Research

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It's Advice, Not Adventure

Resurgent India an oasis in global economic milieu

Market Strategy 2016

1 Introduction

2 Where are markets headed in 2016?

3 Top Picks for 2016

4 Sectoral Views

5 Volatility in earnings growth and market performance

6 Government to drive capex , consumption (Seventh Pay Commission) and reforms

7 Conundrum of global events

8 What can alter India's favourable position

Resurgent India an oasis in global economic milieu

With the onset of CY16, the global growth conundrum seems to be getting aggravated as the US, on the one hand, is on a strong footing whereas other behemoths like China and Japan are adjusting to declining output, accompanied by staggered easing. The situation is getting even more perplexing as the Fed, on the one hand, has resumed its rate hike cycle while commodities have witnessed a massive plunge from historic highs in just over a year i.e. CY15. The key casualties of such moves have manifested in the form of weakening emerging market currencies (including voluntary devaluation), slower global trade resulting in weak GDP/adverse fiscal situation especially for export oriented economies and baffling liquidity flows across all asset classes. This does pose a question about whether the world is bracing for another stagnation/deflationary environment.

Amid the chaos, India, to an extent, seems to be a paradox, despite its own challenges, wherein the green shoots of a recovery are visible as a) Externally, commodities, especially crude prices, have favourably supported the fiscal position, thereby providing arsenal to the government to kick-start the capex cycle and attract massive foreign capital to partially fund the same as India seems to be an oasis of growth across the globe and b) Internally, the government's several confidence building measures, over the last year, such as allowing FDI in several sectors, laying a roadmap for GST, announcing Seventh Pay Commission hike (driver for consumption growth) and increased expenditure on infrastructure coupled with a declining interest rate scenario will allow India to outperform major developing economies.

Revving up capex cycle a must…government on right track: Planned investments grew 20.5% YoY in H1FY16, thereby showing signs of green shoots in the investment cycle. However, the improvement in capex was driven by the government as its share in investment has increased from ~50% in FY10 to ~ 60% in H1FY16. Key sectors that are expected to witness significant capex spends include power T&D, roads, Railways, defence and renewables in CY16E/FY17E.

Consumption to gain momentum as Seventh Pay Commission is implemented: The 23.5% pay hike recommended by the government is expected to influence ~1.4 crore employees resulting in an increase in wage bill to ₹ 3.5-4 trillion. Implementation will lead to a 200 bps impact on GDP over two to three years. An increase in household income will lead to a change in consumption pattern benefiting discretionary sectors like auto, (incremental demand of 16.6% spread over FY17E-18E), building materials, white goods, jewellery and building materials (plywood/tiles) and paints.

Government intent on reforms strong amid uncertainty of implementation: Though the timing of passage of the GST bill remains unclear, the implementation of the same would create a level playing field for all organised manufacturing entities irrespective of their place of operation without hurting inflation meaningfully.

Aggravating global issues may jeopardise India's position: The Fed lift-off is behind us but the trajectory of the same will keep global assets classes on alert. Any negative surprise can jeopardise liquidity flows across the globe. Growth prospects in China and stability in commodities will be essential for global growth and currency markets as any further deterioration can hurt global trade and growth. This can further lead to risk of devaluation of currencies, widening deficits & redemption of investments by SWFs. A revival of commodities, especially crude, can alter India's favourable fiscal position & current account position, therefore, hurting government resources to kick start investment cycle & weakening the currency that has relatively stood tall till now.

Market outlook:

Going ahead, we expect Sensex earnings to grow at a CAGR of 14.6% during FY15-17E. The key determinant of earnings stability/volatility will be how quickly the price correction in commodities gets arrested as it has a meaningful bearing on the profitability of commodity related stocks. In our base case, we assign a target of 29000 levels on the BSE Sensex by December 2016, with an upside of 12.2%.

Going into CY16E, we believe the outperformance of midcaps would continue but the action may get concentrated as valuations are becoming expensive amid EPS CAGR of 24%. The midcap index is trading at 16.1x on FY17E EPS, in that universe. Hence, one has to be selective while investing in midcaps, thereby focusing on visibility of revenues, balance sheet strength, cash flow profile and management quality.

The key reason for the outperformance of midcaps is the fact that the positive impact of operating leverage (lower input costs) and financial leverage (improvement in working capital and decline in interest rates) has been more profound vis-à-vis large caps. This trend is expected to continue on the back of an incremental fall in input costs and likely reduction in interest rates in CY16E. The same is reiterated by the 24.4% earnings CAGR for midcaps vs. 15.6% for large caps in FY15-18E.

Stock Picks for 2016

Company	CMP	Target Price	Upside
Ashoka Buildcon (ASHBUI)	206	240	17%
Bajaj Finserv (BAFINS)	1936	2308	19%
Greaves Cotton (GREAVE)	141	180	28%
Jet Airways (JETAIR)	625	790	26%
Jagran Prakashan (JAGPRA)	159	193	22%
Mahindra & Mahindra (MAHMAH)	1252	1470	17%
Somany Ceramics (SPLIND)	375	465	24%
VA Tech Wabag (VATWAB)	699	830	19%

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2	Where are markets headed in 2016?
3	Top Picks for 2016
4	Sectoral Views
5	Volatility in earnings growth and market performance
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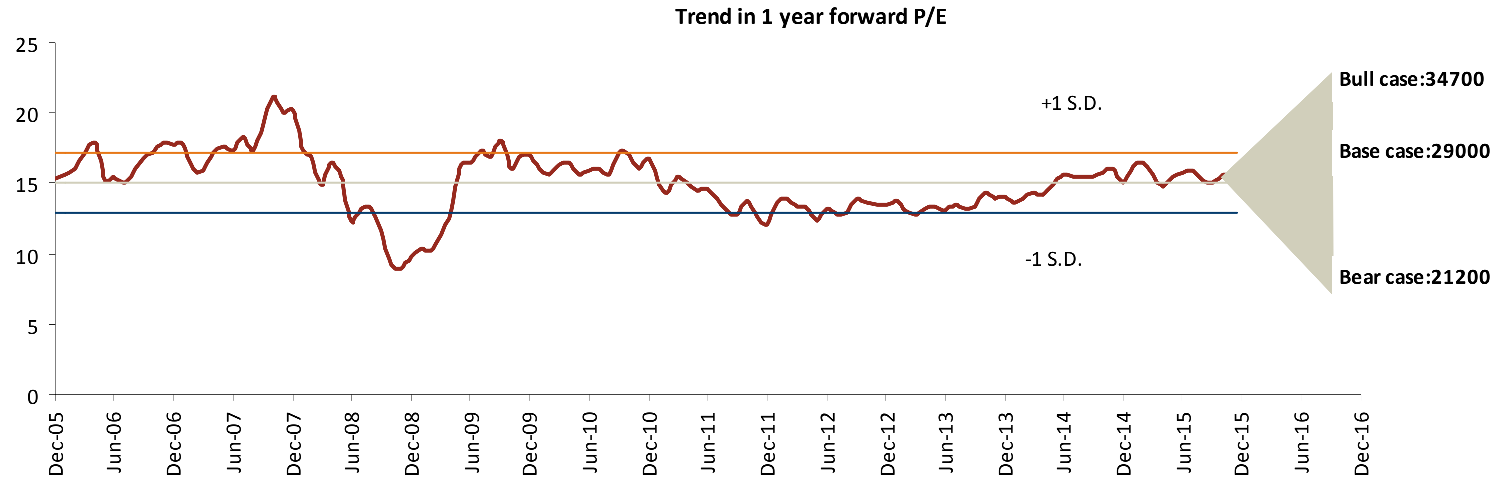
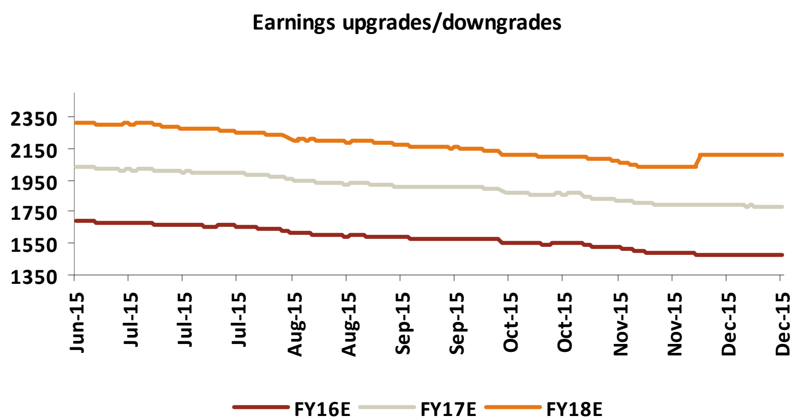
Our base case implies Sensex target of ~29000, upside of 12.2% for CY16E

	Bull Case	Base Case	Bear Case
BSE Sensex Earnings Trend			
FY16E	1495	1461	1318
%YoY Growth	10.0	7.5	-3.0
FY17E	1839	1754	1516
%YoY Growth	23.0	20.1	15.0
FY18E	2103	2103	2103
Key variables as they pan out			
GDP growth rate (%) over FY16E-FY17E	>8%	7.5-8%	6.5-7%
CPI Inflation (%)	4.5-5%	5-5.5%	>6%
10 year bond yields (%)	7.2-7.4%	7.5-7.8%	>8%
Brent Crude prices ($/barrel)	35-50	50-75	>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%
Discounting of Earnings	FY18E	FY17E	FY17E
P/E (x)	16.5	16.5	14.0
Likely Sensex target (Dec 2016)	34742	29000	21224
Current levels	25850	25850	25850
Upside/Downside (%)	34.4	12.2	(17.9)
Likely Nifty Target (Dec 2016)	10528	8788	6431

Earnings cycle still going through bottoming phase…

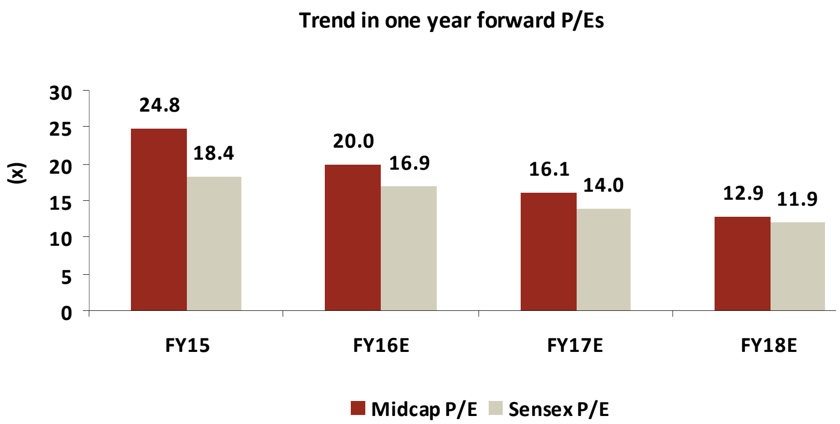


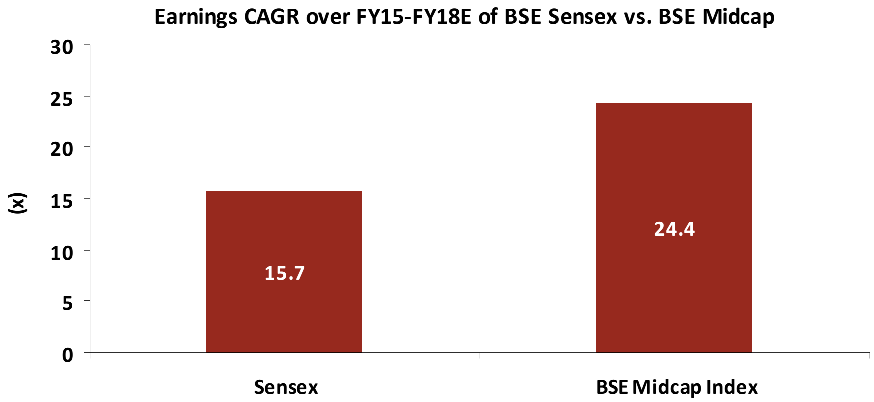


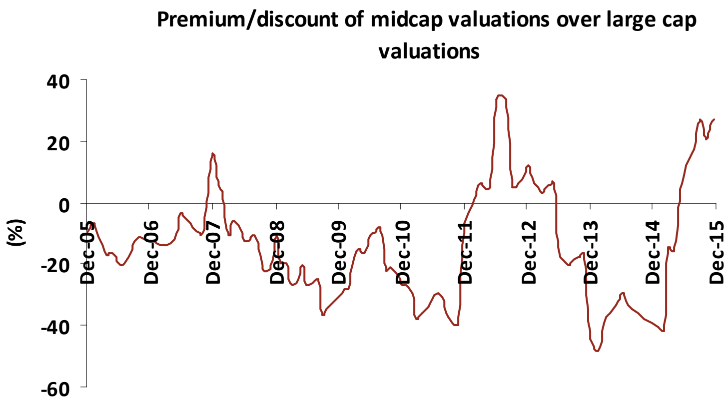
- Going ahead, we expect BSE Sensex earnings to grow at a CAGR of 14.6% in FY15-17E. The key determinant of earnings stability/volatility depends on how quickly the price correction in commodities gets arrested as it has a meaningful bearing on the profitability of commodity related stocks
- The above point is clearly reflected in the fact that the earnings downgrade cycle, which we believe is near its bottom, is clearly reflective of the downward adjustments in profitability of commodity based stocks
- Based on earnings assessment for FY17E, in our base case, we assign a target of 29000 on BSE Sensex by CY16E (discounting the FY17E EPS at 16.5x). In our Bull and Bear case, we have based 16.5x FY18E EPS (Bull case) and 14x FY17E EPS (Bear case), to arrive at targets of 34700, 21200 in both scenarios, respectively.

