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### Potential Mid-Cap Winners

Name	M/Cap (Rs bn)
JK Lakshmi Cement	18
Texamco Rail	18
Titagrah Wagon	4
AIA Eng.	55
Dewan Housing	39
Astra Microwave	7
Elecon Eng.	5
Kolte Patil	8
Eigi Equip.	17
Bajaj Electricals	32
GATI	8
Finolex Cables	25

Source: PL Research

### Nifty look set to go to 9000 levels in the next 18 - 24 months

Our EPS estimates for the Nifty for FY15 is at Rs461.5. The Nifty at 7,264, trades at a PER of 15.7x FY15 earnings. The long term average of the market has been around 14.7x and we are just at a marginal premium to the market and as we see earnings get revised upwards, the valuations will become cheaper. We also believe that with a strong government, we are likely to see the trading range for the market move upwards from the current estimate of 6500-7500 to between 6800-7800 levels in the near term and to a level of around 9000 over the next 18-24 months. Though we expect investors to wait for the budget to see the policies being followed before the next level of investments and if the new government takes the necessary fiscal steps to ensure the fiscal discipline, then we could be in for a prolonged period of strong economic as well as stock market performance. This means that investors need to stay invested in the near term and we are likely to see significant market appreciation over the next few years. However, given the volatility in the market, it is possible that the market will have bouts of ups and downs and we advise investors to buy into every correction in the market as we believe that the resurgent structural story is yet to begin.

	Weight-age (%)	FY13	FY14E	FY15E	FY16E
<b>Banking &amp; Fin.</b>	<b>28.7%</b>				
PER (x)		16.9	16.6	14.2	11.7
PAT Growth (%)		15.0	1.8	16.5	21.9
<b>Technology</b>	<b>14.9%</b>				
PER (x)		25.2	19.2	16.7	14.9
PAT Growth (%)		24.3	30.9	15.4	12.2
<b>FMCG</b>	<b>11.7%</b>				
PER (x)		42.5	36.4	30.6	25.8
PAT Growth (%)		18.5	16.7	18.9	18.9
<b>Oil &amp; Gas</b>	<b>12.4%</b>				
PER (x)		13.2	12.1	10.8	9.6
PAT Growth (%)		3.9	9.0	12.1	11.9
<b>Auto</b>	<b>8.9%</b>				
PER (x)		18.1	14.0	12.1	10.7
PAT Growth (%)		(10.2)	29.9	15.6	13.3
<b>Eng. &amp; Power</b>	<b>8.6%</b>				
PER (x)		13.7	15.7	15.8	14.3
PAT Growth (%)		19.5	(12.5)	(0.5)	10.3
<b>Pharma</b>	<b>4.9%</b>				
PER (x)		29.9	22.2	21.2	18.7
PAT Growth (%)		1.6	34.6	4.7	13.5
<b>Metals</b>	<b>4.9%</b>				
PER (x)		13.2	12.0	10.4	9.9
PAT Growth (%)		(2.1)	10.2	15.3	5.5

	Weight-age (%)	FY13	FY14E	FY15E	FY16E
<b>Cement</b>	<b>3.1%</b>				
PER (x)		19.4	23.0	22.1	18.0
PAT Growth (%)		29.2	(15.6)	4.1	23.1
<b>Telecom</b>	<b>1.6%</b>				
PER (x)		58.1	47.7	24.8	19.0
PAT Growth (%)		(46.6)	21.8	92.1	30.9
<b>Real Estate</b>	<b>0.3%</b>				
PER (x)		42.5	40.1	26.8	19.0
PAT Growth (%)		(40.7)	5.8	49.7	41.4

<b>Nifty as on May 19</b>	<b>7,264</b>				
EPS (Rs) - Free Float		355.7	403.9	461.5	534.0
Growth (%)		1.3	13.5	14.3	15.7
PER (x)		20.4	18.0	15.7	13.6
<b>EPS (Rs) - Free Float</b>					
Nifty Cons.		355.7	427.7	479.5	554.2
Var. (PLe v/s Cons.) (%)		-	(5.6)	(3.7)	(3.7)
<b>Sensex as on May 19</b>	<b>24,363</b>				
EPS (Rs) - Free Float		1,126.0	1,282.2	1,463.7	1,682.4
Growth (%)		(1.8)	13.9	14.2	14.9
PER (x)		21.6	19.0	16.6	14.5
<b>Sensex Cons.</b>		1,126.0	1,352.3	1,503.3	1,738.7
Var. (PLe v/s Cons.) (%)		-	(5.2)	(2.6)	(3.2)

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## Where should the investments be?

