Market Strategy 2015

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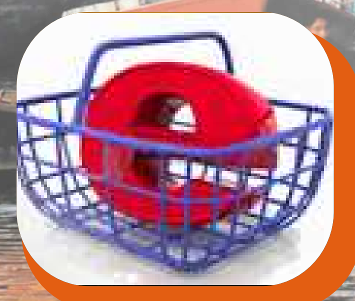
Growth nourishment to resurrect economy...



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Equity markets, having appreciated 29% this year, have been running ahead of an economic recovery, which is expected to follow with a lag. The government has already initiated several confidence building measures and taken key decisions like allowing FDI in several sectors, railway fare hike, online environment & forest clearance, etc. However, an economic recovery is expected only at a gradual pace. After trading around 14x one year forward EPS for most of the last five years, the Sensex is now trading at 14.6x one year forward EPS (FY16E).

We have already witnessed a bottoming out of the economic growth cycle, which coupled with a reduction in crude and other commodity prices has aided lower inflation. This has also led to hopes of a rate cut in the first half of next year. India is entering a new phase of economic growth that would be characterised by a multi-year bull run. In this backdrop, we expect four major themes to play out, which will last for the foreseeable future.

Consumption growth: With a revival in macroeconomic & per capita income growth, lifestyle based consumption sectors would be direct beneficiaries. While consumption expenditure has always been the driver of Indian economic growth, the pace and size of consumption spends is expected to multiply manifold. With favourable demographics and the largest working age population, India is set to have largest middle class by 2050, contributing 32% of global middle class spending. On the one hand, with more people crossing the poverty line, overall consumption is expected to increase while on the other, with rising income level, several households would move up the value chain resulting in premiumisation. Consumption spending is expected to cross $3.2 trillion by 2025, 3x of US$991 billion in 2010. Consumption driven sectors like branded apparel, communication, healthcare, housing, consumer durables, FMCG and automobile would stand out and exhibit accelerated growth in years to come.

Lower cost of capital: Secondly, with an improvement in medium term economic outlook that would warrant higher foreign inflows in sovereign and corporate debt, cost of capital would gradually come down. In addition, a structural shift in retail inflation by almost 400 bps from double digit to expected sustainable 6% levels is a marked improvement leading to positive real interest rates, which may prompt the RBI to cut interest rates by 75-100 bps in the next calendar year. Both these measures would facilitate capital investments, which would drive growth and enhance profitability. This, in turn, would be reflected through expansion in valuation multiples. Our analysis suggests that sectors like auto ancillaries, capital goods, cement, ceramic products, logistics, packaging and plastic products would be key beneficiaries of lower cost of capital and may witness a multiple expansion.

Softening commodity prices: Thirdly, global commodity prices have corrected significantly led by a demand-supply mismatch as global supply continued to increase while demand from the largest consumer, China, tapered down. Going ahead, a commodity slowdown is expected to sustain led by excess supply in the medium-term and a shift towards renewable energy sources in the long run. In the backdrop, sectors like aviation, paints, textiles, auto ancillaries (tyre and battery), logistics, telecom, lubricants and mining could be major beneficiaries.

Favourable regulatory framework: Finally, the new government has been effective in breaking the policy deadlock with several decisions on key policies like increase in FDI limit in insurance, defence & Railway, easing of environment & forest clearance process, etc. already being taken. Moreover, there has been considerable progress in other key reforms like implementation of GST and innovative measures like “Make in India”, “Digital India” and “Smart cities”. These measures will improve business sentiments, provide policy stability and an impetus to a revival in capex cycle. Stalled projects worth ₹ 25 lakh crore could be kick started benefitting several sectors ranging from oil & gas, defence, banks, railways, metal & mining, telecom, construction and infrastructure.

Sensex target: Factoring in the fall in inflation, comfortable CAD, improved sentiments and pick-up in GDP growth, we expect the Sensex EPS to grow at a CAGR of 17% over FY14-17E. A decline in cost of equity coupled with a dovish environment will further fuel portfolio flows for India in equities as well as debt instruments. The Sensex is trading at 15x one year forward P/E multiple(FY16E), in line with historical mean. However given the resurrection of corporate earnings cycle, we believe there exists a case for a re-rating of the Indian markets. We assign a P/E multiple of 15x on FY17E EPS to arrive at a fair value of 32500 by end CY15, implying an upside of 18.6%. The corresponding Nifty target would be 9750.

Strategy 2015 - Sensex & Nifty Target	
Sensex EPS - FY17E	2167
Target Multiple	15x
Sensex / Nifty Target	32500 / 9750

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Risks: Though the markets seem to have shifted into an higher growth trajectory, we highlight certain pitfalls that may inhibit index expansion.

- Brent crude oil has fallen sharply by 47% YTD, and is trading below the fiscal break even price for most oil exporting countries. We have already witnessed the impact of crash in crude prices on Russian economy. With the fall in crude prices, sovereign credit default swaps (CDS) of many oil exporting countries has increased several times, highlighting the global risk perception. A global contagion could put investors in risk off mode, impacting global flows in emerging markets.
- While India would indirectly benefit from divergence of FII flows from such countries in favour of India and may not be directly adversely impacted with crash in crude prices, our exports could be hampered. 38% of our exports are to commodity based economies, which can face slower growth as economic variables deteriorate due to falling oil revenues.
- Risks will also emanate from the complexity of rate cycles panning out in various parts of globe. For instance, strong growth prospects for the US economy will lead to commencement of rate hike cycle in mid 2015 whereas ECB has to be more accommodative to stave of a deflationary trend in the Eurozone while India is all set to see the easing of rate cycles. The implications can be humongous and perplexing as interest rate decisions will have a meaningful impact on Indian rupee vis-à-vis other global currency and hence on GDP/corporate profitability in 2015.
- Finally, with formation of government with a strong mandate and reformist outlook, the investor expectations have built up over the period. While, the government has shown clear intent and has initiated several reforms, things are yet to start moving on the ground level. There is a huge risk of the current government falling short of meeting enormous expectations.

Sector Outlook

- Since we expect the economy and corporate profitability to make a meaningful comeback thereby making cyclical sectors the biggest beneficiary as pick up in utilisation rates, positive operating and financial leverage will lead to recovery in profitability and improve the quality of the balance sheet. Hence we are positive on sectors like banking (pick-up in loans, lower interest to cushion NIMs, lower bond yields to aid provisioning and NPA cycle peaking), cement (increase in capacity utilisation and lower input costs to aid profitability), capital goods (revival in capex cycle to lead to better orders and execution), autos & auto ancillaries (lower rates to boost pent up demand and lower commodity to help margin recovery)
- We are neutral on defensives like IT (demand intact, rich valuation), pharma (rich valuation, tepid domestic growth), oil & gas (earnings dependent on deregulation, limited volume growth) & media (earnings visibility intact, rich valuation)
- We remain negative on sectors like Real estate (High inventory and huge debt pile up and regulatory hurdles to weigh over positive like lower interest rates and pick up in demand), Metals(Lower realisations and levered balance sheets) and shipping (Highly dependent on global trade and demand for commodities)

Stock Picks for 2015

Company	CMP	Target Price	Upside
Credit Analysis & Research (CARE)	1418	2175	53%
Castrol India (CASIND)	501	611	22%
Container Corporation Of India (CONCOR)	1328	1670	26%
Gujarat Pipavav Port (GUJPPL)	191	221	16%
Heidelberg Cement (MYSCEM)	82	105	28%
Infosys Ltd (INFTEC)	1958	2400	23%
SKF India (SKFBEA)	1334	1568	18%
State Bank Of India (STABAN)	308	374	22%
UltraTech Cement (ULTCEM)	2645	3240	22%
Voltas Ltd (VOLTAS)	235	348	48%

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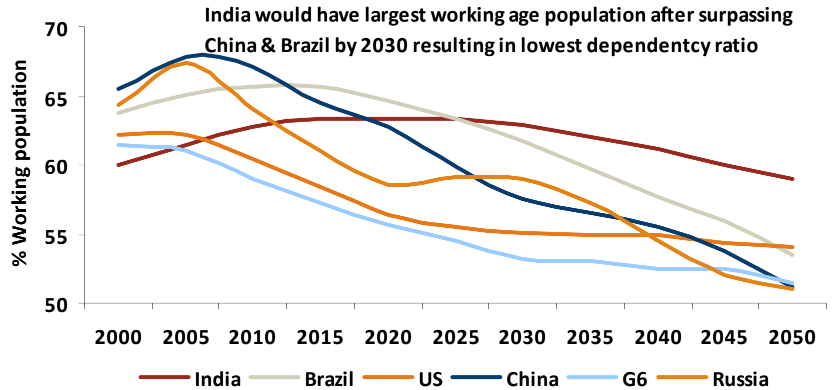
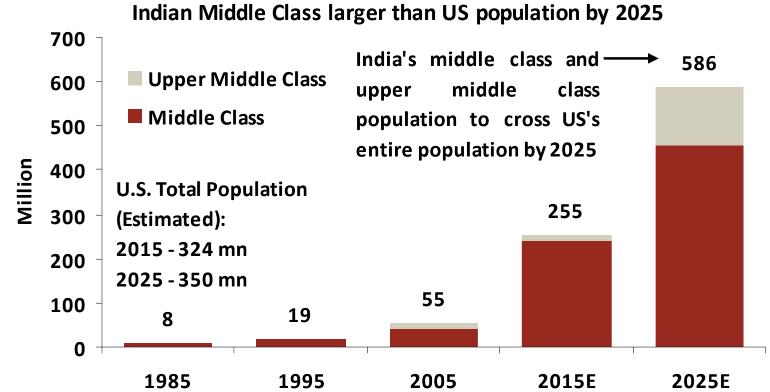
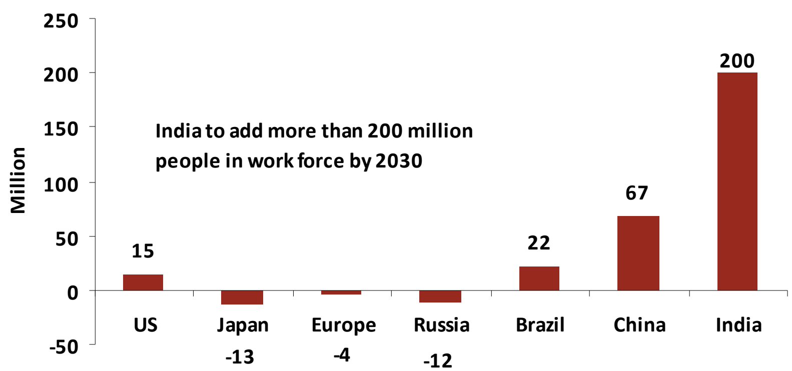
Theme 1 – Demand & Demography to boost consumption

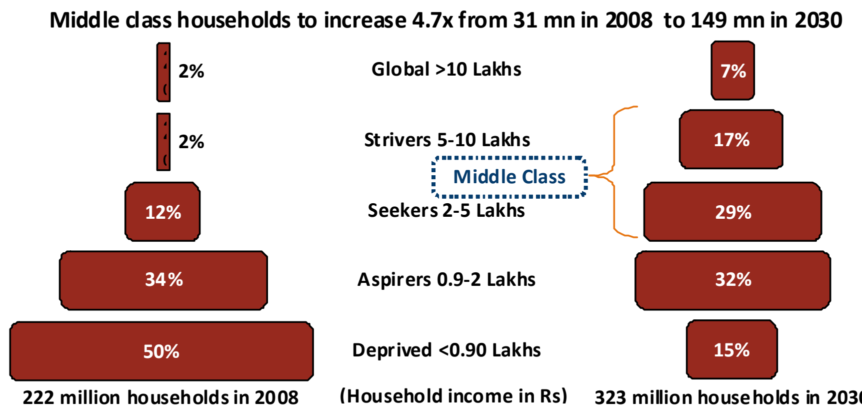
The Indian economy has always been differentiated with other emerging markets by virtue of its unparalleled domestic demand led by young population, rapidly growing middle class and rapid pace of urbanisation. These favourable demographics and rising aspirations to consume better & expensive would lead to premiumisation in the long run. A similar trend in China in the last decade has changed its position on the world map and now India is following suit.

- **Largest work force:** About 300 million people will join the global workforce by 2030, of which 200 million will be in India, which will have the largest workforce of ~1 billion by 2050. This will reduce India's dependency ratio in the country, thus increasing disposable income and fuelling consumption
- **Largest middle class:** By 2025, India's middle class would be ~59 crore larger than population of US and by 2030, India will have world's largest middle class





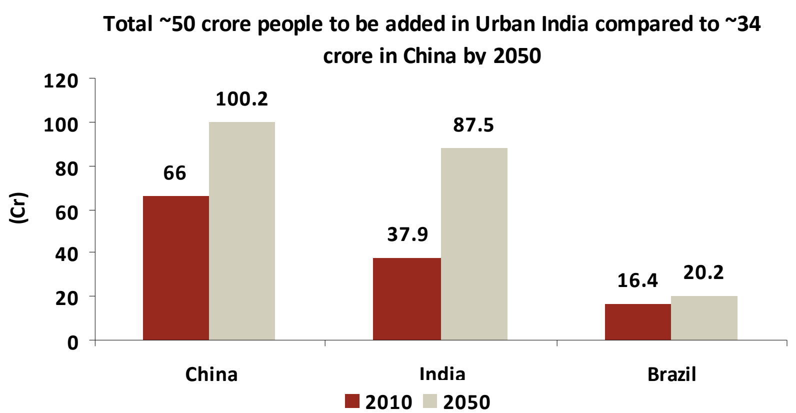


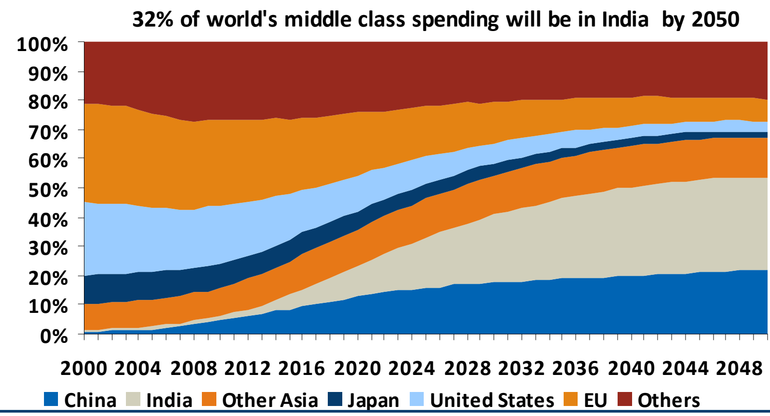


Source: GS (Working age population = share of population aged 15-60), McKinsey, Economic Intelligence Unit, Bloomberg, Reuters, ICICIdirect.com Research

Spurring urbanisation & middle class spending to help economy grow China's way

- **Rapid urbanisation:** Globally, city population generates 80% of world GDP. Within India, 31% of the population living in cities contributes 60% of GDP. It is expected to rise to 75% by 2030. Moreover, 50 crore people are expected to be added to Indian cities by 2050, further fuelling consumption
- **Highest spending by middle class:** 32% of global middle class consumption will originate in India, by 2050, far higher than China that will remain at 22%
- **India lags China by 10 years:** Indian macroeconomic parameters indicate that today it stands where China was 10 years ago. India's per capita income could grow 6x from current levels in next 10 years, if it follows China's growth pattern





Most economic parameters in India in 2013 similar to China in 2003

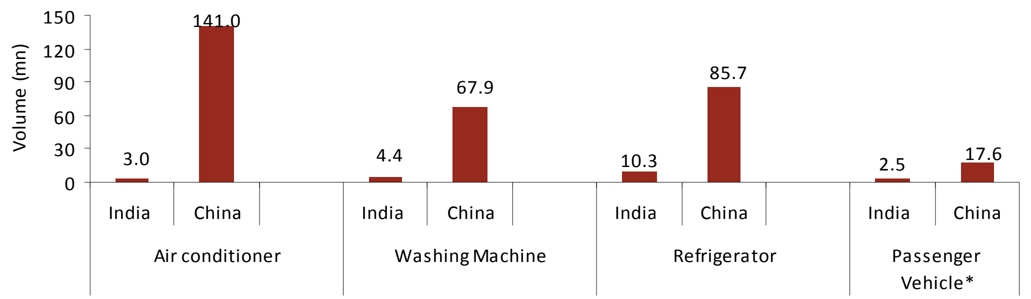
US $	India 2013	China 2003	China 2013
GDP Per Capita (Constant Price)	1,509.5	1,277.2	6,958.7
Per Capita Personal Disposable Income	1,118.0	600.3	3,054.9
Per Capit Private Consumption (US $)	775.8	465.3	1,867.6
Investment Per Capita (US $)	474.4	523.2	1,876.8
Median Age (Yrs)	27.0	31.0	37.0
Saving Rate (%)	30.1	43.8	49.5
Urban Population (%)	32.0	40.0	53.0
FDI Inflows (in US$ bn)	28.0	54.0	124.0

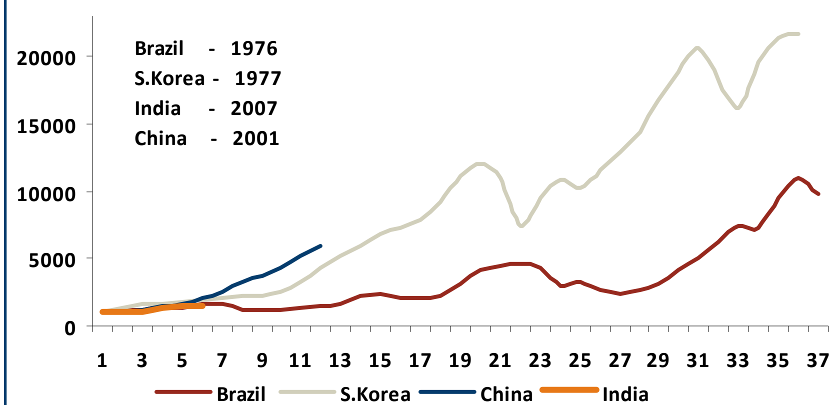
Source: United Nations, IMF, Federal Reserve, OECD, Economist Intelligence Unit, Bloomberg, Reuters, ICICIdirect.com Research

Juggernaut has started…to intensify further

- **India at inflection point:** The per capita income of China witnessed 6x growth post these economies reaching $1000 in per capita. India having crossed US$1000, is at such an inflection point. India's GDP would grow 15x by 2050 to $26.8 trillion, making it the third largest economy after China and the US
- **Consumption to grow over 3x by 2025:** India's consumption would cross $3.2 trillion by 2025, 3x its consumption in 2010 of US$991 billion
- **Medium-term consumption triggers :** 1) Seventh Pay Commission is expected to augment the income levels of ~31 lakh central government employees by nearly 2.5-3.0x, entailing an outlay of ~₹ 50000-60000 crore. 2) Jan Dhan Yojana: Addition of 10 crore new accounts, facilitating direct benefit transfer that would, in turn, boost consumption 3) 'Make In India' to spur share of manufacturing from 16% to 25% of GDP by 2022 by creating 10 crore additional jobs

Comparison between the consumption levels in India and China (FY14)





Per capita income of China & South Korea has grown 6x in 12 years since these economies touched US$1000 per capita. By crossing US$1000 per capita in 2007 coupled with favourable demographics, India is at an inflection point of income boom, which would fuel consumption

Domestic consumption to grow 3.2x to $3.2 trillion by 2025

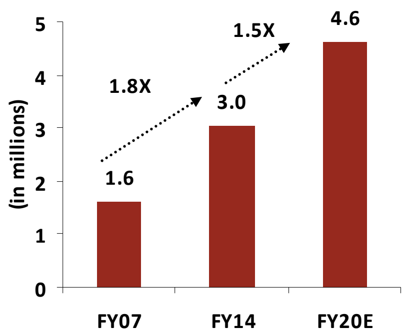
Segments	2005		2010		2025
TOTAL	511	1.9x	991	3.2x	3158
Food	212	1.6x	337	2.3x	774
Apparel	29	1.7x	50	3.2x	158
Housing	60	2.0x	119	2.5x	300
Transport	86	2.2x	188	3.3x	616
Comm.	10	2.9x	30	6.4x	189
Healthcare	35	2.6x	89	4.5x	403
Others	79	2.3x	178	4.0x	718

** Estimated figure of India and China for FY15 and CY14 respectively . Source: United Nations, PWC, BCG, Bloomberg, Reuters, ibisworld, statista, Euromonitor, ICICIdirect.com Research*

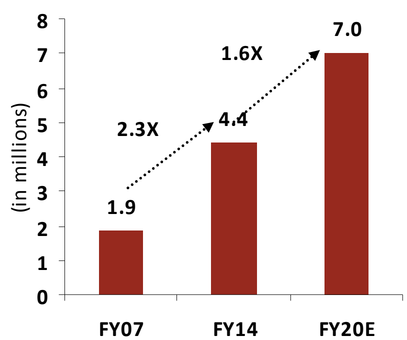
The next big thing is *'premiumisation'*

- With the increase in per capita income, upgradation from unbranded to branded products is imminent. We believe the wave of premiumisation will set in across all segments simultaneously
- Premiumisation is likely to augment demand for expensive, branded and un-penetrated products in the consumer space. We believe categories like passenger cars, smart phones, RACs, washing machines, branded appeals, packaged foods and skin care would be the biggest beneficiaries
- The first beneficiary of the rise in disposable income would be the consumer durables industry. We believe room air conditioners (RAC) & washing machines (WM) markets that are at penetration levels of ~4% & ~10% would grow to 1.5x and 1.6x, respectively by 2020

RAC industry to grow 1.5x by 2020



WM industry to grow 1.6x by 2020



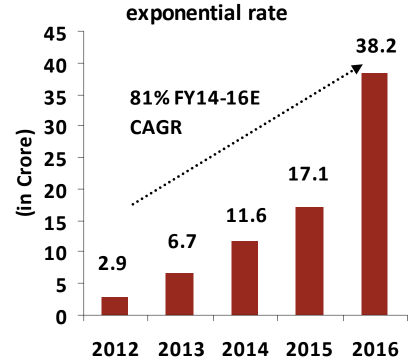
- Average price of top 5 cars sold in China is ₹ 11.4 lakh vs. ₹ 4.9 lakh in India. Considering the myriad similarities in the economies of India and China, we believe a tremendous opportunity for premium passenger car manufacturers exists in India. The trend has begun to take shape, evident from 22% growth in JLR volumes in India to 2913 in CY13