Source: Bloomberg, ICICIdirect.com Research

Midcaps with earnings quality can continue to outperform large caps







- In CY15, the BSE Midcap index outperformed by ~15% as the BSE midcap has delivered 7.5% returns while large caps delivered negative returns of 7.2%. Valuation wise, midcaps have started trading at a premium to large caps. The former is approaching all-time high premium that was witnessed in CY12
- The key reason for the outperformance of midcaps is the fact that the positive impact of operating leverage (lower input costs) and financial leverage (improvement in working capital and decline in interest rates) has been more profound vis-à-vis large caps. This trend is expected to continue on the back of an incremental fall in input costs and likely reduction in interest rates in CY16E. The same is reiterated by the 24% earnings CAGR for midcaps vs. 18% for large caps in FY15-18E
- Going into CY16E, we believe the outperformance of midcaps may continue but the action may get concentrated as valuations are becoming expensive, The midcap index is trading at 16.1x on FY17E EPS, in that universe. So, one has to be selective while investing in midcaps, thereby focusing on visibility of revenues, balance sheet strength, cash flow profile and management quality

Source: Bloomberg, Reuters, ICICIdirect.com Research

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3	Top Picks for 2016
4	Sectoral Views
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7	Conundrum of global events
8	What can alter India's favourable position

Top Picks for 2016

Bajaj Finserv (BAFINS) **Target Price: ₹ 2308(19% upside)**

- Bajaj Finserv, a financial conglomerate under the flagship brand of Bajaj and leadership of Sanjeev Bajaj has witnessed a sharp surge in earnings in all three key business segments. In general insurance, it is the most profitable and efficient player among competitors. Bajaj Finance, a niche consumer durable lender, reported a 4x increase in loan book in FY11-15 and earnings surged at 38% CAGR. We expect consolidated revenue, PAT to grow at a CAGR of 12.9% and 22.9% to ₹ 22996 crore and ₹ 2551 crore, respectively, over FY15-17E
- Its general insurance is a strong business model generating RoE in excess of 24%, reporting underwriting profits on <100% combined ratio. The extensive retail focus enabled market share of ~6% in gross written premium (GWP). It reported sustained profit, net worth growth at 38%, 33% CAGR in FY13-15, respectively. We expect PAT CAGR of 9.7% to ₹ 676 crore by FY17
- Bajaj Finance, a distinguished consumer durables portfolio boosted its loan book, growing 36% YoY to ₹ 31200 crore in FY15. Asset quality sustained despite a weak economic environment. Margins sustain around ~10% due to higher IRR in products. PAT has surged 38% CAGR to ₹ 897 crore in FY11-15 with bulging contribution of 42% from 25% earlier, to consolidated PAT. Expect PAT moderation to 29% CAGR to ₹ 1502 crore
- Bajaj Allianz Life Insurance (BALIC) has been relatively slow in the insurance space and is, hence, trading at low valuations. It recorded first profit in FY10 of ₹ 542 crore and is now earning higher PAT of ₹ 876 crore in FY15. Post regulatory overhang on ULIP, etc, fading now, business potential is huge. PAT expected to grow at 26.7% CAGR to ₹ 1110 crore.
- Based on SoTP valuation, we ascribe a target price of ₹ 2308/share to Bajaj Finserv, which implies a multiple of 14.4x on FY17E consolidated earnings. Even consolidated RoE is at 16-17% and RoA at 2%. The stock is available at reasonable P/E valuation of 12.2x FY17E earnings. Post recent insurance FDI increase, life and general insurance are expected to trade strong, while dividend from them can be an upside risk. We recommend **BUY** rating on the stock.

Jagran Prakashan (JAGPRA) **Target Price: ₹ 193 (22% upside)**

- Jagran Prakashan, a leading print media player, is the most read daily in India with an average issue readership of 16.5 million (IRS Q3 2012). It continues to dominate the market of UP and is second/third in markets of Bihar, Haryana, Jharkhand, Uttaranchal, etc. It has demonstrated advertisement revenue CAGR of 14.0% in FY09-14 vs. industry average of 9.0%. Going ahead, with the economic revival in the offing, ad revenues are expected to grow at 10.8% CAGR in FY15-17E to ₹ 1531.4 crore. Circulation revenues are expected to grow at 4.1% in FY15-17E to ₹ 422.7 crore, aided by cover price hikes & increase in copies. High ad growth coupled with turnaround in other publications (Nai Duniya, Midday, etc) would aid margins. Ex-radio margins are expected to reach 26.2% in FY17E
- Acquisition of "Radio City" (20 stations) and 11 frequencies in Phase III auctions in print rich areas is another growth trigger for Jagran. Radio City's financials remain top notch with the segment posting 28% ad revenue growth in FY15 and operating margins of ~30%. We expect radio ad revenues to grow at 12.0% CAGR in FY15-17E to ₹ 258.2 crore with radio margins at 33.0% in FY17E
- The radio foray gives the investor a co-play of radio and print, both segments being outperformers in their respective genres. We believe the underlying value from Radio City will only be captured on an SOTP based valuation. We value the radio business at a 25x FY17E EPS (25% discount to ENIL's target multiple) and the print business at a 16x FY17E EPS, to arrive at a revised target price of ₹ 193. We have a **BUY** recommendation

Source: Company, ICICIdirect.com Research

Top Picks for 2016

Jet Airways (JETAIR) **Target Price: ₹ 790 (26% upside)**

- The recent sharp fall in ATF prices (down over ~43% from peak of FY14) have provided significant room for margin expansion along with the growth opportunities for an Airline Industry. The Indian air travel market is highly under penetrated market, despite liberalising actions taken by the Government of India. India's penetration of 80 per 1000 population is low relative to other developing markets such as Brazil, Turkey, Indonesia and China, where penetration rates are between 350/1000 and 650/1000 respectively. Considering these earnings growth lever, we expect Jet airways to gain market share along with the improved profitability over the next few years. Assuming the benefit of lower ATF prices, we expect company's EBITDA margin to scale up to 11.3% as witnessed in FY11 from 1% in FY15.
- While the domestic environment will remain challenging over the long-term due to the entry of new players in the industry, we believe a sharp reduction in fuel prices (down over 43% YoY from peak of FY14) remains a key trigger for margin expansion going forward. At average crude price of ₹ 46400/kl, we believe the company can touch the operating margins of 11.3% as witnessed in FY11.
- Jet airways currently has a fleet of 113 aircrafts. The company has made an additional order of 75 Boeing 737 Max 8 planes which will start to get deliver from mid-2018. This would not only enable the company to cater to burgeoning passenger growth in India but also help jet airways in gaining market share. Further replacement of older planes with newer ones will help the company in reducing the maintenance & fuel costs significantly.
- Given the improving macro factors like healthy industry passenger traffic growth (up 19.7% YoY) coupled with lowest ATF prices, we expect the company to report healthy revenue growth along with better margins during the period FY15-17E. Hence, we remain positive on the company and maintain our BUY rating with revised target price of ₹ 790/share (valuing at 0.7x FY17E EV/sales, 6.5x EV/EBITDA).

Greaves Cotton (GREAVES) **Target Price: ₹ 180 (28% upside)**

- Greaves Cotton (GCL) is one of the largest manufacturers of single cylinder (diesel, gasoline engines) and dual cylinder engines, which are used in running 3W vehicles and 4W small commercial vehicles (SCVs). Over the years, GCL has been able to command an overall 3W auto segment share at about 35% in FY08-15. In the 3W goods segment (sub 1-tonne category), GCL commands a dominating position of 80-90% share as market leader OEM i.e. Piaggio (single largest client of GCL) sells the highest 3W goods carrier in the domestic market. The auto segment constitutes ~60% of overall revenues. The revenues of the auto segment is expected to grow on the back of signing of new OEM in the 4W SCV and improved demand from Tata Motors.
- The non-auto engine business segment includes sales from the farm equipment business, industrial engines (marine & fire fighting) and power gensets. Average share of these segments has been hovering around 10-15% of consolidated sales in the last couple of years. Owing to the industrial slowdown and weak macroeconomic conditions, revenues witnessed degrowth in FY15, mainly in the agri business. However, at the same, GCL has been able to maintain its market share across all segments. We expect the segment to post revenues of ₹ 749 crore and ₹ 846 crore in FY16E and FY17E, respectively, thereby representing 8.4% CAGR in FY15-17E.
- We expect revenues to grow at a CAGR of 12% in FY15-17E. Hence, our consolidated net revenues for FY16E, FY17E are at ₹ 1785, ₹ 2116 crore, respectively. The pain point has been the infrastructure segment wherein lower capacity utilisation/sales have hit overall margins. Discontinuation of the infra business and a simultaneous pick-up in capacity utilisation in the engine business will lead to operating leverage gains. Hence, we build in a recovery in FY16E, FY17E and expect margins at 16-17% levels.
- A sharp margin recovery and signing of new OEMs coupled with an improving demand scenario will drive PAT CAGR over 30% in FY15-17E. With a lean balance sheet and strong cash flow generation characteristics, we believe GCL is one of the best stocks in the midcap universe coupled with undemanding P/E of 15x FY17E and ascribe a target of ₹180/share

Source: Company, ICICIdirect.com Research

Top Picks for 2016

Mahindra & Mahindra (MAHMAH) Target Price: ₹ 1470 (17% upside)

- Mahindra & Mahindra's (M&M) utility vehicle portfolio has seen significant market share erosion (from 55% in FY12 to ~37% in FY15 to ~36.4% in YTDFY16) owing to lack of a new appealing launches. New entrants like Duster, Ecosport and recently Creta have gained customer mindspace. However, M&M has been aggressive in FY16, already having launched six vehicles (Jeeto, new age XUV 500, TUV 300, Supro van, Maxxi truck, Thar Crde) and three more to be launched this fiscal. The Launch of Jeeto has taken M&M's market share from 12% last year to 30% in < 2 tonne category. Its newly launched TUV 300 has received good consumers response. Therefore, M&M has expanded its production capacity from 5000 units/month to 6000 units/month. The newly launched TUV300 & the upcoming 'KUV 100' (in January 2016) in the micro SUV segment are likely to offset the decline of its old warhorses (Bolero, Scorpio) going forward. We have built in auto segment volume growth of 5.7%, 22.4% for FY16E, FY17E, respectively
- Owing to a well-diversified product mix, strong pan-India presence & cost-efficient operations, M&M has retained its leadership in domestic tractor industry & maintained its market share over 40% since acquisition of Swaraj Tractors in FY09. Although tractor industry (including M&M) is experiencing YoY de-growth since H2FY15, tractor volumes are expected to recover in H2FY16 mainly due to low base effect & expected improvement in farm incomes. We have built in tractor volume decline of 7.5% for FY16E & growth of 19.7% for FY17E.
- M&M has been one of the worst hit incumbent OEMs in FY15 with problems ranging from loss of market share on the automotive side in H1FY15 to the sudden decline in the FES business in H2FY15. However, the ability to sustain profitability at a respectable level amid all the aforesaid pressures demonstrates business and management strength. We believe that currently the risk reward between positive/negative is loaded in favour of the former. We value the stock on a SOTP basis, valuing the core business at 9x EV/EBITDA FY17E to ₹ 890 and subsidiaries at ₹ 580 to arrive at an SOTP target price of ₹ 1470

Somany Ceramics (SPLIND) Target Price: ₹ 465(24% upside)

