlite | Metals & Mining | 61,466 | 61,466 | — | 15,875 | 15,875 | — |
| Tata Steel | Metals & Mining | 27,774 | 30,774 | 3,000 | (1,429) | 1,571 | 3,000 |
| Cipla | Pharmaceuticals | 5,538 | 5,538 | — | 3,279 | 3,272 | (6) |
| Dr Reddy's Laboratories | Pharmaceuticals | 9,459 | 9,459 | — | 6,279 | 5,745 | (534) |
| Sun Pharmaceuticals | Pharmaceuticals | 19,283 | 19,283 | — | 14,251 | 14,251 | — |
| Infosys | Technology | 39,540 | 39,540 | — | 32,500 | 32,500 | — |
| TCS | Technology | 70,531 | 70,531 | — | 54,441 | 54,441 | — |
| Wipro | Technology | 27,681 | 27,681 | — | 21,928 | 21,928 | — |
| Bharti Airtel | Telecom | 77,784 | 77,784 | — | 17,291 | 14,365 | (2,926) |
| NTPC | Utilities | 45,406 | 45,406 | — | 30,740 | 30,740 | — |
| Tata Power | Utilities | 2,893 | 2,893 | — | 2,264 | 2,346 | 82 |

Source: Kotak Institutional Equities estimates

KIE coverage universe: 9.5% below in net profits

3QFY15 net profits of the KIE coverage were 9.5% below our expectations. Adjusted net profits of the KIE universe declined 2.3% yoy against our expectations of 7.9% yoy increase. In our coverage universe of 148 stocks, 42 beat our earnings forecast by more than 5%, 45 reported adjusted net income in the -5% and +5% range of our estimates and 61 missed our estimates by more than 5%. Exhibit 17 compares the 3QFY15 net profits of KIE coverage sectors with 3QFY14, 2QFY15 and 3QFY15E net profits. (1) Automobiles, (2) banking (high NPLs, loan-loss provisions, fresh impairments dragged down the earnings of banking sector), (3) cement (soft realization due to weakness in underlying demand), (4) consumer products (weaker-than-expected volume growth) and (5) energy sectors fell short of expectations while (1) technology (better-than-expected constant-currency revenue growth), (2) telecom and (3) utilities sectors surpassed net profit estimates.

Exhibit 17: 3QFY15 net income of KIE coverage declined 2.3% yoy and 6.4% qoq
Comprehensive sector-wise PAT analysis of 3QFY15 earnings season (Rs bn)

| | Dec-13 | Sep-14 | Dec-14A | Dec-14E | Change (%) | | |
|---------------------------------|------------|------------|------------|------------|--------------|--------------|--------------|
| | | | | | A/E | yoy | qoq |
| Automobiles | 88 | 78 | 80 | 89 | (9.8) | (8.2) | 2.6 |
| Banks/Financial Institutions | 187 | 203 | 196 | 227 | (13.6) | 4.5 | (3.3) |
| Cement | 14 | 16 | 14 | 16 | (12.3) | (3.4) | (15.1) |
| Consumer products | 54 | 58 | 61 | 64 | (5.3) | 11.2 | 4.0 |
| Energy | 143 | 160 | 88 | 144 | (39.1) | (38.9) | (45.5) |
| Industrials | 19 | 16 | 24 | 25 | (5.1) | 27.2 | 46.6 |
| Infrastructure | 9 | 10 | 12 | 10 | 13.3 | 26.7 | 22.1 |
| Internet | 1 | 1 | 1 | 1 | (7.4) | 14.2 | 9.4 |
| Media | 5 | 5 | 7 | 6 | 12.5 | 27.3 | 44.0 |
| Metals & Mining | 110 | 100 | 101 | 101 | (0.0) | (8.4) | 0.6 |
| Others | 5 | 7 | 1 | 5 | (71.1) | (75.7) | (81.7) |
| Pharmaceuticals | 29 | 32 | 31 | 32 | (2.9) | 4.6 | (3.0) |
| Real Estate | 8 | 4 | 4 | 4 | 2.2 | (46.8) | 1.4 |
| Technology | 126 | 134 | 140 | 136 | 3.0 | 10.9 | 4.0 |
| Telecom | 18 | 29 | 32 | 26 | 23.8 | 82.1 | 12.3 |
| Utilities | 46 | 47 | 53 | 48 | 10.1 | 15.9 | 12.7 |
| KIE universe | 864 | 901 | 843 | 932 | (9.5) | (2.3) | (6.4) |
| KIE universe (ex-Energy) | 720 | 740 | 756 | 789 | (4.2) | 5.0 | 2.1 |

Source: Kotak Institutional Equities estimates

Exhibit 18 shows sectors that exceeded or fell short of our expectations on sales, EBITDA and net profits. We highlight that the media, infrastructure and automobiles sectors bettered our estimates of sales/NI while the energy, real estate and pharmaceuticals came in lower than we expected. The media, technology and telecom sectors beat EBITDA estimates but energy, internet and cement sectors disappointed. Finally, the telecom, infrastructure, media and utilities sectors beat our expectations at the net income level while energy, banks/financial institutions, cement and automobiles sectors disappointed.

Exhibit 18: 3QFY15 net income of banks, cement and energy sectors underperformed expectations
Performance of sectors versus expectations (KIE universe) in 3QFY15/4QCY14 (Rs bn)

| | Companies (#) | Net sales (Rs bn) | | Change (%) |
|---|------------------|-------------------|----------|---------------|
| | | Actual | Expected | |
| Revenues: Sectors posting positive surprises | | | | |
| Media | 5 | 33 | 32 | 8 |
| Infrastructure | 5 | 38 | 41 | 7 |
| Automobiles | 13 | 1,162 | 1,166 | 4 |
| Technology | 8 | 617 | 662 | 1 |
| Revenues: Sectors posting negative surprises | | | | |
| Energy | 12 | 4,000 | 3,757 | (13) |
| Real Estate | 5 | 40 | 38 | (6) |
| Pharmaceuticals | 5 | 141 | 150 | (6) |
| Industrials | 10 | 445 | 422 | (4) |
| Consumer products | 20 | 407 | 440 | (3) |

| | Companies (#) | EBITDA (Rs bn) | | Change (%) |
|---|------------------|----------------|----------|---------------|
| | | Actual | Expected | |
| EBITDA: Sectors posting positive surprises | | | | |
| Media | 5 | 10 | 9 | 7 |
| Technology | 8 | 168 | 170 | 2 |
| Telecom | 5 | 129 | 139 | 1 |
| Real Estate | 5 | 11 | 13 | 0 |
| EBITDA: Sectors posting negative surprises | | | | |
| Energy | 12 | 274 | 287 | (25) |
| Internet | 2 | 1 | 1 | (12) |
| Cement | 6 | 27 | 32 | (9) |
| Infrastructure | 5 | 14 | 17 | (9) |
| Industrials | 10 | 45 | 36 | (8) |

| | Companies (#) | PAT (Rs bn) | | Change (%) |
|--|------------------|-------------|----------|---------------|
| | | Actual | Expected | |
| PAT: Sectors posting positive surprises | | | | |
| Telecom | 5 | 18 | 29 | 24 |
| Infrastructure | 5 | 9 | 10 | 13 |
| Media | 5 | 5 | 5 | 13 |
| Utilities | 8 | 46 | 47 | 10 |
| Technology | 8 | 126 | 134 | 3 |
| PAT: Sectors posting negative surprises | | | | |
| Others | 7 | 5 | 7 | (71) |
| Energy | 12 | 143 | 160 | (39) |
| Banks/Financial Institutions | 28 | 187 | 203 | (14) |
| Cement | 6 | 14 | 16 | (12) |
| Automobiles | 13 | 88 | 78 | (10) |

Source: Kotak Institutional Equities estimates

Exhibit 19 shows the movement in EBITDA margins across sectors over the past few quarters. We are reluctant to look at EBITDA margins for some sectors (cement, energy and metals & mining) and focus on absolute profitability (₹/ton or US\$/ton). Nonetheless, the exercise is useful to understand issues in the sectors. For example, the yoy decline in EBITDA margins of companies in the cement sector reflects weaker cement prices and volumes while EBITDA margins in the technology sector reflects a thrust from a weaker rupee.

Exhibit 19: Overall EBITDA margin remained flat on a yoy basis
 Comparison of EBITDA margin for KIE universe stocks (%)

| | Dec-13 | Mar-14 | Jun-14 | Sep-14 | Dec-14A | Dec-14E |
|---------------------------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Automobiles | 14.4 | 13.6 | 15.0 | 14.4 | 14.0 | 15.0 |
| Cement | 14.3 | 17.8 | 17.0 | 15.1 | 14.1 | 15.4 |
| Consumer Products | 19.5 | 19.0 | 19.3 | 19.6 | 19.9 | 20.6 |
| Energy | 6.8 | 12.5 | 8.3 | 7.6 | 5.9 | 6.8 |
| Industrials | 10.0 | 13.0 | 9.3 | 8.5 | 10.1 | 10.5 |
| Infrastructure | 38.2 | 36.4 | 40.7 | 42.1 | 34.4 | 40.6 |
| Internet | 31.1 | 30.8 | 29.7 | 28.8 | 28.8 | 32.0 |
| Media | 29.8 | 29.2 | 29.0 | 29.4 | 32.4 | 32.7 |
| Metals & Mining | 21.7 | 21.7 | 21.9 | 20.3 | 20.4 | 20.3 |
| Others | 13.9 | 14.9 | 15.3 | 15.3 | 12.9 | 13.5 |
| Pharmaceuticals | 30.7 | 28.6 | 30.9 | 30.2 | 30.1 | 30.1 |
| Real Estate | 26.9 | 19.5 | 33.6 | 33.6 | 33.6 | 31.4 |
| Technology | 27.2 | 27.3 | 25.8 | 25.7 | 26.0 | 25.7 |
| Telecom | 30.9 | 30.9 | 31.8 | 31.6 | 32.4 | 31.7 |
| Utilities | 33.8 | 29.1 | 31.2 | 33.0 | 34.0 | 34.3 |
| KIE universe | 14.0 | 16.2 | 14.7 | 14.3 | 14.0 | 14.1 |
| KIE universe (ex-energy) | 19.1 | 18.8 | 19.3 | 18.7 | 18.7 | 19.0 |

Source: Kotak Institutional Equities estimates

MARKET: NEEDS NEW LEGS TO HOLD UP

We believe the Indian market may need additional positive news to sustain at current levels or to perform given the high expectations around (1) the government's economic reforms agenda and (2) further improvement in India's macroeconomic position. However, earnings numbers continue to disappoint and downside risks to earnings exist. With oil prices moving up, the forthcoming government budget and outcome of the budget session of the parliament would be critical.

Valuations are rich and earnings may be at risk

Exhibits 20-23 show that the valuations of the Indian market are quite expensive. We would have been less worried about valuations if we had high confidence in (1) our earnings estimates and (2) India's current macroeconomic position (because of low crude oil prices) sustaining for an extended period of time. However, we see downside risks to our earnings estimates in several sectors; investment cycle is still quite weak and consumption demand has turned weak in the absence of meaningful investment, lower government expenditure, particularly capital expenditure (down 11% yoy in 9MFY15) and anemic job creation. Oil prices can surprise negatively. We note that several high-quality stocks are trading at very rich valuations despite our aggressive assumptions on earnings growth over the next two years (see Exhibit 24).