Average price of top 5 cars sold in China is about 2x of India

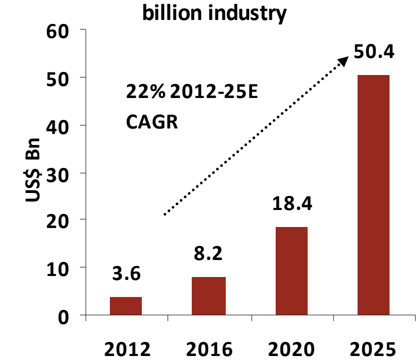
China Sales - CY13			India Sales - FY14		
Rank	Models	Units	Rank	Models	Units
1	VW Lavida Sedan	374,056	1	Suzuki Alto	258,281
2	Buick Excelle	296,183	2	Swift	198,571
3	VW Sagitar	271,188	3	Dzire	197,685
4	VW Jetta	263,408	4	Wagon R	158,954
5	Chevy Sail (Sedan)	263,163	5	Mahindra Bolero	107,181
Weighted Average sale price (Rs Lacs)		11.4	Weighted Average sale price (Rs Lacs)		4.9

- Given the exponential growth in smart phones and changing trends in distribution strategies like flash sale on e-commerce portals, smart phone user growth has already commenced and is expected to grow at 81% CAGR in FY14-16E. In the long term, India would mimic the smart phone penetration levels of Western countries that stand at 55-60% compared to 26% in India
- The deeper penetration of modern day trade and extensive use of e-commerce is expected to bolster growth in the branded apparel market in India, which is likely to grow at 22% CAGR in FY12-2025E. Page Industries has grown at a volume CAGR of 16.7% in FY12-14 to 10.2 crore units
- India's retail beauty and cosmetics industry, currently estimated at $950 million, is likely to treble to $2.68 billion by 2020

Smart phone users to grow at exponential rate



Branded apparel to be a $50.4 billion industry



Source:, Carnewschina, Chinaautoweb, Autocar India, E-Marketer, Crisil, Bloomberg, Reuters, ICICIdirect.com Research

Increasing penetration, premiumisation impel consumer stocks

Sectors & Stock picks	
Sectors	**Preferred Stocks**
FMCG & Consumerables	Marico, Nestle, Pidilite Industries, Kansai Nerolac, Tata Global Beverages, United Spirits, United Breweries
Consumer Durable	Symphony, TTK Prestige, Havells
Auto	Maruti, Eicher Motors
Real Estate related	Oberoi Realty, Kajaria Ceramics
Media	PVR
Retail	Shoppers Stop, Bata, Page Industries, Titan
Healthcare	Apollo Hospital
Life Style	Talwalker Better Vaue

Source: ICICIdirect.com Research

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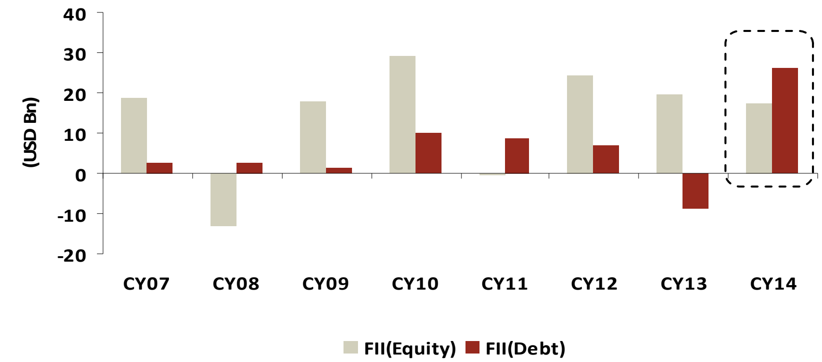
Theme 2 – Debt market to become vibrant, higher & stable debt inflows on

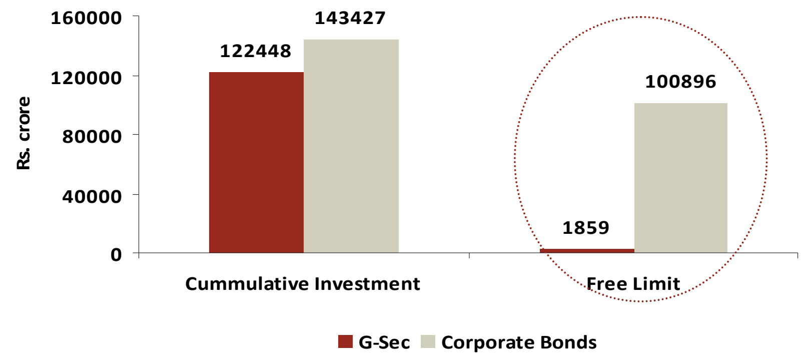
Consistent FII inflows in debt market on improved medium-term outlook may lead to lower yields on corporate bonds and, consequently, lower cost of funds

- The year 2014 witnessed record inflows from foreign institutional inflows in the debt market at ~ US$26 billion. It is only the second time that inflows in debt market have exceeded inflows in equity markets in any calendar year
- Relatively higher yield among global peers, along with stable currency and improved economic outlook and rating, may lead to higher inflows in corporate bonds as well, which have so far been predominantly in government securities only. As the visible medium-term positive outlook on equity markets results in consistent inflows, the structural positive outlook on debt markets is likely to lead to consistent FII inflows in the Indian debt market as well
- Higher rated companies (AAA/AA) are likely to receive the majority of the debt inflows initially due to better liquidity and lower credit risk. The same is already reflected in the record low spread of yield on AAA corporate bonds over G-Sec yield. The unused limit of 98% in corporate bonds offer scope of institutional money flowing towards it as G-Sec limit is almost exhausted
- We expect the government to initiate reform oriented measures to develop the Indian debt market, which will provide an additional source of funding for companies. Few of the measures already announced like allowing PFs, EPFO and insurance companies to invest more in corporate bonds with more flexibility of investment in sub AAA rated papers is in a similar direction
- Relatively better yielding corporate bonds and expectations of lower future retail inflation along with lower deposit rates will make corporate bonds (NCDs/corporate FDs) attractive for retail investors. At the same time, bank base rates may not come down significantly. Therefore, raising funds from the debt market may be cheaper for corporates, leading to improved supply in the market. The increased supply and demand in the corporate debt papers will aid in the development of the overall debt market in India

- Apart from CY11, when inflows into equity market was negative, 2014 witnessed higher FII inflows into the debt market compared to inflows in equities. Inflows in the debt market may be stable and consistent, going forward, due to a structural improvement in inflation and improving macroeconomic data



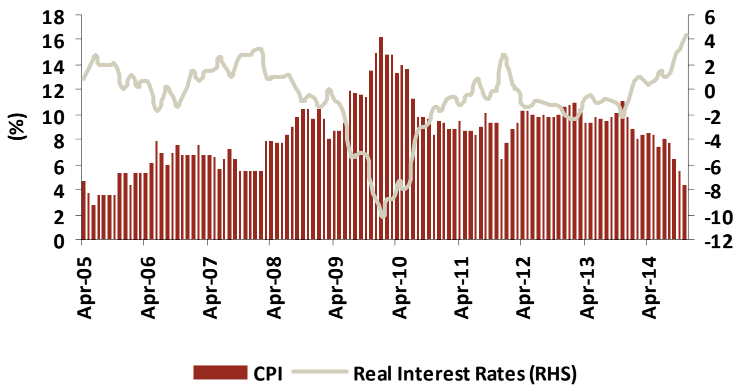
- With expectations of improving corporate health on improving economy and growth visibility, FII inflows in corporate bonds may accelerate



Source: SEBI, Bloomberg, ICICIdirect.com Research

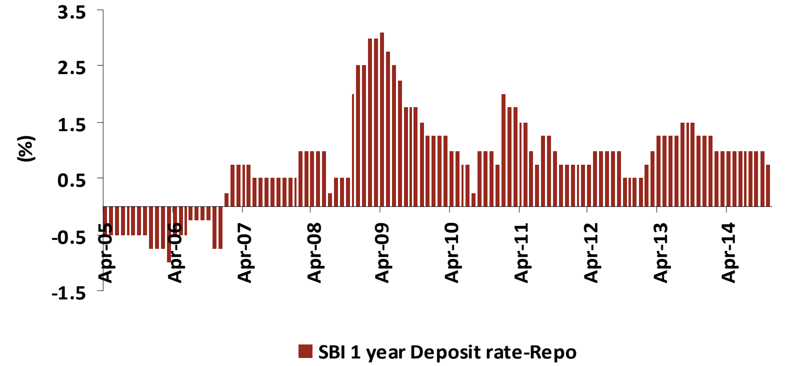
RBI to cut rates; cost of funds may come down by ~200 bps

- A structural shift in retail inflation by almost 400 bps from double digits to expected sustainable 6% levels is a marked improvement leading to positive real interest rates

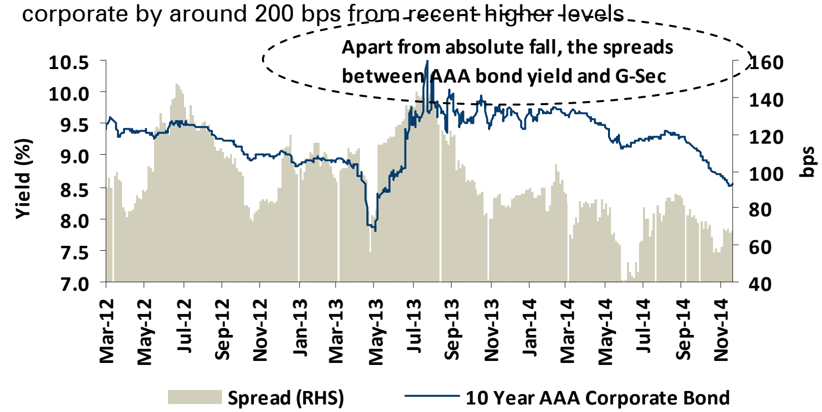


- Assuming the 6% CPI inflation target of the RBI is achieved and it remain around that level, it will provide the RBI much needed comfort in lowering the Repo rates by 75-100bps to 7.00-7.25% level
- Considering our estimate of Repo at 7.00% and assuming the repo and SBI deposit spread of 100 bps will lead to deposit rates of 8% . It will result in 2% real interest rates (deposit rate minus inflation), which we assume should be RBI's comfortable level. Therefore, expectation of a 75-100 bps rate cut looks reasonable in calendar year 2015

- Historical spread between SBI one year deposit rate over Repo rate is around 100bps



- The 10 year AAA corporate bond yield has come down from 9.7% to 8.5% (120 bps) on rate cut expectations. With expectations of 75-100 bps rate cut and resultant repo at around 7%, AAA corporate bond yield may further come down ~50 bps to 8% (historical spread of 100 bps over repo)
- The fall in corporate bond yield will domestic cost of funds of Indian corporate by around 200 bps from recent higher levels



Source: Bloomberg, Capitaline ,ICICIdirect.com Research

Scenario analysis: Increase in EV as cost of funds reduces

- The benchmark Sensex PE has on an average traded at a premium of 18% over the implied PE derived from G-Sec yield (1/yield)
- While the current premium of actual one year forward PE over implied PE (1/bond yield) is at its historical average of ~18%, the premium will decline to 11% if we consider the expected decline in 10 year G-Sec will fall to ~ 7.5%, given he improvement in macro variable persists . Therefore, it implies the attractiveness of the market despite the recent rally in the market in CY14

Implied PE still at historical averages - room for expansion remains

	Implied PE	Actual Forward PE	Premium
Sep-13	11.5	13.3	16%
Dec-14	12.5	14.8	18%
Expected(10 Year at 7.5%)	13.3	14.8	11%

- Furthermore, the above-mentioned actual market PE premium over implied G-Sec yield has historically expanded to 40-60% during the previous market rallies in 2007 and 2010. The same implies that the market premium is not yet peaked which can lead to further rerating of the markets in the medium to long term.

Bull Market Premium yet to be priced in !!!

	Implied PE	Actual Forward PE	Premium
Dec-07	12.7	20.1	58%
Oct-10	12.3	17.0	38%

- To analyse the potential increase in the enterprise value (EV) only due to a reduction in the cost of debt, going forward, we have used the Gordon growth model to discount the return on capital employed
- The sensitivity analysis of EV was then done with 50 bps, 100 bps, 200 and 300 bps change in WACC

Following are the primary assumptions/outcome of our analysis

- Assumed constant RoCE at 15% to understand the impact of a reduction in weighted average cost of capital
    - No change in capital mix
    - Long term growth at 4%
    - Debt component in EV remains constant
- The analysis shows that the EV increases by 29% if there is a 200 bps reduction in weighted average cost of funds signifying that the EV increases significantly with a decline in cost of capital

Lower Capital Cost to boost EV

Assumptions:	
Current ROCE	15%
Long Term Growth	4%

	Scenario 1	Scenario 2	Scenario 3	Scenario 4
Reduction in WACC(bps)	50	100	200	300
Increase in EV	6%	13%	29%	50%

Source: Bloomberg, ICICIdirect.com Research

Lower capital cost to trigger multiples expansions

A study of BSE 500 companies*

- We have conducted a study that aims to identify the sectors whose RoCE have declined given the adverse economic cycle and would now benefit given the consequent rate cut lowering the cost of capital
- The levered sectors have been the worst hit in terms of higher capital cost as the higher interest rate has had a dual effect in terms of both cost of debt as well as equity. With the tapering down of inflation, interest rates are expected to move into the benign territory, going ahead, benefiting the levered sectors
- For the same, BSE 500 companies (ex banks, NBFC and brokerages) were analysed to asses their WACC and ROCE (last four year's average – FY11-14)
- The companies were then segregated on the basis of their respective sectors
- We then conducted a sensitivity analysis of respective sector's WACC with every 50 bps reduction in the cost of debt to ascertain which sectors would turn EVA accretive on the back of lower cost of capital

The primary condition of assessment

- Average of last four years RoCE > FY14 RoCE
- The sectors whose RoCE would turn EVA accretive post the lower cost of capital
- Higher the difference, greater will be the stock returns when normalcy of earnings cycle resumes (pick-up in utilisation/lower input costs and lower financing costs to improve forward RoCE and valuations)
- We exclude sectors that are highly dependent on government regulations/policies
- The output reflects that sectors such as auto ancillaries, capital goods, cement, ceramic products, logistics, packaging and plastic products would be key beneficiaries of lower cost of capital that would trigger multiple expansions for these sectors
- Sectors like textiles and tyres are also included as their input costs leverage was visible from FY14 onwards, which was negative over FY12-13 and is likely to continue going into FY15-16

*Source: Capitaline, ICICIdirect.com Research, * Ex banks, NBFC and brokerages*

Lower capital cost to trigger multiples expansions

Output based on interest rate sensitivity with cost of capital	FY14 WACC	WACC in diff scenario -0.5%	-1.0%	-1.5%	-2.0%	ROCE (4 yr avg)	ROCE (FY14)
Agro Chemical	12.6	12.3	11.9	11.6	11.2	20.1	21.6
Alcoholic Beverages	13.3	13.1	13.0	12.8	12.6	5.1	-12.2
Auto Ancillaries	12.5	12.2	12.0	11.7	11.5	15.3	14.3
Automobile	12.5	12.2	11.9	11.7	11.4	19.7	17.8
Cables	12.7	12.5	12.3	12.2	12.0	8.6	6.3
Capital Goods Electrical Eq	12.8	12.5	12.1	11.8	11.5	17.9	8.7
Capital Goods-Non Elec.	13.2	13.0	12.7	12.5	12.3	14.7	12.8
Cement	12.6	12.3	11.9	11.6	11.2	15.0	11.8
Ceramic Products & Tiles	12.5	12.2	11.9	11.7	11.4	15.0	13.2
Chemicals	12.4	12.0	11.7	11.4	11.1	20.7	15.7
Construction	13.6	13.4	13.3	13.2	13.1	6.5	4.6
Consumer Durables	12.2	11.8	11.4	11.0	10.6	29.4	25.3
Crude Oil & Natural Gas	12.3	11.9	11.5	11.2	10.8	22.8	17.1
Gems and Jewellery	12.0	11.8	11.6	11.4	11.2	15.1	12.2
Diversified	13.4	13.2	13.0	12.9	12.7	6.2	7.4
Edible Oil	12.9	12.7	12.5	12.2	12.0	10.8	12.0
Entertainment	12.3	11.9	11.5	11.1	10.8	19.1	19.2
Fertilizers	13.0	12.8	12.5	12.3	12.1	12.8	7.6
FMCG	12.2	11.8	11.4	11.1	10.7	40.1	42.3
Gas Distribution	12.4	12.0	11.7	11.4	11.1	19.1	16.1
Glass & Glass Products	12.9	12.8	12.7	12.6	12.6	4.7	5.6
Healthcare	12.0	11.7	11.3	11.0	10.7	10.4	8.1
Hotels & Restaurants	12.9	12.6	12.3	12.1	11.8	4.1	1.3
Infrastructure Developers	13.6	13.5	13.4	13.2	13.1	6.7	6.6

Output based on interest rate sensitivity with cost of capital	FY14 WACC	WACC in diff scenario -0.5%	-1.0%	-1.5%	-2.0%	ROCE (4 yr avg)	ROCE (FY14)
IT - Hardware	12.0	11.7	11.4	11.1	10.8	14.8	14.3
IT - Software	12.0	11.5	11.1	10.6	10.1	31.0	34.5
Logistics	12.1	11.6	11.2	10.7	10.2	19.2	17.2
Media	12.3	11.9	11.6	11.2	10.9	20.5	22.1
Mining & Mineral products	12.7	12.4	12.0	11.7	11.4	35.8	21.0
Non Ferrous Metals	12.8	12.5	12.2	11.9	11.7	12.1	9.5
Packaging	12.4	12.2	11.9	11.6	11.3	14.8	8.8
Paints/Varnish	12.1	11.7	11.2	10.8	10.3	35.1	33.4
Paper	12.6	12.4	12.2	12.0	11.9	6.9	6.3
Pharmaceuticals	12.0	11.7	11.3	11.0	10.6	19.7	21.3
Plantation	12.4	12.0	11.7	11.4	11.1	19.7	14.9
Plastic products	12.5	12.2	11.9	11.7	11.4	12.6	11.7
Power	13.3	13.1	12.9	12.7	12.5	8.3	7.7
Realty	13.2	12.9	12.6	12.3	12.0	7.5	6.7
Refineries	12.5	12.3	12.1	11.8	11.6	9.5	9.7
Retail	12.6	12.4	12.2	12.0	11.8	9.8	7.4
Ship Building	13.5	13.4	13.2	13.1	13.0	8.0	5.3
Shipping	13.1	12.9	12.7	12.5	12.2	7.4	8.4
Steel	13.2	13.1	12.9	12.7	12.5	9.3	6.9
Sugar	13.6	13.5	13.4	13.3	13.2	6.1	-1.3
Telecomm-Service	13.2	13.0	12.7	12.5	12.3	7.0	8.3
Textiles	13.4	13.3	13.2	13.0	12.9	10.3	11.7
Tobacco Products	12.0	11.5	11.0	10.5	10.0	46.1	46.7
Trading	12.7	12.6	12.5	12.4	12.2	7.3	7.4
Tyres	12.4	12.2	11.9	11.6	11.3	17.9	22.7

Source: Capitaline, ICICIdirect.com Research

Lower capital cost to trigger multiples expansions

Sectors & Stock picks	
Sectors	**Preferred Stocks**
Auto Ancillaries	Wabco, Exide, Apollo Tyres, JK Tyres
Capital Goods	SKF Bearings, Greaves Cotton, Kalpatru Power
Cement	Heidelberg , Jk Cement, Mangalam
Ceramic Products & Tiles	Kajaria
Construction	Simplex, NCC
Media & Entertainmnet	PVR, TV Today
Hotels & Restaurants	Indian Hotels , EIH
Packaging	Essel Propack
Textiles	Siyaram Silk
Logistics	Concor, GDL, GPPL

*Source: Capitaline, ICICIdirect.com Research, * Ex banks, NBFC and brokerages*

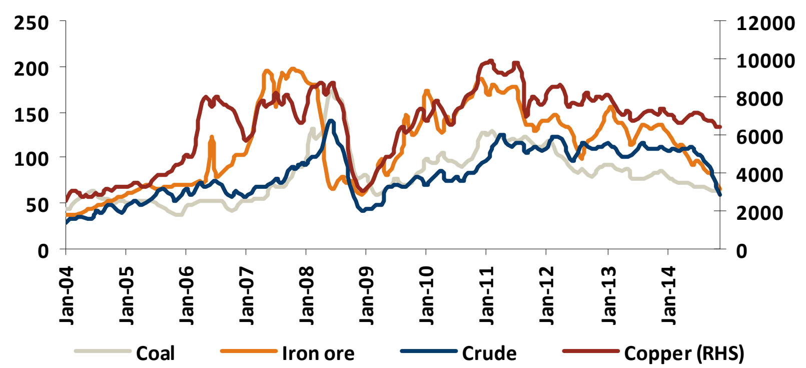
Market Strategy 2015

Theme 3 – End of commodity super-cycle?