- Somany Ceramics (Somany) has emerged as one of the largest tiles player in the Indian tiles industry with overall market share of 6.1%. It witnessed 23.3% CAGR in topline in FY10-15 through aggressive capacity expansion from 16.7 MSM (million square metre) in FY10 to 47.25 MSM (excluding outsourced capacity of 9 MSM) currently largely through a JV model. Going ahead, we expect Somany's capacity to expand to ~57 MSM excluding outsourced capacity of 9 MSM) by FY17E
- Somany, being one of leading player in the industry, is likely to key beneficiary in the growing tile industry (India's per capita consumption stands at 0.54 sm/person in comparison to 3-4 sm/person among peer countries) and government's initiatives like 'Swachh Bharat Abhiyaan', 'Housing for all by 2022' and 'Smart City Mission'. Furthermore, key reforms such as implementation of GST and possible anti dumping duty would act as key catalyst for the organised player such as Somany. We expect Somany's revenues to grow at a CAGR of 18.7% at ₹2162.5 crore during FY15-FY17E.
- Somany could also benefit significantly from renegotiation of contract between RasGas and Petronet (Petronet has back to back arrangement with Gail, which provides long term gas supply to end user such as tiles manufacturer). If it materialises, it would eventually lead to a sharp fall in natural gas prices from US$12-13 per MMBTU to US$7-8 per MMBTU and could improve tiles manufactures margin significantly (300-400 bps assuming half the benefit will be passed on to consumers). This would lead to significant upgrade in the EPS. Currently, we have considered margin expansion of 83 bps to 7.3% during FY15-FY17 and have not factored in this development.
- Somany has also strengthened its balance sheet significantly from 1.8x in FY11 to 0.4x currently through WC improvement, internal accruals and QIP proceeds aggregating ₹120 crore. The strength in balance sheet lends us comfort about its growth prospects, going ahead
- We remain positive on Somany's growth considering a structural shift in the industry, its strong brand recall, wide distribution network and softening natural gas prices and improvement in return ratio

Source: Company, ICICIdirect.com Research

Top Picks for 2016

Ashoka Buildcon (ASHBUI)	Target Price: ₹ 240 (17% upside)

- Ashoka Buildcon (ABL) is a leading road developer with a portfolio of 21 projects encompassing ~5,000 lane km and spread across Maharashtra, Madhya Pradesh, Chhattisgarh, Karnataka, West Bengal and Odisha. Out of its portfolio of 21 projects, 17 are fully operational
- ABL secured significant orders worth ₹ 2248 crore in YTDFY16. Key order inflow wins are :- i) Eastern Peripheral Expressway (project cost: ₹ 789 crore) in UP ii) Mumbai JNPT Port (project cost: ₹ 414 crore) iii) first international order win of ₹ 124 crore in Maldives and iv) two annuity based BOT projects in Karnataka worth ₹ 527 crore With these order wins, ABL's order book improved significantly at ₹ 4444.4 crore implying 2.3x order book to bill ratio on a TTM basis providing strong revenue visibility over next couple of years. We anticipate ABL's construction revenues will grow at a CAGR of 12.3% at ₹2380 crore during FY15-FY17E.
- In terms of toll revenues, ABL's toll revenues are expected to grow at 37.1% CAGR during FY15-17E mainly due to the commencement of operations of major projects under Ashoka Concession (ACL) by FY16 despite projects like Katni, Dhule, Nashirabad, etc. completing their concession period in FY15, FY16. Consequently, we anticipate ABL's cash profit will grow at a CAGR of 27.0% at ₹ 374 crore in FY15-17E
- Overall, we remain positive on the road sector with the sorting out of key policy issues and MoRTH's target to award 12,918 km in FY16E & ~24000 km over the next two years largely in the EPC mode over the next two years. This will ensure there are enough opportunities with better terms in the EPC and BOT space for quality player like ABL
- Considering the strong track record, well funded BOT road project portfolio and huge opportunity from awarding in the road vertical, going forward, we remain positive on its long term prospects of ABL. Hence, we recommend **BUY** with an SoTP target price of ₹ 240/share. We have rolled over our valuation to FY18. We value ABL's BOT projects at ₹ 37.8/share and its EPC business (net of debt) at ₹ 100/share (6x FY18 EV/EBITDA) and ACL at ₹ 71.8/share.

VA Tech Wabag (VATWAB)	Target Price: ₹ 830 (19% upside)

- VA Tech Wabag (Wabag) is a leading MNC in the water treatment space (water desalination, sewage water treatment, waste water treatment, etc), with a global presence. The company operates on an asset light-EPC led model in water treatment projects across municipal & industrial segments, where it focuses on design & engineering while outsourcing civil construction and erection jobs. Wabag has executed over 2,250 projects till date and has a market share of 14% in the Indian market. The company garners a higher EBITDA margin of ~13-14% across its India business followed by 8-9% across the India international business and 5-6% across the Europe segment taking overall EBITDA margin to ~9.3%. Wabag registered strong growth in its order inflow over FY10-15, resulting in 13.8% CAGR in order backlog. This led to revenue and PAT CAGR of 14.6% and 23.1%, respectively, in the same period
- The order backlog till date is at ₹ 7,075.7 crore vs. ₹ 5,239 crore YoY and including a framework contract of ₹ 1,542 crore. The current order backlog is at ₹ 8,618 crore. Wabag's order backlog, revenue are expected to increase at a CAGR of 15.6%, 15.5%, respectively, in 2014-17E driven by the robust opportunity across the water treatment industry. We have pencilled in an order intake of ₹ 3,450 and ₹ 4,200 crore for FY16E and FY17E, respectively, thus leading to a book-to-bill ratio of ~2.3x
- Wabag has successfully restructured its global operation and turned many of its loss making subsidiaries profitable. Furthermore, the management expects to increase the revenue share of its high margin O&M business from the current 20% to 25% by FY17E. This would enhance its margin by 60 bps over FY15-17E to 10.2%
- Wabag expects to maintain its low D/E ratio factoring in its asset light business model that would continue to provide positive FCF (average FCF of ₹ 150 crore in FY15-17E). The management has maintained its guidance of 20% growth across order intake and revenue for FY16E. Furthermore, robust order intake in H1FY16 will not only enhance the company's order book position but also strengthen our positive outlook on the company. Hence, we maintain our target price of ₹ 830 and maintain **BUY** on Wabag assigning a target P/E of 22x on FY17E EPS

Source: Company, ICICIdirect.com Research

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3	Top Picks for 2016
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Which sectors and stocks will find favour?

Apparels

- The Indian apparel market is expected to grow at a CAGR of 10% from the current $42 billion to $115 billion over CY14-25. Higher growth will be driven by changing demographics, rising aspiration and growing brand awareness. We expect cotton prices to stabilise, going forward. This would result in steady margins within companies in our coverage universe
- Overall, within our coverage universe, we expect revenues to register growth of 9.6% CAGR in FY15-17 while EBITDA and PAT are likely to grow at 14.9% and 27%, respectively, in the same period
- We expect companies with strong pan-India brand franchises like Arvind, Page Industries, Kewal Kiran and Siyaram Silk Mills to outpace the overall market growth. Arvind being a fully integrated textile & apparel player with a strong portfolio of aspirational global brands, remains our top pick

Banking

- We expect the banking sector to underperform next year owing to steep asset quality woes still ahead, especially in case of PSU banks. In the private banking space, we suggest selective stock picking, preferably large banks with strong retail presence
- We do not see NPA & restructured assets cycle turning in a hurry despite a gradual recovery in the economy. System wide GNPA as on Q2FY16 was at ₹ 338590 crore (5.05% of credit), whereas RA has been ~6.5% and SDR & 5/25 at ~0.7% of advances
- Credit growth has remained at sub 10% levels until recently. This is not expected to improve soon with slow nominal GDP growth. On the margins front, concerns emanate from a shift to marginal cost based lending rate calculation, which can impact margins over FY17E
- Our banking coverage is slated to post a PAT CAGR of 5.8% in FY15-17E to ₹ 65523 crore. We prefer HDFC Bank , Bajaj Finance and Bajaj Finserv in the NBFC space

Auto

- We have a positive outlook on the auto space, mainly due to the structural factors (higher discretionary spending, favourable demographics and lower penetrations), potential impact of the Seventh Pay Commission on volume growth and strong line-up of new launches. An improving macro environment will continue to have a positive impact on CV demand. We expect the I-direct auto universe (ex-Tata Motors) to register topline growth of 12%, 19% for FY16E, FY17E, respectively
- Cumulative benefit of lower input cost, higher utilisation levels is likely to support margins for companies. Government's higher focus on emission norms (implementation of BS IV by April 2017), new product launches, increasing content per vehicle will benefit ancillary companies. We expect I-direct auto universe (ex-Tata Motors) margins to expand 184 bps, 55 bps to 14.8% and 15.4% in FY16E and FY17E, respectively
- On the valuation front, there is relative margin of safety as leading auto players are available at ~14x PE FY17E (below historical average/Sensex P/E). Our top picks from the auto-space are Tata Motors and M&M

Capital Goods

- Key segments that would contribute significantly to order inflows, in CY16E, would get concentrated on power T&D, railways, road EPC and renewables. Power BTG orders, driven by UMPPs, will be sporadic and lumpy while structural contribution of orders from the defence segment would see a gradual up-tick. In CY16E, majority of the order inflows is expected to come from government entities
- We expect our coverage universe to report 13.7% YoY topline growth in FY17 coupled with 20 bps expansion in margins to 11.6%. PAT is expected to grow 13.8% YoY with upside risks such as better-than-expected operating and financial leverage from EPC companies owing to lower input costs
- Overall, we remain positive on product based companies with a better balance sheet, which includes names like Grindwell Norton, Greaves Cotton and Timken India. In the EPC space, our focus would be on companies wherein an improvement in execution and balance sheet will drive profitability growth. This includes L&T and VA Tech Wabag. Avoid companies with major exposure to the power BTG space

Source: ICICIdirect.com Research

Positive Outlook on Sector | Neutral Outlook on Sector | Negative Outlook on Sector

Sectoral Outlook

Cement

- After witnessing a lower demand growth over the past two years, we expect cement demand to improve with CAGR of ~6% to 311 MT over next 3 years vs. 4% over the past two years. The increased spending on infrastructure (on roads and highways) and housing for all program of government remains a key driver. Furthermore, lower interest rate is expected to help revive private spend in housing, commercial and industrial activity.
- We expect pricing to stabilize over the next 3 years led by higher utilisation (from 73% to 77%), slowing pace of capacity addition (CAGR of 9% during FY09-FY15 vs ~5% over next 3 years), and M&A activities. Further, EBITDA/ton is expected to remain healthy (above ₹ 1000/tonne) led by lower freight & fuel costs. We prefer Ultratech cement (on high growth trajectory) and Ambuja Cement (available at lower than current replacement cost of $150/tonne) among large-caps, Star Ferro & Cement remains our top pick in the mid-cap space (available at 5x FY17E EV/EBITDA)

FMCG

- Our FMCG coverage universe is expected to witness ~12.6% revenue growth (ex Nestlé India) as volume growth continues to remain lacklustre mainly due to slower urban consumption recovery and subdued rural demand on the back of falling agri output & minimal increase in MSPs. Simultaneously, falling commodity prices could lead to aggressive price cuts and increase in promotion activity
- With commodity prices falling sharply, RM cost (percentage of sales) for our coverage universe may fall 100-200 bps. However, we believe companies would increase promotional spend significantly to spur volume growth. This would lead to a marginal increase in operating margins. We expect GST implementation to lead to a reduction in logistic cost, simplified tax structure and benefit organised players with level playing field in categories dominated by highly unorganised entities
- FMCG stocks would continue to command premium multiples with lighter B/S & high return ratios. We prefer stocks (ITC, HUL) present in low penetrated categories like packaged foods, personal care with possibility of premiumisation in future.