Exhibit 20: We expect earnings of the BSE-30 Index to grow 18.3% in FY2016 and 17.9% in FY2017

Valuation summary of BSE-30 sectors (full-float basis), March fiscal year-ends, 2015-17E

| | Mcap. (US\$ bn) | Adj. mcap. (US\$ bn) | EPS growth (%) | | | PER (X) | | | EV/EBITDA (X) | | | Price/BV (X) | | | Div. yield (%) | | | RoE (%) | | |
|---------------------------------|--------------------|-------------------------|----------------|-------------|-------------|-------------|-------------|-------------|---------------|-------------|------------|--------------|------------|------------|----------------|------------|------------|-------------|-------------|-------------|
| | | | 2015E | 2016E | 2017E | 2015E | 2016E | 2017E | 2015E | 2016E | 2017E | 2015E | 2016E | 2017E | 2015E | 2016E | 2017E | 2015E | 2016E | 2017E |
| Automobiles | 76.5 | 47.3 | 7.2 | 28.6 | 25.9 | 16.5 | 12.8 | 10.2 | 9.0 | 7.7 | 6.5 | 3.4 | 2.8 | 2.3 | 0.7 | 1.0 | 1.3 | 20.6 | 22.0 | 22.8 |
| Banking | 165.5 | 131.3 | 20.3 | 19.1 | 16.6 | 21.0 | 17.6 | 15.1 | — | — | — | 2.9 | 2.7 | 2.4 | 1.1 | 1.3 | 1.5 | 14.1 | 15.1 | 15.7 |
| Consumers | 81.6 | 46.1 | 12.5 | 14.6 | 13.4 | 37.2 | 32.5 | 28.7 | 25.8 | 22.1 | 19.2 | 15.2 | 13.5 | 12.1 | 1.7 | 1.9 | 2.2 | 40.7 | 41.5 | 42.1 |
| Energy | 97.7 | 38.5 | (8.8) | 14.4 | 19.1 | 12.7 | 11.1 | 9.3 | 7.1 | 6.1 | 4.9 | 1.4 | 1.3 | 1.2 | 2.0 | 2.5 | 2.9 | 11.2 | 11.8 | 12.8 |
| Industrials | 34.8 | 26.2 | (34.0) | 53.3 | 35.4 | 41.1 | 26.8 | 19.8 | 21.8 | 15.6 | 12.7 | 3.0 | 2.8 | 2.5 | 0.8 | 0.9 | 1.3 | 7.3 | 10.3 | 12.7 |
| Metals & Mining | 59.2 | 20.9 | (3.7) | 19.4 | 7.6 | 14.5 | 12.2 | 11.3 | 7.7 | 6.8 | 5.8 | 1.7 | 1.6 | 1.5 | 2.6 | 3.0 | 2.8 | 12.0 | 13.2 | 13.0 |
| Pharmaceuticals | 48.3 | 24.7 | 8.0 | 14.6 | 16.0 | 30.1 | 26.3 | 22.6 | 20.7 | 17.6 | 15.1 | 6.4 | 5.3 | 4.4 | 0.7 | 0.8 | 1.0 | 21.4 | 20.2 | 19.6 |
| Technology | 149.7 | 68.1 | 11.2 | 13.4 | 18.1 | 22.2 | 19.6 | 16.6 | 16.1 | 13.6 | 11.2 | 6.0 | 5.1 | 4.3 | 1.9 | 1.8 | 2.1 | 27.1 | 26.0 | 25.9 |
| Telecom | 23.2 | 8.1 | 79.6 | 4.4 | 14.3 | 24.2 | 23.1 | 20.2 | 7.5 | 6.7 | 5.8 | 2.2 | 2.1 | 2.0 | 0.5 | 0.9 | 1.2 | 9.2 | 9.1 | 9.8 |
| Utilities | 22.7 | 8.3 | (9.2) | 19.1 | 16.1 | 14.1 | 11.8 | 10.2 | 9.9 | 8.1 | 6.8 | 1.3 | 1.2 | 1.1 | 2.4 | 2.5 | 2.9 | 9.5 | 10.5 | 11.3 |
| BSE-30 Index | 759 | 419 | 4.4 | 18.3 | 17.9 | 19.8 | 16.8 | 14.2 | 11.0 | 9.4 | 7.8 | 2.9 | 2.6 | 2.3 | 1.5 | 1.7 | 1.9 | 14.8 | 15.7 | 16.5 |
| BSE-30 Index (ex-energy) | 662 | 381 | 8.3 | 19.2 | 17.6 | 21.6 | 18.1 | 15.4 | 12.3 | 10.5 | 8.9 | 3.5 | 3.1 | 2.7 | 1.4 | 1.6 | 1.8 | 16.1 | 17.2 | 17.8 |

Source: Kotak Institutional Equities estimates

Exhibit 21: The BSE-30 Index trades at 17.4X FY2016E 'EPS' and 14.6X FY2017E 'EPS' (free-float basis)

Valuation summary of BSE-30 sectors (free-float basis), March fiscal year-ends, 2015-17E

| | Mcap. (Rs bn) | Adj. mcap. (Rs bn) | Adjusted net profits (Rs bn) | | | Adjusted P/E (X) | | |
|---------------------------------|------------------|-----------------------|------------------------------|--------------|--------------|------------------|-------------|-------------|
| | | | 2015E | 2016E | 2017E | 2015E | 2016E | 2017E |
| Automobiles | 4,761 | 2,942 | 187 | 238 | 300 | 15.7 | 12.4 | 9.8 |
| Banking | 10,296 | 8,164 | 377 | 445 | 519 | 21.6 | 18.3 | 15.7 |
| Consumers | 5,079 | 2,868 | 82 | 93 | 106 | 35.1 | 30.8 | 27.1 |
| Energy | 6,080 | 2,393 | 192 | 214 | 255 | 12.5 | 11.2 | 9.4 |
| Industrials | 2,166 | 1,632 | 38 | 58 | 79 | 42.5 | 28.1 | 20.6 |
| Metals & Mining | 3,680 | 1,300 | 93 | 111 | 126 | 14.0 | 11.7 | 10.3 |
| Pharmaceuticals | 3,005 | 1,536 | 51 | 59 | 69 | 29.9 | 26.1 | 22.4 |
| Technology | 9,313 | 4,233 | 194 | 220 | 260 | 21.8 | 19.2 | 16.3 |
| Telecom | 1,444 | 506 | 21 | 22 | 25 | 24.2 | 23.1 | 20.2 |
| Utilities | 1,415 | 515 | 30 | 41 | 48 | 17.3 | 12.7 | 10.8 |
| BSE-30 Index | 47,239 | 26,091 | 1,265 | 1,501 | 1,787 | 20.6 | 17.4 | 14.6 |
| BSE-30 Index (ex-energy) | 41,159 | 23,698 | 1,074 | 1,287 | 1,532 | 22.1 | 18.4 | 15.5 |

Source: Kotak Institutional Equities estimates

Exhibit 22: We expect earnings of the Nifty-50 Index to grow 17.1% in FY2016 and 17.6% in FY2017
Valuation summary of Nifty-50 sectors (full-float basis), March fiscal year-ends, 2015-17E

| | Mcap. (US\$ bn) | Adj. mcap. (US\$ bn) | EPS growth (%) | | | PER (X) | | | EV/EBITDA (X) | | | Price/BV (X) | | | Div. yield (%) | | | RoE (%) | | |
|-----------------------------------|--------------------|-------------------------|----------------|-------------|-------------|-------------|-------------|-------------|---------------|-------------|------------|--------------|------------|------------|----------------|------------|------------|-------------|-------------|-------------|
| | | | 2015E | 2016E | 2017E | 2015E | 2016E | 2017E | 2015E | 2016E | 2017E | 2015E | 2016E | 2017E | 2015E | 2016E | 2017E | 2015E | 2016E | 2017E |
| Automobiles | 76.5 | 45.0 | 7.2 | 28.6 | 25.9 | 16.5 | 12.8 | 10.2 | 9.0 | 7.7 | 6.5 | 3.4 | 2.8 | 2.3 | 0.7 | 1.0 | 1.3 | 20.6 | 22.0 | 22.8 |
| Banking | 188.4 | 142.4 | 16.5 | 19.9 | 17.9 | 19.3 | 16.1 | 13.7 | — | — | — | 2.6 | 2.3 | 2.1 | 1.3 | 1.5 | 1.8 | 13.4 | 14.6 | 15.3 |
| Cement | 30.8 | 14.7 | 3.6 | 31.2 | 33.4 | 31.3 | 23.9 | 17.9 | 15.9 | 11.2 | 8.4 | 3.1 | 2.9 | 2.5 | 0.8 | 0.8 | 0.9 | 10.0 | 12.0 | 14.0 |
| Consumers | 94.5 | 51.3 | 13.2 | 16.7 | 13.4 | 38.9 | 33.3 | 29.4 | 26.7 | 22.4 | 19.5 | 15.4 | 13.5 | 11.9 | 1.6 | 1.8 | 2.0 | 39.5 | 40.5 | 40.7 |
| Energy | 113.9 | 39.9 | (14.9) | 9.0 | 16.4 | 12.0 | 11.0 | 9.5 | 6.9 | 6.1 | 4.9 | 1.4 | 1.3 | 1.2 | 2.2 | 2.6 | 3.0 | 11.5 | 11.6 | 12.4 |
| Industrials | 34.8 | 25.4 | (34.0) | 53.3 | 35.4 | 41.1 | 26.8 | 19.8 | 21.8 | 15.6 | 12.7 | 3.0 | 2.8 | 2.5 | 0.8 | 0.9 | 1.3 | 7.3 | 10.3 | 12.7 |
| Media | 5.6 | 3.2 | (4.8) | 3.4 | 35.0 | 41.2 | 39.8 | 29.5 | 25.0 | 23.7 | 18.1 | 6.6 | 6.1 | 5.5 | 0.8 | 1.1 | 1.4 | 16.0 | 15.3 | 18.7 |
| Metals & Mining | 70.7 | 21.4 | (1.4) | 16.1 | 5.8 | 12.9 | 11.1 | 10.5 | 7.4 | 6.5 | 5.6 | 1.7 | 1.5 | 1.4 | 3.0 | 3.3 | 3.2 | 12.8 | 13.7 | 13.3 |
| Pharmaceuticals | 60.3 | 29.8 | 12.2 | 14.4 | 16.9 | 30.2 | 26.4 | 22.6 | 20.4 | 17.3 | 14.7 | 6.7 | 5.5 | 4.6 | 0.6 | 0.8 | 0.9 | 22.3 | 20.9 | 20.3 |
| Real Estate | 4.5 | 1.1 | (21.0) | 43.4 | 48.5 | 54.3 | 37.8 | 25.5 | 16.3 | 14.2 | 10.1 | 1.0 | 0.9 | 0.9 | 1.3 | 1.3 | 1.3 | 1.8 | 2.5 | 3.6 |
| Technology | 183.3 | 79.4 | 12.1 | 12.7 | 17.2 | 21.7 | 19.3 | 16.4 | 15.7 | 13.3 | 11.1 | 5.9 | 5.0 | 4.2 | 1.8 | 1.7 | 1.9 | 27.2 | 25.8 | 25.4 |
| Telecom | 23.2 | 8.0 | 79.6 | 4.4 | 14.3 | 24.2 | 23.1 | 20.2 | 7.5 | 6.7 | 5.8 | 2.2 | 2.1 | 2.0 | 0.5 | 0.9 | 1.2 | 9.2 | 9.1 | 9.8 |
| Utilities | 35.6 | 12.6 | (2.7) | 21.8 | 19.5 | 14.6 | 12.0 | 10.0 | 10.4 | 8.7 | 7.4 | 1.5 | 1.4 | 1.3 | 2.2 | 2.5 | 3.0 | 10.5 | 11.8 | 13.0 |
| Nifty-50 Index | 922 | 474 | 2.8 | 17.1 | 17.6 | 19.4 | 16.5 | 14.1 | 11.1 | 9.5 | 7.9 | 2.8 | 2.5 | 2.3 | 1.5 | 1.7 | 2.0 | 14.6 | 15.4 | 16.1 |
| Nifty-50 Index (ex-energy) | 808 | 434 | 8.4 | 19.1 | 17.9 | 21.2 | 17.8 | 15.1 | 12.5 | 10.6 | 8.9 | 3.3 | 3.0 | 2.6 | 1.5 | 1.6 | 1.8 | 15.6 | 16.6 | 17.3 |