Commodity prices are directly related to the phases of prosperity and stagnation in the global economy that form long cycles. Commodity super cycles are long and rapid rises happen in prices across commodities, propelled by persistent increases in demand that outstrip supply. A commodity super cycle, in general, is driven by population growth and expansion of infrastructure in emerging economies that lead to long term demand and higher prices for industrial and agricultural commodities. While infrastructure spend requires raw materials such as copper, aluminium, steel, etc, which have finite supplies, a burgeoning global middle class adds to demand for agricultural commodities. Furthermore, energy demand rises in tandem with expanding economies. The commodity boom, which began at the start of the 21st century, can primarily be attributed to the industrialisation of the BRIC (Brazil, Russia, India, China) nations, particularly China

- A prolonged period of high commodity prices has resulted in an increase in supply. Elevated supply coupled with tapering in growth in demand from China and the shale revolution in the US, resulted in a paradigm shift in demand and supply economics. Subsequently, global commodity prices reached inflection points and are now headed downwards

Key commodity prices ($) since 2004



Commodity prices have crashed from their peaks ($/tonne)

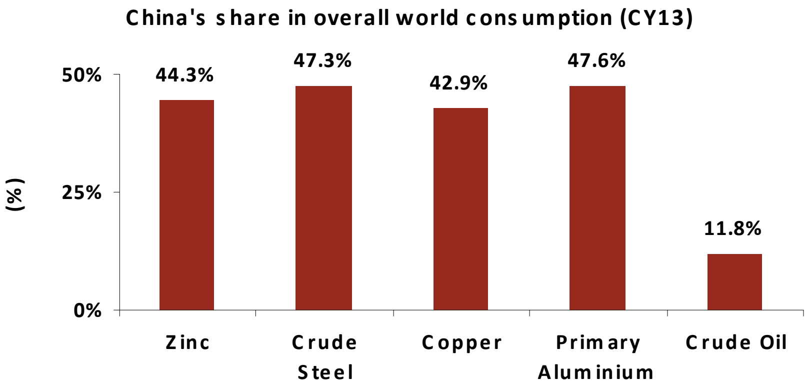
Commodities	2002	2014	Peak	% decline from peak
Crude ($/barrel)	27	59	144	(58.9)
Iron	15	67	205	(67.3)
Coal	NA	62	195	(68.2)
Copper	1550	6409	9879	(35.1)

- Going forward, we believe for the commodity slowdown to sustain, the short-term triggers could be the shale gas discovery (abundant oil supply), China slowdown and abundant agricultural produce (amid subdued demand) while the long term triggers could be a shift towards renewable energy
- Therefore, on the back of incremental production of oil, shale gas and coal in the US and subsequent to its turning into a net exporter of these commodities (importer earlier), we expect prices of these commodities to remain subdued, going forward
- We believe the fall in commodity prices could benefit certain sectors namely aviation, paints, textiles, auto ancillaries (tyre and battery), logistics, telecom, lubricants and mining
- Consequently, some of the stocks that could benefit from this theme are: Container Corporation of India, BlueDart, Kajaria Ceramics, UltraTech Cement, Heidelberg Cement, Kansai Nerolac Paints, Page Industries, Tata Power, Castrol India, Exide Industries and JK Tyre

Source: Bloomberg,,ICICIdirect.com Research

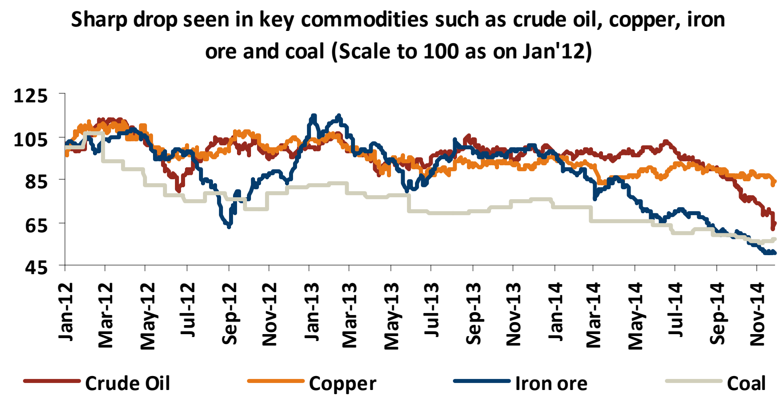
Slowing down of China's growth engine, overhang on global commodity market…

- Since the start of economic reforms that began in 1978, China has witnessed an unprecedented phase of industrialisation and economic development. Over the last few decades the structural process of urbanisation, motorisation and rising per capita income have catapulted China to the position of a major commodity consumer globally



- China's GDP growth rate has averaged ~9% during 2000-10 led by investment spending that led to a surge in global commodity demand. However, with a shift in focus of the Chinese regime towards consumption led growth, China's GDP growth rate has slowed down from 9.8% in CY10 to 7.7% in CY13

- Given the scale of China's appetite for commodities, small shifts in its domestic demand-supply balance have had major implications for global commodity markets. With increasing share in consumption of different commodities, China's effect on global commodity markets in recent years has been magnified resulting in sharp volatile movements in commodity prices. Slowing down of the Chinese economy adversely impacted commodity demand in general. In addition to cooling off of the Chinese economy, excessive supply has resulted in subdued commodity prices



- With the global economic recovery still in infancy, it's too early to expect a major demand–side pick-up for commodity prices. Instead, supply side factors are expected to continue to play a key role in determining commodity prices. The new Chinese government is also likely to focus on more conservative growth over the rapid expansion of the past decade. This is likely to adversely impact short-term demand prospects

Source: Bloomberg, BP Statistical Review, World Steel Association, ICICIdirect.com Research

Shale gas - Game changer for petroleum product & natural gas prices

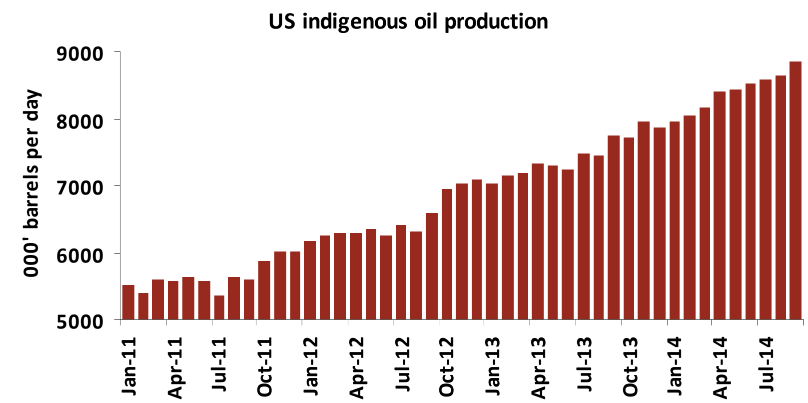
Shale gas revolution: Game-changer for world

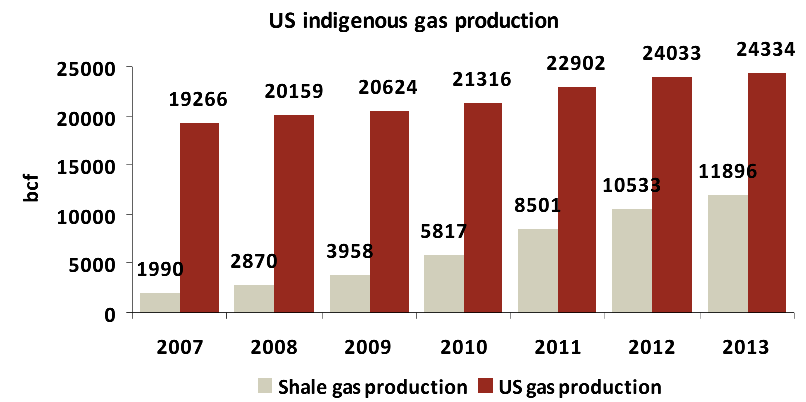
- Shale oil & gas is rapidly emerging as a significant and relatively low cost unconventional resource in the US. The American domestic energy revolution will have implications that stretch far beyond the US oil industry. The US Energy Information Administration (EIA) estimates shale oil & gas reserves at 10% and 32% as a percentage of total world oil & gas reserves, respectively. Oil & gas resources have increased 11% and 47%, respectively, due to inclusion of shale oil & gas to the global oil & gas resources. Development of shale resources by more countries could lead to a substantial increase in the world's oil & gas supply, creating a demand supply mismatch, thus impacting oil & gas prices. This would have a ripple impact on coal as well as other energy commodity prices

Technically recoverable shale oil and gas unproved resources in the world

	Crude oil (bn barrels)	Natural gas (tcf)
Shale/ tight oil and shale gas proved reserves	N/A	97
Shale/ tight oil and shale gas unproved resources	345	7201
Other proved reserves	1642	6741
Other unproved resources	1370	8842
Total Resources	3357	22882
Increase in total resources on shale inclusion (%)	11	47
Shale resources as a percent of total (%)	10	32

- Today, US produces more natural gas than any other country in the world and is also poised to produce higher indigenous oil than imports for the first time in 18 years. A six-fold increase in US shale gas production from 1990 billion cubic feet (bcf) in 2007 to 11896 bcf in 2013 has significantly reduced its dependence on imported gas. Shale gas now contributes ~50% of US indigenous gas production of 24334 bcf in 2013





Source: Bloomberg, EIA, ICICIdirect.com Research, Bn – billion, tcf– trillion cubic feet

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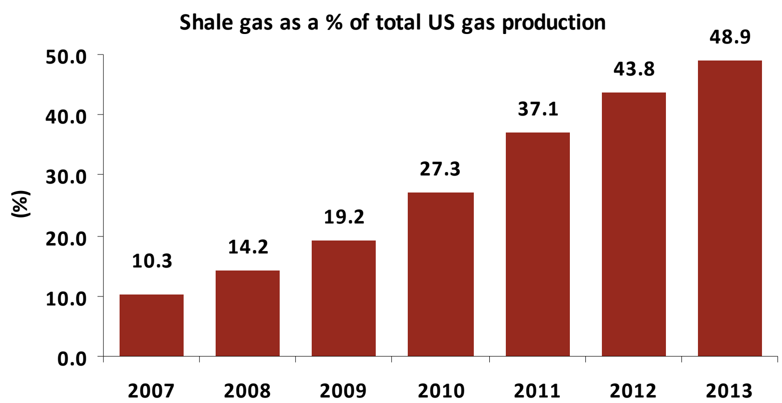
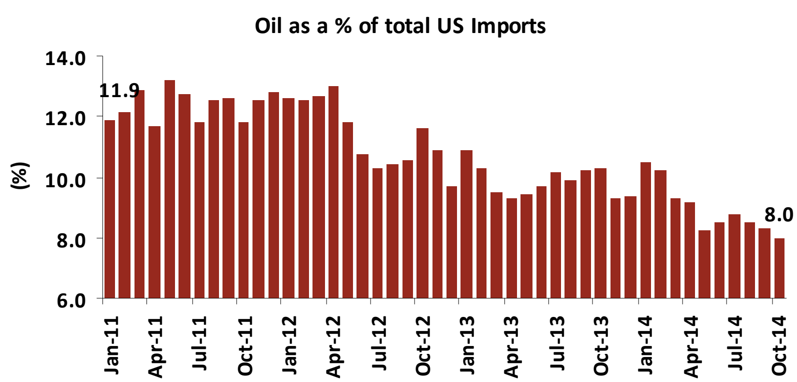


- An increase in US shale oil & gas production has contributed to a significant decline in petroleum imports. An increase in indigenous oil production by ~55% since 2011 has led to a decline in US oil imports as a percentage of total imports from 11.9% in January, 2011 to 8% in October, 2014



- With Brent crude oil prices at $60 per barrel currently, there is an apprehension that expensive US tight oil projects and mature oil production regions could become unviable. However, projected oil prices remain high enough to support development & drilling activity in the regions of Bakken, Eagle Ford, Niobrara and Permian Basin, which contribute the majority of US oil production. Going forward, EIA expects US. crude oil production to average 9.3 million barrels per day (mbpd) in 2015, up 0.7 mbpd from 2014 in spite of the decline in oil prices

World Oil Demand & Supply Statistics

	Earlier		Revised	
	CY14	CY15	CY14	CY15
World Oil Demand	91.19	92.38	91.13	92.26
Non-OPEC Supply	55.91	57.16	55.95	57.31
OPEC NGLs and non-conventionals	5.83	6.03	5.83	6.03
Total supply excluding OPEC crude	61.74	63.19	61.78	63.34
Difference (OPEC supply needed)	29.45	29.19	29.35	28.92
Targeted OPEC production	30.00	30.00	30.00	30.00
Surplus supply (mismatch)	0.55	0.81	0.65	1.08

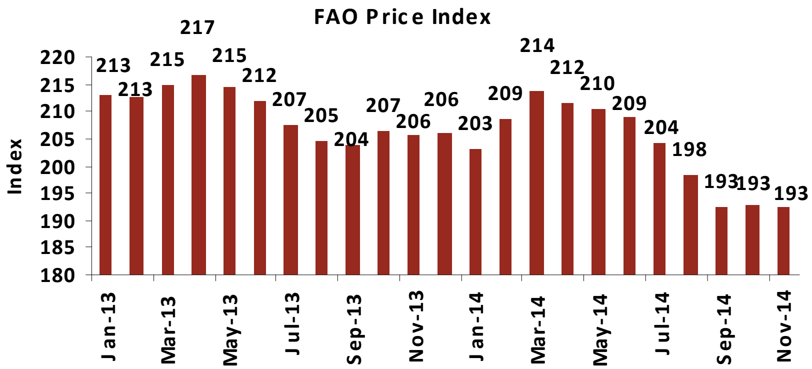
- Increase in US oil supplies and Opec's decision to maintain oil production would lead to an increase in world oil supply to 93.3 mbpd in 2015E. Also, world oil demand is expected to decline to 92.3 mbpd in 2015E. Increasing crude oil supply & reduced oil demand forecasts will lead the surplus supply level to increase from 0.7 mbpd in 2014E to 1.1 mbpd in 2015E. This demand-supply mismatch is likely to keep oil prices lower in the near term

Source: Bloomberg, EIA, OPEC, ICICIdirect.com Research

Global food prices in downward trajectory

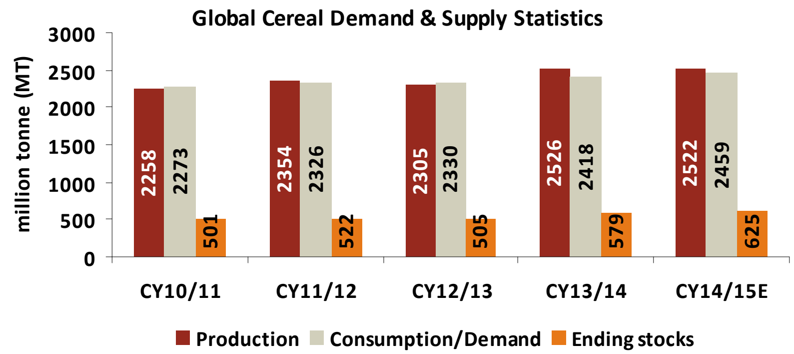
FAO index down 6.4% YoY & 6.6% on YTD basis

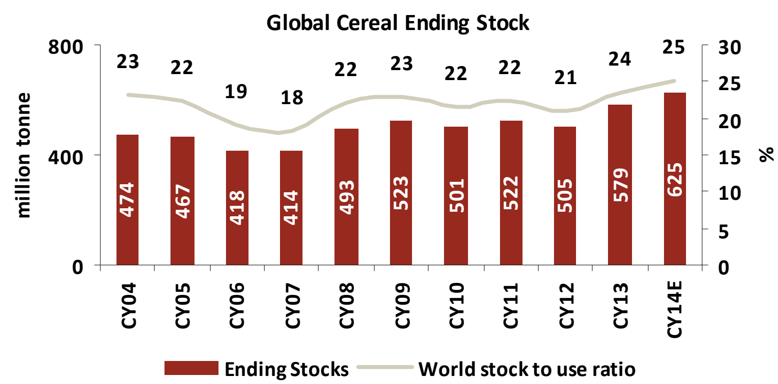
- As per globally accepted standards, the indicator of food prices released by United Nations (UN) i.e. Food and Agriculture Organization Index (FAO Index), global food prices are on a downward trajectory (down 6.4% YoY and 6.6% on YTD basis). The primary reason for the fall has been robust production of agri commodities globally and restrictions on their transport in international trade



- Among commodity indices that constitute the FAO Price Index, the major fall was seen in the price index of dairy, which is down 29% YoY, followed by the Vegetable Oils Price Index (down 16.9% YoY), Sugar Price Index (down 8.2% YoY) and Cereal Price Index (down 5.8% YoY)
- On the cereals front, goods supplies & prospects of another bumper production in 2014 continued to weigh on prices. On the dairy front, prices remained subdued on account of increased export availability and reduction in imports by major importers like China & the Russia Federation
- Global cereal production is been forecasted at ~2522 million tonne (MT) in CY14 while consumption/ demand for the same stands at ~ 2459 MT, indicating a surplus (~63 MT in 2014) of production.

Cereals: Production outpaces demand





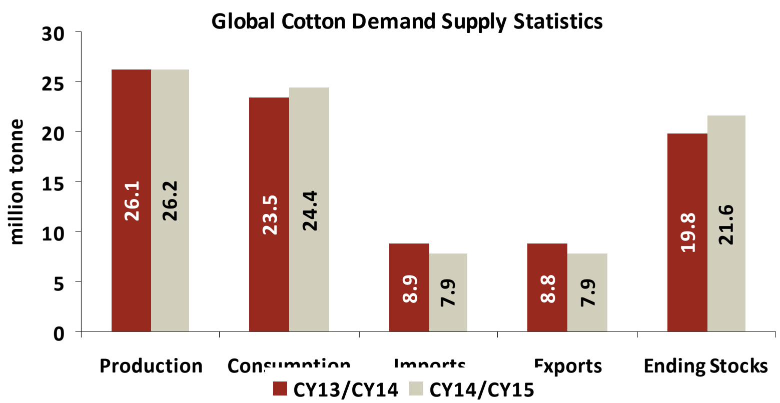
- In the last three years, global cereals inventory/stockpiles are on an increasing trend with world stock to use ratio (inventory in the system to total consumption) increasing from 21% in CY12/13 to 25% in CY14/15E, thereby depicting cereal production outpacing demand
- Global cereal stocks for the season ending in 2015 is estimated at ~625 MT, up 8.0% YoY and at their highest in last 15 years that will eventually keep a check on the rise in agricultural produce prices globally

Source: FAO, UN, ICICIdirect.com Research

Cotton & rubber: abundant inventory, price correction to continue

Cotton inventory at record levels: China at fault

- Cotton prices have tumbled to a five-year low in 2014 on the back of robust production amid subdued demand. For CY14/season ending CY15, global cotton production is expected at 26.2 MT while consumption is expected at 24.4 MT. Cotton Inventory globally is expected to increase 9.2% YoY to 21.6 MT



Indian cotton production: at record levels

- Cotton production in India has steadily increased in the last decade with production in FY14 at 375 lakh bales (of 170 kg each) vis-à-vis 158 lakh bales in FY02, growing at a CAGR of 7.5% in FY02-14.
- With record cotton inventory and production domestically and globally, cotton prices are expected to be subdued, going forward. The Government of India, in this backdrop, has increased the MSP price of cotton at one of the slowest paces in the last four years. MSP for FY15 was up merely ~1.4% i.e. ₹ 0.5/kg
- Restrictions of imports by China (due to subdued domestic growth) coupled with robust production in the US have resulted in record stockpile of cotton in the global market (multi-year high). This is likely to keep any steep price appreciation under check

Global natural rubber inventory up 24% YoY in 2013

- As per the study conducted by the International Rubber Study Group, natural rubber production has doubled from the levels in 2000. In the past 14 years, rubber production has been surplus for six years with the surplus peaking out in CY13. Going forward, the same situation is likely to persist in CY14 with natural rubber prices remaining muted as supply continues to outstrip demand

Global Rubber Demand/Supply Statistics

Production (000's MT)	2007	2008	2009	2010	2011	2012	2013
Natural rubber	10,057	10,098	9,723	10,393	11,230	11,603	12,036
Synthetic rubber	13,367	12,738	12,393	14,115	15,073	15,142	15,495
Total rubber	23,424	22,836	22,116	24,508	26,303	26,745	27,531
Consumption (000's MT)	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**
Natural rubber	10,133	10,181	9,361	10,773	11,007	11,027	11,322
Synthetic rubber	13,087	12,517	12,129	13,984	14,803	14,925	15,483
Total rubber	23,220	22,698	21,490	24,757	25,810	25,952	26,805
Surplus/deficit	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**
Natural rubber	-76	-83	362	-380	223	576	714
Synthetic rubber	280	221	264	131	270	217	12
Total rubber	204	138	626	-249	493	793	726

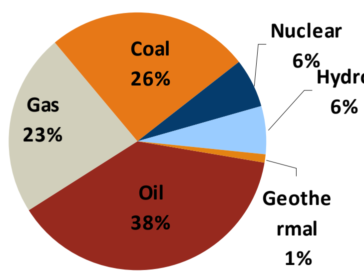
- Global natural rubber inventory increased 24% YoY to 714,000 tonne in 2013. The synthetic rubber inventory, on the other hand, has declined to 12,000 tonne, thereby resulting in a marginal decline of 8% in the total rubber inventory in 2013. In the recent past, global rubber prices have gone into a downward spiral with increasing concerns on demand-supply mismatch. The benchmark Bangkok RSS-4 rubber prices have declined from $2.2/kg in March to ~$1.7 levels. These are five-year low prices
- The increase in domestic tapping from the Kerala region and increase in global supplies as Thailand inventory comes into the market may keep prices under control. Going ahead, we believe RSS-4 prices would continue to remain at ~$1.8/kg (Bangkok) and ~₹ 135/kg in the domestic market. On the crude linked derivatives side, like synthetic rubber/carbon black prices are also expected to witness declines albeit in a lagged manner owing to the recent fall in Brent crude prices to below $60/bbl

Source: International Cotton Advisory Committee, Bloomberg, Cotton Advisory Board, Ministry of Agriculture (GOI), ICICIdirect.com Research

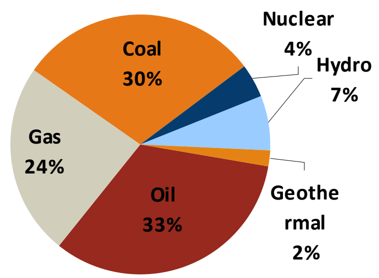
Long term growth anchors for commodity cycle

Renewable energy (RE) – Logical way to meet energy needs!