Consumer Discretionary

- Companies are expected to record topline growth of ~15% YoY largely driven by volume growth, with the passing on of the benefit of lower raw material prices. We believe the trigger for sales growth of organised players would be the Seventh Pay Commission and implementation of GST
- We believe benign commodity prices (TiO_2, copper) in the near term would benefit Asian Paints and Pidilite Industries in terms of expansion in EBITDA margin in the range of ~300-500 bps in FY15-17E to 16%-21%. For electrical goods manufacturers, EBITDA margins may improve on the back of better operating leverage
- We are positive on select midcap electrical goods companies and paint companies considering the revival in demand coupled with expansion in margin. We believe market leaders will command a premium valuation considering they are direct beneficiaries of lower raw material prices while passing on minimum benefit to customers

Healthcare

- We believe the recent setbacks on account of USFDA issues have already been factored in stock prices. Going ahead, the Street apprehensions on account of compliance issues and currency volatility in emerging markets are likely to be mitigated by acceleration in US approvals (YTD 135 ANDAs against 105 in CY14) and sustainable growth in domestic formulations
- US, Indian formulations remain key growth drivers for the sector (~50% of overall universe sales) on the back of a strong pipeline and incremental product launches. Our FY15-18E growth expectations for US and Indian formulations for I-direct pharma universe are at 15.3% and 17.8%, respectively. Similarly, our FY15-18E growth estimates for EBITDA, PAT for the universe are at 19.7%, 22.8% respectively
- We continue to maintain our positive view on the sector on the back of earnings visibility, consistent operating cash flows, healthy operating margins, relatively low leverage and strong return ratios

Source: ICICIdirect.com Research

Positive Outlook on Sector | Neutral Outlook on Sector | Negative Outlook on Sector

Sectoral Outlook

Hotel

- With the high focus of the government on improving the sector along with an economic revival, we expect it to return to a growth trajectory over the next three years. Growth in room demand has consistently remained subdued in the past four years due to challenging macroeconomic conditions with average margins touching as low as 15% in FY15 from a peak of 31% in FY08 while it witnessed a dream run in FY02-08 (coinciding with the economic boom)
- However, the industry's prolonged cyclical downturn is nearing its end. After plummeting to a decadal low of 59% in 2013-14, occupancy rates (ORs) in the industry increased to 60% in 2014-15 with a moderation in supply growth and pick-up in demand
- Going forward, we expect demand to grow marginally better than growth in room inventory. ORs, therefore, are expected to reach 63% in FY19. In terms of ARRs, intense competition would restrict growth to 3% CAGR during this period

IT

- FY16E key positives include 1) demand recovery in the US and Europe, 2) up-tick in discretionary demand in the US, 3) traction in digital technologies and 4) large deal closure velocity and ramp-ups
- Negatives could be uneven demand trends across energy & utilities, telecom and insurance vertical, cost pressures due to onsite hiring, visa regulation, pricing, S&M investments and wage inflation
- Tier-I rupee revenue growth could moderate to ~12-13% in FY17E led by volatility in top customers and cross-currency headwinds; EBIT margins could range at 24% as rupee depreciation could likely offset headwinds from pricing and onsite hiring, while PAT growth could also range at 12-13% in FY17E
- At 15.6x FY17E earnings, though valuations are reasonable and reflect modest 7% premium relative to Sensex multiple, growth has moderated as well and suggest incremental returns could align to earnings growth

Infrastructure

- With government efforts towards policy measures like premium rescheduling and amendments in model concession agreements in the road vertical, UDAY scheme and gas pooling in power vertical, there have been visible green shoots in the investment cycle
- In terms of verticals, we believe the road vertical is in a sweet spot. The sorting out of key policy issues and MoRTH target to award 12,918 km in FY16E and ~24000 km largely on EPC mode over the next two years lends us comfort that there will be huge opportunities, going ahead. We anticipate road EPC universe coverage revenues to grow at a CAGR of 20.9% at ₹ 12,278 crore
- Though the green shoots are visible in the sector, we continue to prefer players who can ride the opportunities with strength in balance sheet and better execution capabilities. Hence, we prefer PNC Infratech in the EPC space and Ashoka Buildcon in the BOT vertical

Logistics

- Subdued container volumes are expected to get ramped up in the second half of the year. Trade activities are expected to pick up on account of the government's thrust on 'Make in India', which is expected to result in better Exim and domestic volumes. This could lead to a better scenario for logistics players like Container Corporation of India (Concor) and Gujarat Pipavav Port
- Express logistic companies like BlueDart and Gati are expected to benefit from the rapid growth in e-commerce as they have made several investments in setting up infrastructure to serve ecommerce players. The segment, with a margin profile superior to other logistic business, would also be margin accretive For BlueDart, revenue, EBITDA and PAT are expected to grow at a CAGR of 22%, 44% and 45%, respectively, in FY15-17E. For Gati, revenue, EBITDA and PAT CAGR in FY15-17 is expected at 15%, 13% and 16%, respectively
- Also, implementation of GST would lead to operational efficiencies and result in a shift in market share from unorganised players to organised players

Source: ICICIdirect.com Research

Positive Outlook on Sector | Neutral Outlook on Sector | Negative Outlook on Sector

Sectoral Outlook

Media

- In the print space, ad growth is expected to expected to witness a revival in FY17 on the back of an economic recovery. Our print media coverage universe ad revenues are expected to grow 10.4% in FY17E vs. 4% in FY16. Reduced newsprint costs are also expected to boost margins. Jagran Prakashan with a dual play on radio and print is our top pick from the segment with topline and adjusted earnings CAGR of 14.3% and 22.6%, respectively, in FY15-17E
- Broadcasters would also benefit from the expected economic rebound in FY17. Consequently, we expect our broadcaster coverage universe to showcase ad revenue growth of 16.1% YoY, with Zee, Sun and TV Today exhibiting 17.3%, 14.9% and 11.1% YoY growth, respectively
- In the multiplex space, Inox is expected to post superior revenue & PAT growth of 15.7% & 46.9%, respectively, in FY17, led by robust footfall, increased traction in margin accretive advertisement revenue and F&B sales

Oil & Gas

- The earnings of PSU oil companies are expected to decline 5.8% in FY17E (Brent oil prices at $55/bbl and ₹ 65/US$) if Brent oil prices continue to stay at current subdued levels. However, if the subsidy burden (~$4/bbl in H1FY16) is lowered/ removed and cess levy is changed from fixed rate of ₹ 4500/tonne ($9.5/bbl) to ad-valorem basis (8% of oil price i.e. $4.4/bbl at $55/bbl), then it may provide some respite to oil companies. In the short term, lower oil prices would impact profitability of OMC's due to inventory losses, however, in the medium term OMC's would report a decent performance given the deregulation of diesel prices and higher marketing margins
- After years of subdued volumes, we expect volume growth to pick up in gas utilities space due to lower LNG prices and also due to favourable policies by the government (higher demand from power companies). We estimate earnings of gas utilities will increase 30.6% in FY17E assuming lower gas prices. We prefer CGD companies and lubricants within the sector due to lowering of raw material costs

Metals

- On account of slowing down of the Chinese growth engine, we have an underweight stance on the metal sector. Muted growth in China has led majority of metals to go to the surplus zone, which has put downward pressure on prices. On a YTD basis Zinc, Copper , Steel and Aluminum prices have declined by 30%, 26%, 25% and 17% respectively. As most commodities are either finely balanced, heading into surplus or already in deep surplus in absence of a major supply disruption, excess supply is likely to cap near term commodity price growths.
- Overall, within our Metals coverage universe, we expect EBITDA to register a marginal growth of 1.6% CAGR in FY15-17E while PAT is expected to decline by 2.9% during the aforesaid period. We expect aggregate EBITDA margin of our coverage universe to decline from 16.3% in FY15 to 13.2% in FY16E. On the back of muted demand and subdued prices, we maintain our cautious stance on the sector. Going forward, any steps taken by the government to protect the domestic sector remains key monitorables

Power

- We are optimistic on the power sector, as CY15 saw many key positive reforms taken by the GoI (mainly UDAY, enhanced renewable focus, increased CIL output, gas pooling strategy and coal auction). Successful execution of the same will not only reduce the discoms' debt burden but also improve its efficiency and curb future losses
- Furthermore, with 175 GW renewable capacity target by 2022, CY16 may witness close to 6 GW of solar and 4 GW of wind capacity addition. Overall, we expect ~18 GW to be added in CY16). Also, PLFs across power plants are likely to improve in CY16 driven by the above-mentioned measures. Consequently, the financial performance of the sector is expected to be strong with sales expected to grow 8.5% YoY and PAT expected to report healthy growth of 19.0% YoY
- We recommend Power Grid (robust earnings profile as capitalisation of assets is robust)

Source: ICICIdirect.com Research

Positive Outlook on Sector | Neutral Outlook on Sector | Negative Outlook on Sector

Sectoral Outlook

Real Estate

- There has been key policy related progress in the real estate sector like Cabinet approval for the real estate bill & rationalisation of tax structure for REIT listings in CY15. These steps should bring back transparency in the sector, thereby bringing back consumer and investor confidence in the long run
- Nonetheless, elevated property prices are making it unaffordable. This coupled with a transition phase with new bill compliance such as keeping 70% of project sales in different escrow account for construction of the same project and keeping all approvals before registration of projects may keep sales volumes under pressure in the short-term. Furthermore, low investment demand, due to muted returns over the last one year, is also a dampener.
- Overall, we remain underweight on the real estate sector given the slowdown in sales volume. In such a scenario, we continue to prefer players who have quality management, execution bandwidth and relative strength in the balance sheet. Hence, we prefer Mahindra Lifespace and Oberoi Realty in the real estate sector

Telecom

- While incumbents have already launched their high speed 4G services, big bang launch from Reliance Jio is awaited, which could pose a threat to them. High speed data will have a multiplier effect on data consumption and would keep data revenues buoyant. Data volumes for our coverage are expected to grow at 55.4% CAGR in FY15-17E to 1111 billion MB. This would translate to 46.6% FY15-17E CAGR in data revenues to ₹ 26545.5 crore
- Voice revenues are expected to grow at a steady pace of 5.8% CAGR in FY15-17E to ₹ 72554.0 crore, as voice minutes exhibit 9.0% growth to 2096 billion minutes in the same period
- Though the policy stance of the regulator has been accommodative in terms of spectrum trading and sharing guideline, the proposition to relax spectrum cap norms, hyper intense competition and huge capex requirements for continuous network overhaul and spectrum payments remain a concern. We remain neutral on the sector

Retail

- The overall outlook in the domestic retail sector continues to remain buoyant. The sector is estimated to reach a size of $1.3 trillion by 2020E, growing at a CAGR of 13%. The organised retail share is expected to increase from 8% to ~17% by 2020E
- In FY16, the retail industry has witnessed massive disruptions due aggressive online discounting. To counter these, offline retailers are planning to launch their digital & omni channel, going forward. Retailers like Shoppers Stop, Westside and Titan Company are aggressively planning to launch their online channel, in order to have synergy benefits
- On the space addition front, we expect major brick & mortar retailers to adopt a conservative approach towards new space addition plans. They are expected to focus on higher same store sales growth (SSSG).
- In our retail universe, we expect overall revenue growth of 9.1% CAGR (FY15-17) while EBITDA, PAT may 13.8%, 13.1%, respectively, in the same period

Source: ICICIdirect.com Research

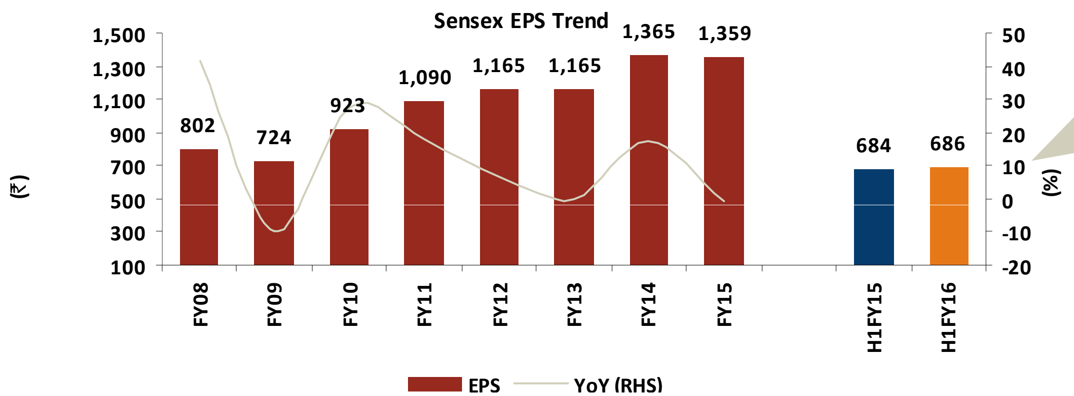
Positive Outlook on Sector | Neutral Outlook on Sector | Negative Outlook on Sector

Market Strategy 2016

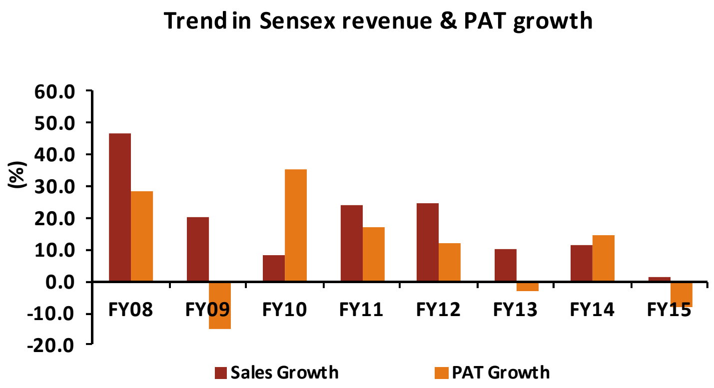
1	Introduction
2	Where are markets headed in 2016?
3	Top Picks for 2016
4	Sectoral Views
5	Volatility in earnings growth and market performance
6	Government to drive capex , consumption (Seventh Pay Commission) and reforms
7	Conundrum of global events
8	What can alter India's favourable position

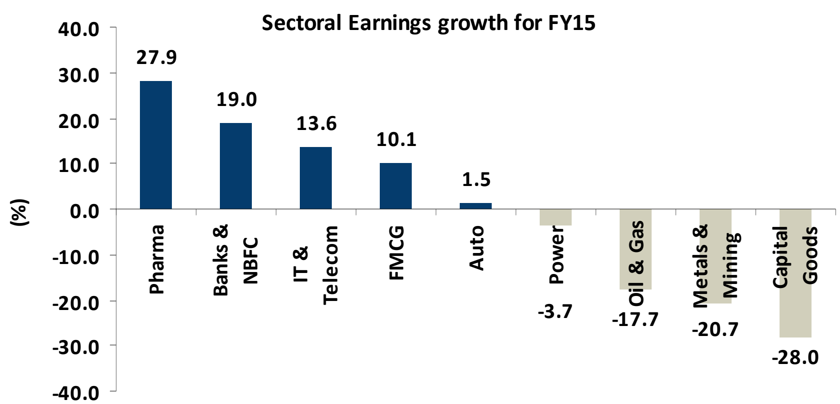
2015: Year of lost earnings…opportunity in adversity!!!