In continuation to our note dated May 16, 2014 on the elections, in this report, we have a look at our top picks and are reiterating our sector preferences as in our report dated May 13, 2014. With the Indian electorate giving a thumping victory to the NDA in the General election, the markets have been on a roll. We believe that this growth in the markets is only a precursor to the growth in the economy and both the economy and the market will be in a fast forward mode over the next 18-24 months. Currently it is only the market which has been on a fast forward mode, as the growth tends to be back ended. 335 seats for the NDA have virtually ensured that the NDA can have a strong government at the centre without any support from any post poll alliances. We believe that this has given good opportunity for the NDA to have a free run in terms of implementing the policies that they have and what they want to implement. The expectations from the NDA government run very high as reflected in the bullish sentiments' ever since the results were declared. We continue to believe that this will result in upgrades in GDP estimates for FY15 and through to FY16 and FY17, followed by upgrades in earnings for corporate. This also should result in turnaround for the fortunes of the banking industry as generally any economic improvements and growth are followed by a reduction in the non performing assets. In the near term, we are likely to witness strong inflows and should the fiscal discipline get improved, this will also result in a strengthening of the INR. This is definitely not good news for IT and Pharma companies focussed on exports. Hence we continue to recommend underweight in both IT and Pharma sectors. Our new sector weights are as below.

### Exhibit 1: Nifty Weightages

Sector	Rating	Current Weightages	Recommended Weightages
BFSI	Over Weight	28.7%	33.0%
IT	Under Weight	14.9%	10.0%
FMCG	Under Weight	11.7%	10.0%
Oil & Gas	Over Weight	12.4%	13.0%
Auto	Over Weight	8.9%	10.0%
Eng. & Power	Over Weight	8.6%	11.7%
Pharma	Under Weight	4.9%	2.0%
Metals	Neutral	4.9%	4.9%
Cement	Over Weight	3.1%	3.5%
Telecom	Neutral	1.6%	1.6%
Real Estate	Neutral	0.3%	0.3%
<b>Total</b>		<b>100.0%</b>	<b>100.0%</b>

Source: PL Research

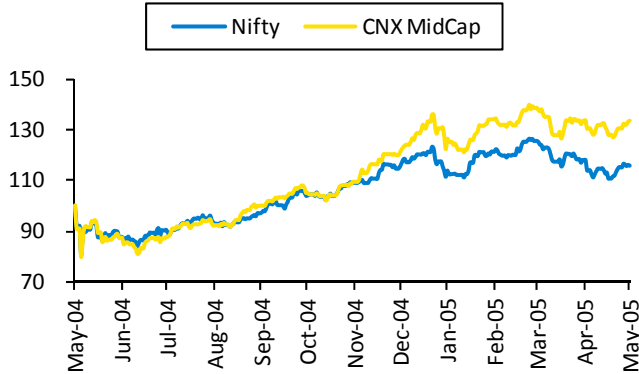
Based on the above thought process, we have removed Infosys and Britannia from the top picks and have added increased weight to Banking, Automobiles, and Engineering & Capital Goods while reducing the weight of FMCG to reflect the possible contraction in the PERs.

Anecdotal evidence in the behaviour of the markets point out two extremes. Once a bull market rally begins, the defensives which have had a PER expansion earlier due to underperformance of the cyclical will see an immediate contraction in PERs. This story will get repeated here again and we are likely to see this affecting IT, Pharma and FMCGs which have been the beneficiaries of this trend earlier. On the contrary, the sectors which have been bearing the brunt of the slowdown in the economy, i.e. Capital goods, Banking, EPC, Cement etc will see a significant re rating in the near term, both in valuations as well as earnings quicker than the defensives.

### Where one should invest, mid caps for now but stay with quality

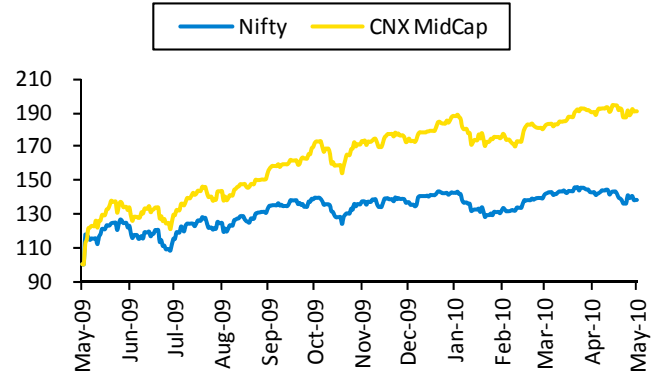
After any election, if the sentiments turn out to be good, it is the small and mid caps which tend to outperform the large caps in the near to medium term and we do believe that the same pattern will be followed this time as well. In our note dated May 13, 2014, we had recommended investors to remain underweight in defensive sectors like IT and Pharma and FMCG while remaining overweight in Financials, automobiles, capital goods and materials. We reiterate the view mentioned on May 13, 2014. We also believe that investors need to more look into many of the mid cap stocks within these sectors as we expect to see a valuation expansion for the mid caps in these sectors as these sectors are going to be the biggest beneficiary of a economic growth.