Source: Kotak Institutional Equities estimates

Exhibit 23: The Nifty-50 Index trades at 17.4X FY2016E 'EPS' and 14.6X FY2017E 'EPS' (free-float basis)
Valuation summary of Nifty-50 sectors (free-float basis), March fiscal year-ends, 2015-17E

| | Mcap. (Rs bn) | Adj. mcap. (Rs bn) | Adjusted net profits (Rs bn) | | | Adjusted P/E (X) | | |
|-----------------------------------|------------------|-----------------------|------------------------------|--------------|--------------|------------------|-------------|-------------|
| | | | 2015E | 2016E | 2017E | 2015E | 2016E | 2017E |
| Automobiles | 4,761 | 2,797 | 177 | 225 | 283 | 15.8 | 12.4 | 9.9 |
| Banking | 11,718 | 8,859 | 429 | 507 | 597 | 20.6 | 17.5 | 14.8 |
| Cement | 1,915 | 916 | 31 | 41 | 54 | 29.3 | 22.4 | 16.9 |
| Consumers | 5,879 | 3,194 | 88 | 101 | 115 | 36.5 | 31.5 | 27.7 |
| Industrials | 2,166 | 1,582 | 37 | 56 | 77 | 42.5 | 28.1 | 20.7 |
| Media | 346 | 197 | 5 | 5 | 7 | 41.2 | 39.8 | 29.5 |
| Metals & Mining | 4,398 | 1,331 | 104 | 123 | 138 | 12.8 | 10.9 | 9.6 |
| Pharmaceuticals | 3,751 | 1,853 | 62 | 71 | 83 | 30.0 | 26.2 | 22.3 |
| Real Estate | 277 | 70 | 1 | 2 | 3 | 54.3 | 37.8 | 25.5 |
| Technology | 11,404 | 4,938 | 230 | 260 | 305 | 21.5 | 19.0 | 16.2 |
| Telecom | 1,444 | 500 | 21 | 22 | 25 | 24.2 | 23.1 | 20.2 |
| Utilities | 2,214 | 786 | 46 | 62 | 76 | 17.0 | 12.6 | 10.4 |
| Nifty Index | 57,358 | 29,505 | 1,438 | 1,696 | 2,021 | 20.5 | 17.4 | 14.6 |
| Nifty-50 Index (ex-energy) | 50,274 | 27,023 | 1,231 | 1,474 | 1,762 | 22.0 | 18.3 | 15.3 |

Source: Kotak Institutional Equities estimates

Exhibit 24: Certain high-quality stocks trade at expensive multiples for FY2017 after factoring in strong earnings growth in FY2015-17E
List of stocks with high multiples and high earnings growth, March fiscal year-ends, 2015E-17E

| Company | Sector | EPS (Rs) | | | EPS growth (%) | | | PER (X) | | | Price/BV (X) | | |
|--------------------------|-------------------|----------|-------|-------|----------------|-------|-------|---------|-------|-------|--------------|-------|-------|
| | | 2015E | 2016E | 2017E | 2015E | 2016E | 2017E | 2015E | 2016E | 2017E | 2015E | 2016E | 2017E |
| Bharat Forge | Automobiles | 35.7 | 45.3 | 56.4 | 70 | 27 | 24 | 33 | 26 | 21 | 8.3 | 6.7 | 5.3 |
| Hero Motocorp | Automobiles | 134.5 | 184.3 | 220.8 | 27 | 37 | 20 | 21 | 15 | 13 | 8.4 | 6.9 | 5.6 |
| Maruti Suzuki | Automobiles | 117.1 | 189.3 | 249.5 | 27 | 62 | 32 | 31 | 19 | 14 | 4.6 | 3.9 | 3.3 |
| ACC | Cement | 45.7 | 63.4 | 84.7 | (2) | 39 | 34 | 35 | 25 | 19 | 3.7 | 3.4 | 3.0 |
| Ambuja Cements | Cement | 9.1 | 11.5 | 14.3 | 35 | 26 | 24 | 29 | 23 | 19 | 3.8 | 3.5 | 3.0 |
| Shree Cement | Cement | 206.8 | 350.4 | 473.7 | (12) | 69 | 35 | 53 | 32 | 23 | 7.5 | 6.2 | 5.0 |
| UltraTech Cement | Cement | 75.6 | 101.8 | 141.4 | 1 | 35 | 39 | 41 | 30 | 22 | 4.5 | 3.9 | 3.4 |
| Asian Paints | Consumer Products | 15.4 | 20.9 | 23.9 | 20 | 36 | 14 | 54 | 40 | 35 | 16.8 | 13.6 | 11.2 |
| Page Industries | Consumer Products | 181.5 | 224.3 | 275.1 | 32 | 24 | 23 | 65 | 52 | 43 | 33.4 | 24.6 | 18.0 |
| United Spirits | Consumer Products | (32.3) | 5.2 | 25.4 | (261) | 116 | 386 | (103) | 635 | 131 | 16.1 | 12.7 | 9.7 |
| ABB | Industrials | 11.6 | 24.0 | 32.2 | 39 | 107 | 34 | 125 | 60 | 45 | 10.8 | 9.4 | 7.9 |
| Bharat Heavy Electricals | Industrials | 7.3 | 11.8 | 15.7 | (48) | 62 | 33 | 35 | 22 | 17 | 1.9 | 1.7 | 1.6 |
| Larsen & Toubro | Industrials | 37.5 | 55.8 | 76.4 | (23) | 49 | 37 | 44 | 30 | 22 | 4.0 | 3.6 | 3.2 |
| Siemens | Industrials | 17.2 | 23.2 | 28.7 | 177 | 35 | 24 | 72 | 53 | 43 | 9.1 | 8.2 | 7.3 |
| Thermax | Industrials | 23.5 | 32.1 | 38.8 | 14 | 36 | 21 | 51 | 38 | 31 | 6.5 | 5.8 | 5.2 |
| Cipla | Pharmaceuticals | 16.2 | 23.6 | 31.8 | (6) | 45 | 35 | 41 | 28 | 21 | 4.8 | 4.3 | 3.7 |
| Dr Reddy's Laboratories | Pharmaceuticals | 137.1 | 140.7 | 155.9 | 9 | 3 | 11 | 24 | 24 | 21 | 5.1 | 4.3 | 3.7 |
| Lupin | Pharmaceuticals | 54.3 | 61.9 | 74.6 | 33 | 14 | 21 | 31 | 27 | 22 | 8.2 | 6.5 | 5.2 |
| Sun Pharmaceuticals | Pharmaceuticals | 30.7 | 34.5 | 39.0 | 11 | 13 | 13 | 30 | 26 | 23 | 7.8 | 6.2 | 5.0 |
| Bharti Airtel | Telecom | 15.0 | 15.6 | 17.9 | 80 | 4 | 14 | 24 | 23 | 20 | 2.2 | 2.1 | 2.0 |
| Bharti Infratel | Telecom | 10.5 | 12.9 | 15.8 | 31 | 23 | 23 | 35 | 29 | 23 | 3.9 | 3.8 | 3.7 |
| IDEA | Telecom | 8.3 | 8.8 | 8.5 | 39 | 7 | (4) | 19 | 18 | 19 | 2.5 | 2.2 | 2.0 |

Source: Kotak Institutional Equities estimates

Our growth estimates for FY2016 and FY2017 net profits for the BSE-30 Index stand at 18.3% and 17.9%, respectively, driven by a sharp expected rise in the net profits of automobiles, industrials and metals and mining. These growth estimates reflect our expectation of a revival in the domestic capital investment cycle. Other than the aforementioned sectors, we would watch for earnings risks in two other sectors—banking and energy.

- **Banking.** We see two conflicting earnings drivers in the banking sector in FY2016—(1) potential increase in NPLs and (2) lower interest rates. Our banking profit growth numbers take into account significant treasury gains from an expected 75-100 bps fall in the repo rate in CY2015 (25 bps of which is already behind us). We note that the 10-year G-Sec yields have softened in India to 7.70% from 8.96% at the start of FY2015. Our economics team expects the yields to fall further to 7.25-7.50% in FY2016. We have factored in reasonably high credit costs in FY2016 (see Exhibit 25) but note that credit costs can surprise negatively if economic conditions do not improve and the government is unable to address the underlying challenges in the power and steel sectors.