CY15 turned out to be a year of lost earnings with the Sensex EPS remaining flat. The key draggers for the earnings mainly include the metals & mining and oil & gas sectors, which were adversely impacted largely due to the sharp decline in global commodities. However, India being a net importer, would be a key beneficiary of commodities correction, enabling strong fiscal management (sharp reduction in crude import bill) and a benign cost scenario. This, coupled with lower inflation and a benign interest rate cycle, has empowered India Inc with strong earnings levers, going ahead.



Optically, FY15 saw Sensex earnings de-growth, which is similar to the cycle seen in FY09, as global commodity prices witnessed a sharp correction in the range of 20-45% in CY15. However, the core earnings of sectors like pharma, IT, financials and FMCG were intact, indicating that qualitatively, the fundamentals are unharmed. Sectors like auto, consumer durables, textiles, paints, etc. have started benefitting from lower raw material costs



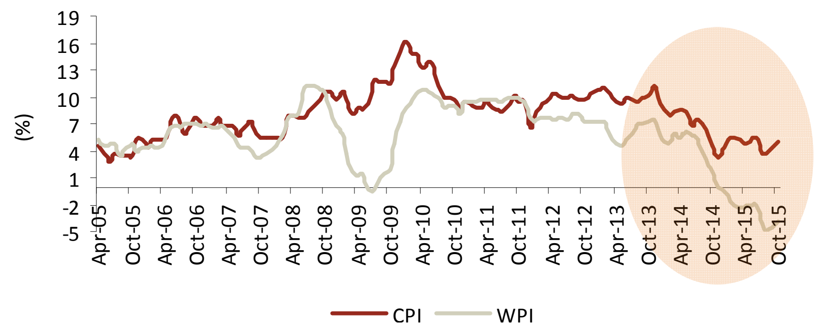


Source: Capitaline, ICICIdirect.com Research

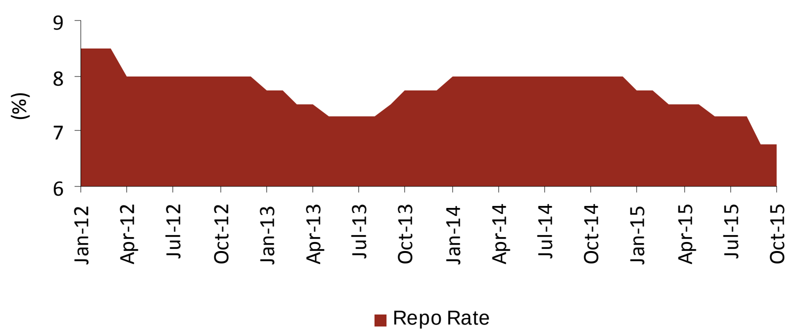
Key elements in place for cyclical upturn…

Amid the earnings hiccups, the macro indicators show that the economy is poised for a cyclical upturn. The Chinese slowdown and the resultant falling commodity prices (especially crude) have provided a huge cushion to the government to maintain a balance between growth and fiscal consolidation . Furthermore, with falling inflation, the rate cut cycle (125 bps repo rate cut in CY15) has begun, which is expected to be a huge boost for a revival of the capex cycle as well as relief on working capital strains. The government's improving gross tax collection (21.7% YoY in H1FY16) is also expected to provide a lever for higher allocation towards infrastructure spending.

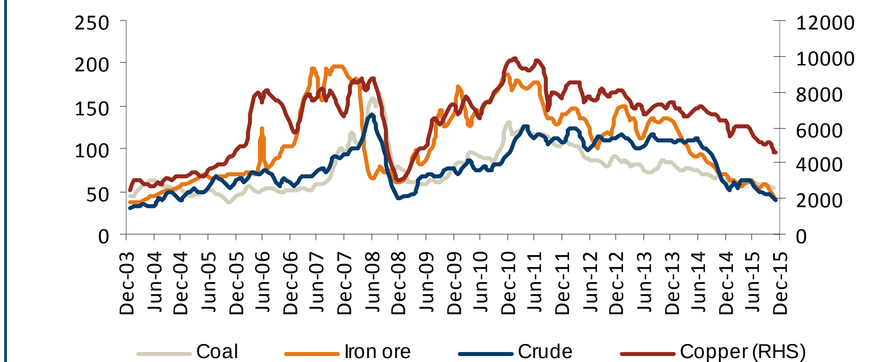
Declining inflation to spur benign rate cycle…



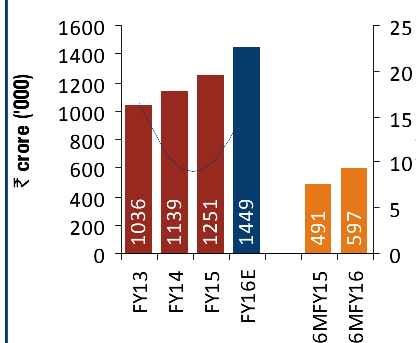
125 bps repo rate cut during CY15



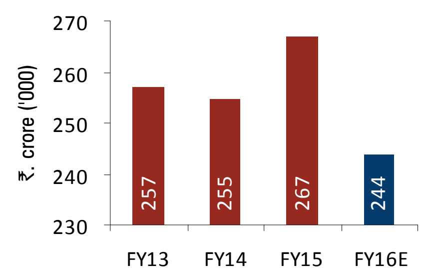
Key commodity prices ($) since 2004



Improving gross tax collections



Falling subsidy burden



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

Commodity debasing slows credit offtake; quality of credit remains volatile!!!

Commodity debasing and asset quality woes led to a deceleration in credit disbursement to the industrial segment, primarily troubled sectors including metals, jewellery and textile. Exposure to the construction and infra segment increased owing to re-financing under the restructuring package (especially in case of the power sector). Led by a deceleration in commodity prices, working capital became leaner for sectors like petroleum, which, in turn, resulted in lower funding requirement. Agriculture and retail loans have been in focus in the past few years contributing a major proportion to incremental credit offtake.

Trend of incremental credit composition

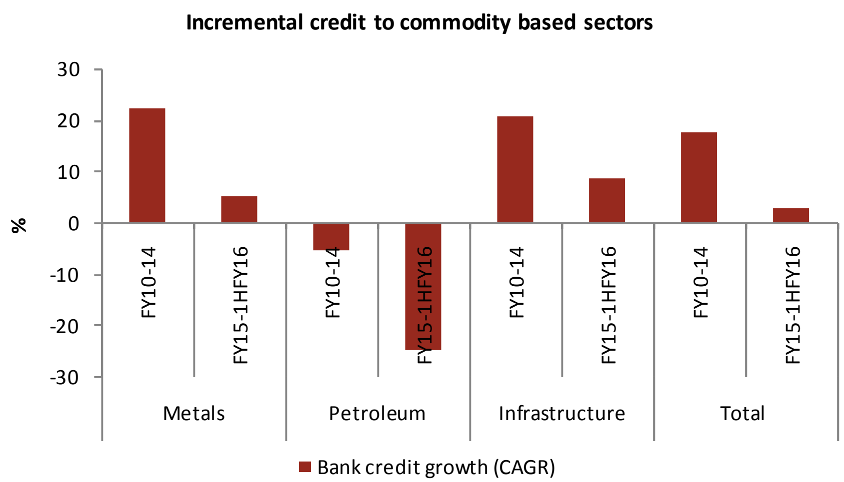
Incremental credit (₹ crore)	FY13	FY14	FY15	FY16YTD
Agriculture & Allied Activities	43,288	79,524	100,592	57299
Industry	292,854	292,697	142,243	-7007
Services	128,926	185,147	74,969	37186
Personal Loans	114,749	139,077	159,147	119302
Non-Food Credit	**579,818**	**696,445**	**476,951**	**206781**

Commodity debasing dampens working capital funding

	Metals		Petroleum		Infrastructure		Total	
CAGR (%)	FY10-14	FY15-1HFY16	FY10-14	FY15-1HFY16	FY10-14	FY15-1HFY16	FY10-14	FY15-1HFY16
Net Sales	10.6	(33.5)	20.9	(22.9)	15.2	(25.1)	17.6	(25.2)
Net Current Assets	4.1	(36.9)	12.4	(72.8)	5.7	(34.9)	7.7	(48.6)
Debt	20.6	(21.0)	17.6	(25.9)	27.4	(43.1)	22.5	(32.3)

Industry-wise incremental credit composition

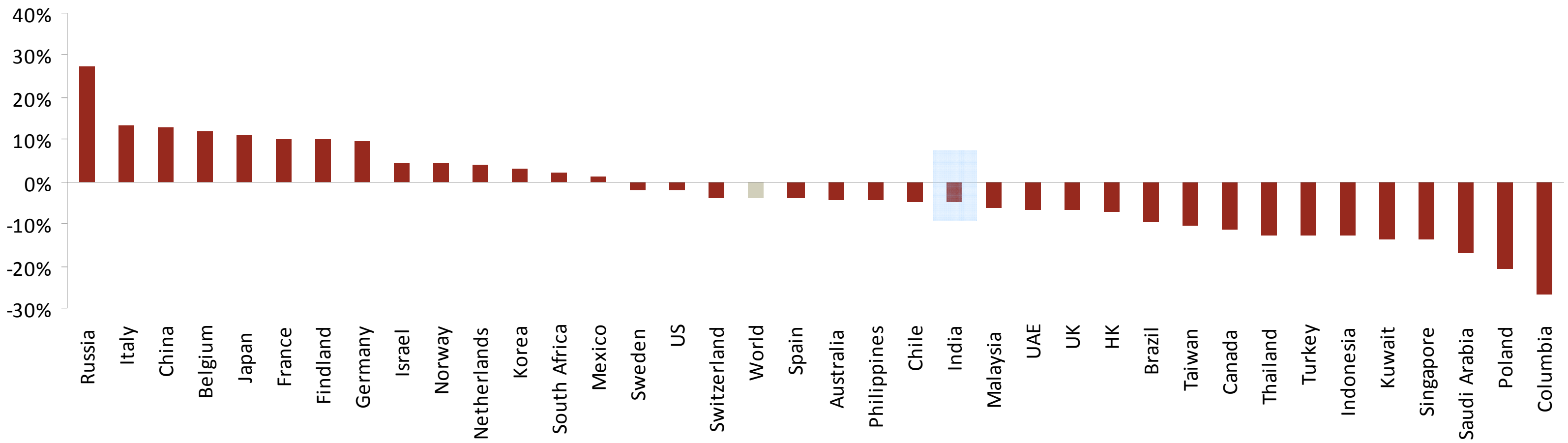
Incremental credit (₹ crore)	FY13	FY14	FY15	FY16YTD
Textiles	24,112	20,462	-294	-7566
Petroleum, Coal Products	3,150	-839	-8,695	-11130
Basic Metal & Metal Product	52,289	47,853	24,608	8411
Gems & Jewellery	9,815	10,824	1,929	-1140
Construction	3,550	9,247	11,732	660
Infrastructure	99,707	110,059	88,174	36341
-Power	84,913	72,497	70,664	25025
-Roads	20,369	26,087	10,832	7338
Others	100,231	95,091	24,788	-32,583
Industry	**292,854**	**292,697**	**142,243**	**-7007**