- Since mid-1800s, the global use of fossil fuels (coal, oil & gas) has dominated energy supply for long. However, on the flip side, it has led to rapid growth in carbon dioxide (CO2) emissions. To meet the growing energy needs in a climate-constrained world requires a fundamental shift in how those energy services are delivered
- Over 1 billion people still lack access to modern energy services. As a result of the UN initiative, achieving universal energy access has risen to the top of the international agenda. However, as studies revealed, the world recently passed 400 ppm* of atmospheric CO2—potentially enough to trigger a warming of 2°C compared with pre-industrial levels. Such fears of an climate disruption have catalysed the growth of RE
- On a global basis, it is estimated that RE accounted for ~13% of the total primary energy supply in 2013. In recent years, prices for RE technologies like wind and solar have continued to fall even though nuclear power attractiveness was dented by the Fukushima incident in Japan. RE is slowly but surely becoming increasingly mainstream and competitive vis-à-vis conventional energy sources. In the absence of a level playing field, due to strong political interests in conventional energy, high penetration of RE is still dependent on a policy environment



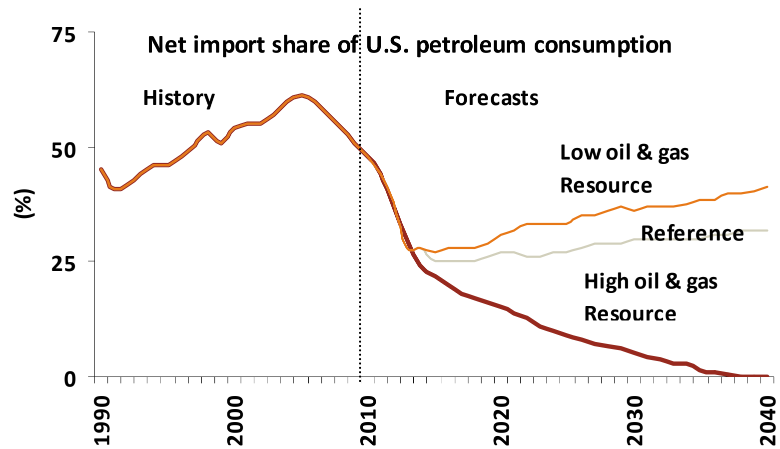
Fossil fuels used to constitute 87% of energy supply in 2004



Fossil fuels still constitute 87% of energy supply in 2013

Developed economies influencing the global energy landscape!

- In the last few years, the US has dramatically changed its energy consumption and export behaviour by starting to initiate oil exports. The US has now become the largest net exporter of crude oil causing a dramatic impact on crude oil prices (down ~40% YTD)
- Growing US domestic production of natural gas and oil continues to reshape its energy economy. The long term production and price trends would depend substantially on expectations about resources and the technology advancements
- Major global emission/efficiency change in the transportation sector has been led by US. Fuel use in the US transportation sector has changed fundamentally in the past several years. The stringent norms on efficiency (Target:37.2mpg* 2040 vs. 21.5 mpg 2012) would pave the way for market penetration of bio-fuels, hybrid-electric, and plug-in electric systems gradually
- Germany, a major behemoth in global economics, has pledged to move 80% of its energy requirements to renewable sources by 2050. This target may have doubters in terms of execution but one thing is for sure that the ball of change towards renewable has started to roll



*Source: Bloomberg, US Energy Information Administration ,ICICIdirect.com Research *mpg~ miles per gallon ppm ~parts per million*

Fall in commodity price: Sectoral benefits

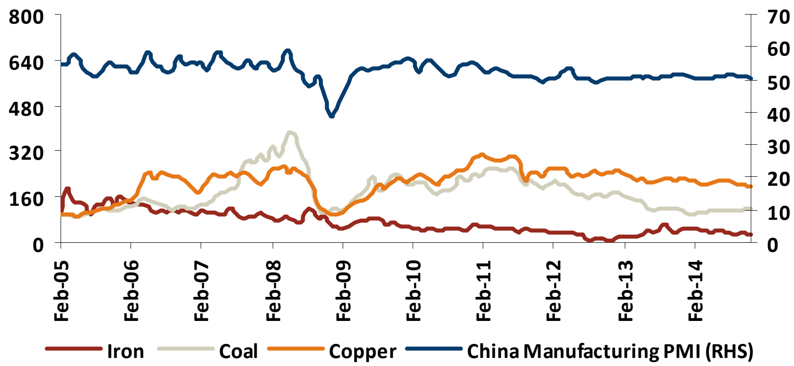
Commodity	Domestic Demand in FY14	Unit	Price Performance (CY14) Jan-14	Dec-14	YTD CY14	Sectors to Benefit	Remarks	Companies to benefit
ATF	5.5 MMT	US$/bbl	126.3	76	-40%	Aviation	For airline operators, every 10% drop in ATF prices results in EBITDA margins improvement in the range of 300-340 bps	Jet Airways
Base Oil		US$/tonne	1125	904	-20%	Lubricant	For every US$100/tonne drop in base oil price, EBITDA margin for lubricant players increases by 200-350 bps (considering other things remaining constant)	Castrol
Diesel	68.4 MMT (Million Metric Tonne)	US$/bbl	124.6	71.7	-42%	Logistics	Logistics companies to benefit; a part of benefits will be passed on to the end users, which would further help in increasing volumes thereby leading to operational efficiencies	Concor, BlueDart, Gateway Distriparks
						Telecom	Telecom operators stand to gain from drop in diesel prices. For telecom operators we expect 60 bps increase in operating margins for every 10% fall in crude prices	Bharati Airtel, Idea, Rcom
						Cement	For the cement companies, freight accounts for ~23% of sales revenue. Of the total freight costs, road transport accounts for 50%. With recent fall in diesel prices (down by 4.9% over the past six months), we expect, EBITDA margins to improve by ~70-80 bps	UltraTech; Heidelberg; Mangalam Cement
						Mining	Apart from explosives, diesel forms a majority of raw material costs for mining companies. For Coal India, for every ₹ 1 drop in diesel price for full fiscal year, it results in savings of around ₹ 120 crore of operational expenses (EBITDA accretive)	Coal India, NMDC
Natural Gas		US$/mmbtu (spot)	17-19	11-13	-33%	Ceramics	Industry is likely to benefit from the softening natural gas prices (accounts for 15%-25% of total sales). The benefits of softening natural gas prices are likely to visible with lag effect	Kajaria Ceramics
Titanium Dioxide (TiO2)		₹/kg	233	208	-11%	Paints	Decline in TiO2 prices and flattish currency movement would help in margin expansion of ~130 bps and ~240 bps YoY for Asian Paints and Kansai Nerolac respectively. We believe, company would pass on some benefit of decline in raw material to the end customers	Asian Paints, Kansai Nerolac
HPDE/LDPE		US$/tonne	1545	1220	-21%	Plastic, Pipes	Plastic resins which form the raw material for all plastics are direct crude derivatives and hence industry is likely to see improvement in EBITDA margins due to fall in crude price	NA
Iron ore	103.7 MT	US$/tonne	135	70	-48%	Steel	Steep fall seen in global iron ore prices makes imports more feasible for steel plants located near the coast	JSW Steel
Thermal Coal	739.4 MT	US$/tonne	85	64	-25%	Metals, Power	Falling global thermal coal prices makes import more cheaper for Metal and power companies	Tata Power
Coking Coal		US$/tonne	143	119	-17%	Steel	On account of subdued steel prices, domestic steel majors were not able to reap benefit of falling coking coal prices	NA
Lead		US$/tonne	2191	2035	-7%	Battery	Lead is a major cost for battery manufacturers (~50% of raw materials), thus ~1% change on lead prices could impact EBITDA margins by ~20 bps (other things remaining constant)	Exide Industries, Amara Raja batteries
Cotton	4.3 MT	US$/lb	90	67	-26%	Textiles	Drop in cotton prices to benefit textile players; however the benefit is expected to be limited as cotton produrement is done at MSP prices. However, for every 10% drop in cotton price, textile manufacturers witness ~100-200 bps improvement in margins	Page Industries, Siyaram Silk Mills and Kewal Kiran Cl.
Natural Rubber	1 MT (Million Tonne)	₹/kg	152.6	117.5	-23%	Tyre	Natural rubber has seen a second consecutive year of decline in prices. This has aided EBITDA margins expansion (300-500 bps) for various tyre makers. On the basis of sensitivity, for every ₹ 10/ kg of rubber EBITDA margins could improve by ~100-200 bps	JK Tyres, Apollo Tyres, Balkrishna Industries

What can spoil the party!!

Growth in China rebounds on new economic policies

- Though major economic indicators in China point to a weak industrial outlook (HSBC Manufacturing PMI fell to 50.3 in November 2014 and averaged 50.8 during CY14 vs. 53.8 during CY10), any positive surprise could support commodity prices

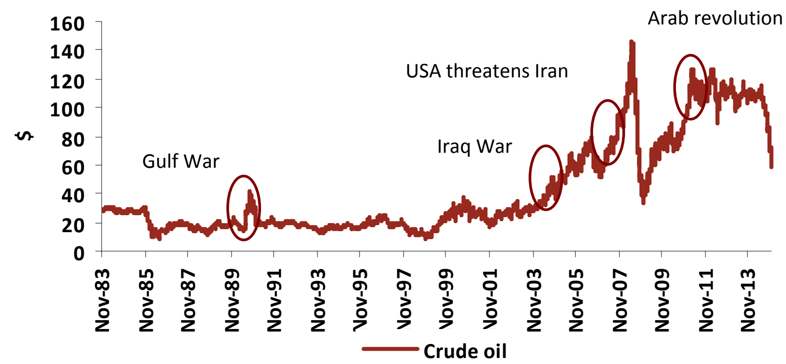
Growth in China could lead recovery in industrial commodities



Geopolitical concerns

- Certain commodities (for instance, crude oil) have reacted sharply to political tensions in the past. Periods marked by World Wars (1915-18, 1939-45), international border disputes and restricted trade barriers especially concerning those rich with natural resources (Opec countries) have resulted in increased price volatility (with prices surging as high as ~3x in three months during the 1990 Gulf War). A recent case in point is Russia's intervention in Ukraine during February 2014 that prompted Western nations to impose international sanctions against the oil-rich nation. During this period, Brent crude prices jumped 10% to $114/ barrel on fears of supply disruptions by Russia.

Geopolitical tensions could spike crude oil prices



Easy liquidity may flow into commodities

- Quantitative easing (QE) has been an active central bank monetary tool employed by the US Federal Reserve during 2008 financial crisis to boost the demand environment. The three programmes of QE saw massive bond purchases by the US Fed that pumped $3.7 trillion in the economy
- As the US economy strengthened, the Fed wound down its third QE programme and is set to tighten its monetary policy during late-2015. However, fears of a slowdown and disinflation have gripped China and other developed nations (eurozone, Japan). Note, interest rates have hit rock-bottom at Europe and Japan. As a result, QE appears to be a key policy instrument that could lift growth in these economies. Recent statements by central banks of Europe and Japan also mirror our view. Though China is some distance away from effecting bond buying programmes given other monetary tools available (benchmark rate, reserve requirement rate), it would be hard to neglect the impact of such benign liquidity conditions on commodity prices as consumer confidence picks up and growth improves in these major economies

Source: Bloomberg, ICICIdirect.com Research

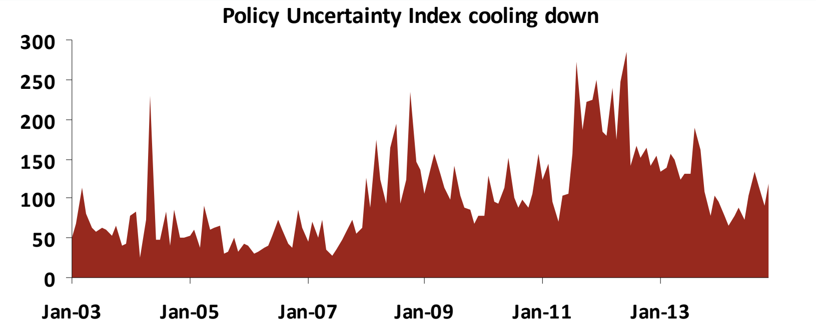
Market Strategy 2015

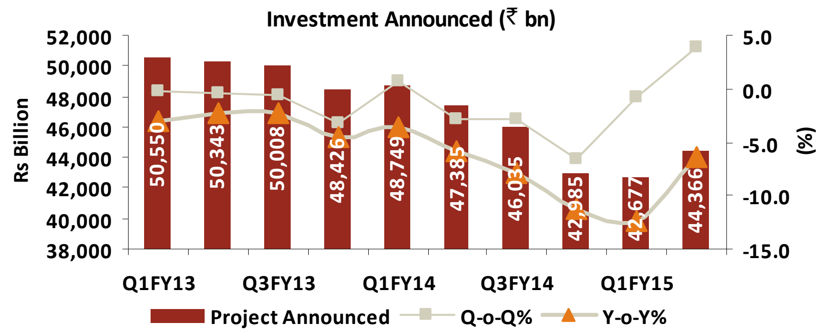
Theme 4 – Reforms initiation showing green shoots in investments

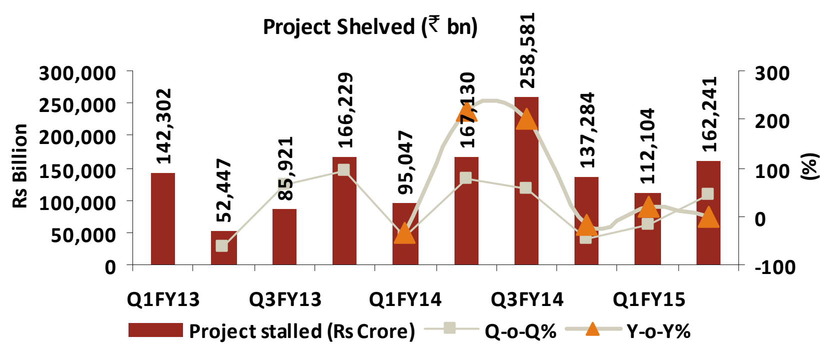
The pro-reform new government has taken various reform initiatives such as increase in FDI limit in insurance, defence & Railway, easing of environment & forest clearance, etc. in a short span of six months. These initiatives have already shown some green shoots in the economy

New government reform announcements

Date	Key reforms
Jul-14	With the commitment to have housing for all by 2022, the FM announced a sum of ₹ 4000 crore earmarked for NHB at lower cost for affordable housing
Jul-14	REIT has been given a tax pass through status to avoid double taxation
Jul-14	RBI eased norms for funding new infrastructure norms & subsequently relaxed further for existing projects upto ₹ 500 crore
Jul-14	The Cabinet approved 49% foreign investment in insurance companies through the FIPB route ensuring management control in the hands of Indian promoters
Aug-14	FDI ceiling in defence sector has been hiked to 49% from current 26% with control remaining with the Indian JV partner
Aug-14	The Cabinet approved a proposal to open up cash-strapped Railways to foreign investment by allowing 100% FDI
Sep-14	The Enviroment Ministry has announced that the ministry is looking to reduce the time lag for clearance through the online process
Oct-14	The Centre will soon roll out 'Sardar Patel Urban Housing Mission', which will ensure 30 million houses by 2022
Oct-14	The government has approved raising natural gas prices to US$5.6 mmbtu from US$4.62 mmbtu
Oct-14	The goverment has acted promptly in coming out with an ordinance to set the rules for re-allocating blocks within a month from the Supreme Court coal mine de-allocation decision
Oct-14	The government ended a decade old policy of controlling diesel prices, which is likely to lower the fiscal burden
Oct-14	The government has relaxed rules for FDI in the construction sector by reducing minimum built-up area as well as capital requirement and easing exit norms
Nov-14	The government has cleared the Deendayal Upadhyaya Gram Jyoti Yojana, which entails a ~₹ 43,000-crore investment and aims to deliver the dream of 24x7 electricity supply
Dec-14	The Government introduced the GST Bill in the Lok Sabha for roll-out of the new regime from April 2016 subsuming various levies like entry tax and octroi







Source: Policyuncertainty.com, capex.cmie.com, ICICIdirect.com Research

Long-term triggers for investments

Reforms

FDI in defence, construction, railways and insurance

Auction of coal mines to provide predictable & stable business environment

Long-term bonds for infrastructure projects, new restructuring/refinancing norms for infrastructure projects

Investment trust:
Real estate investment trust, Infrastructure Investment trust

+

New investments

Make in India

Digital India

100 smart cities

Rail infrastructure projects like suburban corridor projects, dedicated freight lines, passenger terminals, bullet trains, Industrial corridors etc.

Ease of doing business → GDP Growth

Make in India

Make in India aims to increase the share of manufacturing in GDP from 16-25% by 2022 and will create 100 million additional jobs

Digital India

The adoption of key technologies across sectors spurred by the Digital India initiative could help boost India's GDP by $550 billion to $ 1-trillion by 2025

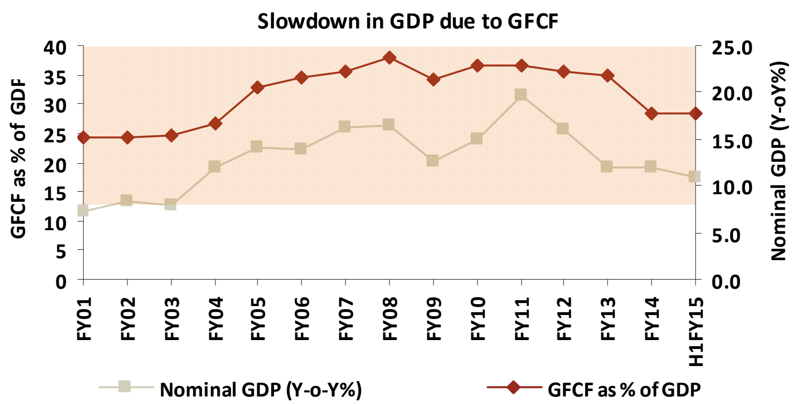
Smart Cities

A committee on investment requirements in urban infrastructure estimates total investment requirement potential could exceed ₹ 7 lakh crore over 20 years

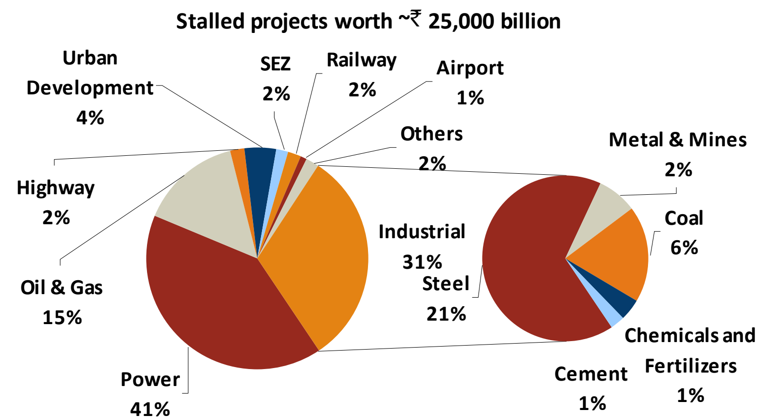
Source: Press Reports, ICICIdirect.com Research

Likely revival of ₹ 25,000 billion crore stalled projects to support GFCF

India's GDP has slowed down in the last couple of years on account of a sharp deceleration in GFCF due to policy paralysis. However, with the new stable government in place, the reform process has picked up pace, which is likely to revive stalled projects in the coming years.