Exhibit 25: We have factored in reasonably high credit costs in FY2016
LLP as a percentage of average loans, March fiscal year-ends, 2011-17E (%)

| | 2011 | 2012 | 2013 | 2014 | 2015E | 2016E | 2017E |
|---------------------------|------|------|------|------|-------|-------|-------|
| Public banks | | | | | | | |
| Bank of Baroda | 0.6 | 0.9 | 1.2 | 1.0 | 1.0 | 1.0 | 1.0 |
| Bank of India | 0.7 | 1.1 | 1.6 | 1.4 | 1.2 | 1.2 | 1.2 |
| Canara Bank | 0.6 | 0.7 | 1.1 | 1.0 | — | — | — |
| Oriental Bank of Commerce | 1.1 | 1.2 | 1.4 | 1.4 | 1.6 | 1.4 | 1.4 |
| Punjab National Bank | 1.1 | 1.2 | 1.4 | 1.8 | 1.7 | 1.4 | 1.2 |
| State Bank of India | 1.4 | 1.5 | 1.3 | 1.4 | 1.4 | 1.3 | 1.2 |
| Union Bank | 1.0 | 1.4 | 1.0 | 1.2 | — | — | — |
| Old private banks | | | | | | | |
| City Union Bank | 0.9 | 0.8 | 0.9 | 1.1 | 0.9 | 0.8 | 0.7 |
| DCB Bank | 1.3 | 0.6 | 0.3 | 0.5 | 0.7 | 0.4 | 0.4 |
| Federal Bank | 1.7 | 0.9 | 0.7 | 0.4 | 0.5 | 0.5 | 0.6 |
| Karur Vysya Bank | 0.1 | 0.2 | 0.6 | 0.7 | 1.2 | 0.6 | 0.6 |
| J&K Bank | 0.6 | 0.5 | 0.6 | 0.3 | 1.6 | 1.0 | 1.0 |
| New private banks | | | | | | | |
| Axis Bank | 0.9 | 0.7 | 1.0 | 1.0 | 0.9 | 0.9 | 0.8 |
| HDFC Bank | 1.0 | 1.1 | 0.8 | 0.7 | 0.6 | 0.6 | 0.6 |
| ICICI Bank | 1.0 | 0.4 | 0.6 | 0.8 | 1.0 | 0.9 | 0.8 |
| Yes Bank | 0.3 | 0.1 | 0.5 | 0.5 | 0.5 | 0.8 | 0.8 |
| IndusInd Bank | 0.8 | 0.6 | 0.6 | 0.8 | 0.6 | 0.7 | 0.8 |

Source: Kotak Institutional Equities estimates

The Indian banking system runs the risk of a further increase in restructured loans and NPLs in the power sector. Gross NPLs in the power sector seem to be quite low compared to overall NPLs and loans (see Exhibit 26), going by SBI's FY2014 data, which we see as broadly representative of the Indian banking sector. The problems of resource availability for the coal-based power plants could be partly resolved through two potential developments: (1) coal auction process has been put in place and 27 mines reserved for the power sector with a total production capacity of 117 mtpa (see Exhibit 27) should be available to the winners of the auctions or allocations by the end of the fiscal year; this should partly alleviate the problem as can be seen in Exhibit 28 and (2) international prices of coal continue to fall; Indonesian coal prices are down 22% yoy. Even as the problem for coal-based power plans begins to get resolved, the PLFs of the gas plants remain low (see Exhibit 29). The government is considering gas pooling to address the availability of gas for the power sector but no concrete plan has yet been formulated.

Exhibit 26: NPLs in the power sector are low compared to NPLs in other sectors
Break-up of NPLs across sectors, March fiscal year-end, 2014

| | SBI - 2014 | | | Sector - 2014 | | |
|------------------------------|------------------------|----------------|------------|------------------------|----------------|------------|
| | Total loans (Rs bn) | NPL (Rs bn) | NPL (%) | Total loans (Rs bn) | NPL (Rs bn) | NPL (%) |
| Coal and mining | 115 | 5 | 4.5 | 353 | 16 | 4.5 |
| Iron and steel | 1,072 | 64 | 6.0 | 2,685 | 134 | 5.0 |
| Metal and metal products | 334 | 40 | 12.1 | 934 | 65 | 7.0 |
| Engineering | 392 | 32 | 8.2 | 1,456 | 119 | 8.2 |
| of which electronics | 125 | 14 | 11.1 | 367 | 29 | 8.0 |
| Electricity | 293 | 21 | 7.3 | 1,088 | 89 | 8.2 |
| Textiles | 560 | 46 | 8.2 | 2,040 | 167 | 8.2 |
| Cotton | 442 | 30 | 6.8 | 1,011 | 69 | 6.8 |
| Jute | 5 | 1 | 24.5 | 20 | 5 | 24.5 |
| Others | 112 | 14 | 12.7 | 1,009 | 93 | 9.2 |
| Sugar | 114 | 4 | 3.5 | 348 | 12 | 3.5 |
| Tea | 7 | 0 | 4.9 | 32 | 2 | 4.9 |
| Food processing | 463 | 31 | 6.6 | 1,480 | 98 | 6.6 |
| Vegetable oil and vanaspati | 92 | 22 | 23.7 | 213 | 50 | 23.7 |
| Tobacco/tobacco products | 27 | 0 | 0.5 | 186 | 1 | 0.5 |
| Paper/paper products | 77 | 17 | 22.0 | 331 | 73 | 22.0 |
| Rubber/rubber products | 74 | 5 | 6.2 | 368 | 23 | 6.2 |
| Chemicals/dyes/paints | 637 | 45 | 7.1 | 1,677 | 119 | 7.1 |
| Fertilizer | 161 | 0 | 0.2 | 306 | 1 | 0.2 |
| Petrochemicals | 200 | 7 | 3.3 | 435 | 14 | 3.3 |
| Drugs and pharmaceuticals | 146 | 33 | 22.3 | 492 | 49 | 10.0 |
| Others | 131 | 6 | 4.6 | 443 | 55 | 12.5 |
| Cement | 121 | 9 | 7.2 | 541 | 39 | 7.2 |
| Leather/leather products | 38 | 1 | 3.2 | 103 | 3 | 3.2 |
| Gems and jewelry | 549 | 31 | 5.6 | 720 | 40 | 5.6 |
| Construction | 117 | 8 | 7.1 | 614 | 44 | 7.1 |
| Petroleum | 519 | 1 | 0.1 | 635 | 1 | 0.1 |
| Automobile and trucks | 169 | 3 | 1.6 | 677 | 11 | 1.6 |
| Computer software | 13 | 3 | 20.9 | 176 | 18 | 10.5 |
| Infrastructure | 1,910 | 51 | 2.7 | 8,398 | 223 | 2.7 |
| Power | 924 | 9 | 0.9 | 4,883 | 46 | 0.9 |
| Telecom | 352 | 3 | 0.8 | 904 | 7 | 0.8 |
| Roads and ports | 402 | 20 | 4.9 | 1,574 | 77 | 4.9 |
| Others | 233 | 19 | 8.3 | 1,036 | 92 | 8.9 |
| Other industries | 1,773 | 125 | 7.1 | 6,552 | 197 | 3.0 |
| Total industry | 9,467 | 564 | 6.0 | 31,607 | 1,544 | 4.9 |
| Agriculture | 2,435 | 170 | 7.0 | 6,694 | 388 | 5.8 |
| Retail | 2,759 | 50 | 1.8 | 10,367 | 187 | 1.8 |
| Others | 1,570 | 23 | 1.5 | 7,904 | 116 | 1.5 |
| Total | 16,231 | 807 | 5.0 | 56,572 | 2,235 | 4.0 |

Notes:

- (a) The above data is for the consolidated group of SBI.
(b) We have taken an average for NPLs in the retail portfolio.

Source: RBI, Kotak Institutional Equities estimates

Exhibit 27: 27 mines to be auctioned with reserves of 4 bn tons and mining capacity of 117 mtpa
Region wise summary of coal mines to be auctioned to power, non-regulated and steel (coking coal) sector

| State | Coal field | No. of mines | Reserves (mn tons) | Mining capacity (mtpa) |
|-------------------------------|-----------------|-----------------|-----------------------|---------------------------|
| Auctions - Power | | | | |
| Chhattisgarh | Mand - Raigarh | 6 | 806 | 26 |
| | Hasdeo Arand | 1 | 259 | 6 |
| Jharkhand | North Karanpura | 4 | 644 | 21 |
| | Others | 3 | 362 | 12 |
| Madhya Pradesh | Singrauli | 2 | 176 | 9 |
| Odisha | IB valley | 2 | 153 | 7 |
| | Talcher | 6 | 1,158 | 30 |
| West Bengal | Raniganj | 3 | 578 | 7 |
| Sub total | | 27 | 4,138 | 117 |
| Of which | | | | |
| Operational (Schedule II) | | 7 | 706 | 19 |
| Near producing (Schedule III) | | 9 | 1,625 | 39 |
| Few approvals | | 11 | 1,808 | 60 |

Source: Ministry of Coal, Kotak Institutional Equities estimates

Exhibit 28: Likely large shortfall in coal supply despite contribution from new mines

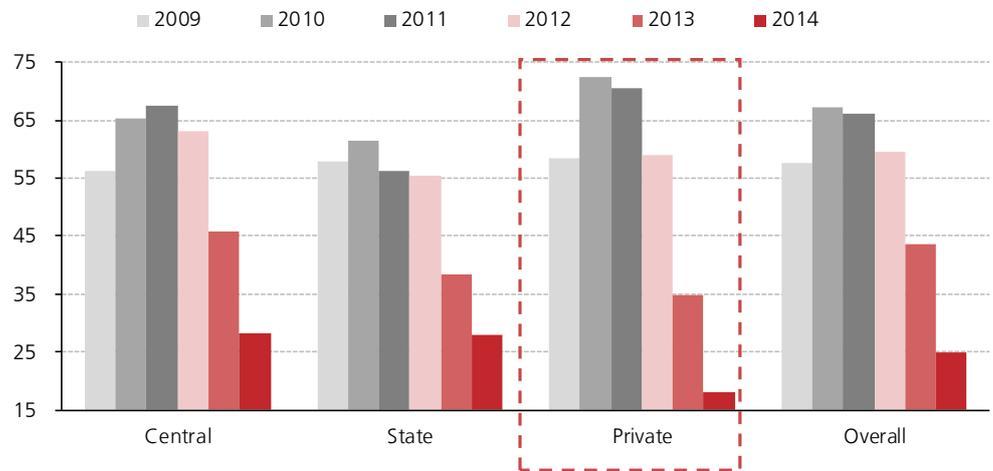
Details of demand-supply for operational and under-construction projects, March fiscal year-end, 2018E (mn tons)

| | Power | | | Total |
|-----------------------|--------------|------------|--------------|--------------|
| | Private | Public | Non-power | |
| Demand | 375 | 424 | 237 | 1,037 |
| Supply | | | | |
| CIL+SCCL | 199 | 313 | 98 | 610 |
| New coal mines | | | | |
| Producing | 15 | 27 | 16 | 58 |
| Near-producing | 23 | 43 | 6 | 72 |
| Others | 24 | 40 | 3 | 67 |
| Total | 62 | 111 | 25 | 198 |
| Total supply | 261 | 424 | 122 | 808 |
| Gap | (114) | — | (115) | (229) |

Source: Kotak Institutional Equities estimates

Exhibit 29: PLF of gas-based power plant has declined to 25% leaving huge unutilized capacity

Sector-wise PLF of gas capacity, March fiscal year-ends, 2009-14 (%)



Source: CEA, Kotak Institutional Equities

The weak financial condition of the SEBs remains a challenge as the subsidy burden continues to increase (see Exhibit 30). Furthermore, the weak financial condition of the SEBs has resulted in lower-than-required purchase of power by SEBs leading to low capacity utilization for the generation companies.

Exhibit 30: Subsidy burden continues to increase

Subsidy booked and received by SEBs, March fiscal year-ends, 2007-15E (Rs bn)



Source: PFC, Kotak Institutional Equities estimates

The Indian steel industry is in a similar position. Several small players in the steel sector have already defaulted in the past 24-30 months and banks have restructured their loans to these companies (see Exhibit 31 for status of loans and recent financials). We note the deteriorating financial condition of some of the larger players, which are yet to restructure their loans, and their extremely high net debt relative to EBITDA. Some of these are running at low capacity utilizations given lack of upstream resources, iron ore and coal. They could become more profitable with low-cost captive iron-ore mines but that scenario looks unlikely now as the government moves to transparent auctions for allocation of mineral ores. In addition, weak global steel cycle, excess global capacity and the appreciation of the Indian rupee against currencies of China and Russia will continue to pressure steel prices and profitability of Indian steel companies.