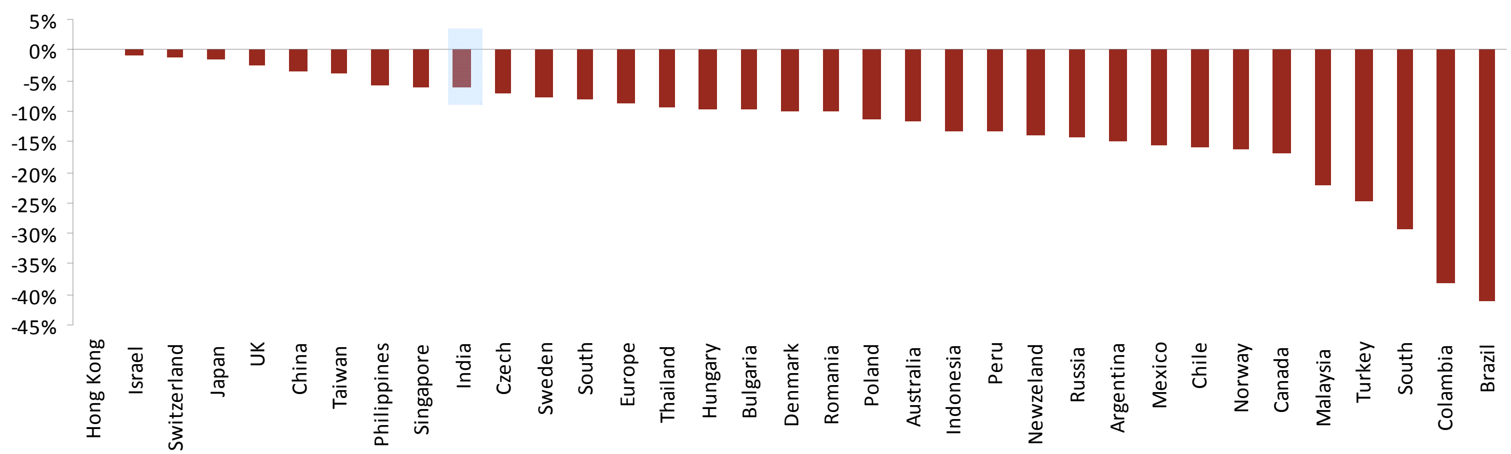
Source: Capitaline, RBI, ICICIdirect.com Research

India performance in equities, currencies: Better than most emerging economies

Global equity returns: India sees ~5% decline, better than most emerging markets…

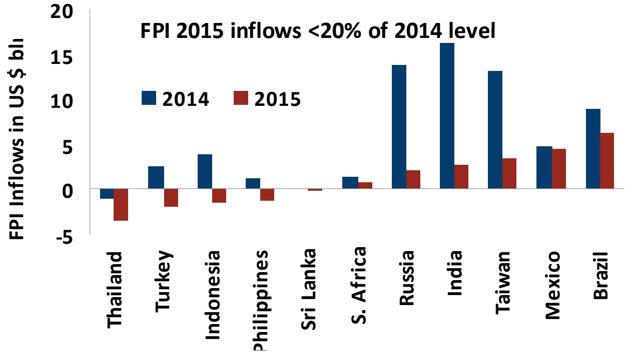


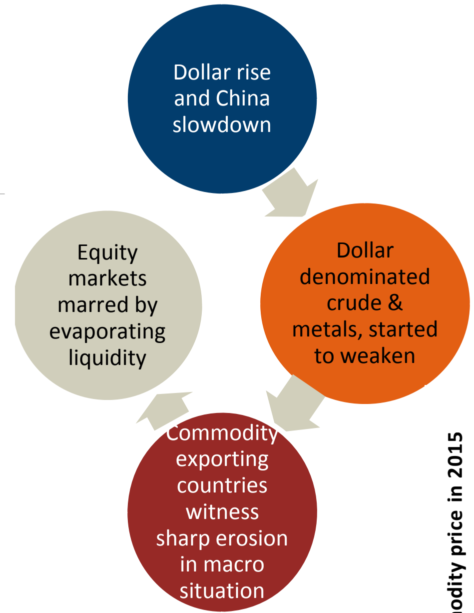
Global currency returns: Dollar strength pushes all other currencies lower. rupee stays resilient…

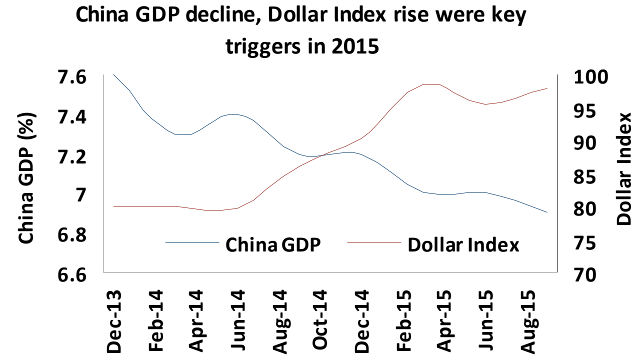


Source: Bloomberg, ICICIdirect.com Research

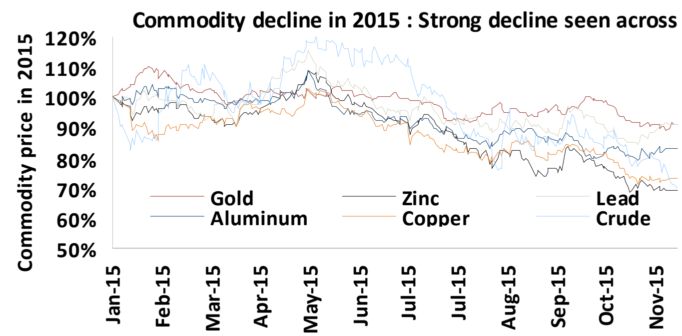
Assets spiral downward in 2015

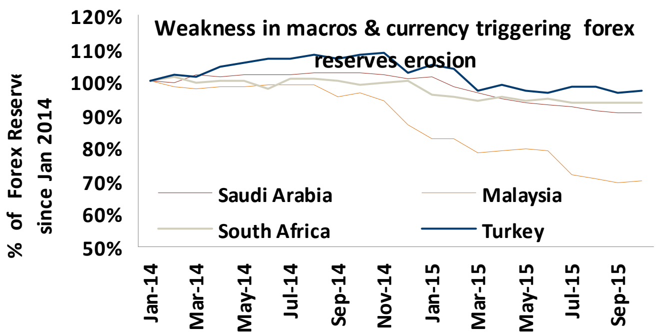


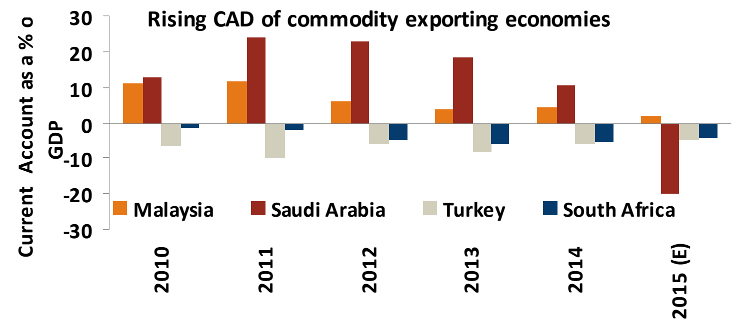




As the weakness in the Chinese economy and strength of the dollar showed, the commodity space witnessed a sharp decline. This triggered a tectonic shift as the "petro-dollar" based asset creation halted and commodity exporting nations saw a worsening of macros. The countries witnessed a sharp erosion in forex reserves with increased CAD. In the second half of the year, this asset sell-off spilled over to the equity and junk bond markets, both of which faced severe selling pressure.

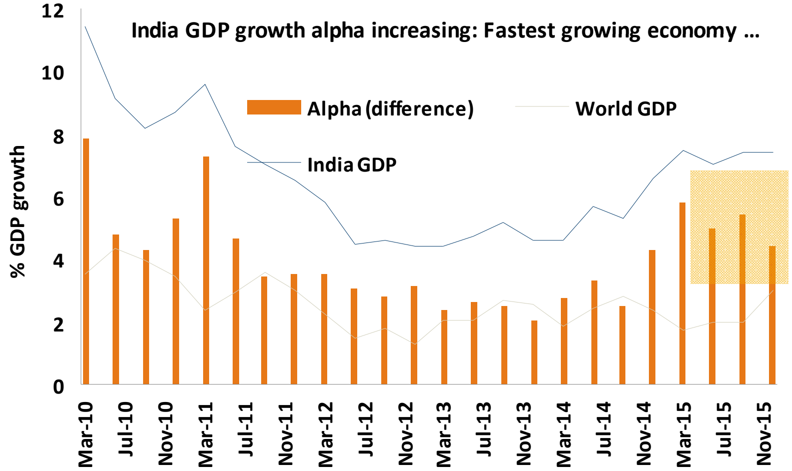


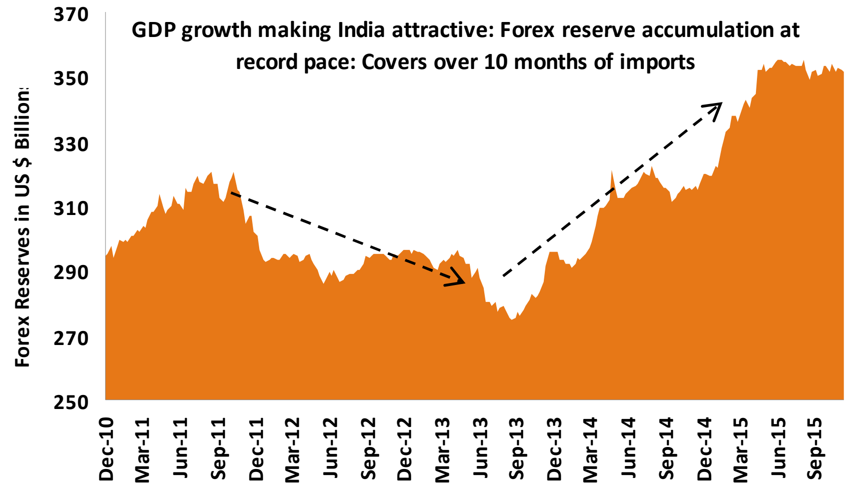




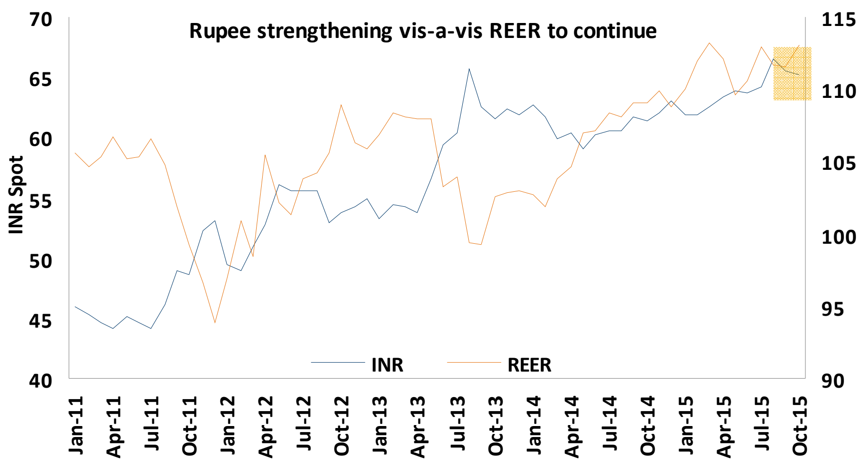
Source: Bloomberg, Worlldbank.org, ICICIdirect.com Research

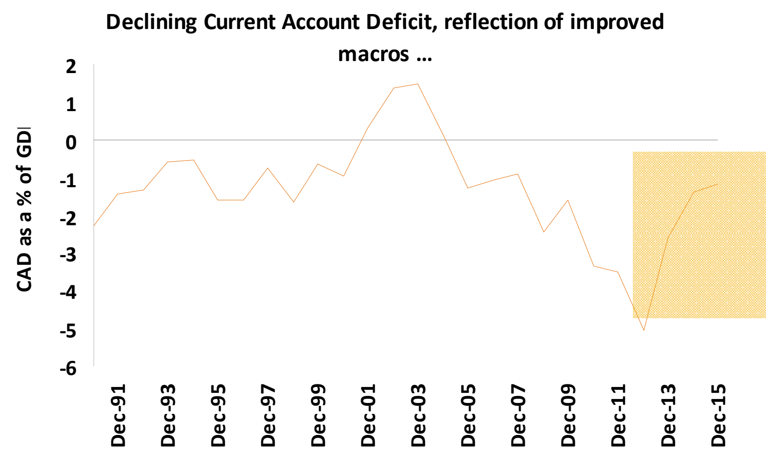
India poised for sustained growth ….