- India's nominal GDP has come down to 10-12% in the last few years from 15-20% earlier. One of the reasons for the slowdown in GDP growth rate is on account of a sharp slowdown in investment in the economy [(as reflected in the gross fixed capital formation (GFCF)]
- GFCF as percentage of GDP has fallen from mid-thirties during FY10-13 to ~28% in the last few years due to policy paralysis such as environment clearance and land acquisition issues

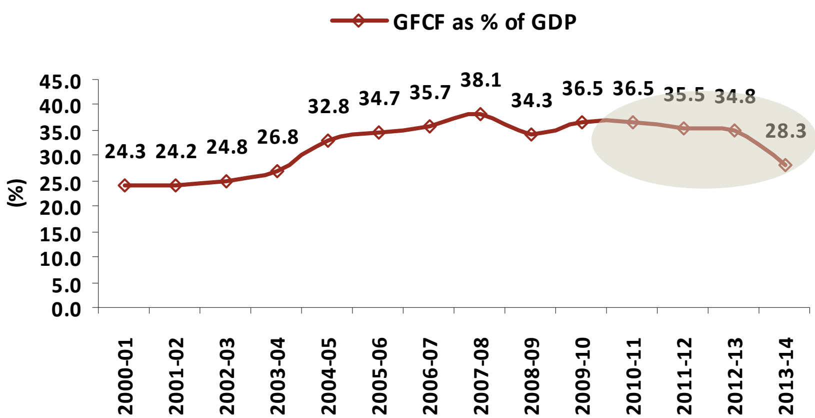


- Currently, as many as 495 projects aggregating ~₹ 25,000 billion have been reported to the Project Monitoring Group (PMG) that has been stalled due to various reasons like delay in environment & forest clearance, land acquisitions, etc
- Out of this, the PMG has managed to resolve all regulatory & supervisory issues for 186 projects that have an outlay of ~₹ 6,900 billion. Furthermore, progress towards policy action is likely to revive investment in the stalled projects, which should support GFCF, going ahead

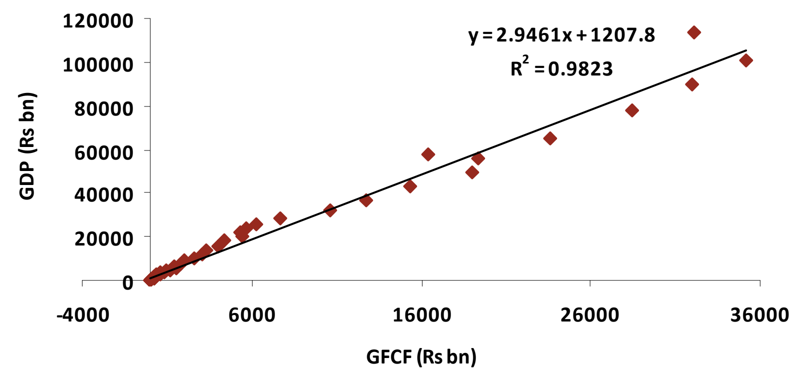
Source: RBI, CCI, ICICIdirect.com Research

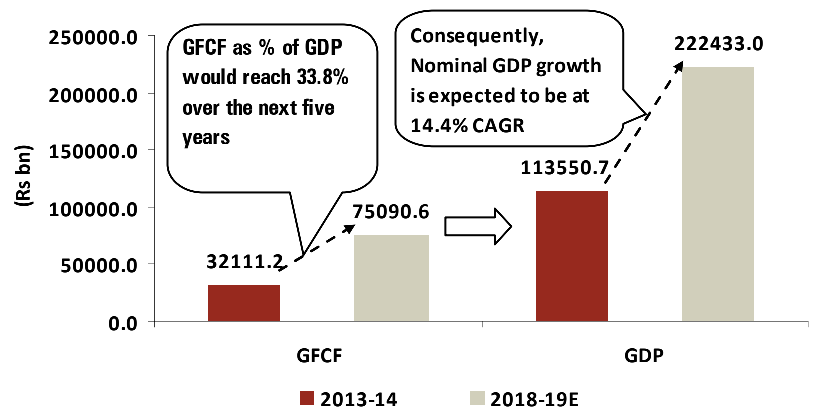
Regression suggests 18.5% CAGR in GFCF to support 15% nominal GDP growth

- Our analysis of various macro variables indicate that there is high correlation between GFCF and GDP. Hence, we regressed GFCF and GDP data from 1951 to H1FY15 and found the linear correlation of Y=1207.8+2.9461 X where GDP (Y) is a function of GFCF (X). Also, R Square of 0.9823 lends us comfort on this model to show the relationship between GDP and GFCF
- Historically, GFCF as a percentage of GDP has been in the range of 32-35%. However, recently it fell to 28.3% as on FY14. Still, we believe with a revival of stalled projects and increased capex, it would again go up to 33.8% over the next five years based on our regression analysis
- The regression model and our back of the envelope calculation show that to sustain ~15% CAGR in nominal GDP growth in FY14-19E, incremental ~₹ 43,000 billion of GFCF has to happen, which would imply ~18.5% CAGR in nominal GFCF. This is in line with the last recovery cycle during FY03-08
- As mentioned earlier, currently there are 495 projects worth ₹ 25,000 billion, which are stalled. These projects are likely to contribute 10-15% in the incremental GFCF



Regression Statistics	
Multiple R	0.9911
R Square	0.9823
Adjusted R Square	0.9820
Standard Error	3518.2
Observations	65





Source: RBI, ICICIdirect.com Research

Potential game changer reforms…

(A) GST - Step toward operational efficiency…

- The introduction of Goods and Services Tax (GST) would be a very significant step in the field of indirect tax reforms in India, which is likely to get implemented by April 2016. By amalgamating a large number of central and state taxes into a single tax, it would mitigate the cascading or double taxation in a major way and is likely to bring uniformity in taxation across the nation

As per the design, the central and state taxes to be subsumed in GST are:

At Central level	At State level
•Excise/Additional Excise	•VAT/Sales tax
•Service Tax	•Entertainment Tax
•Additional Custom duty (CVD)	•Luxury tax
•Special additional duty of customs (SAD)	•Taxes on Lottery/betting
	•State Cess and Surcharges

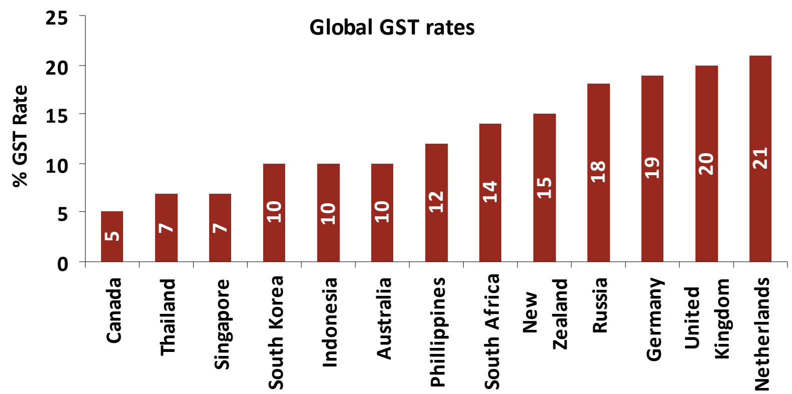
- From the consumer point of view, the biggest advantage would be in terms of a reduction in the overall tax burden on goods, which is currently estimated at 25-30%. This would also make Indian products competitive in the domestic and international markets, which would indirectly also spur the growth in economy. As per the NCAER workings, GST, once implemented, would lead to an incremental impact on GDP, which works out to 0.9 to be 1.7% of GDP. As per our rough estimates, prices of final products are also likely to come down by ~1% (assuming 20% GST rate), which, in turn, would spurt the growth in consumption.
- In our view, GST is a step in the right direction. However, the full implementation is likely to take some more time. The issue of pending state compensation, consensus on tax rates (states favouring higher rate in lieu of revenue forgone) and constitutional amendments are key things that need to get sorted out first

Illustration showing benefits of GST using 20% rate

	Current System	GST
Manufacturer		
Cost of Goods	0	0
Add: Value Addition	1000	1000
Basic Price	1000	1000
Add: CENVAT @12.5%	125	0
Add: GST @20%	0	200
Total Price	1125	1200
Wholesale/Distributor		
Cost of Goods	1125	1200
Less: Input GST Credit	0	200
Add: Value Addition	500	500
Basic Price	1625	1500
Add: VAT @12.5%	203.1	0
Add: GST @20%	0	300
Total Price	1828.1	1800
Retailer		
Cost of Goods	1828.1	1800.0
Less: Input VAT Credit	203.1	0
Less: Input GST Credit		300
Add: Value Addition	200	200
Basic Price	1825.0	1700.0
Add: VAT @12.5%	228.1	0
Add: GST @20%	0	340
Total Price paid by Consumer	2053.1	2040.0
Total Value Added	1700	1700
Total Taxes Paid	353.1	340
Effective tax rate (% of value addition)	21	20

Source: RBI, Bloomberg, ICICIdirect.com Research

Potential game changer reforms…



- More than 100 countries across the world have introduced GST or Federal VAT in one form or the other. The GST rate in various countries ranges from as low as 5% in Taiwan to as high as 25% in Denmark. India is expecting a dual GST model. It will comprise a central GST and a state GST. The Centre and states will each legislate, levy and administer the central GST and state GST, respectively. There are indications the revenue neutral rate (RNR) could be in the range of 20-24%

(B) Modified LARR – To expedite execution

- In September 2013, the former government had passed a new Land Acquisition and Rehabilitation Bill (LARR) & Resettlement Bill replacing the archaic Land Acquisition Act. The new act requires compensation to the owner of the acquired land to be four times the market value in rural areas and twice that in urban areas. Beside this, the Act provides for obtaining the consent of 70% of the affected families and mandatory social impact assessment

- These provisions had impacted the industry as they had elongated the land acquisition process by two or three years. For instance, a delay in land acquisition alone has contributed over 20% of the total stalled projects worth ~₹ 25,000 billion

- Recent media reports indicate the new government is in the process of easing the existing LARR provision. The government is looking to reduce the provision for obtaining the consent from 70% to 50% and exempt the social assessment impact provision for PPP projects

- We believe solving the land acquisition problem through modification in LARR bills for the industry would expedite project execution and facilitate investment in the country

Source: RBI, ICICIdirect.com Research; (Top Left) Financial Savings data available only till FY12

Potential game changer reforms…

(C) Mining auction to bring transparency & predictability

- Coal production in India has been a laggard with domestic production growing a mere ~4% CAGR in FY07-14 to 566 million tonne (MT) in FY14. This is despite India having a robust over 300 billion tonne of geological resources of coal. The production has been a dampener on the back of sluggish growth achieved by Coal India (the largest coal producing company in India), and environmental issues dampening the business environment. Coal imports (including coking coal), on the other hand, have increased sharply at 21.5% CAGR in FY07-14 to 168 MT in FY14

Total Coal Production & Consumption in India

Particulars	FY07	FY08	FY09	FY10	FY11	FY12	FY13	FY14
CIL	361	380	404	431	431	436	452	462
SCCL	38	41	45	50	51	52	53	50
Others	32	37	45	50	50	52	52	53
Total domestic production	431	457	493	532	533	540	558	566
Coking coal imports	18	22	21	25	20	32	33	37
Non coking coal imports	25	28	38	49	49	71	105	131
Total imports	43	50	59	73	69	103	138	168
Total domestic consumption	474	507	552	605	602	643	695	734

Government reacts swiftly to coal block cancellation

- In September, 2014, the Supreme Court had declared the allocation of 204 coal blocks as illegal and, consequently, cancelled the coal block allocation since 1993. The government came out with a fresh approach paper for coal mine auction within three months from the order cancellation. The government has also prepared the blueprint for auctioning 101 coal blocks by March 2015. This will pave the way for investment in end user industries such as coal mining, metals, power & cement sectors as these will provide predictability and stability to the business environment

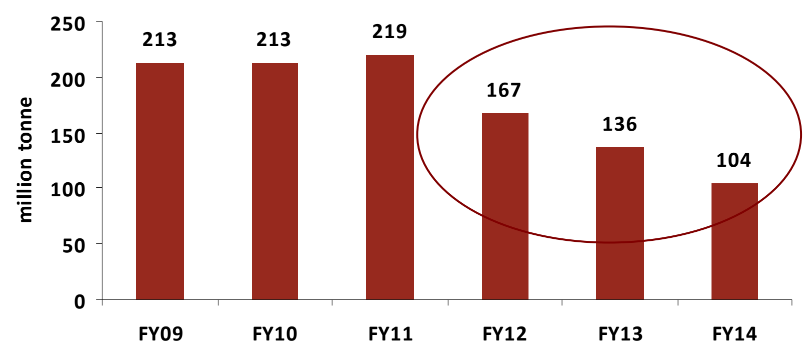
Government action on coal auction

Date	News flow
Aug-14	Allocation of all coal mines in 1993-2010 declared illegal by Supreme Court
Sep-14	The apex court cancelled allocation of 204 coal blocks
Oct-14	Coal Mines (special Provisions) Ordinance, 2014 promulgated by the President
Dec-14	Commercial coal mining in India crossed the first hurdle with the Lok Sabha clearing changes in law to allow private companies to produce coal
Dec-14	The Coal Ministry released an approach paper for e-auction coal mines, fixing a floor price of ₹150 per tonne for unregulated sectors other than power. For the power sectors, auction of coal mines will be through reverse bidding

Iron ore: Next on the cards for auction???

- India has, in the past, exported more than 100 MT of iron ore annually with peak iron ore production at 219 MT in FY11. However, with rampant flouting of environmental rules and consequent restrictions imposed by the Supreme Court and respective state governments of mineral rich states, India has turned from an exporter of iron ore to a net importer of iron ore, with major steel players like JSW Steel and Tata Steel resorting to imported iron ore despite being mineral rich domestically. With its prompt action to resolve the coal issue, we believe the government could come out with auction on iron ore in CY15

Iron ore Production



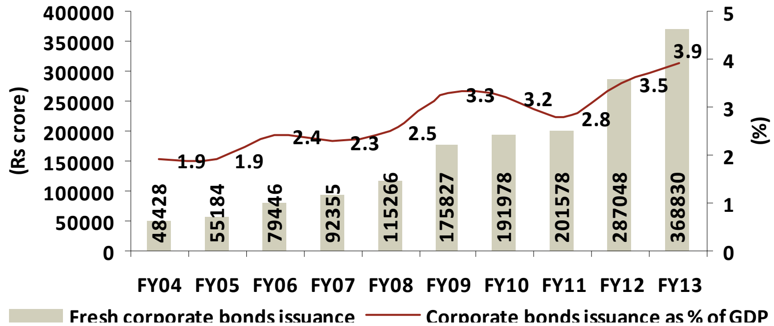
Source: RBI, ICICIdirect.com Research; (Top Left) Financial Savings data available only till FY12

Potential game changer reforms…

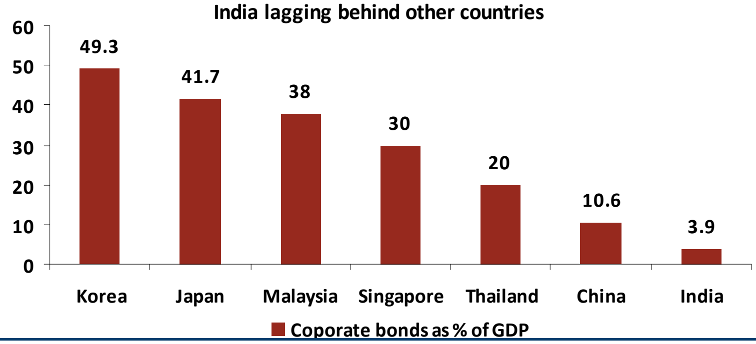
(D) Revival in corporate bond market to facilitate capex funding

- The corporate bond market in India remains in a nascent stage. India needs to develop its corporate bond market rapidly to meet funding needs of its infrastructure development and ensure the momentum of growth of corporate sector. Addressing issues in a combined manner and in coordination with different regulatory bodies will help India to come out of the clutches of the "vicious cycle" it faces and initiate a "virtuous cycle". This can ease financing constraints both in terms of "cost of funds" as well as ease "access to funds". Our back of the envelope calculation indicates the corporate bond market may potentially grow 6x to US$350 billion annually in the next decade to facilitate capex funding

Corporate bond market still at nascent stage



India lagging behind other countries



Demand side issues

- Narrow Investor base – low retail participation while FII interest not as expected
- Excessive regulatory restrictions on investments by banks, insurance companies, pension funds and PF organisations
- Different stamp duty structure across states
- Low liquidity in the secondary market

Supply side issues

- Issuance procedure is time consuming, high cost & requires high disclosures
- Lack of credit enhancement systems
- Low accessibility to SMEs or lower rated bonds
- Absence of liquid yield curve

Other issues

- Lack of incentives for market makers
- Tax related issues
- Dearth of a well-functioning derivatives market
- Large Fiscal deficit
- Lack of robust bankruptcy laws

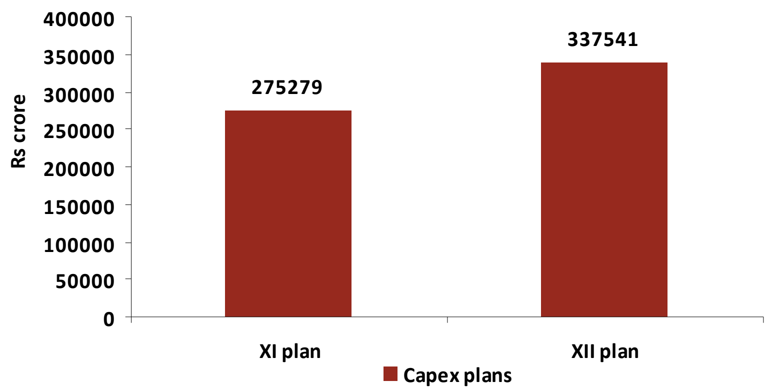
Source: RBI, CRISIL, ICICIdirect.com Research

Key themes to spark capex revival…

(A) Oil & gas: Reform led initiatives to drive investment

- Clarity on subsidy sharing mechanism and production sharing contracts would boost investments in the oil and gas sector, going forward. According to a report by global consultants IHS-CERA, India's producible gas reserves could rise two-fold by 55-91 trillion cubic feet (tcf) at gas prices of $10-12 per million British thermal units (mmbtu). At present, 48% of India's basins have not even been explored while in the 52% that have been, India has been unable to produce oil & gas at optimum levels due to regularity concerns over the pricing.

- India needs to step up investment in the sector as hydrocarbon imports drain foreign exchange and hurt the fiscal situation. As a result, the plan outlay for the XIIth Five Year Plan has been increased considerably by 22.6% to ₹ 3,37,541 crore



Plan Outlay in 12th Five Year Plan (Refining) (₹ crore)						
Company	FY13	FY14	FY15	FY16	FY17	Total
IOCL	15046	12754	12700	8585	7115	56200
CPCL	1486	2310	3330	4020	4500	15646
BPCL	4479	6035	9091	9355	3829	32789
HPCL	4605	4681	5060	2465	2738	19549
NRL	664	776	1453	2572	3530	8995
ONGC-MRPL	2825	2437	3386	6104	6485	21237

Plan Outlay in Twelfth Five Year Plan (exploration & production) (₹ crore)						
Company	FY13	FY14	FY15	FY16	FY17	Total
ONGC	36571	36163	34042	30412	30274	167462
OIL	2764	2953	3302	3353	3291	15663

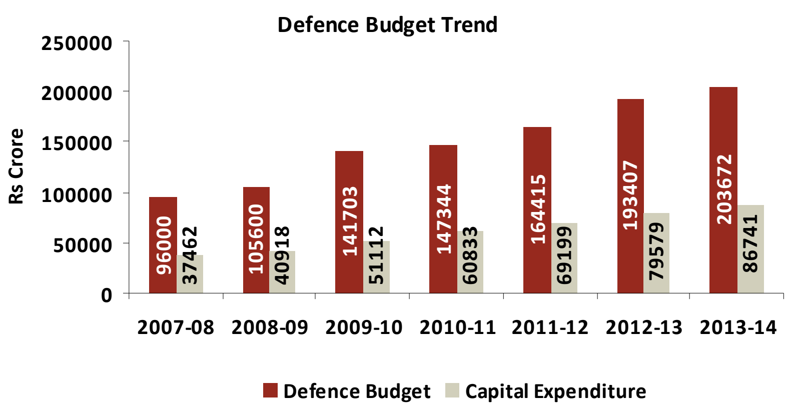
The recent move by the government

- The Petroleum Ministry is working towards putting in place a hassle free framework for extension of production sharing contracts (PSCs) with small and medium sized oil & gas fields. This would help nearly 28 fields held by both government and private firms

Source: CSO, Bloomberg, ICICIdirect.com Research

(B) Defence: Execution holds key

- India's defence budget has grown at a CAGR of ~12% over the past eight years but remains insufficient in light of ageing aircraft and naval fleet
- Of the total defence budget ~40% goes into capacity expansion of which the army accounts for 53% and Air Force for 31% while the remainder goes to the navy for any capex formation. Further, in an effort to improve deterrence, the government has increased modernisation funds by a CAGR of ~16% from ₹ 27903.4 in 2008 to ₹ 68627 crore in 2014 (BE)



- In terms of physical infrastructure for combat, India lags significantly behind China in all three wings of defence. This further heightens the need to develop and assimilate latest technology in modern weaponry. Though funds have been issued from time to time, execution on part of public defence companies has been sluggish, further compounding the problem of increasing capabilities

Projected expenditure by each service division

In USD Million	2010-11	2011-12	2012-13	2013-14	2014-15
Capital Expenditure	13110	14421	15863	17450	19195
Army (53%)	6948	7643	8407	9249	10173
Navy (16%)	2098	2307	2538	2792	3072
Air Force (31%)	4064	4471	4918	5410	5950

Millitary Capabilities 2012

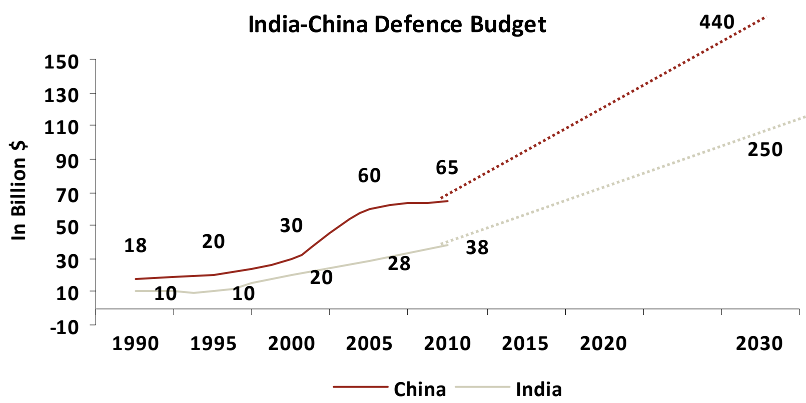
In units	Active forces	Reserves	Main Battle Tanks	Principle surface combatant	Tactical Submarine	Combat capable aircraft	Strategic Missiles
India	1325000	1155000	3274	24	15	870	54
China	2285000	510000	7430	77	61	1903	502
Pakistan	642000	0	2411	10	8	423	60

Source: 13th Finance Commission, KPMG, ICICIdirect.com Research

Key themes to spark capex revival…

Growth in GDP to fuel defence budget

- This lost decade (2000-10) has created a significant gap between the military capability of China and India, with India struggling hard to match up to the might of China
- In terms of percentage of GDP spent on military expenditure, China stood at ~2% whereas India remained at 3%. Going ahead, anticipating the expense as percentage of GDP remains at present levels, China is expected to increase its military expenditure to nearly $440 billion whereas India is expected to spend around $250 billion by 2030. This entails a CAGR of ~10% in the defence budget, which provides enormous scope for Indian defence companies



- The government is planning an acquisition across three wings in the range of $100-130 billion over the next 10-15 years to fill in for the vacuum created in the minimum deterrence of defence

Defence wing wise requirement

	Category	Quantity	Deal Size (US$)
Navy	Submarines	9	20-30 billion
	Warships	42	13-15 billion
	Navalised aircraft	79	7-8 billion
	Helicopters	80	1-2 billion
Army	Tanks & Vehicles	2300	
	Artillery		12.5-15 billion
	Missiles	6683	1.2-1.5 billion
	Other (Bulletproof jackets)	59000	
Airforce	Fighter Aircraft	644	34-35 billion
	Helicopters	564	4-5 billion
	Transport & other Aircraft	367	12-14 billion
	Missile Systems		2.5 billion
	UAVs	10	110 million
	Airfield Infrastructure upgrade	30	