Exhibit 31: Loans to steel sector under severe stress

Breakdown of loans by major steel companies, March fiscal year-ends, 2012-14 (Rs bn)

| Company | 2012 | 2013 | 2014 | FY2014 EBITDA | Remarks |
|-------------------------|--------------|--------------|--------------|---------------|---|
| Adhunik Metal | 41 | 49 | NA | 6 | |
| Bhushan Power and Steel | 179 | 248 | 293 | 32 | |
| Bhushan Steel | 215 | 285 | 352 | 27 | Alleged corruption case against company |
| Electrosteel Steel | 61 | 72 | 83 | (1) | Under CDR |
| Essar Steel | 267 | 296 | 314 | 8 | Very low EBITDA versus interest paid |
| Jai Balaji Industries | 22 | 24 | 26 | 0 | Under CDR |
| Jindal Saw | 36 | 52 | 58 | 6 | |
| Jindal Stainless | 107 | 116 | 116 | 6 | |
| JSPL | 171 | 246 | 364 | 58 | |
| JSW Steel | 199 | 213 | 348 | 92 | |
| L&T Special Steels | 10 | 12 | 15 | (1) | |
| Monnet Ispat | 58 | 86 | 102 | 4 | |
| Mukand Steel | 20 | 22 | 20 | 2 | |
| OCL Iron & Steel | 16 | 16 | 16 | 0 | |
| PSL | 37 | 38 | 49 | (2) | Under CDR |
| Ramsarup Industries | 20 | 20 | 20 | (0) | Under CDR |
| Rashtriya Ispat Nigam | 26 | 49 | 49 | 9 | |
| SAIL | 163 | 216 | 253 | 44 | |
| Sarda Energy | 11 | 14 | 15 | 3 | |
| Surana Industries | 18 | 22 | 28 | (1) | Under CDR |
| Tata Steel | 621 | 683 | 839 | 164 | |
| Usha Martin | 25 | 32 | 35 | 7 | |
| Uttam Galva | 28 | 30 | 34 | 4 | |
| Varun Industries | 16 | 23 | NA | 0 | CDR failed, banks moved DRT to take control of assets |
| Visa Steel | 16 | 24 | 27 | 1 | Under CDR |
| Welspun Corp. | 53 | 56 | 58 | 7 | |
| Total | 2,106 | 2,546 | 3,514 | | |

Source: Companies, Capitaline, Kotak Institutional Equities

- **Energy.** The net profits of the government-owned energy companies will depend on (1) the level of crude oil price and (2) subsidy-sharing formula. We assume US\$70/bbl crude price in FY2016 and see downside risks to our earnings estimates for GAIL and ONGC in the BSE-30 Index in case crude oil price is lower versus our assumption (see Exhibit 32). The profit estimates of the energy companies may change positively if the government were to (1) reduce the subsidy on LPG and kerosene and (2) formulate a favorable subsidy-sharing formula, which could reduce the subsidy burden on the upstream companies significantly (see Exhibits 33 and 34 on the extent and sharing of under-recoveries). We already model nil under-recoveries for the government-owned downstream companies.

Exhibit 32: Downside risks to our earnings estimates for GAIL and ONGC due to weaker-than-assumed crude oil price

Earnings sensitivity to crude price, March fiscal year-end, 2016E

| Dated Brent crude price (US\$/bbl) | 50 | 60 | 70 |
|---|-----|-----|-----|
| Fuel subsidies (Rs bn) | 129 | 249 | 395 |
| ONGC | | | |
| Assuming 40% burden on upstream | | | |
| Net realizations (US\$/bbl) | 46 | 51 | 55 |
| EPS (Rs) | 20 | 27 | 33 |
| Assuming nil subsidies on upstream | | | |
| Net realizations (US\$/bbl) | 50 | 60 | 70 |
| EPS (Rs) | 23 | 32 | 42 |
| GAIL (a) | | | |
| EPS (Rs) | 15 | 20 | 27 |

Notes:

(a) We assume nil subsidy burden on GAIL.

Source: Kotak Institutional Equities

Exhibit 33: We assume 40% subsidy burden on upstream companies

Share of under-recoveries for various participants, March fiscal year-ends, 2009-17E (Rs bn)

| | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015E | 2016E | 2017E |
|--|--------------|------------|------------|--------------|--------------|--------------|------------|------------|------------|
| Macro-assumptions | | | | | | | | | |
| Dated Brent crude oil price (US\$/bbl) | 89 | 67 | 84 | 113 | 112 | 108 | 87 | 70 | 75 |
| Exchange rate (Rs/US\$) | 46 | 47 | 46 | 48 | 54 | 60 | 61 | 63 | 65 |
| Subsidy burden | | | | | | | | | |
| Petrol | 52 | 52 | 22 | 49 | 11 | — | — | — | — |
| Diesel | 523 | 93 | 344 | 812 | 921 | 628 | 109 | — | — |
| LPG | 176 | 143 | 220 | 300 | 396 | 465 | 398 | 196 | 295 |
| Kerosene | 282 | 174 | 196 | 274 | 294 | 306 | 254 | 198 | 218 |
| Subsidy burden | 1,033 | 461 | 782 | 1,434 | 1,621 | 1,399 | 761 | 395 | 513 |
| Gross under-recoveries | 1,062 | 491 | 814 | 1,465 | 1,651 | 1,429 | 791 | 425 | 544 |
| Subsidy sharing | | | | | | | | | |
| Payment by government (direct budgetary support) | 29 | 30 | 32 | 31 | 31 | 31 | 31 | 31 | 31 |
| Payment by government (oil bonds/cash) | 713 | 260 | 410 | 835 | 1,000 | 708 | 333 | 236 | 307 |
| Net under-recovery of oil companies | 320 | 201 | 372 | 599 | 621 | 691 | 428 | 158 | 206 |
| Receipt from upstream companies | 329 | 144 | 303 | 550 | 600 | 670 | 428 | 158 | 206 |
| Share of ONGC | 282 | 116 | 249 | 445 | 494 | 564 | 363 | 138 | 180 |
| Share of GAIL | 18 | 13 | 21 | 32 | 27 | 19 | 10 | — | — |
| Share of Oil India | 29 | 15 | 33 | 74 | 79 | 87 | 55 | 21 | 27 |
| Net under-recovery of OMCs | (9) | 56 | 69 | 49 | 21 | 21 | — | — | — |
| Share of BPCL | (3) | 12 | 16 | 14 | 5 | 5 | — | — | — |
| Share of HPCL | (6) | 12 | 15 | 13 | 5 | 5 | — | — | — |
| Share of IOCL | (0) | 32 | 38 | 23 | 10 | 11 | — | — | — |

Notes:

(a) Petrol price was deregulated in June 2010; however, downstream companies continued to bear losses in FY2011-13.

(b) Assuming 20% savings on LPG subsidies from FY2016 onwards.

Source: Kotak Institutional Equities estimates

Exhibit 34: Earnings of ONGC and OIL can vary a lot depending on the level of crude price
 EPS of ONGC and OIL under speculated subsidy-sharing, March fiscal year-end, 2016E

| | | | | | | |
|--|------|------|------|------|------|-------|
| Dated Brent crude price (US\$/bbl) | 50.0 | 60.0 | 70.0 | 80.0 | 90.0 | 100.0 |
| Net realizations (US\$/bbl) | 50.0 | 60.0 | 61.5 | 63.0 | 64.5 | 66.0 |
| Gross fuel subsidies (Rs bn) (a) | 129 | 271 | 444 | 617 | 790 | 963 |
| Required government compensation (Rs bn) | 129 | 271 | 355 | 438 | 521 | 604 |
| ONGC | | | | | | |
| Subsidy burden (Rs bn) | — | — | 77 | 154 | 231 | 308 |
| EPS (Rs) | 23 | 32 | 37 | 41 | 45 | 49 |
| OIL | | | | | | |
| Subsidy burden (Rs bn) | — | — | 12 | 25 | 38 | 51 |
| EPS (Rs) | 49 | 63 | 67 | 70 | 73 | 75 |

Notes:

(a) Assuming no incremental measures for curtailing of LPG and kerosene subsidies.

Source: Kotak Institutional Equities estimates

The good part is that only 40% of the net profits of the BSE-30 or Nifty-50 Index (see Exhibits 35-36) have direct linkages to the Indian economy and thus, the scope of earnings disappointments from a slower-than-expected recovery in the Indian economy will be confined to those sectors. The rest is contributed by sectors and companies with (1) revenues and profits from overseas businesses (IT, pharmaceuticals, TTMT), (2) revenues and profitability linked to global commodity cycles (private energy, metals), (3) revenues and profits regulated by regulations (regulated power utilities) and (4) revenues and profits controlled by the government (PSU energy).

Exhibit 35: About 60% of the net profits of the BSE-30 Index comes from global and government-regulated sectors
 Break-up of net profits of the BSE-30 Index across sectors, March fiscal year-ends, 2014-17E

| | Net profits (Rs bn) | | | | Contribution (%) | | | | Incremental profits | | | |
|-----------------------------|---------------------|--------------|--------------|--------------|------------------|------------|------------|------------|---------------------|------------|------------|------------|
| | 2014 | 2015E | 2016E | 2017E | 2014 | 2015E | 2016E | 2017E | 2016E | | 2017E | |
| | | | | | | | | | (Rs bn) | (%) | (Rs bn) | (%) |
| Automobiles | 270 | 289 | 372 | 468 | 12 | 12 | 13 | 14 | 83 | 19 | 96 | 19 |
| Banking | 408 | 491 | 585 | 682 | 18 | 21 | 21 | 21 | 94 | 22 | 97 | 19 |
| Consumers | 121 | 136 | 156 | 177 | 5 | 6 | 6 | 5 | 20 | 5 | 21 | 4 |
| Energy | 527 | 481 | 550 | 655 | 23 | 20 | 20 | 20 | 69 | 16 | 105 | 21 |
| ONGC | 266 | 225 | 279 | 329 | 12 | 9 | 10 | 10 | 54 | 12 | 50 | 10 |
| Reliance Industries | 220 | 221 | 237 | 283 | 10 | 9 | 8 | 9 | 16 | 4 | 45 | 9 |
| Industrials | 80 | 53 | 81 | 109 | 3 | 2 | 3 | 3 | 28 | 6 | 29 | 6 |
| Metals & Mining | 263 | 253 | 303 | 326 | 12 | 11 | 11 | 10 | 49 | 11 | 23 | 5 |
| Coal India | 151 | 146 | 176 | 166 | 7 | 6 | 6 | 5 | 30 | 7 | (11) | (2) |
| Pharmaceuticals | 92 | 100 | 114 | 133 | 4 | 4 | 4 | 4 | 15 | 3 | 18 | 4 |
| Technology | 378 | 420 | 476 | 562 | 17 | 18 | 17 | 17 | 56 | 13 | 86 | 17 |
| Telecom | 33 | 60 | 62 | 71 | 1 | 3 | 2 | 2 | 3 | 1 | 9 | 2 |
| Utilities | 111 | 101 | 120 | 139 | 5 | 4 | 4 | 4 | 19 | 4 | 19 | 4 |
| BSE-30 Index | 2,283 | 2,384 | 2,819 | 3,323 | 100 | 100 | 100 | 100 | 435 | 100 | 504 | 100 |
| BSE-30 change (%) | 8.0 | 4.4 | 18.3 | 17.9 | | | | | | | | |
| BSE-30 ex-energy change (%) | 9.3 | 8.3 | 19.2 | 17.6 | | | | | | | | |
| BSE-30 EPS (FF) | 1,331 | 1,413 | 1,676 | 1,996 | | | | | | | | |