In relative terms, India continues to be in a sweet spot as it is well positioned to weather any bout of global volatility. The macros have improved significantly. Also, the economy is on the cusp of GDP expansion on the back of likely government capex expansion and consumption growth via "mini" stimulus in the form of the Seventh Pay commission hike. Positive real growth along with stable currency will be key for 2016.





*Source: Bloomberg, ICICIdirect.com Research * REER - Real Effective Exchange Rate*

Market Strategy 2016

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GST: Important but no silver bullet

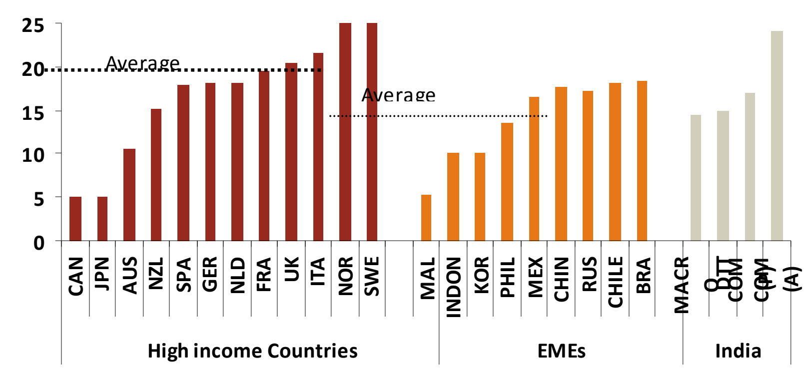
GST - a leapfrog towards eliminating the complexities of indirect taxation: With the implementation of GST, the taxation burden would be divided between goods & services through a lower rate by increasing the tax base, which would create a level playing field for all manufacturing entities irrespective of their place of operation

- 'Clean' duel VAT : Unlike many countries, India is expected to implement a Cleaner duel VAT. A common base and common rate across goods & services and very similar rates (across states) will facilitate administration and improve compliance
- Lowest tax to GDP: India has one of the lowest tax to GDP ratios compared to other emerging economies. With more than 60% of the services contribution to GDP, indirect tax collection is likely to increase post GST implementation considering standard GST rate may be ~17.5% higher than service rate of 14.5%

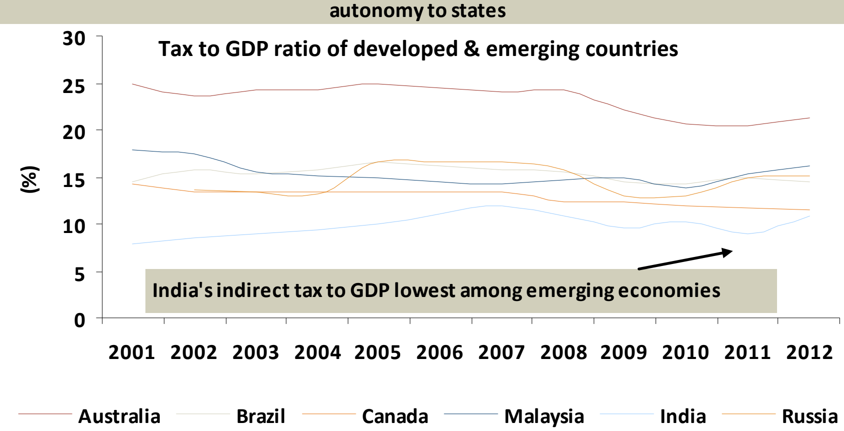
Recommended rate by Committee

	RNR	Rate on Precious metals	"Low rate (goods)	"Standard" rate (goods & services)	Demerit rate
		6		16.9	
Preferred	15.0	4	12	17.3	40
		2		17.7	
		6		18.0	
Alternative	15.5	4	12	18.4	40
		2		18.9	

Standard rate of VAT in various economies & India recommended rates



Nature of VAT	Country Example	Disadvantages
Independent VATs at Centre and states	Brazil, Russia, Argentina	Differences in base and rates weaken administration and compliance. Inter-state transactions difficult to manage
VAT levied and administered at Centre	Australia, Germany, Austria, Switzerland, etc	State government relieved of responsibility of raising taxes, which also takes away fiscal discretion of states
Dual VAT	Canada and India today	A combination of the above two limits both their disadvantages
"Clean" dual VAT	India's GST	Common base and common rates facilitate administration and compliance, including for inter-state transactions while continuing to provide some fiscal autonomy to states

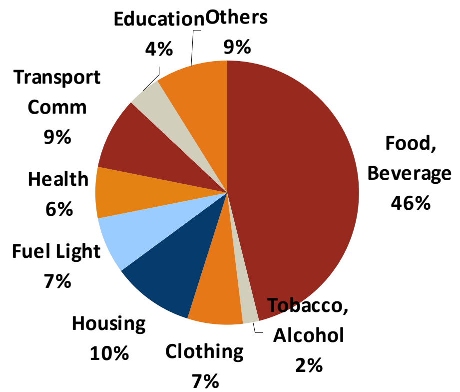


*Source: GST committee report Dec'15, IMF,ICICIdirect.com Research *RNR= Revenue Neutral Rate *COM (P) Committee Preferred *COM (A) – Alternative , *DTT – Direct Tax Turnover*

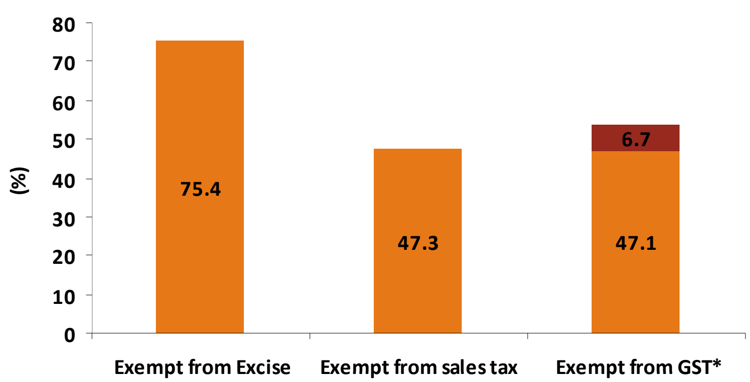
Implementation of GST not to impact inflation substantially

- CPI inflation : Some of the categories like food & beverages, rent and clothing have large weights in the CPI basket. These are either exempted or taxed at low rates. i.e. 75% of the CPI components are exempted from excise while 47% of them are exempted from sales tax. Post GST, 54% of CPI components would be exempted. However 6.7% (alcohol, petrol & diesel) would be taxed alternatively. We believe CPI inflation in India may not increase substantially, as major components of CPI (47.1%) would be exempted from GST. The similar trend has been seen across other economies where GST was implemented.

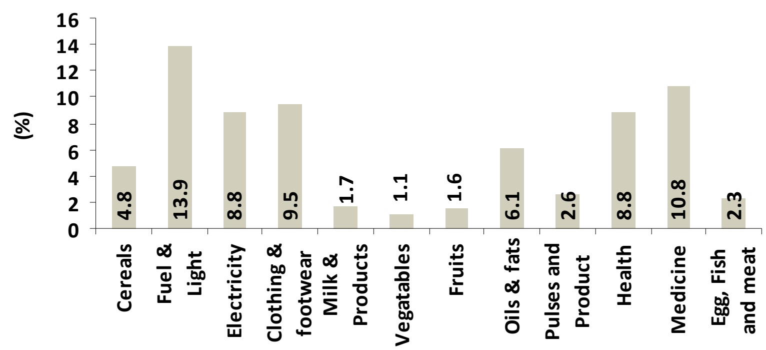
Food, rent & clothing have high weight in CPI (%)



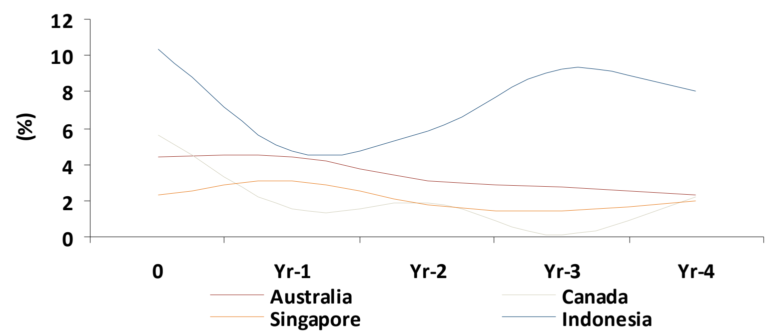
Large part of CPI exempt from excise/VAT (%)



Low average tax rate in most categories



Inflation trend post GST implementation in other economies (%)



*Source: GST committee report Dec'15, IMF, World bank, ICICIdirect.com Research *items exempted from both excise and sales tax , to which are added alchohol, tobacco, petroleum product*

Sectoral impact of GST

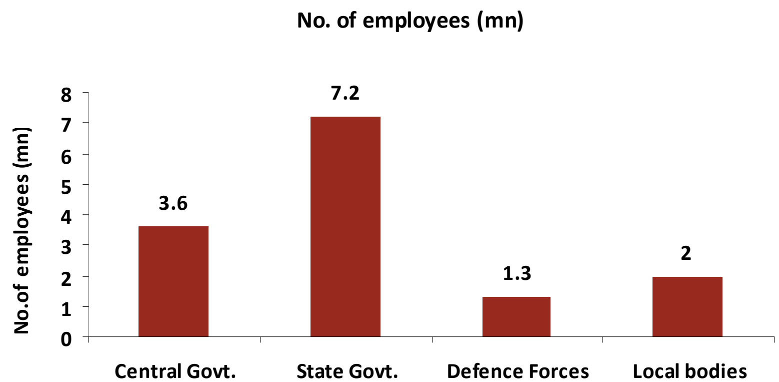
Industries	Impact on Sector	Current Applied Indirect Tax	Recommended GST rate	Stocks to Benefit
Auto	We believe GST would have a positive impact on auto sector as benefit of lower taxation would be passed on to consumers by way of lowering vehicular price by 10-20%	At present, small cars (<4 metre & engine size of <1200 cc for petrol & <1500 cc for diesel) are taxed at ~30% (which comprises 12.5% excise duty + CST 2% + National Calamity contingent duty 1% + VAT in the range of 12.5-14.5% + road tax in the range of 3-20%). Sedans & SUVs are taxed at ~45% & ~52%, respectively	GST 17-18%	M&M, Tata Motors, Ashok Leyland, Maruti Suzuki
	There would be level playing field, as it would not restrict OEMs from procuring quality & good material from vendors, that are located outside its manfacturing state. At present, 2% CST is levied on such transaction resulting in higher input cost for OEMs	In case of motorcycles, the effective tax rate is ~30%	GST 17-18%	Bajaj Auto, Hero MotoCorp, Eicher Motors
	We believe auto ancillary industry would also have a positive impact on GST. Apart from lower taxation, a more uniform tax structure would result in higher cost & tax for unorgnaised players. It would tend to benefit organised players in terms of market share, going forward	At present, the spare parts industry is taxed at ~28%	GST 17-18%	Amara Raja, Exide, Apollo Tyre, JK Tyre, Balkrishna Industries, Bosch, Mahindra CIE
Financial Services	Financial services will not have any direct impact. Fee based services will get expensive for customers to the extent of variation in GST over current service tax rate	Service tax: 14.5%		-
Consumer Durable	Currently, consumer goods manufacturers need to pay indirect taxes like excise, VAT, CST and octroi. However, with introduction of GST, indirect tax liability of the companies would reduce substaintially, which augurs well either in terms of higher volume growth or better margins	At present, consumer durable manufacturers (without consideration of tax incentives) are taxed at ~25%	GST 17-18%	Bajaj Electricals, Havells India, Voltas, V-Guard
FMCG	FMCG companies in categories like biscuits, atta and packaged foods would benefit as introduction of GST would bring a level playing field by bringing unorganised players under its purview	Currently, most unorganised players are exempted from pay excise duty on biscuits	~12% for essential goods	Brittania, ITC
	The government appointed panel has recommended one demerit rate of 40% on tobacco and tobacco products with flexibility to levy additional excise duty over & above GST. We believe some part of the excise duty would be subsumed in GST. We also believe the GST rate could be static for at least two or three years after its implementation, which could give some flexibility to the company in terms of price hikes	Currently ITC pays 51% (25-26% VAT + specific excise duty)	40% demerit tax + excise duty by central government	Marginally Negative for ITC & VST Industries
	Introduction of GST would result in supply chain benefits for FMCG industry as centralisation of warehouses would reduce operational cost substantially			HUL, ITC, Dabur, Marico
Construction / building material	Currently, there is huge pricing difference between organised and unroganised players due to clandestine sales and tax evasion. Once GST comes into the picture, organised players will get a level playing field especially in verticals like tiles (unorganised market: 40-45%) and plywood (unorganised market: 70-75%)	Excise Duty: 12.5% + State VAT: 12.35%	GST 17-18%	Century Plyboard, Kajaria Ceramics, & Somany Ceramics

..contd.