Source: Australian Defence College, McKinsey, ICICIdirect.com Research

Key themes to spark capex revival…

(C) Railways: Imperative to improve countrywide logistics

- The Railway track length of 53956 km in 1950-51 has increased to 64600 km in 2011-12 (an increase of just 20% over the last six decades) whereas railway freight traffic has increased from 73.2 million tonnes (MT) to 969 MT (13.2 times) resulting in severe capacity constraints and resulted in heavy congestion on key network routes. Over the years, the government has added capacity in railways but due to paucity of funds many projects were downsized, thereby affecting the operations of railways

Freight revenue break-up and operation ratio

₹ crore	FY10	FY11	FY12	FY13	FY14
Passenger	23,735	25,986	28,632	32,536	37,922
Goods	57,958	62,441	69,382	86,255	94,490
Others	4,748	5,518	5,677	7,111	7,354
Total	86,441	93,945	103,691	125,903	139,766
Operating ratio (%)	95.3	94.6	94.9	88.6	87.7

- As funds dried up, shortage of ₹ 41000 crore in the Eleventh Plan led to downsizing of expansion plans for railways

Fund generation for Indian Railways during 11th and 12th Plan

₹ Crore	Approved Outlay	FY08	FY09	FY10	FY11	FY12	Total for 11th Plan	Excess /Short	12th Plan (BE)
Gross Budgetary Support	63635	8668	10110	17716	19485	21060	77039	13404	194000
Internal Generation	90000	14948	18941	12196	11528	9091	66704	-23296	105000
Extra Budgetary Resources	79654	5364	7284	9760	9680	16316	48404	-31250	220000
Total	233289	28980	36335	39672	40693	46467	192147	-41142	519000

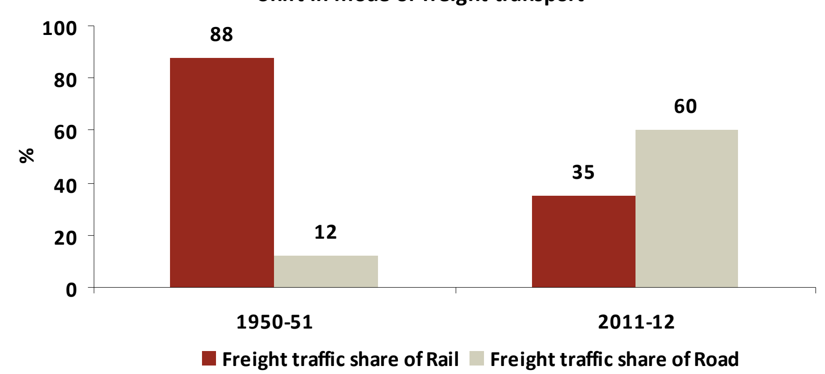
- The government has been cross-subsidising the passenger segment through the freight segment, thereby hurting its operation ratio and ability to garner funds. Over the years, the operating ratio of railways has remained abysmally low, thereby necessitating foreign fund requirement

Gauge conversion and track doubling lagged in both plans

Item	10th Plan Actual (Km)	11th Plan Original Target (Km)	11th Plan Revised Target (Km)	11th Plan Actual (Km)	12th Plan Target (Km)	12th Plan Revised Target (Km)
New Lines	920	2000	2000	2205	4000	1392
Gauge Conversion	4289	10,000	6000	5290	5500	2000
Doubling	1300	6000	2500	2756	7653	4633
Railway Electrification	1810	3500	4500	4501	6500	6500

- Constrained capacity addition for Railways has resulted in a shift in the modal mix from a rail to road. Rail freight traffic, which had a share of 88% in 1950-51 has shrunk to 35% while the share of road freight traffic has increased from a share of 12% to ~ 60%

Shift in mode of freight transport



Source: Media sources, ECI, ICICIdirect.com Research

Key themes to spark capex revival…

Long term plans: FDI in Railways to bridge funding gap

- Over the long term, the government intends to make railway self sufficient to fund capex through internal accruals. Subsequently, through the Twelfth to Fifteenth Plan, the government envisages internal accrual will grow at a CAGR of ~15% whereas the overall Budget is expected to grow 11.2% over the same period

Funding sources by Railways

₹ Crore	11th Plan (Actual)	12th Plan (BE)	13th Plan (BE)	14th Plan (BE)	15th Plan (BE)	Total
Gross Budgetary Support	77039	194000	405200	479000	106900	1185100
Internal Generation	66704	105000	150600	355100	711900	1322600
Extra-Budgetary Sources	48404	120000	159700	233000	71200	583900
Private Sector		100000	202600	136900		439500
Total	192147	519000	918100	1204000	890000	3531100

- However, in the near term, the government has made some headway and attracted foreign funds and made significant progress in projects like dedicated freight corridor (DFC) (Plan period 2012-17)

Dedicated Freight Corridor

Funding of dedicated freight corridor (in Rs Crore)	
Total DFC estimated cost	95900
Funding through WB	13600
Funding through JICA	31500
Total Funding	45100
Remainder amt through GBS	50800

- The government has ambitious plan to revive investments in railways with a focus on high speed rail, dedicated freight corridor and intends to provide up to 20% viability gap funding

PPP priorities

Project	Total Cost (Rs Cr)	Timeframe (Years)	PPP investment expected in 5 years	Cost to government
High speed coridor (Mumbai-Ahmedabad)	60,000	10	20,000	Viability Gap upto 20% of cost
Elevated rail Corridor in Mumbai Suburb	20,000	5	20,000	Viability Gap upto 20% of cost
Wagon leasing , Private freight terminals & other	5000	5	5000	
Loco & Coach Manufacturing	6000	6	5000	Equity share of Rs 300 crore & assured offtake of products for 10 years
A> Renewable energy projects (Solar, Wind etc)	1000	5	1000	Assured offtake
B> Energy Saving Projects	1000		1000	
C> Captive Power Generation	4000		4000	
Total	97,000		56,000	

Scope for FDI/PPP investment

Investments through PPP	Rs crs
High speed corridor (Mum-Ahd)	60000
Elevated rail Corridor in Mumbai Suburb	20000
Redevlopment of Stations	1,10,000
Dedicated Freight Corridor	1,34,000
Logistics Parks	17000
Wagon leasing & other freight schemes	5000
Loco & Coach Manufacturing	6000
Captive & Renewable power generation	6000
Port Connectivity projects	5000
Resource mobilization through PPP	
Land & airspace	50000

Source: RBI, Bloomberg, ICICIdirect.com Research

Key themes to spark capex revival…

(D) Smart cities - Demystified

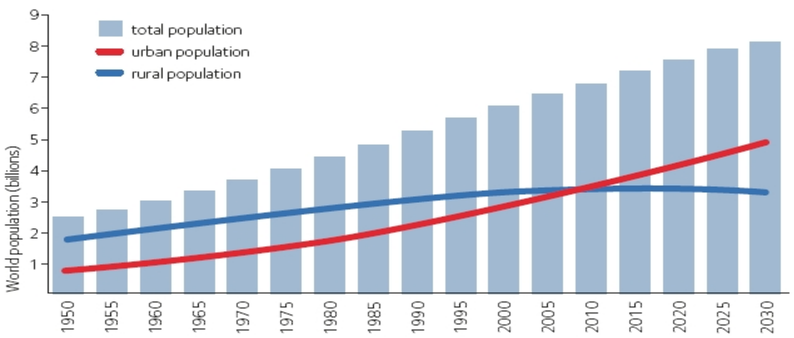
- A smart city is a region with superior overall urban infrastructure and one which leverages technology that improves services delivered to residents.

Smart cities driven by rapid urbanisation

- Only 2% of the population was urbanised in 1800, which rose to 13% in 1900 and 47%, 50% in 2000 and 2008, respectively. Estimates suggest that urbanisation could reach 70-75% in 2050 with almost a majority of the growth being centred in the developing world. City population generates ~80% of the global GDP today while 600 urban centres with 20% of the world population generates 60% of the global GDP. Of the 600 cities, 380 developed cities accounted for 50% of global GDP in 2007 with 190 North American cities alone contributing 20% of the global GDP. Estimates suggest that even by 2025, 600 cities would still account for 60% of the GDP but with rising contribution of new cities from emerging economies. Total 136 new cities are likely to enter the top 600 club but a majority of them could be from the China, India and LatAm

Urbanisation in India at inflection point.

- The urban population in India is 31% of the total population. However, it contributes 60% of GDP. It is estimated that the contribution of urban India to GDP may rise to 75% in the next 15 years. Interestingly, urbanisation is at an inflection point in India, given urbanisation globally has increased rapidly till it reached ~60-65% after crossing over 30%



What is the cost involved in developing smart cities?

- The Indian government plans to develop 100 smart cities as satellite towns of larger cities and has made a budgetary allocation of ₹ 7,060 crore towards the same. A committee on investment requirements in urban infrastructure estimates a per capita investment cost (PCIC) of ₹ 43,386 for a 20 year period, which includes estimates for water supply, sewerage, sanitation and transportation related infrastructure. Total investment potential could exceed ₹ 7 lakh crore over 20 years

Case study: Panasonic investing $500 million in smart town in Fujisawa Japan

- Panasonic plans to invest ~¥60 billion (~$500 million) to develop a sustainable smart town (SST) in Fujisawa. The company plans to use a 47 acre site to build ~1000 homes that could accommodate ~3000 people. Total 100 families have moved to SST since April 2014 while the township could be fully accommodated by 2018. Solar panels fitted on row houses could generate 3 MW of power/day, enough to meet 30% of the town's requirement while the solar panel installed in the city could generate 103 KW/day, which will be fed to the grid. Panasonic expects a 30% reduction in water consumption. It also expects to earn ¥27 billion in revenues initially when all houses are sold while a consortium of 18 companies, providing essential services such as energy, security, mobility and healthcare could earn up to ¥30 billion in revenues over a 30 year period. Panasonic plans to add three more SST near Osaka and Fujisawa.

Case study: Overview of projects undertaken in Barcelona

- Barcelona created a smart city office to coordinate >100+ projects. Some of the projects announced include 1) telecommunication network (integration of fibre optic networks boosting Wi-Fi network), 2) urban platform (city operating platform with apps three intelligent data (central decision making room with indicators). Other key projects include lightning directorate plan, self-sufficient islands (energy sufficient island to improve energy consumption & production) and electric vehicles (improve mobility), tele-management of irrigation (remotely managed automated irrigation infrastructure that helps control the frequency and duration of irrigation), orthogonal bus network to improve urban mobility, open government strategy to improve transparency and smart parking

Source: www.un.org, ICICIdirect.com Research

Key beneficiaries from capex revival

Sectors & Stock picks	
Sectors	**Preferred Stocks**
Capital Goods	L&T
Construction & Infrastructure	NBCC, Simplex Infrastructure & NCC
Cement	Ultratech, Heidelberg & JK Cement
IT	TCS, Infosys
Logistics	Concor, Blue Dart, Gujarat Pipavav Port

*Source: Capitaline, ICICIdirect.com Research, * Ex banks, NBFC and brokerages*

Market Strategy 2015

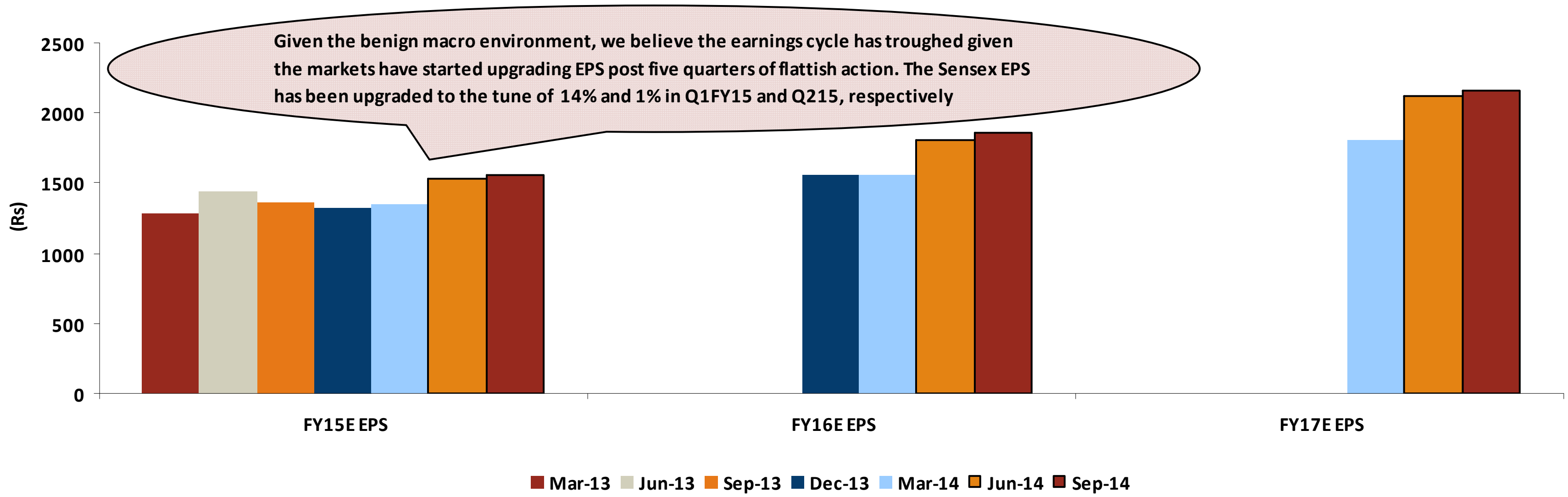
1	Introduction
2	Theme 1 – Demand & Demography to boost consumption
3	Theme 2 – Debt market to become vibrant, higher & stable debt inflows
4	Theme 3 – End of commodity super-cycle?
5	Theme 4 – Reforms initiation showing green shoots in investments
6	Sensex target for December 2015
7	Risks and Concerns
8	Top Picks for 2015

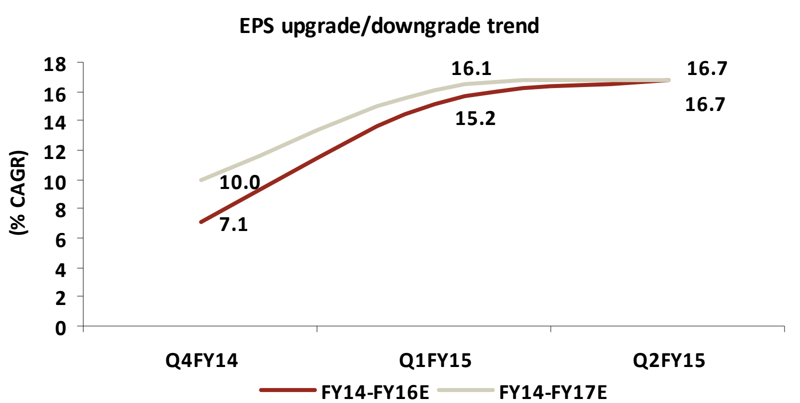
Our base case implies Sensex target of 32500, upside of 18.6% for CY15

Sensex target of 32400, upside of 18.5% for CY15			
	Bull Case	Base Case	Bear Case
BSE Sensex Earnings Trend			
FY16E	1861.7	1890.0	1709.1
%YoY Growth	22.0	23.9	12.0
FY17E	2327.2	2166.7	1914.2
%YoY Growth	25.0	14.6	12.0
Earnings CAGR over FY14-FY16E	16.8	17.7	11.9
Earnings CAGR over FY14-FY17E	19.5	16.7	11.9
Key variables as they pan out			
GDP growth rate (%) over FY16E-FY17E	>7%	6.5%	5%-5.5%
CPI Inflation (%)	4.5-5%	5.5-6%	>7%
10 year bond yields (%)	7.2-7.4%	7.5-7.8%	>8%
Brent Crude prices ($/barrel)	50-60	65-75	>80
Cut in Repo rates over FY16E-FY17E	200-250	100-150	50-75
Fisal Deficit	3.0%	3.8%	>4.5%
CAD	<2%	2.0%	3.0%
FII Inflows ($ billion)	30.0	15-20	<10
Political Election outcome			
Delhi	BJP forms government	BJP forms government	BJP fails to form government
Bihar	BJP forms government	BJP forms government	BJP fails to form government
Discounting of Earnings	FY17E	FY17E	Average of FY16E/FY17E EPS
P/E (x)	17.1	15.0	12.7
Likely Sensex target (Dec 2015)	35785.1	32500.0	22951.3
Current levels	27396.0	27396.0	27396.0
Upside/Downside (%)	30.6	18.6	(16.2)

Source: Bloomberg, ICICIdirect.com Research

Revving macros to augur well for corporate earnings cycles and valuations…

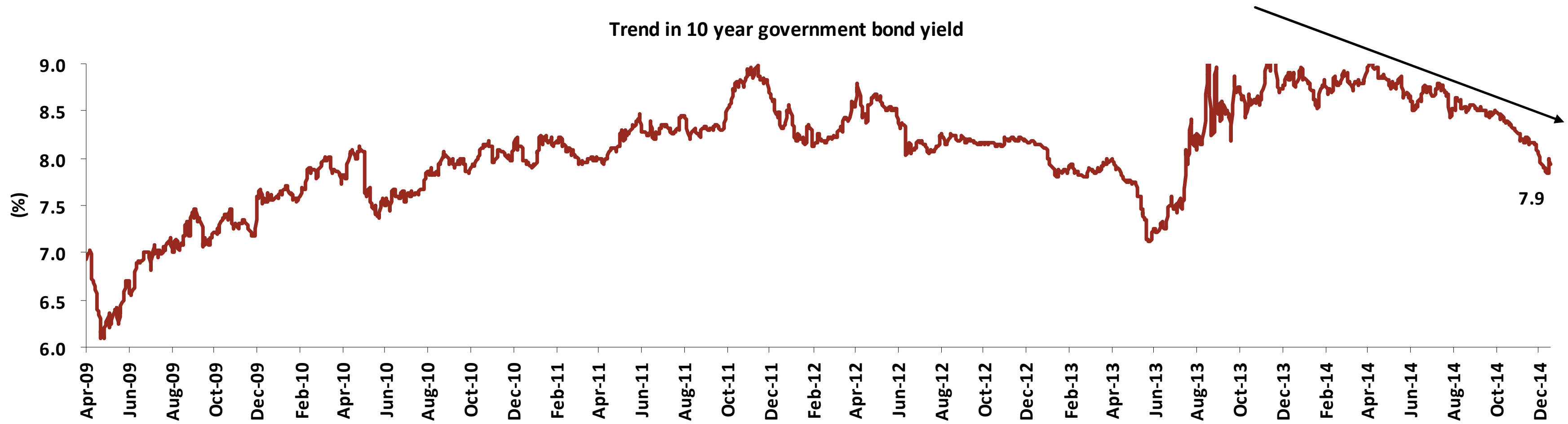




- Factoring in the fall in inflation, comfortable CAD, improved sentiments and pick-up in GDP growth, we expect Sensex EPS to grow at a CAGR of 17.7% over FY14-16E. Hence, we expect Sensex EPS for FY15E and FY16E at ₹ 1570 and ₹ 1890, respectively
- The perceived improvement in macros has begun to percolate into EPS consensus as the Street has upgraded Sensex earnings CAGR from 7.1% (FY14-16E) and 10.0% (FY14-17E) in Q4FY14 to 16.7% each for FY14-16E and FY14-17E, respectively in Q2FY15. This will also leads to expansion of P/E multiples as and when confidence of the consensus rises.

Source: Bloomberg, ICICIdirect.com Research

Falling yields and rising flows: Creating a positive loop



FII flow in Asian Equity & Bond mkt YTD

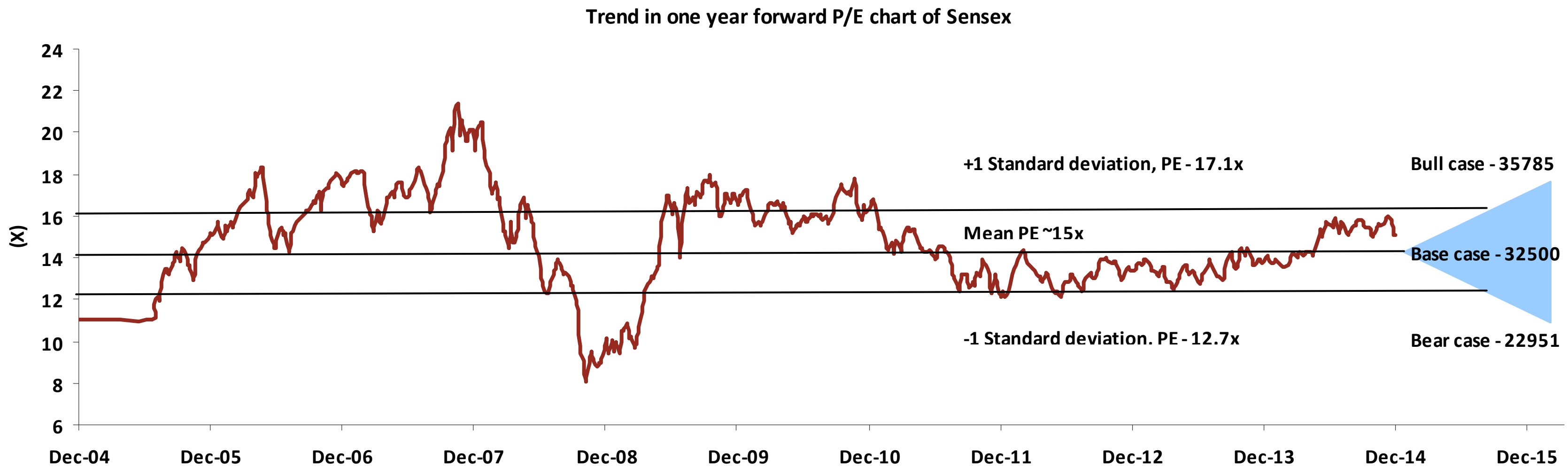
	Equity YTD ($ mn)	Bond YTD ($ mn)
India	15,998	26,397
Indonesia	3,572	24,007
Japan	22,519	92,312
Philippines	1,256	(155)
S. Korea	5,764	35,415
Thailand	(1,115)	6,484

- The recent decline in 10 year bond yields reflect the improving fundamentals of the Indian economy, swift decline in crude prices and perceived higher magnitude of rate cut.. However, intrinsically, the risk premiums or the cost of equity for the Indian markets have also declined, thereby implying a re-rating of P/E multiples, going ahead

- The decline in cost of equity coupled with a dovish environment will further fuel portfolio flows for India on equities as well as debt instruments. For instance, in YTDCY14, FII flows in the debt segment have surpassed that in the equity segment (even though equities have received $17.3 billion in CY14). This, in our view, will result in a positive macro loop wherein the strong appetite for debt will lead to better deficit and growth financing, which will make Indian equities attractive to foreigners and augment incremental flows into the equity segment

Source: Bloomberg, ICICIdirect.com Research

Valuations reasonable across historical & relative basis



Global Indices fwd P/E		
Indices	**CY14E/FY15E P/E**	**CY15E/FY16E P/E**
DOW JONES	15.5	14.9
S&P 500	17.0	15.8
NASDAQ	23.4	19.4
FTSE 100	13.8	13.3
CAC 40	14.7	13.4
DAX	13.8	12.6
NIKKEI 225	19.0	16.8
HANG SENG INDEX	11.0	10.3
SHANGHAI	12.2	10.9
S&P/ASX 200	14.6	13.6
Straits Times	14.5	13.4
Sensex	17.2	15.0

- The Sensex is trading at 15x on one year forward P/E multiple(FY16E), which is in line with the historical mean. However, given the resurrection of corporate earnings cycle, which is expected to exhibit a CAGR of 17% over FY14-16E, we believe there exists a case for re-rating of the Indian markets
- In our base case, we assign a P/E multiple of 15x on FY17E EPS to arrive a fair value of 32500 by end-CY15, implying an upside of 18.6%
- In our Bull case, we assign a a P/E multiple of 17x on FY17E EPS to arrive at a fair value of 35785 by end CY15 implying an upside of ~30.6%
- In bear case, we assign a P/E multiple of 12.7x on average of FY16E and FY17E EPS to arrive at a fair value of 22951 by end CY15 implying a decline of 16.2%
- Even on a relative basis, Indian markets are trading inexpensive given the high growth prospects. On a comparative basis, US, Japanese, European markets are trading in the range of 13-17x on a one year forward basis, which explains that Indian markets are attractively placed for upsides

Source:, ICICIdirect.com Research

Market Strategy 2015

Oil price shock … good, bad and the ugly!