**Exhibit 2: 1yr. Performance after the Election Results 2004**



Source: Bloomberg, PL Research

**Exhibit 3: 1yr. Performance after the Election Results 2009**



Source: Bloomberg, PL Research

Investing in mid caps is prone to disaster at times, especially in a period of low economic growth as they suffer from poor liquidity, inability to raise capital if they are in cash crunch when the cycle turns for the worse and resulting increased leverage leading to lower growth in earnings. All these tend to change when the economy turns for the better. Among our universe of coverage, though we do have a preference for the private sector banks Vs the PSU banks, given the growth prospects of the economy and the low valuations of the PSU banks and some of the private sector banks and financial institutions; we have become structurally bullish on the financials. We continue recommend an overweight in financials. We also believe that the economic growth will result in better times for consumption related themes and automobiles, capital goods and materials. We also recommend an overweight in these sectors.

The recent rally has also resulted in some of the highly leveraged mid cap stocks being in the limelight and the run up in some of these stocks have been very high. While on a broader basis we continue to remain optimistic on the market, the recent irrational price movements in some of the leveraged mid cap stocks warrant to exercise caution. We advise investors to stay with quality.

We expect the global growth and liquidity to remain robust in CY14 and extend to CY15 as well resulting in a significant increase in institutional investor's inflow into Indian markets over the next few months resulting in a strong Rupee. This may not be good news for the IT, generic pharma companies focussed on exports and hence we continue to recommend an underweight position in these sectors as the performance of these sectors are more tuned in for the global and US performance rather than any domestic related story. In FMCG, we have historically seen a near term PER contraction as the cyclical end up with a superior growth. Reflecting this thought process we have removed Infosys, Britannia and NIIT Tech from our top picks, while reducing the weight of IT, Pharma and FMCG.

## Sectoral Performances

**Exhibit 4: Sectoral Performances**

Sector	1 Month	3 Month	6 Month	12 Months
Bank	19.3	43.7	36.3	14.5
Auto	6.6	19.5	20.1	32.4
FMCG	(3.3)	6.9	3.9	2.3
Energy	17.4	33.5	27.6	21.7
Finance	16.0	35.7	30.6	12.6
Infrastructure	15.4	34.6	27.9	20.2
IT	(7.6)	(13.6)	(3.7)	37.0
Media	3.1	9.1	3.3	1.9
Metal	14.2	31.2	27.0	31.8
MNC	3.0	15.1	14.4	13.5
Pharma	(6.5)	(5.9)	(1.0)	7.9
Public Sector Enterprises	24.6	40.4	39.4	19.8
PSU Banks	26.9	71.3	43.7	5.1
Real Estate	13.1	40.3	24.8	(16.1)
Service	7.9	16.1	16.0	16.8
<b>NIFTY</b>	<b>7.0</b>	<b>17.9</b>	<b>17.0</b>	<b>17.3</b>
<b>SENSEX</b>	<b>7.3</b>	<b>17.2</b>	<b>16.2</b>	<b>19.7</b>
<b>BSE Midcap</b>	<b>8.6</b>	<b>25.0</b>	<b>27.7</b>	<b>20.5</b>

Source: Bloomberg, PL Research

The sectoral performances are also reflecting our sectoral preferences. Both the IT and Pharma stocks continue to underperform and we also their underperformance extending to absolute levels as well. Our inference has been that the investors are selling these sectors in anticipation of the impact a strong INR can have on these sectors in the near term and buying into those cyclical including the Financials where the anticipated growth story should play out and result in an out performance over the next 24 months.

The FMCG sector has also underperformed in the near term. However, given the potentials of the sector and the opportunity that exists, with an increase in consumption, we expect this sector also to perform over a longer term, though not in the immediate term. Hence we recommend an underweight in FMCG and we remove Britannia from our top picks.

We believe that this will tend to take the market into a new trading range and this will have a potential to take it into structural Bull Run extending over the next few years. Our current overweight is Financials, Capital Goods, Materials and Automobiles.