Source: Kotak Institutional Equities estimates

Exhibit 36: About 60% of the net profits of the Nifty-50 Index comes from global and government-regulated sectors
Break-up of net profits of the Nifty-50 Index across sectors, March fiscal year-ends, 2014-17E

| | Net profits (Rs bn) | | | | Contribution (%) | | | | Incremental profits | | | |
|--------------------------------------|---------------------|--------------|--------------|--------------|------------------|------------|------------|------------|---------------------|------------|------------|------------|
| | 2014 | 2015E | 2016E | 2017E | 2014 | 2015E | 2016E | 2017E | 2016E | | 2017E | |
| | | | | | | | | | (Rs bn) | (%) | (Rs bn) | (%) |
| Automobiles | 270 | 289 | 372 | 468 | 9 | 10 | 11 | 11 | 83 | 16 | 96 | 16 |
| Banking | 520 | 606 | 726 | 857 | 18 | 20 | 21 | 21 | 121 | 24 | 130 | 21 |
| Cement | 59 | 61 | 80 | 107 | 2 | 2 | 2 | 3 | 19 | 4 | 27 | 4 |
| Consumers | 134 | 151 | 176 | 200 | 5 | 5 | 5 | 5 | 25 | 5 | 24 | 4 |
| Energy | 692 | 589 | 641 | 746 | 24 | 20 | 18 | 18 | 53 | 10 | 105 | 17 |
| ONGC | 266 | 225 | 279 | 329 | 9 | 8 | 8 | 8 | 54 | 11 | 50 | 8 |
| Reliance Industries | 220 | 221 | 237 | 283 | 8 | 7 | 7 | 7 | 16 | 3 | 45 | 7 |
| Industrials | 80 | 53 | 81 | 109 | 3 | 2 | 2 | 3 | 28 | 6 | 29 | 5 |
| Media | 9 | 8 | 9 | 12 | 0 | 0 | 0 | 0 | 0 | 0 | 3 | 0 |
| Metals & Mining | 346 | 341 | 396 | 419 | 12 | 12 | 11 | 10 | 55 | 11 | 23 | 4 |
| Coal India | 151 | 146 | 176 | 166 | 5 | 5 | 5 | 4 | 30 | 6 | (11) | (2) |
| Pharmaceuticals | 111 | 124 | 142 | 166 | 4 | 4 | 4 | 4 | 18 | 4 | 24 | 4 |
| Real Estate | 6 | 5 | 7 | 11 | 0 | 0 | 0 | 0 | 2 | 0 | 4 | 1 |
| Technology | 468 | 525 | 591 | 693 | 16 | 18 | 17 | 17 | 67 | 13 | 102 | 17 |
| Telecom | 33 | 60 | 62 | 71 | 1 | 2 | 2 | 2 | 3 | 1 | 9 | 1 |
| Utilities | 156 | 152 | 185 | 221 | 5 | 5 | 5 | 5 | 33 | 7 | 36 | 6 |
| Nifty-50 Index | 2,883 | 2,963 | 3,469 | 4,081 | 100 | 100 | 100 | 100 | 506 | 100 | 611 | 100 |
| Nifty-50 change (%) | 6.6 | 2.8 | 17.1 | 17.6 | | | | | | | | |
| Nifty-50 ex-energy change (%) | 6.8 | 8.4 | 19.1 | 17.9 | | | | | | | | |
| Nifty-50 EPS (FF) | 409 | 429 | 506 | 603 | | | | | | | | |

Source: Kotak Institutional Equities estimates

Triggers other than earnings

Given the lack of earnings surprises as a positive trigger for the market over the next 1-2 quarters, we examine other factors behind the Street's bullishness. Most of these are macro-related factors and relate to ongoing economic reforms and the recent improvement in India's macroeconomic position and the market's expectations of further improvement. We would ascribe a meaningful portion of the Street's recent bullishness and the market's high valuations to the abovementioned factors.

In our view, the room for disappointment is quite low in the context of the Street's high expectations and the market's high valuations. The market has high expectations around (1) continuation of economic reforms leading to higher GDP growth and lower interest rates in the Indian economy over the next 12 months, (2) recovery in investment cycle post completion of certain ongoing investment reforms in the next 3-4 quarters and (3) continuation of the supportive global macro-environment and strong global liquidity for a reasonable period of time. We are constructive on these factors but are concerned about the fact that the market may be already paying inordinately in the form of rich valuations for several sectors and stocks for the likely improvement in India's macroeconomic position and subsequent benefits to earnings from the same.

We examine the risks to the macro-driven positive view below.

- ▶ **Continuation of economic reforms.** The government's ability to implement reforms will be tested in the forthcoming session of the parliament (starting on February 23, 2015) when it will attempt to convert four ordinances into legislations and also steer the GST constitutional amendment bill through the parliament. Exhibit 37 gives details of the ordinances and the GST bill. There is little doubt about the government's resolve to implement reforms given the alacrity with which it has promulgated ordinances to clear certain hurdles related to investment.

Exhibit 37: Key bills and ordinances pending approval of the parliament for conversion into full-fledged acts of parliament
Details of key economic bills and ordinances

| | Status | Comments | Impact |
|--|---|--|---|
| The Coal Mines (Special Provisions) Bill, 2014 | | | |
| Facilitate e-auction of coal blocks for private companies for captive use and allot mines directly to state and central PSUs. It will allow private sector commercial mining in the coal sector | Cabinet approval received on December 24, 2014 | The Coal Mines (Special Provisions) Bill, 2014 replaces the Coal Mines (Special Provisions) Ordinance, 2014 that was promulgated on October 21, 2014 | Allotment of coal mines more transparent and opening up of coal sector for private sector commercial mining. Domestic coal production to increase |
| Insurance Laws (Amendment) Ordinance, 2014 | | | |
| Allows foreign investors to hold up to 49% of the capital in an Indian insurance company. It allows for nationalized general insurance companies to raise funds from the capital markets | Insurance Laws (Amendment) Ordinance, 2014 passed on December 29, 2014 | Report of select committee of Rajya Sabha tabled on December 10, 2014; committee recommend an increase in FDI limit to 49% from the current 26% | Greater FDI inflow possible |
| Land Acquisition, Rehabilitation and Resettlement Act, 2013 | | | |
| The act details a process of doing a social impact assessment (SIA) and identifying the public purpose in cases where any land is to be acquired by any government. This activity could take around two to three years and has been 'blamed' for making the process of land acquisition longer | The act was amended by an ordinance promulgated by the President on December 31, 2014 | The new law possibly makes the timeline to acquire land shorter, thereby making the process efficient | Improved investment climate and ease of doing business |
| MMDR (Amendment) Ordinance, 2015 | | | |
| The central government may invite competitive offers for grant of mineral concession in case of coal minerals, and state governments may invite competitive offers in case of other minerals | President approved MMDR (Amendment) Ordinance, 2015 on January 12, 2015 | Government will introduce a new MMDR bill to replace MMDR ordinance | Clarity in mines development process and allotment of new mines; improved profitability of projects without access to resources currently |
| The Constitution (122nd Amendment) Bill, or the Goods and Services Tax Bill | | | |
| Give concurrent taxing powers to both the Union and States. The bill suggests the creation of Goods and Services Tax council and a Goods and Services Tax Dispute Settlement Authority | Cabinet approval received on December 18, 2014; bill to be introduced in the budget session of the parliament | Issues with respect to compensation and scope of GST have been resolved between center and states. GST council to finalize revenue-neutral rate | ~100 bps increase in GDP, ~70 bps increase in central taxes as percentage of GDP |

Source: PRS, Kotak Institutional Equities

In our view, any uncertainty regarding the passage of the bills will unnerve the market. We note that the government does not have a majority in the upper house of the parliament and has to either (1) depend on the support of opposition parties to clear the bills in the upper house of the parliament or (2) use the seldom-used option of joint sessions of the parliament to pass the bills. We note that a government cannot call a joint session for a constitutional amendment bill (GST, in this case). However, it can do so for 'normal' bills and attempt to pass the bills through a simple majority of the two houses on a combined basis. The current government has a small majority on a combined basis.

- **Contribution of low global crude oil prices to an improved macro-environment.** The market's bullishness has certainly moved up following the collapse in global prices and the consequent improvement in India's macroeconomic position. Thus, any increase in crude oil prices will dampen the extent of improvement and investment sentiment. Oil prices have already moved up to US\$60/bbl over the past one month.

Exhibit 38 shows the large variation in the government's revenues from the oil sector at various levels of crude oil prices. As can be seen, crude price at US\$50-60/bbl will result in huge savings for India and significant additional revenues for the government, which it can use to boost capital expenditure or to reduce borrowings for FY2016. However, crude oil price at US\$80/bbl will result in no material improvement in India's macroeconomic variables versus FY2015 levels (average crude price of US\$85/bbl). At higher levels, macroeconomic position will in fact deteriorate.