Crude oil price has fallen sharply by 47% YTD due to increased production in non-Opec countries, reluctance of Opec to cut production & slowing economic activity in China, Japan and Europe. It is currently trading below the fiscal break even price for most oil exporting countries. We have already witnessed the impact of crash in crude prices on Russian economy. With the fall in crude prices, sovereign credit default swaps (CDS) of many oil exporting countries has increased several times, highlighting the global risk perception. A global contagion could put investors in risk off mode, impacting global flows in emerging markets. Impact on each country/region varies depend on their oil intensity. Below, we have summarised economic implication of falling crude oil price on various economies

Fall in crude oil price… impact positive, mixed bag and negative for different ecnomies

Countries	Implication	Comments
US	Positive	The US economy annually expanded 5% in Q3 following 4.6% growth in the previous quarter. The impact of declining energy price on the US economy will be mixed. If crude oil price falls further from here some of the shale gas project may turn unviable. Given that most of the shale gas producers are highly leveraged reduction in output of shale gas will make it difficult for them to pay back the loans they have taken out. Energy debt currently accounts for 16% of the US junk bond market, so the amount at risk is substantial. However, on the other hand, inflation is likely to stay between 1% and 1.6% (Fed estimates) as result of a cratering in oil prices, which, in turn may spur growth by boosting discretionary spending by Americans. Overall, the impact is net positive for the US economy
Eurozone	Negative	In Europe, oil-related expenditure accounts for ~5% of total spending. Hence, falling oil prices rather than helping increase spending is pushing down the headline inflation rate and making actual deflation. If this happens then it will lead to a long period of stagnant growth – which would further delay EU attempts to reduce its debt to GDP ratios
Title	Mixed Bag	China is currently experiencing a slowdown in GDP growth, with the September 2014 quarter being the slowest growth period after the 2008 financial crisis. Crude oil fall brings some relief as China imports 60% of its oil requirement and is the world's largest importer of oil. The fall in crude oil will translate into saving huge foreign exchange outflows of ~$30 billion for China. However, China's benefit from crude fall will partially be offset as it is also the world's fourth largest crude oil producer. The general downtrend in commodity prices will adversely impact China as it is the largest producer & consumer of coal. Lower oil prices will add disinflationary pressure & strengthen the central bank's easing bias
India	Positive	India being an oil importing nation, a drop in oil price is a positive. Oil imports comprise 37% of total imports of the country. A 47% drop in oil price will mean a lower import bill and reduce the current account deficit, which India has been running over a decade now. The next big positive is reduced subsidy burden, which, in turn, will aid the government to achieve its fiscal deficit target of 4.1% of GDP. Further, consumer price inflation has slowed down to 4.38% from over 10%, which provides room for the Reserve Bank of India to cut lending rates, which are at 8%. On the negative side, India derives 32% of its exports from commodity driven economies, which will get adversely impacted. Also, 27% of remittances are from gulf countries, which may also slow down. Both these factors, to some extent, offset the benefit of a lower import bill

Source: CBR, World Bank, Media sources, ECI, ICICIdirect.com Research

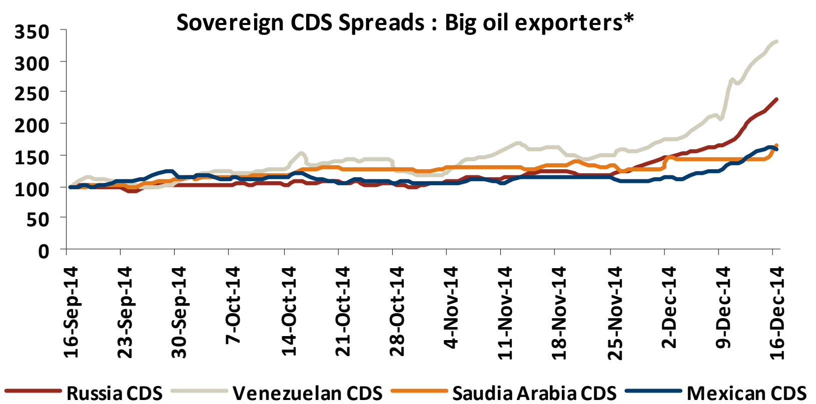
Oil price shock … good, bad and the ugly!

Fall in crude oil price... impact positive, mixed bag and negative for different ecnomies		
Countries	**Implication**	**Comments**
Africa	Mixed Bag	African countries like Gabon, Angola and the Republic of the Congo, Guinea's derive of 40-75% of its government revenue from oil trading majorly oil exports. With drop in the oil revenues would be difficult for this economies to service their debt. Further the depreciation of their currencies makes U.S. dollar denominated debt more expensive leading to increased pressure. While for the oil importing sub-Saharan African countries like Kenya, Cote d'Ivoire, Seychelles and Ethiopia the plunge in oil prices could boost the region's growth to 5% in 2015 from 4.5% earlier (Fitch Ratings estimates)
Russia	Negative	Russia's weak macroeconomic fundamentals is on account of economic sanctions levied by West, falling crude oil price & recent sell-off in rouble. The main risks are current account to slip into deficit & continued capital outflow.Russia's oil & gas exports (68% of total export revenue) is expected to fall by ~$50 billion in 2015, which will have a negative impact on Russia's current account, currently running a surplus of $52.3 billion. Given that oil revenues account for more than 50% of Federal Budget, there is a possibility of some fiscal stress. Inflation, which stood at 9.1% in November, is expected to remain at elevated levels due to western sanctions on import from West & recent sharp fall in ruble.Weak wage growth, high inflation & ruble depreciation will continue eroding purchasing power.Therefore, GDP forecast has been revised downward to -0.8% YoY. Russia's central bank and government have estimated capital outflow of ~$120-130 billion amid loss of investor confidence. Weak currency & high interest rate may lead to deterioration in macroeconomic conditions.
Middle East	Negative	In the oil exporting Middle East region, oil revenues are falling but government spending is high leading to weakening fiscal positions. In the Middle East, the share of oil in federal government revenue is 22.5% of GDP and 63.6% of exports for the Gulf Cooperation Council countries. The fiscal break-even prices range from $54 per barrel for Kuwait to $184 for Libya. If crude oil price sustains at current levels, the short-term effect of reduced oil revenues on the GCC economies would take the form of budget deficits, lower government spending and rationalised spending policies, a drop in imports and a certain reduction in employment opportunities for expatriates
Japan	Negative	For Japan, the world's third largest oil importer, the biggest threat of falling crude price in the short-term will be general state of deflation.The Bank of Japan has a target to achieve stable inflation of 2% in two years.The country faces the risk of lower crude prices outweighing the recent fall in yen, slowing down the central bank's mission to rid Japan of deflation. The index, which achieved a peak of 1.5% in April, fell to 0.9% in October. The Bank of Japan sees a $10 drop in crude oil prices weighing on CPI growth by at least 0.1 percentage point. A sustained period of sub-$60 per barrel could push inflation back into negative

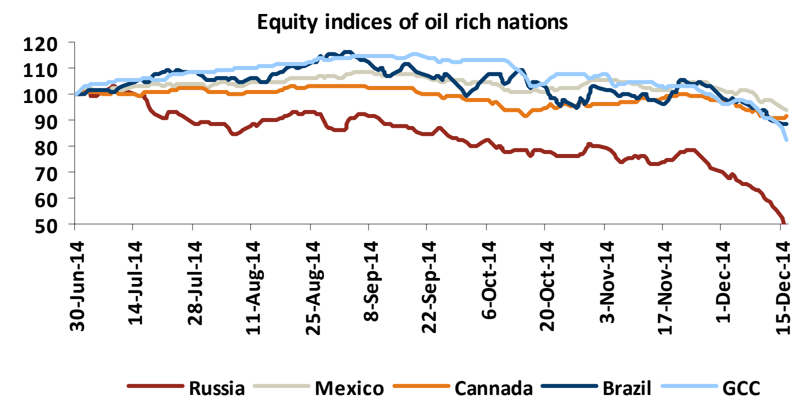
Source: CBR, World Bank, Media sources, ECI, ICICIdirect.com Research

Oil becomes "Achilles heel" for oil rich nations

Crude below fiscal breake even price of major importing nations					
Country	Sovereign Rating	Govt Debt as % of GDP	Production in million of barrels/day	Reserves(in billions of barrels)	Fiscal breakeven price
Algeria	NR	9.9	1.9	12.2	131
Angola	Ba2	29.3	1.8	9.5	98
Ecuador	Caa1	18.6	0.5	7.2	80
Iran	NR	10.7	3.6	151.2	131
Iraq	NR	34.2	3.0	143.1	101
Kuwait	Aa2	7.3	2.8	104.0	54
Libya	NR	0.0	1.5	47.1	184
Nigeria	Ba3	17.8	2.5	37.2	123
Qatar	Aa2	37.8	2.0	25.4	60
Saudi arabia	Aa3	3.6	11.7	267.0	106
UAE	Aa2	17.6	3.2	97.8	77
Venezuela	Caa1	57.3	2.5	211.1	118
Canada	Aaa	85.6	3.9	173.6	NA
Mexico	A3	43.5	2.9	10.4	NA
Russia	Baa2	10.9	10.4	60.0	107



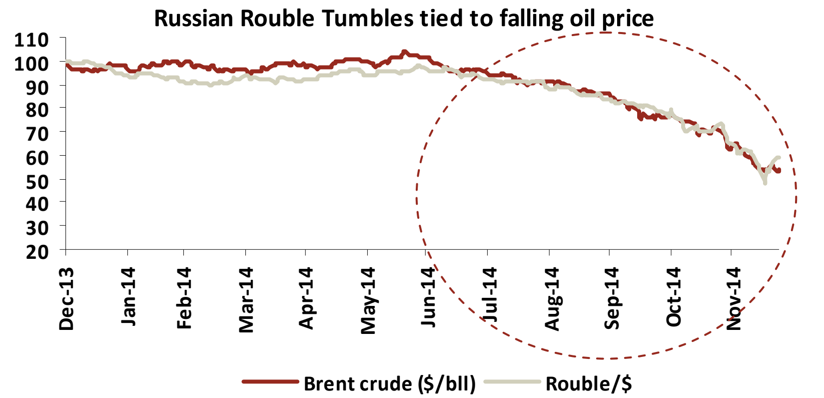
- Brent crude oil is trading below the fiscal break even price for most oil exporting countries (as seen in chart on the left)
- As oil price retreated, the most vulnerable country has been Russia, partly because of its dependence on oil for its revenues and partly on account of geo-political events
- As evident from the above graph of sovereign CDS spreads for the four oil exporting countries, it is clear that the damage is not limited to Russia
- While the Russian CDS has increased 137.8%, the Venezuelan CDS has more than tripled. Saudi Arabia and Mexico are relatively better placed although the CDS spread has jumped by 58% and 65%, respectively
- Russian stock markets have already corrected by 44%. Any restrictive measure like capital or foreign exchange control can further lead to material correction on the bourses, triggering exclusion of Russia from the MSCI Emerging Market Index
- Russia's weightage stands at 3% of the MSCI Emerging Market Index. Any exclusion from the index will lead to diversion of fund flow to emerging markets like India



Source: IMF, Bloomberg, ICICIdirect.com Research

Russia … should market brace for a contagion, Not yet!

- The sharp decline in the Russian rouble (RUB) has sparked fears of a possible crisis. The rouble is down more than 70% against the US dollar on a year-to-date (YTD) basis. A number of factors such as fall in oil prices, waning investor confidence and high inflation have been weighing on the rouble



- However in the near-term, Russia is equipped to contain the current phase of currency depreciation from becoming a full-blown contagion
- Russia's total external debt (as % of GDP) is 35% and the short-term debt component is a mere 4.0% of GDP

Russia's External sector vulnerability metrics remain positive

%	External debt to GDP	External debt to exports	External debt service to GDP	External debt service ratio	Reserves to short term external debt
Jun-13	34	121	9	283	523
Jun-14	35	123	9	253	505

- Over the next year, nearly US$120 billion is due for redemption. However, banks have a net positive external assets position, which reduces concern. Meanwhile, other sectors have a net positive assets position in the short-term, which is a good sign

Russia has a positive net foreign assets position

US$ bn	External debt	External Assets	Net external assets
Total	734.0	1,036.0	302.0
Short term	94.3	672.0	577.7
Long term	639.6	364.7	-274.9
General Govt.	59.9	63.0	3.1
Short term	0.4	1.0	0.6
Long term	59.6	62.0	2.4
Banks	208.9	288.7	79.8
Short term	57.6	123.5	65.9
Long term	151.3	165.2	13.9
Other Sectors	449.1	252.6	-196.5
Short term	29.1	115.2	86.1
Long term	420.0	137.0	-283.0

Russia US$200 billion of "usable reserves", which is sizeable

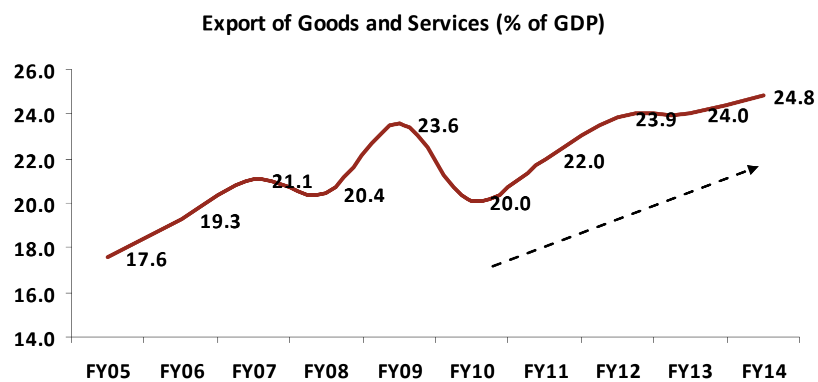
FX reserves position	USD bn
International Reserves	416
CBR FX reserves	200
Reserve Fund	88.1
National Welfare Fund	79.2
Others*	48.8

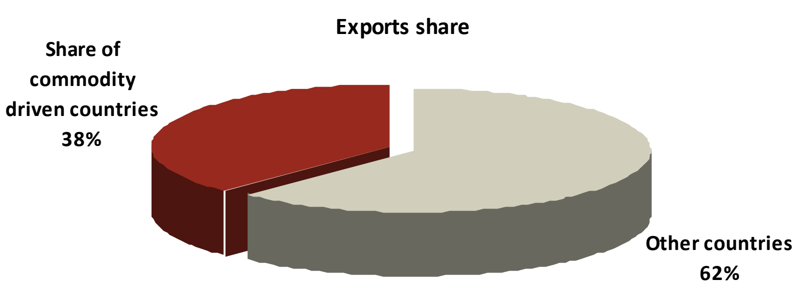
- Russia's macroeconomic fundamentals are likely to deteriorate further as a weak currency and high interest rates weigh on household and corporate balance sheets. However, the recent sell-off in the currency may not evolve into a full-blown crisis, given Russia's adequate forex reserves, manageable external debt situation and expectation of continued, credible policy

Source: CBR, World Bank, Media sources, ECI, ICICIdirect.com Research

Impact of these global events on India: Risk of exports to slow down

- India's exports contribute almost a fourth of India's GDP. Over the last five years , contribution of exports to India's GDP has been increasing
- Of the total, 38% of exports is to commodity based economies, which, as highlighted earlier, can face slower growth as economic variables deteriorate due to falling oil revenues





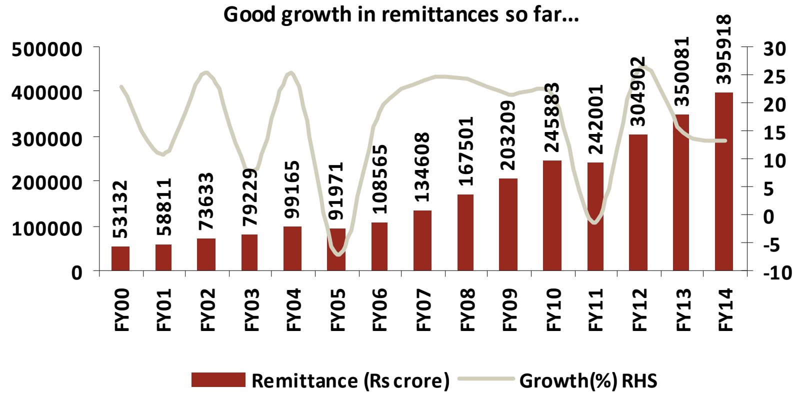
Exports to major commodity economy					
Commodity Ecnomies	FY14 (₹ crore)	% Share of total exports	H1FY15 (₹ crore)	% Share of total exports	Impacted due to
UAE	184779	9.70	102021	10.58	Fall in crude oil price
China	90561	4.75	34991	3.63	Overall slowdown and fall in metal prices
Saudi Arabia	73864	3.88	42758	4.43	Fall in crude oil price
Brazil	33871	1.78	24847	2.58	Fall in agri commodity prices
Vietnam	33253	1.75	17718	1.84	Fall in metal prices
South Africa	30770	1.62	19893	2.06	Fall in agri commodity prices
Russia	30770	1.62	19893	2.06	Fall in crude oil price
Iran	30057	1.58	12207	1.27	Fall in crude oil price
Indoneasia	29340	1.54	13521	1.40	Fall agri/crude oil prices
Thailand	22431	1.18	10022	1.04	Fall in agri commodity prices

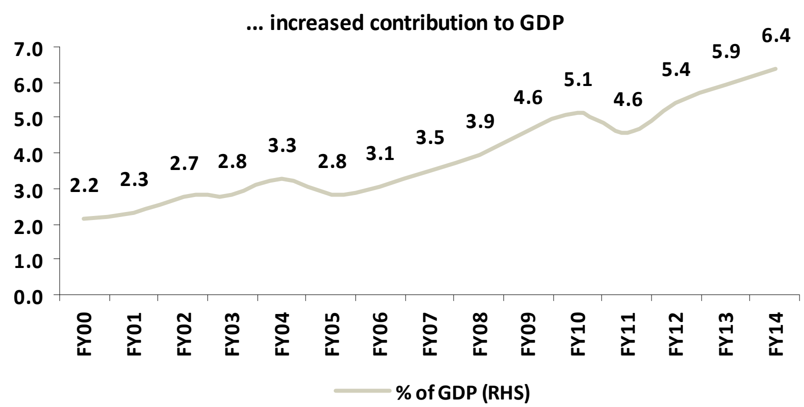
- Total 9.7% of India's total exports is to the United Arab Emirates and another 3.8% is to Saudi Arabia. Although both economies are relatively better placed among oil-based economies, a further fall in crude oil price can lead to spending cuts in future, which can, consequently, reduce the demand

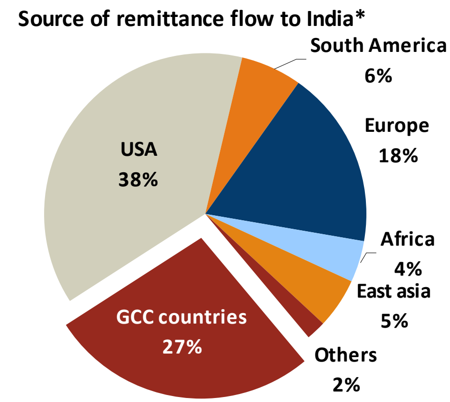
- Exports to countries affected by decline in crude oil price is ₹ 3.22 lakh crore as on FY14, accounting for 17% of total exports. India's exports to agrarian economies is worth ₹ 3.94 lakh crore, which will also come under pressure from lower food prices