We have had a look at number of mid cap stocks which could turn out to be good investment bets over the next 18-24 months. Though we do not have active coverage in the below mentioned mid cap stocks, we have a soft coverage. These stocks could turn out to be Midcap winners over the next 24 months as these stocks had suffered in the last five years due to a combination of domestic slow down and mid cap value contraction: **JK Lakshmi Cement, Texmaco, Titagarh Rail, AIA Engineering, Dewan Housing Finance, Astra Microwave, Elecon Engineering, Gati, Finolex Cables and Bajaj Electricals** are some of the companies which we believe have great potential to give handsome returns.

**Exhibit 5: Top Picks**

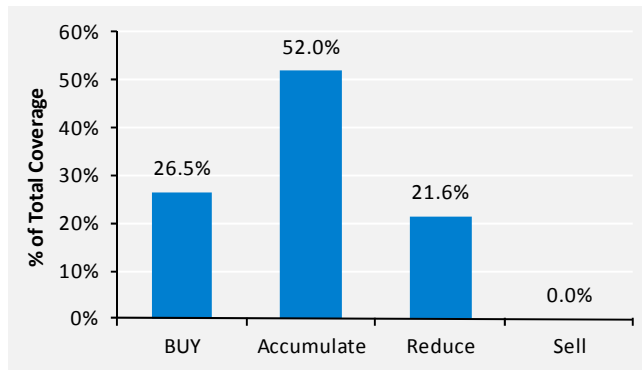
	CMP (Rs)	M/Cap (Rs bn)	Comments
<b>Large Cap</b>			
ITC	338	2,695.3	Strong growth in cigarette business. Economic revival should boost hotel profitability
HDFC Bank	812	1,947.8	Best banking stock in the industry with low NPAs. Should benefit with excellent growth.
State Bank of India	2,568	1,917.2	Largest PSU bank with low valuations. Should see the valuation differential with private sector banks narrow
Larsen & Toubro	1,525	1,400.3	Biggest beneficiary of economic growth. Though stretched valuations, favourable outlook
Wipro	482	1,187.3	Strong order inflow and low relative valuation
Axis Bank	1,860	873.7	Strong growth with quality in earnings. Re rating to continue
Maruti Suzuki	2,215	669.0	Best play on the revival of the car market in India
NMDC	169	671.0	Most efficient and the largest iron ore producer in India
Dr.Reddy's Laboratories	2,286	388.9	Ideally positioned and the best play on global generics
Hero Motocorp	2,448	488.9	Continued market share gains and benefits of cost reduction to kick in
Zee Entertainment Enterprises	273	260.2	Shifting business model from cyclical to annuity and full benefit to kick in on digitization
ACC	1,442	271.1	Biggest beneficiary of increase in capacity utilisation and cement prices across India
Motherson Sumi Systems	260	229.0	Excellent ROE and high growth to result in further re rating
Aurobindo Pharma	600	174.7	Re rating steam still left on product launches
<b>Mid Caps</b>			
Shriram Transport Finance	912	207.0	Best NBFC in the second hand vehicle market. Should see AUM and asset quality improve in H2FY15
Pidilite Industries	322	165.0	The industrial chemical business should see a significant improvement
UPL	306	131.3	Global growth, reducing debt and improving profitability to drive growth
ING Vysya Bank	641	121.2	Cleaned up balance sheet with stable asset quality. Should see a re-rating
Crompton Greaves	195	125.0	Improving margin profile, reducing losses in global subsidiaries, and positive order book
Thermax	853	101.7	Working towards a US\$2bn turnover in the next 4-5 years
Federal Bank	115	98.3	Well positioned and a dynamic management with cheap valuations
MindTree	1,335	55.7	Strong operational performance to continue
Balkrishna Industries	562	54.4	Strong export business and benefit of capacity addition to kick in
P.I. Industries	271	36.6	Custom synthesis order book visibility for the next 2-2.5 years

Source: Company Data, Bloomberg, PL Research



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<b>BUY</b>	: Over 15% Outperformance to Sensex over 12-months	<b>Accumulate</b>	: Outperformance to Sensex over 12-months
<b>Reduce</b>	: Underperformance to Sensex over 12-months	<b>Sell</b>	: Over 15% underperformance to Sensex over 12-months
<b>Trading Buy</b>	: Over 10% absolute upside in 1-month	<b>Trading Sell</b>	: Over 10% absolute decline in 1-month
<b>Not Rated (NR)</b>	: No specific call on the stock	<b>Under Review (UR)</b>	: Rating likely to change shortly

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