Exhibit 38: Large savings for the Indian consumers and central government; state governments to lose revenues
Petroleum sector contribution and fiscal-related data, March fiscal year-ends, 2008-16E (Rs bn)

| | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015E | 2016E | |
|--|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|
| Crude price (US\$/bbl) | 82 | 85 | 70 | 87 | 114 | 111 | 108 | 85 | 50 | 80 |
| Exchange rate (Rs/US\$) | 40 | 46 | 47 | 46 | 48 | 54 | 61 | 61 | 63 | 63 |
| Retail price without taxes (Rs/liter) | | | | | | | | | | |
| Gasoline | | | | | | | 47 | 42 | 28 | 43 |
| Diesel | | | | | | | 41 | 42 | 29 | 44 |
| Excise duty (Rs/liter) | | | | | | | | | | |
| Gasoline | | | | | | | 3.6 | 5.4 | 10.3 | 3.6 |
| Diesel | | | | | | | 9.5 | 11.7 | 17.5 | 9.5 |
| Petroleum sector contribution to Central/State Governments of India | | | | | | | | | | |
| Central exchequer | | | | | | | | | | |
| Customs duty | 126 | 63 | 46 | 241 | 100 | 33 | 38 | 30 | 19 | 30 |
| Cess | 69 | 68 | 66 | 68 | 71 | 121 | 119 | 119 | 119 | 119 |
| Excise duty | 548 | 541 | 625 | 680 | 620 | 629 | 643 | 872 | 1,451 | 685 |
| Gasoline | 201 | 211 | 248 | 268 | 288 | 237 | 224 | 299 | 471 | 256 |
| Diesel | 238 | 215 | 231 | 304 | 190 | 225 | 271 | 456 | 909 | 315 |
| Royalty | 31 | 31 | 39 | 37 | 36 | 39 | 42 | 33 | 20 | 32 |
| Petroleum profit | 42 | 47 | 55 | 36 | 74 | 94 | 114 | 91 | 55 | 88 |
| Corporate tax | 163 | 120 | 179 | 171 | 164 | 134 | 144 | 140 | 158 | 203 |
| Dividend | 65 | 45 | 81 | 98 | 101 | 89 | 92 | 88 | 100 | 136 |
| Tax on dividend | 19 | 11 | 19 | 24 | 23 | 21 | 23 | 27 | 30 | 41 |
| Others (includes service tax) | 9 | 9 | 10 | 9 | 10 | 14 | 19 | 15 | 9 | 14 |
| Total | 1,072 | 935 | 1,118 | 1,365 | 1,198 | 1,174 | 1,233 | 1,416 | 1,961 | 1,349 |
| State exchequer | | | | | | | | | | |
| Sales tax | 564 | 633 | 650 | 787 | 969 | 1,109 | 1,237 | 1,209 | 863 | 1,320 |
| Royalty | 42 | 25 | 33 | 46 | 75 | 82 | 86 | 68 | 41 | 66 |
| Octroi, duties | 17 | 19 | 19 | 22 | 30 | 34 | 39 | 31 | 19 | 30 |
| Dividend to state govt. | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Entry tax/others | 11 | 5 | 18 | 35 | 55 | 40 | 47 | 38 | 23 | 37 |
| Total | 634 | 683 | 721 | 890 | 1,129 | 1,265 | 1,409 | 1,346 | 946 | 1,453 |
| Total contribution from petroleum sector | 1,706 | 1,618 | 1,839 | 2,255 | 2,328 | 2,439 | 2,642 | 2,762 | 2,908 | 2,802 |
| Total fuel subsidy | 379 | 742 | 150 | 384 | 685 | 969 | 855 | 635 | 213 | 439 |
| Net contribution from petroleum sector | 1,327 | 875 | 1,689 | 1,871 | 1,643 | 1,471 | 1,787 | 2,126 | 2,695 | 2,363 |
| Net income of government companies | | | | | | | | | | |
| ONGC | 199 | 195 | 196 | 211 | 281 | 251 | 266 | 225 | 201 | 302 |
| OIL | 18 | 22 | 26 | 29 | 34 | 36 | 30 | 28 | 29 | 40 |
| GAIL | 26 | 28 | 33 | 37 | 39 | 46 | 41 | 34 | 22 | 39 |
| Total net income | 243 | 244 | 255 | 276 | 354 | 332 | 337 | 288 | 252 | 381 |
| Crude import bill | | | | | | | | | | |
| Net crude imports (US\$ bn) | 56 | 63 | 56 | 69 | 95 | 98 | 95 | 78 | 48 | 76 |
| Net crude imports (Rs bn) | 2,237 | 2,893 | 2,650 | 3,138 | 4,533 | 5,329 | 5,720 | 4,729 | 2,998 | 4,797 |

Source: PPAC, MOPNG, GOI, Kotak Institutional Equities estimates

The level of oil prices in FY2016 will have a material impact on India's macroeconomic variables and also the choice of policy actions, both fiscal and monetary. Exhibit 39 shows our estimates of India's macroeconomic variables at various levels of crude prices. A low oil price will result in a significant improvement in India's BoP and fiscal position, which will result in the government being in a position to provide fiscal stimulus (through higher capital expenditure) and the RBI to cut policy rates aggressively. However, a rebound in prices to US\$80/bbl and above will cramp the government's ability to provide fiscal stimulus and also restrict the RBI's flexibility to cut policy rates.

Exhibit 39: Low oil prices can result in significant 'savings' for the economy

Key macroeconomic variables at various levels of crude prices, March fiscal year-end, 2016

| | 50 | 60 | 70 | 80 | 90 | 100 |
|---------------------------|-------|-------|-------|-------|-------|-------|
| CAD/GDP (%) | (0.3) | (0.8) | (1.2) | (1.7) | (2.2) | (2.7) |
| GFD/GDP (%) | 3.56 | 3.60 | 3.64 | 3.69 | 3.74 | 3.79 |
| Average CPI inflation (%) | 5.4 | 5.5 | 5.5 | 5.6 | 5.6 | 5.7 |

Source: Kotak Institutional Equities estimates

We assume FY2016 crude price at US\$70/bbl (Dated Brent basis) and expect the government's GFD/GDP ratio to decline to 3.6% (see Exhibit 40) from 4.1% in FY2015 despite an increase in the government's capital expenditure. At the same time, we expect the RBI to cut policy rates by 50-75 bps over the next 9-12 months given CPI inflation being in the range of 5-6% through FY2016. Our assumptions are quite benign and in line with consensus expectations.

Exhibit 40: We expect the government's GFD/GDP ratio to decline to 3.6% in FY2016

Major central government budgetary items, March fiscal year-ends, 2012-16E (Rs bn)

| | 2012 | 2013 | 2014P | 2015E | 2016E | Change (%) | | |
|---|---------------|---------------|----------------|----------------|----------------|----------------|-----------------|-----------------|
| | | | | | | 2014P/ 2013 | 2015E/ 2014P | 2016E/ 2015E |
| Receipts | | | | | | | | |
| 1. Revenue receipts (2d + 3) | 7,514 | 8,776 | 10,153 | 11,264 | 12,851 | 16 | 11 | 14 |
| 2. Gross tax revenues (a + b) | 8,892 | 10,362 | 11,388 | 12,523 | 14,417 | 10 | 10 | 15 |
| 2.a. Direct taxes | 4,974 | 5,624 | 6,426 | 7,096 | 8,105 | 14 | 10 | 14 |
| 2.a.1. Corporation tax | 3,228 | 3,563 | 3,947 | 4,341 | 4,862 | 11 | 10 | 12 |
| 2.a.2. Income tax | 1,645 | 1,965 | 2,378 | 2,711 | 3,199 | 21 | 14 | 18 |
| 2.b. Indirect taxes | 3,917 | 4,738 | 4,962 | 5,427 | 6,313 | 5 | 9 | 16 |
| 2.b.1. Customs duty | 1,493 | 1,653 | 1,721 | 1,842 | 1,971 | 4 | 7 | 7 |
| 2.b.2. Excise duty | 1,449 | 1,758 | 1,695 | 1,869 | 2,282 | (4) | 10 | 22 |
| 2.b.3. Service tax | 975 | 1,326 | 1,546 | 1,716 | 2,060 | 17 | 11 | 20 |
| 2.c Transfers to states, UTs and national funds | 2,594 | 2,960 | 3,228 | 3,544 | 4,080 | 9 | 10 | 15 |
| 2.d Net tax revenues | 6,298 | 7,403 | 8,160 | 8,979 | 10,337 | 10 | 10 | 15 |
| 3. Non-tax revenues | 1,217 | 1,374 | 1,992 | 2,285 | 2,514 | 45 | 15 | 10 |
| 4. Non-debt capital receipts (a + b) | 369 | 422 | 401 | 455 | 755 | (5) | 14 | 66 |
| 4.a Recovery of loans | 189 | 163 | 125 | 105 | 105 | (23) | (16) | 0 |
| 4.b Other receipts (disinvestments) | 181 | 259 | 276 | 350 | 650 | 6 | 27 | 86 |
| 5. Total receipts (1 + 4) | 7,884 | 9,198 | 10,553 | 11,719 | 13,606 | 15 | 11 | 16 |
| Expenditure | | | | | | | | |
| 6. Non-plan expenditure | 8,920 | 9,967 | 11,104 | 11,980 | 12,540 | 11 | 8 | 5 |
| 6.a. Interest payments | 2,732 | 3,132 | 3,775 | 4,270 | 4,407 | 21 | 13 | 3 |
| 6.b. Subsidies | 2,179 | 2,571 | 2,555 | 2,587 | 2,279 | (1) | 1 | (12) |
| 6.b.1. Food | 728 | 850 | 920 | 1,150 | 1,200 | 8 | 25 | 4 |
| 6.b.2. Fertilizer | 700 | 656 | 680 | 730 | 700 | 4 | 7 | (4) |
| 6.b.3. Oil | 685 | 969 | 855 | 615 | 279 | (12) | (28) | (55) |
| 6.b.3. Other subsidies | 66 | 96 | 101 | 92 | 100 | 5 | (8) | 8 |
| 6.c. Others | 4,009 | 4,265 | 4,774 | 5,122 | 5,854 | 12 | 7 | 14 |
| 7. Plan expenditure | 4,124 | 4,136 | 4,531 | 4,984 | 6,230 | 10 | 10 | 25 |
| 8. Total expenditure (6 + 7) | 13,044 | 14,104 | 15,635 | 16,964 | 18,770 | 11 | 8 | 11 |
| Deficit | | | | | | | | |
| Primary deficit (PD) | 2,428 | 1,774 | 1,306 | 974 | 757 | (26) | (25) | (22) |
| Gross fiscal deficit (GFD) | 5,160 | 4,906 | 5,081 | 5,244 | 5,164 | 4 | 3 | (2) |
| Gross borrowings | 5,100 | 5,580 | 5,639 | 5,942 | 6,220 | 1 | 5 | 5 |
| Net market borrowing (dated securities) | 4,364 | 4,674 | 4,689 | 4,670 | 4,464 | 0 | (0) | (4) |
| Short-term borrowing (TBills) | 1,161 | 534 | 227 | 334 | 350 | | | |
| Nominal GDP at market prices | 88,320 | 99,885 | 113,450 | 126,538 | 142,988 | 13.6 | 11.5 | 13.0 |
| PD/GDP (%) | 2.7 | 1.8 | 1.2 | 0.8 | 0.5 | | | |
| GFD/GDP (%) | 5.8 | 4.9 | 4.5 | 4.1 | 3.6 | | | |

Source: Ministry of Finance, Kotak Institutional Equities estimates

- ▶ **Strong global liquidity due to benign policies of the global central banks.** A sharper-than-expected recovery in the US (recent economic data has been quite strong; see Exhibit 41 for details) will push the US Fed into raising interest rates by the middle of CY2015. A section of the market had started assuming that the recent strength in the US dollar may induce the US Fed to postpone its decision to raise interest rates. If the US economic recovery continues unhindered by the strong US dollar, an increase in US Fed rates is inevitable.

Nonetheless, India should see strong inflows if the government were to continue with reforms and the RBI were to reduce interest rates in line with our expectations. This may offset some volatility at the time of normalization of interest rates in the US. With other global central banks (BoJ, ECB) pursuing aggressive QE programs, global liquidity will be benign. It is another issue whether such programs will lead to a pick-up in investment demand from additional borrowing (due to lower interest rates) or in increased consumption in those countries or areas, the purported aims of QE programs. We suspect the erosion in income of savers from low yields may be preventing them from consuming or borrowing more and in fact, forcing them to save more as incomes on debt financial savings decline sharply. The benefit of QE programs may be simply accruing to owners of capital through appreciation in asset prices (through lower yields on bonds or cost of capital for equities, real estate) but that may not be resulting in additional consumption or investment.