Source: Ministry of Commerce, CSO, ICICIdirect.com Research

Adverse impact on remittance…







- Remittances have grown at a CAGR of 7.5% in the last 10 years to ₹ 395918 crore contributing 6.4% to the GDP
- As per the RBI study, the Gulf region accounts for an average of 27% of total remittance inflows to India, with major source countries being UAE and Saudi Arabia
- Whenever oil revenues decline, these countries may try to tighten their belts by emphasising local production and downsizing their foreign labour force in which Indians dominate
- Thus, there is a possibility of lower remittances if crude oil declines further. This would have a serious impact on remittance-dependent states such as Kerala and Goa

*Source: Ministry of Commerce, CSO, ICICIdirect.com Research; * RBI study 2010*

No magic wand with new government, reforms will take time…

Announcement	Expectation	Reality
Narendra Modi sworn in as PM	Big bang reforms	Most of the reforms need to be backed by legislation rather than just executive approval.The reform bills introduced by government needs to be passed in both Houses. While the BJP has a clear majority in the Lok Sabha with a total of 282 members, it is far below the half way mark in the 245-member Rajya Sabha with 45 seats.Therefore, the government needs to depend on friendly parties as well as opposition parties for all legislations, which would need the assent of the Upper House. BJP can only become the single largest party in Rajya Sabha by 2016 end
Make in India	Increasing the share of manufacturing sector in GDP from current 16% to 25% by 2022.The scheme aims to create 100 million additional jobs by 2022 in the manufacturing sector. Also, 60 million people work in the manufacturing sector in India as of FY12 end. Creation of National Investment & Manufacturing Zones	After the NDA government came to power, the July-September growth in manufacturing has been 0.1% & almost nil growth in gross fixed capital formation. To expect the share of manufacturing sector to increase by 900 bps in eight years is a daunting task, as it has not happened in any of the growing Asian economies. To add another 100 million jobs in the manufacturing sector by 2022, the employee generation should grow at a CAGR of 13%, which is an ambitious target. Although the central government may introduce reforms to make the "Make in India" scheme a reality, many areas like land, power & labour fall within the state government domain
Gas price hike	Announcement of gas price hike to $8-8.4 per mmbtu during UPA regime was expected to be implemented by the NDA government. This would have had a long term impact in terms of deepwater gas discoveries turning viable leading to higher investment in offshore gas discoveries & higher gas production	After tweaking the gas pricing formula, the new gas price of $5.6 per mmbtu was announced, which is not attractive for investments. The government announcement lacks clarity on the premium for deep-water explorations, which may lead to a delay in investment decisions. Economics of satellite fields /NEC-25 (RIL) & KG D5/satellite fields in the Mahanadi Basin (ONGC) are unviable.With the fall in global natural gas prices, the gas price for India will remain at lower levels leading to delayed investments and, consequently, lower gas production in future
Defence reforms	Clearance of stalled defence proposals & hike in FDI in defence	Given the backdrop of slow decision making in the defence sector in the UPA regime, the MoD has set the ball rolling in defence procurement by clearing the stalled defense deals (| 1.2 trillion since June) & living up to the expectations of faster & streamlined procurement process. However, FDI limit hike from 26% to 49% is a dampener. The FDI limit comes with a rider of management control with resident Indians, thereby leaving foreign OEMs with minority control in the venture. Lower FDI limit & stringent management control regulation will remain a major bottleneck in technology inflow in India. Therefore, the revised policy is not a significant departure from the earlier 26%. The government has just received six proposals for FDI in defence since June

Source: ICICIdirect.com Research;

Market Strategy 2015

Top Picks for 2015

Credit Analysis & Research (CARE)	Target Price: ₹ 2175 (53% upside)

- CARE, the second largest company by market share, is a pure play on the rating business with ~99% (₹ 230 crore) of its FY14 core revenue generated from the rating segment. The highlight of CARE's business is its best-in class EBITDA margin of 60%+ and PAT margin of 50%+. The business model is asset light in nature with not much capex (₹ 10-15 crore) while it generates strong operating cash flow. Post its listing, the dividend payout ratio has improved from 30% (FY12) to 63% (FY14). We expect this to grow to ~73% by FY17E. Considering the improving economic outlook with the expected upturn in the investment cycle, peaking of interest rates and gradual & structural development of the bond market we have factored in 18% PAT CAGR in FY14-17E to ₹ 210 crore vs. 12% CAGR seen in FY11-14
- In 1993, CARE was the third credit rating agency (CRA) to be incorporated in India. However, it gained significant ground to become second largest CRA by revenue post FY09. It clocked 50% revenue CAGR in FY08-11 vs. 30% by peers. CARE is strong in bank loan rating (BLR) & bond market while it does not have a significant presence in SME space as of now. We expect it to maintain its revenue market share of ~28%, going ahead
- CARE's strong margins can be attributed to i) relatively lower employee cost ii) high proportion of large ticket bank loans & bonds (high margin business) and iii) offices being largely owned saving on lease cost. Going ahead, margins are expected to decline from 64% in FY14 to 62% by FY17E owing to a rising focus on the low margin SME business and mainly due to expected rise in staff costs
- CARE has emerged as a strong player in the rating business with strong margins and improving market share with best brand recall after Crisil. It is trading at a discount to the consolidated business of Crisil & Icra. If we just consider Crisil's core rating business, CARE, trading at 20x FY17E EPS, is at a steep discount to Crisil's ~60x multiple. The company has strong RoE of 27% for FY14 and potential to further enhance it to 46% by FY17E. We value CARE at 30x FY17E EPS (~50% discount to Crisil's core rating business multiple) and arrive at a target price of ₹ 2175

Castrol India (CASIND)	Target Price: ₹ 611 (22% upside)

- Castrol India, a 71% subsidiary of British Petroleum plc, is one of the leading players in the domestic lubricants business. The company operates three manufacturing plants in India and has the largest distribution network of 380 distributors, servicing over 105,000 retail sites. The main focus of Castrol is on the lucrative automotive lubricant segment where it commands a market share of ~22% in value terms. The company derives ~90% of its revenues from the automotive segment and ~10% in industrial segment. Castrol reported revenues of ₹ 3179.6 crore and PAT of ₹ 508.6 crore in CY13
- Castrol's volume had remained subdued over the past few years due to the slowdown in the Indian economy. The prospects of the lubricant industry are highly dependent on growth in the automotive sector. We expect the automobile sector to post sales growth at 13.2% CAGR over FY14-17E to 314 lakh units in FY17E. Hence, Castrol's total volume is expected to increase at 3.8% CAGR over CY13-16E from 196.8 million litre in CY13 to 220 million litre in CY16E on the back of an improvement in auto sales and industrial growth
- Castrol is the price maker in the automotive lubricant industry. With the sharp decline in crude oil prices over the past few months, raw materials costs (base oil prices) for Castrol are expected to come down, aiding the improvement in margins. We expect gross margins to increase by ₹ 29.1 per litre over CY13-16E from ₹ 70.7 per litre in CY13 to ₹ 99.8 per litre in CY6E. Subsequently, we expect EBITDA to increase from ₹ 34.9 per litre in CY13 to ₹ 60.4 per litre in CY16E
- Castrol's strong brand positioning and superior distribution network allows it to command higher pricing power and premium for its products over its competitors. The company's focus on the personal mobility segment will remain the key driver for the automotive lubricant business and create value for shareholders, going forward. We expect revenues and profits to grow at a CAGR of 7.1% and 20.5% over CY13-16E to ₹ 3910.9 crore and ₹ 889.1 crore, respectively. We value Castrol India at 34x CY16E EPS of ₹ 18 to arrive at a target price of ₹ 611 in 12-18 months

Source: Company, ICICIdirect.com Research

Top Picks for 2015

Container Corporation of India (CONCOR) Target Price: ₹ 1670 (26% upside)

- Concor is well poised to benefit from an improving economic scenario owing to its pan-India presence and strong competitive intensity by virtue of infrastructure and scalability. It is planning to garner higher volumes and provide value added services and is, thus, investing in setting up private freight terminals (PFT) and multi modal logistic parks (MMLP) across 15 locations in India. Currently, the PFTs at Khatuwas and Nagulpally are operational and are expected to scale up in the near term. Further, Concor plans to acquire land in the central and eastern regions of the country, in close proximity to the dedicated freight corridor (DFC), to scale up its PFT business
- Over FY10-13, Concor's volume growth remained sluggish and grew at a CAGR of 2.2%. However, FY14 has seen a revival in cargo volumes with 10.9% YoY growth. Going ahead, we expect total cargo volumes to grow at a CAGR of ~11% over FY14-17E on account of the improving economic scenario and Concor's strategy of providing better rates for volume commitments by clients
- Concor is the market leader with a dominant market share (79%) among container train operators while other CTOs are still miniscule in size. Concor has an unmatched infrastructure and existing pan-India presence that would enable it to capture higher volume growth in a improved economic scenario. It has made strategic investments in building infrastructure close to the proposed DFC with the intention of capturing higher volume share over the longer term. Further, with implementation of GST imminent we expect both Exim and domestic cargo to grow considerably. Consequently, we envisage earnings per share will register a CAGR of 16% over FY14-17E to ₹ 76 with return on equity improving from 13.8% in FY14 to 15.8% in FY17E. Considering the expected acceleration in earning growth, improvement in return ratios and debt free status we assign a P/E multiple of 22x FY17E EPS to arrive a target price of ₹ 1670

Gujarat Pipavav Port (GUJPPL) Target Price: ₹ 221 (16% upside)

- Gujarat Pipavav Port with a capacity of 850,000 TEUs and strategically located on the western coast of India with proximity to industrial clusters provides scope for significant growth. Besides containers, the port is well equipped to handle bulk cargoes including fertiliser and agri-products. Further, GPPL plans to expand its container handling capacity to 1.35 million TEUs as the port container volumes have grown at a CAGR of ~12% over CY10-13. In terms of infrastructure, the port is well connected via road and rail besides housing a container freight station to manage its throughput.
- Port revenues grew at a CAGR of ~22% over CY10-13 aided by ~12% growth in container volume whereas bulk volume growth remained mostly flattish. As nearly 70% of the revenue is derived from container, GPPL's growth was highly skewed towards a particular segment. In order to diversify the cargo base, GPPL entered into various arrangements with tank farms owners and providing Ro-Ro facility for auto logistics handlers. Going ahead, as GPPL is present in proximity to auto hubs coupled with acting as a gateway to northern hinterland auto manufacturers, it is well poised to gain through new business addition
- With the addition of a couple of new business lines and improved revenue visibility, GPPL is expected to post a revenue CAGR of nearly 20% in CY11-15 whereas EBITDA CAGR is expected at ~27% in the same period. As nearly 70% of GPPL's cost is fixed, the new business is expected to further improve the operating leverage, thereby aiding the EBITDA margin. Further, GPPL's debt free structure and ECB funding for new capex is expected to bring down the interest cost. A diversified cargo portfolio and presence in high growth segments like tank farms and auto export provide confidence on the earnings growth of GPPL. Consequently, we revise our estimates upwards and arrive at a DCF based target price of ₹ 221

Source: Company, ICICIdirect.com Research

Top Picks for 2015

Heidelberg Cement (MYSCEM)	Target Price: ₹ 105 (28% upside)

- Heidelberg Cement is a player in the central regional that contributes over ~94% of its total revenues. The company has recently doubled its cement capacity to 6 MT from 3 MT in CY13 at a total capex of ₹ 1570 crore. With a revival in demand along with stabilisation of new capacity, we expect its margin to reach over 15% by CY16E with capacity utilisation of over 85% during the same period
- After scaling up capacity, the company is now focusing towards cost reduction. It has installed a conveyor belt between its limestone reserves and clinker units, which are 20 km away (at ₹ 200 crore) to transport limestone to its clinkerisation unit, which is currently being transported by trucks. This would help the company in achieving cost savings of about ~₹ 45-50/tonne. Further, to reduce its power costs, the company is currently setting up a 13 MW waste heat recovery plant (capex of ₹ 150 crore), which will be commissioned by early 2016E. Considering the benefit of conveyor belt, economies of scale coupled with better utilisations, we expect operating margins to improve to 14.8% in CY15E and 15.4% in CY16E from 6.3% in CY13
- A healthy operating environment coupled with strong promoter back-up (Heidelberg AG: world's third largest producer) allay our concerns with regard to its debt servicing ability. The D/E currently stands at 1.2x
- Given the scope for margin expansion along with better demand-supply matrix, we expect the company to report a net profit of ₹ 104.4 crore in CY16E. We expect EBITDA/tonne of ₹ 662/tonne in CY16E from ₹ 260/tonne in CY13. On an EV/tonne basis, the stock is trading at $86/tonne (on capacity of 5.4 MT), which leaves scope for further upside once its operating matrix improves fully. Hence, we remain positive on the stock with a target price of ₹ 105/share (i.e. valuing at 9.5x CY16E EV/EBITDA, $100/tonne on capacity of 5.4 MT)

Infosys Ltd (INFTEC)	Target Price: ₹ 2400 (23% upside)

- Infosys announced the selection of Dr Vishal Sikka, the former SAP executive board member, as its new Chief Executive Officer and Managing Director (CEO & MD), effective August 1, 2014, for a period of five years. Under the new CEO, Infosys is undergoing another strategic transformation and is broadly emphasising on two themes: 1) renewing the core business and 2) innovating into new business. Acknowledging that this transformation is demanding and could stretch, the management is confident of execution and believes such a company could sustain 15-18% revenue growth and 25-28% EBIT margins
- The new management emphasised massive embrace of design thinking – new – in renewing existing offerings such as consulting services, product engineering & Finacle and committing considerable investments in this area. Currently, ~8300 entry level and 160+ senior employees have been trained on design thinking while more could follow. Interestingly, 70% of US based consultants have been trained on design thinking while 1000 people have been trained on AI/machine learning with 500 being added every quarter. The company noted that next generation PLM, integration of physical with digital, is creating opportunities with Infosys starting three to six such engagements in the last four months. The company is hiring aggressively in new technologies with headcount up 59% in data analytics, 31% in infrastructure services, 22% in security, 13% in cloud, and 4% in digital in the last two quarters. Infosys is adding more feet on the ground and has added 207 (104 US, 42 Europe, 61 RoW) sales heads in the last two quarters
- With a cash pile of $5 billion, the company has put in place an active M&A strategy to augment growth in underpenetrated segments & geographies
- We expect Infosys to report rupee revenue, earnings CAGR of 9%, 14% in FY14-16E (average 25.6% EBIT margins in FY15-16E), vs. 18%, 12% reported in FY09-14 (average 28.1%), respectively. Though the earnings trajectory may improve over time, incoming CEO continues to impress with his strategic direction. We value Infy at 20x its FY16E EPS of ₹ 120

Source: Company, ICICIdirect.com Research

SKF India (SKFBEA) — Target Price: ₹ 1568 (18% upside)

- SKF India (SKF) is the leader in the Indian bearing market (pegged at ₹ 8000-8500 crore) with ~28% share. Known for deep groove ball bearings (forming ~35% of revenues and ~45% market share), SKF is equally present across the industrial (46% of sales) and automotive segments (54% of sales including exports). With expected industrial revival and an uptick in auto demand, going ahead, SKF is well poised to capture the opportunity given its strong balance sheet with cash flow generation and scalability bandwidth
- With the auto industry finally showing signs of recovery after nearly two years of a demand slump, new launches and product refreshes are the key, going ahead. SKF, being the largest bearings player in the industry, commands scalability bandwidth coupled with a lean balance sheet and is poised to capture the opportunity arising from the revival in demand in the automotive segment. We expect SKF's manufactured product (auto) sales to exhibit ~14.6% CAGR over CY13-16E, in line with overall auto growth assumptions
- Industrial bearings (46% of revenues) are sourced from the parent (~90%) and SKF Technologies. We expect import substitution of industrial bearings, through ramp up in SKF Technologies, to be a key revenue driver for SKF's revenues and margin expansion as SKF would improve its turnaround time while the resultant cost saving would lead to market share gains. Consequently, we expect industrial (traded goods) sales to grow at 11.6% CAGR over CY13-16E with overall EBITDA margins recovering to 13.7% in CY16E vs. 11.5% in CY13
- Given SKF's leadership position in the bearing space, strong earnings growth (CAGR of 24% in CY13-16E), healthy balance sheet with robust cash flow generation (₹ 680 crore over CY14E-16E) and core RoEs in excess of 30%, we ascribe a P/E multiple of 26x on CY16E EPS and a target price of ₹ 1568/share

State Bank Of India (STABAN) — Target Price: ₹ 374 (22% upside)

- SBI is the largest bank in the country both by asset size (₹ 19 lakh crore balance sheet size) and profitability (~₹ 12000 crore). SBI has managed ~16-17% market share in both deposits and advances consistently. Going ahead, we expect SBI to maintain its market share and grow in line with industry with deposit CAGR of 15.5% to ₹ 1860692 crore and credit CAGR of 15.2% to ₹ 1604457 crore in FY14-16E. For FY15, growth is expected to be relatively subdued
- In 1993, retail deposit funds ~80% of total deposit, which is stable in nature while its bulk deposit proportion is sub 10%. CASA stood at 42.79% for the bank. Hence, liquidity risk and interest rate risks remain limited for SBI. Hence, it is maintaining one of the highest domestic NIM among PSU banks at ~3.5%. A strong operational performance led by NII enables SBI to cover up for higher provisioning & post decent profitability
- GNPA stood at ₹ 60712 crore (4.9% of credit) while its standard restructured assets are manageable at 3.5% (₹ 43962 crore) as on September 2014. Considering the large size of SBI, its exposure to stressed sectors is relatively low. Overall, the bank has relatively stable asset quality compared to other PSU banks with stressed asset (NNPA + RA) proportion of 6.2% as on Q2FY15 compared to ~10% for other PSU banks. We expect GNPA and NNPA ratio at 4.7% and 2.5%, respectively, by FY16E.
- We expect the bank to post healthy 18% CAGR in profit to ₹ 15908 crore, over FY14-16E with return ratios of RoA at 0.7-0.8% and RoE of 11-12%+. We continue to recommend SBI led by comfort on scale and relatively lower headwinds on the asset quality
- We have a target price of ₹ 383, valuing the core book at 2.5x FY16E standalone ABV and adding ₹ 45 for associate banks & subsidiaries (life & general insurance, AMC, etc)

Source: Company, ICICIdirect.com Research

Top Picks for 2015

UltraTech Cement (ULTCEM) — Target Price: ₹ 3240 (22% upside)

- We continue to prefer UltraTech Cement in the large-cap space as we believe the company is best placed to capture the full growth potential in tandem with a sharp economic recovery, given its pan-India presence and high cost efficiencies among large caps in the cement space. The current grey cement capacity stands at 60.2 MT (ex-MP unit of Jaypee Cement) with market share of 17% in the cement industry in India
- The company has consistently remained ahead of its peers in terms of capacity expansion with a CAGR of 23% vs. peer's CAGR of 13% over the past five years. During FY14, UltraTech increased its capacity by 6% YoY to 53.9 MT by commissioning the 3.3 MT clinker plant in Karnataka. The company recently acquired Jaypee's Gujarat cement unit with 4.8 MT capacity. Further MoU for acquiring 4.9MT cement capacity in Madhya Pradesh of Jaypee Cement has resulted in total capacity of ~65 MT, which is well ahead of the company's targeted expansion plans for FY15E
- The lower lead distances due to a pan-India presence, captive power plants (733 MW), higher sales realisations due to a higher trade mix has helped the company to generate healthy operating margins (i.e. 18-20%) in the industry. It has also been able to reduce its power consumption per tonne gradually through various initiatives. Power requirement of ~80% is met through captive power plants, which helps the company in maintaining lower fuel costs per tonne
- We believe the industry's capacity utilisation bottomed at ~71% in FY14. We think low capacity additions and demand recovery should lift utilisation levels from hereon given the cyclical upturn in the economy coupled with an expected policy push to drive investments in the infrastructure sector. Being a net debt free company, UltraTech is well positioned to reap the benefit of a recovery in demand and generate healthy free cash flows in future. The stock is currently trading at 13.7x and 11.3x EV/EBITDA for FY16E and FY17E, respectively, against last four year's average valuations of 13.0x. We value the stock at 13.5x its FY17E thereby arriving at a target price of ₹ 3240

Voltas Ltd (VOLTAS) — Target Price: ₹ 348 (48% upside)

- Voltas, India's leading room air conditioner (RAC) manufacturer (with ~20% volume market share) & electro-mechanical project & services (EMPS) player, is set to benefit from a changing demographic profile & revival in India's investment cycle. Its unitary cooling products (UCP) division's revenue has grown at 16% CAGR in FY10-14 mainly due to a change in product mix towards premium products. With sustained demand from tier-II, tier-III cities and rising trend of urbanisation, we expect the UCP division to witness volume growth of ~8% (vs. ~5% industry growth) for FY14-17E. In the EMPS business, Voltas' strategy to focus on profitability by bidding for small size, high margin projects and their timely execution would help in margin expansion in future. Given the strong performance of UCP division, its contribution to revenue may change from current 39% to 44% by FY17E. We expect consolidated sales, earnings CAGR of ~12%, ~24%, respectively, in FY14-17E
- Voltas follows an asset light model for its UCP division, which has an assembling capacity of 7,70,000 units and a total dealer network of over 6500 in India. Strong brand recall value and relatively lower A&P expenditure than competitors helped Voltas maintain EBIT margin of 9-12% in FY10-14. We expect EBIT margin of the segment to remain strong (~12.5-12.8% in FY14-17E) due to increasing contribution of split AC. Strong RoCE of ~40-43% in FY11-14 & strong cash flow generation capacity of UCP division helped in funding higher working capital requirement of EMPS business in difficult times. We believe a steady recovery in profitability of EMPS & robust cash flow generation capacity of UCP division would generate operating cash flow of ₹ 413 crore in FY17E
- Voltas is trading at a PE multiple of 20x FY16E and 18x FY17E earnings. We expect the EMPS segment to narrow its losses in FY14 and start contributing to the EBITDA in FY15E by executing high margin projects. It will help reduce working capital requirements with improving return ratios, going forward. The continuous outperformance of the UCP division makes Voltas a re-rating candidate in line with consumer durable stocks. Based on our SOTP valuation, we arrive at a target price of ₹ 348

Source: Company, ICICIdirect.com Research

Disclaimer

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