Exhibit 41: Recent data shows strong growth in the US economy

Trend in key economic variables for US

| Monthly indicators | Sep-13 | Oct-13 | Nov-13 | Dec-13 | Jan-14 | Feb-14 | Mar-14 | Apr-14 | May-14 | Jun-14 | Jul-14 | Aug-14 | Sep-14 | Oct-14 | Nov-14 | Dec-14 | Jan-15 |
|--|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| Average private earnings (yoy, %) | 2.0 | 2.2 | 2.5 | 1.3 | 1.9 | 1.8 | 2.2 | 2.3 | 2.1 | 2.0 | 2.4 | 2.2 | 2.3 | 2.6 | 2.4 | 2.8 | 2.8 |
| Conference Board consumer confidence (X) | 80.2 | 72.4 | 72.0 | 77.5 | 79.4 | 78.3 | 83.9 | 81.7 | 82.2 | 86.4 | 90.3 | 93.4 | 89.0 | 94.1 | 91 | 93.1 | 102.9 |
| Core PCE (yoy, %) | 1.3 | 1.3 | 1.3 | 1.3 | 1.2 | 1.2 | 1.3 | 1.4 | 1.5 | 1.5 | 1.5 | 1.5 | 1.5 | 1.5 | 1.4 | 1.3 | |
| Housing starts (SAAR, '000) | 863 | 936 | 1,105 | 1,034 | 897 | 928 | 950 | 1,063 | 984 | 909 | 1,098 | 963 | 1,028 | 1,092 | 1,043 | 1,089 | |
| Industrial production (yoy, %) | 3.4 | 3.6 | 3.2 | 3.3 | 2.9 | 3.2 | 3.6 | 3.9 | 4.3 | 4.5 | 5.1 | 4.4 | 4.5 | 4.4 | 5.2 | 4.9 | |
| ISM manufacturing (X) | 55.6 | 55.8 | 56.0 | 56.1 | 51.8 | 54.3 | 54.4 | 55.3 | 55.6 | 55.7 | 56.4 | 58.1 | 56.1 | 57.9 | 57.6 | 55.1 | 53.5 |
| ISM non-manufacturing (X) | 54.0 | 55.0 | 53.8 | 53.1 | 54.3 | 52.5 | 53.7 | 55.3 | 56.1 | 56.3 | 57.9 | 58.6 | 58.1 | 56.9 | 58.8 | 56.5 | 56.7 |
| Non-farm payrolls ('000) | 150 | 225 | 317 | 109 | 166 | 188 | 225 | 330 | 236 | 286 | 249 | 213 | 250 | 221 | 423 | 329 | 257 |
| Participation rate (%) | 63.2 | 62.8 | 63.0 | 62.8 | 63.0 | 63.0 | 63.2 | 62.8 | 62.8 | 62.8 | 62.9 | 62.8 | 62.7 | 62.8 | 62.9 | 62.7 | 62.9 |
| Personal savings rate (% of disposable income) | 5.2 | 4.7 | 4.3 | 4.1 | 4.9 | 5.0 | 4.8 | 5.0 | 5.1 | 5.1 | 5.0 | 4.7 | 4.5 | 4.5 | 4.3 | 4.9 | |
| Retail sales excl. automobiles (yoy, 3MMA, %) | 3.3 | 2.6 | 2.2 | 2.3 | 2.0 | 1.5 | 1.3 | 2.0 | 2.9 | 3.3 | 3.1 | 3.2 | 3.0 | 3.0 | 3.0 | 2.3 | |
| S&P house price index (yoy, %) | 13.3 | 13.6 | 13.8 | 13.4 | 13.2 | 12.9 | 12.4 | 10.8 | 9.3 | 8.1 | 6.8 | 5.6 | 4.83 | 4.49 | 4.33 | | |
| Unemployment rate (%) | 7.2 | 7.2 | 7.0 | 6.7 | 6.6 | 6.7 | 6.7 | 6.3 | 6.3 | 6.1 | 6.2 | 6.1 | 5.9 | 5.7 | 5.8 | 5.6 | 5.7 |
| Quarterly indicators | Mar-13 | Jun-13 | Sep-13 | Dec-13 | Mar-14 | Jun-14 | Sep-14 | Dec-14 | | | | | | | | | |
| CAD/GDP (%) | (2.7) | (2.6) | (2.5) | (2.3) | (2.3) | (2.3) | (2.2) | | | | | | | | | | |
| GFD/GDP (%) | (5.5) | (4.2) | (4.0) | (3.3) | (2.9) | (3.1) | (2.8) | | | | | | | | | | |
| Real GDP (SAAR, qoq, %) | 2.7 | 1.8 | 4.5 | 3.5 | (2.1) | 4.6 | 5.0 | 2.6 | | | | | | | | | |

Source: Bloomberg, CIEC Kotak Institutional Equities

Model Portfolio: Minor changes

Exhibit 42 is our revised Model Portfolio. We have added 200 bps to ITC (500 bps now versus 300 bps weight earlier) at the expense of Wipro (200 bps now versus 400 bps weight earlier). We have also redistributed weights between Infosys and TCS, reducing the former by 100 bps and increasing the latter by 100 bps.

Exhibit 42: Quality stocks dominate our Model Portfolio
KIE Model Portfolio

| Company | Price (Rs) 16-Feb-15 | Rating | KIE weight (%) |
|-------------------------------|-------------------------|--------|-------------------|
| Automobiles | | | |
| Apollo Tyres | 187 | BUY | 2.0 |
| Hero Motocorp | 2,805 | BUY | 2.0 |
| Mahindra & Mahindra | 1,210 | ADD | 2.0 |
| Maruti Suzuki | 3,572 | BUY | 3.0 |
| Tata Motors | 574 | BUY | 6.0 |
| Automobiles | | | 15.0 |
| Pvt. Banking/Financing | | | |
| Axis Bank | 570 | ADD | 6.0 |
| HDFC | 1,288 | ADD | 7.0 |
| HDFC Bank | 1,068 | ADD | 10.0 |
| Federal Bank | 139 | BUY | 2.0 |
| ICICI Bank | 338 | BUY | 10.0 |
| LIC Housing Finance | 463 | ADD | 2.0 |
| Pvt. Banking/Financing | | | 37.0 |
| Consumers | | | |
| Britannia Industries | 2,034 | ADD | 2.0 |
| Dabur India | 267 | ADD | 2.0 |
| ITC | 390 | ADD | 5.0 |
| Marico | 353 | ADD | 2.0 |
| Consumers | | | 11.0 |

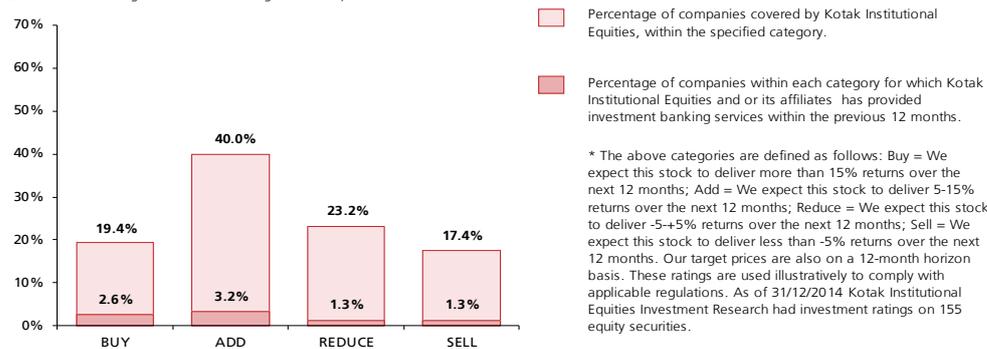
| Company | Price (Rs) 16-Feb-15 | Rating | KIE weight (%) |
|---------------------------------|-------------------------|--------|-------------------|
| Energy | | | |
| Bharat Petroleum | 726 | BUY | 2.0 |
| Petronet LNG | 183 | ADD | 2.0 |
| Reliance Industries | 903 | ADD | 5.0 |
| Energy | | | 9.0 |
| Industrials/Construction | | | |
| Crompton Greaves | 172 | BUY | 2.0 |
| Larsen & Toubro | 1,648 | ADD | 2.0 |
| Industrials/Construction | | | 4.0 |
| Pharmaceuticals | | | |
| Cipla | 672 | BUY | 3.0 |
| Lupin | 1,662 | BUY | 2.0 |
| Pharmaceuticals | | | 5.0 |
| Technology | | | |
| Infosys | 2,279 | ADD | 9.0 |
| TCS | 2,585 | ADD | 5.0 |
| Tech Mahindra | 2,900 | ADD | 3.0 |
| Wipro | 662 | ADD | 2.0 |
| Technology | | | 19.0 |
| BSE-30 | | | 100.0 |

Source: Kotak Institutional Equities estimates

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Kotak Institutional Equities Research coverage universe

Distribution of ratings/investment banking relationships



Source: Kotak Institutional Equities

As of December 31, 2014

Ratings and other definitions/identifiers

Definitions of ratings

BUY. We expect this stock to deliver more than 15% returns over the next 12 months.

ADD. We expect this stock to deliver 5-15% returns over the next 12 months.

REDUCE. We expect this stock to deliver -5 to +5% returns over the next 12 months.

SELL. We expect this stock to deliver <-5% returns over the next 12 months.

Our target prices are also on a 12-month horizon basis.

Other definitions

Coverage view. The coverage view represents each analyst's overall fundamental outlook on the Sector. The coverage view will consist of one of the following designations: Attractive, Neutral, Cautious.

Other ratings/identifiers

NR = Not Rated. The investment rating and target price, if any, have been suspended temporarily. Such suspension is in compliance with applicable regulation(s) and/or Kotak Securities policies in circumstances when Kotak Securities or its affiliates is acting in an advisory capacity in a merger or strategic transaction involving this company and in certain other circumstances.

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Corporate Office

Kotak Securities Ltd.
27 BKC, Plot No. C-27, "G Block"
Bandra Kurla Complex, Bandra (E)
Mumbai 400 051, India
Tel: +91-22-43360000

Kotak Mahindra (UK) Ltd
8th Floor, Portsoken House
155-157 Minories
London EC3N 1LS
Tel: +44-20-7977-6900

Overseas Offices

Kotak Mahindra Inc
50 Main Street, Ste. 890
Westchester Financial Centre
White Plains, New York 10606
Tel: +1-914-997-6120

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Kotak Securities Limited. Registered Office: 27 BKC, C 27, G Block, Bandra Kurla Complex, Bandra (E), Mumbai 400051. CIN: U99999MH1994PLC134051, Telephone No.: +22 43360000, Fax No.: +22 67132430. Website: www.kotak.com. SEBI Registration No: NSE INB/INF/INE 230808130, BSE INB 010808153/INF 011133230, OTC/INB 200808136, MCX/SX INE 260808130/INB 260808135/INF 260808135, AMFI ARN 0164 and PMS INP00000258. NSDL: IN-DP-NSDL-23-97. CDSL: IN-DP-CDSL-158-2001. Compliance Officer Details: Mr. Sandeep Chordia. Call: 022- 6605 6825 or Email: sandeep.chordia@kotak.com