Logistic	Logistics services are charged service tax at 14.5%, which is billed to customers. However, post implementation of GST, the rate is expected at 17-18%. This is also expected to be billed to customer. Hence, quantitative impact would be neutral in nature	Service tax @ 14.5% (incl. 0.5% Swachh Bharat cess)	GST 17-18%	Gati, Blue Dart
	Qualitatively, with GST implementation, there is likely to be a shift from unorganised to organised market. GST would create seamless movement of goods across. This would reduce logistics costs. Further, due to consolidation of warehouses, larger players with larger warehouses will tend to benefit			
Hotel	Hotel rooms are subject to service tax of 8.4%. Luxury tax varies from state to state of 4-12.5%. Hence, aggregate tax is around 12.4-20.5%. Implementation of GST and anticipated tax rate of 18% will negatively impact hotel sector. However, compliance cost will be lower due to uniform tax structure	Service tax on rooms: 8.4%; luxury tax on rooms: 4-12.5%	GST 17-18%	EIH Ltd, Taj GVK
	Aggregate tax on F&B is 20.1%. With the implementation of GST, the tax rate will be lower and help in reducing compliance	VAT on food: 14.5% Effective Service tax on food bill: 5.6%		
	GST proposes to impose 40% tax on aerated drinks compared to VAT of 20%. This will lead to higher pricing of non alcoholic beverages	VAT on non alcholic beverage: 20%		
Aviation	Government has proposed to include ATF in GST. If ATF is included in GST it will have a positive imact on aviation sector. Sales tax in ATF ranges from 4% to 30% across states. However, majority of states charge sales tax in range of 20-30%	ATF sales tax : 4-30%	GST 17-18%	Jet Airways
Textile & apparel	We believe GST will be negative for textile & apparel sector assuming GST rate around 17-18%. Textile products do not have any excise duty. GST will result in higher taxes for the sector. On the flip side, it will help organised players to have a level playing field with unorganised sector, which operates with thin margins dominated by cash transactions. GST is not applicable to exports. Hence, it would not impact textile exporting companies	No excise duty on textile & apparel products. Sales tax of 2% on yarn with no taxes on fabric segment. Other taxes levied include VAT (4.2%) along with surcharge & octroi. Total taxes excluding service tax is ~7-8%		
Retail	Non-apparel retailers can benefit from GST as current tax stucture is much higher than proposed GST rate of 17-18%	VAT of 12% with excise & other taxes adds up to taxes of ~26%, which is substantially higher than expected GST rate		
Media / Telecom	GST will safeguard media companies across genres such as cable distributors, DTH, movie exhibitors, distributors from the brunt of double taxation by paying service tax to Centre and entertainment tax to state government. GST will lead to one uniform tax levy for companies and be a positive for PVR, Eros, Hathway and Dish. In addition, the input tax credit offset available will further tone down overall tax rate. DTH players would get room for increase in ARPUs in line with cable players as they increase rates to pass on impact of GST	1) 23-26% of entertainment tax on net ticketing revenues by multiplexes, 9-10% VAT , 14.5% service tax 2) 5-6% entertainment tax by DTH, 14% service tax 3) Service tax 14.5%		PVR Ltd, Inox Leisure, Eros International, Dish TV
Cement	Cement companies are subject to different tax rates across states, which impact cement prices. Aggregate indirect tax in the industry is ~24-26%. With GST in place, the effective rate will be lowered and help in lowering cement prices. Also, compliance cost of cement companies will be substantially lower on account of uniform tax structure	Excise duty: 10-12.3% VAT : 12.5% other taxes: 1.3% Total effective tax rate: 24-26%	GST 17-18%	

Seventh Pay Commission - Decadal event to revive consumption

- **2% impact on GDP:** The Pay Commission is set up once every decade to recommend the pay structures of government employees. The Central government's implementation of the Seventh Central Pay commission (CPC) will result in a 65 bps impact on GDP. The total impact across governments (state governement.:100 bps; local bodies: 30 bps) at all levels is expected to be ~2% of GDP
- **₹ 3.5 trillion in hands of 1.4 crore workers:** The 23.5% pay hike recommended by CPC is expected to influence ~1.4 crore employees across government. resulting in an increase in wage bill to the tune of ₹ 3.5-4 trillion
- **What happened during Sixth CPC :** Pay revision of central government. employees led to impact of 77 bps on GDP in FY10. The central government wage bill increased at 61%, 38% in FY09, FY10, respectively while state government. wage bill increased by 20%, 31%, respectively, in the same period



Financial Implication of 7th CPC (₹ crore)

	FY17 (w/o CPC)	FY17 (with CPC)	Financial Impact	% increase
Pay	244300	283400	39100	16.0
Allowance				
HRA	12400	29600	17200	138.7
TPTA	9900	9900	0.0	0.0
Other Allowance	24300	36400	12100	49.8
Pension	142600	176300	33700	23.6
Total	433500	535600	102100	23.6

Impact of 6th CPC & 7th CPC on macro-fiscal statement

	FY09	FY10	FY11	FY12	FY13	FY14	FY15	FY16	FY17 w/o CPC	FY17 Inc CPC
Pay & allowance/GDP	2.1	2.5	2.0	1.9	1.9	1.9	1.9	1.9	1.8	2.3
Pension/GDP	0.8	1.2	1.0	0.9	1.0	0.9	0.9	0.9	0.9	1.1
PAP/GDP	2.9	3.7	3.0	2.9	2.9	2.8	2.8	2.8	2.8	3.4
Increase in PAP/GDP		0.8								0.7
PAP/GDP (excl Rail)	2.0	2.7	2.2	2.1	2.1	2.0	2.0	2.0	2.0	2.4
Increase in PAP/GDP		0.6								0.5
PAP/RE (excl Rail)	14.1	18.4	16.2	16.2	16.9	16.8	17.2	18.5	18.1	22.3
Increase in PAP/RE		4.3								4.3

- The Sixth CPC recommended a salary hike of 35% that was implemented in 2008, over 30 months behind schedule. This led to a significant pay-out of arrears, which led to a boost in consumption
- Although insignificant arrears are expected this time around, the quantum of hike and abundant financing options in a declining interest rate environment will provide a fillip to consumption
- Most state governments replicate the recommendations of central CPC with a lag. Given that the total wage bill of all the state governments is roughly 2x of the central government, we expect a further impetus to consumption

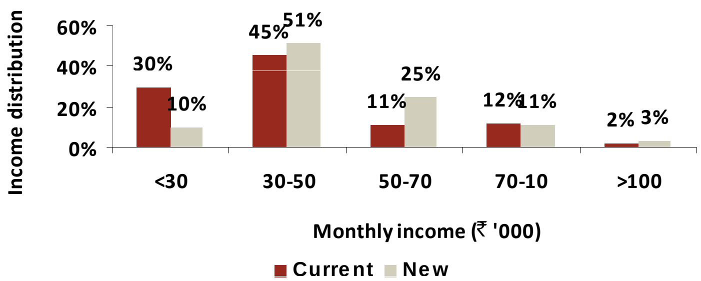
Source: Seventh Central Pay Commission , Indian Labour Year Book 2011-12 , Census Report 2011, ICICIdirect.com Research, PAP-Pay, Allowances & Pensions, RE-Revenue Expenditure

Change in consumption pattern & income distribution to boost discretionary growth

Income distribution

- Post the wage hike, we expect the average salary of a central government employee in the lowest grade pay at ~₹ 29,000 per month
- As seen in the chart below, the wage hike will lead to a reclassification of central government employees under various monthly income distribution categories. Maximum drop would be witnessed in less than ₹ 30,0000 monthly income category wherein the drop would be ~67%
- Number of central government employees earning ₹ 50-100,000 will increase 57% while employees earning >100,000 will increase 50%

Income distribution-pre & post CPC



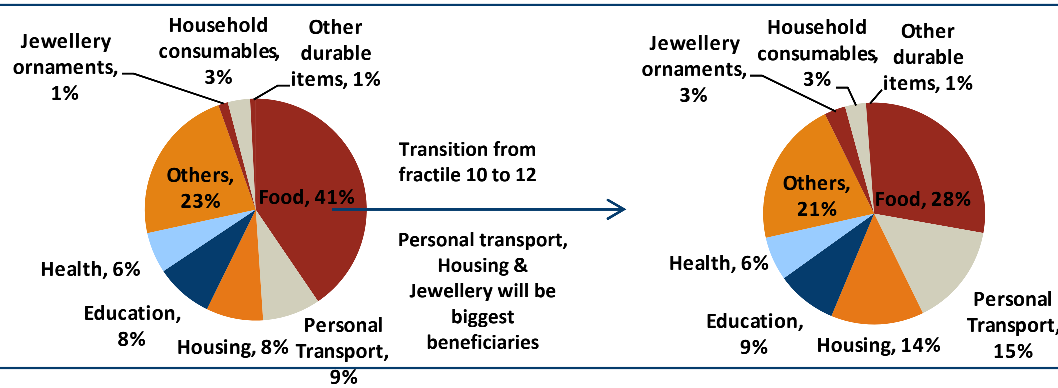
Consumption trend based on monthly per capita expendiure (₹)												
Fractile	1	2	3	4	5	6	7	8	9	10	11	12
Food	415	532	628	741	855	948	1058	1183	1343	1576	1946	2859
Personal Transport	14	20	35	58	80	112	141	183	241	329	524	1535
Housing	14	22	36	49	69	96	127	159	228	323	471	1392
Education	16	25	38	54	72	101	125	158	220	326	492	908
Consumer services	23	31	39	51	64	79	92	119	158	227	377	854
Health	21	33	47	59	74	87	120	140	171	232	343	659
Others	50	66	83	101	120	131	150	177	193	239	310	510
Fuel/light	80	95	108	123	140	153	164	181	206	238	298	418
Clothing	46	55	67	81	93	108	120	136	156	189	259	397
Jewellery ornaments	1	2	2	4	5	9	9	16	25	54	87	316
Household consumables	18	24	31	38	47	55	63	79	98	127	185	314
Other durable items	2	3	4	5	6	8	11	16	25	32	58	121
Total	701	909	1118	1363	1625	1888	2181	2548	3063	3892	5350	10282

- *Consumption patterns vary across monthly per capita expenditure (MPCE) as affluent households allocate their household budgets differently compared to poor households*
- *In the table below, a fractile class represents a population whose MPCE lies between two fractiles. Eg. fractile 1 represents '0-5%' category i.e. bottom 5% of the population ranked by MPCE, fractile 2 represents '5-10%' category, next 5% of the population ranked by MPCE*

Change in consumption pattern

The current pay structure [30% employees earning less than ₹ 30,000 per month (pm) and 45% employees earning 30-50k pm] category implies that majority of the employees will be placed in fractile 10. Their consumption pattern will be similar to that exhibited in fractile 10

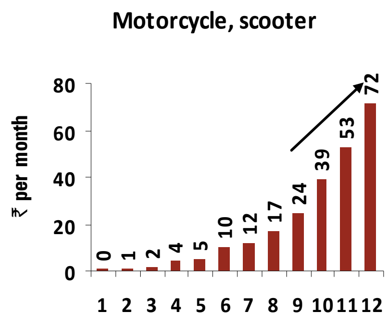
Post the wage hike, we expect part of the incremental income to be spent towards items that exhibit maximum growth in transition from the 10th to the 12th fractile.

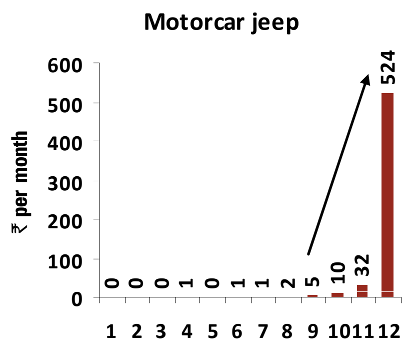


Source:, Seventh Central Pay Commission , NSS-68TH Round , ICICIdirect.com Research

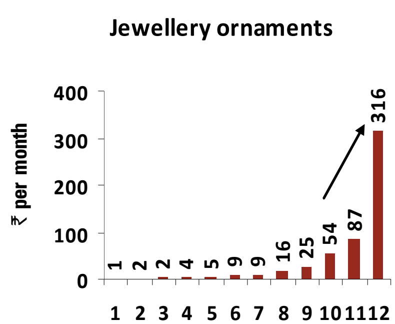
Pay commission -Exponential growth in consumer durable & housing

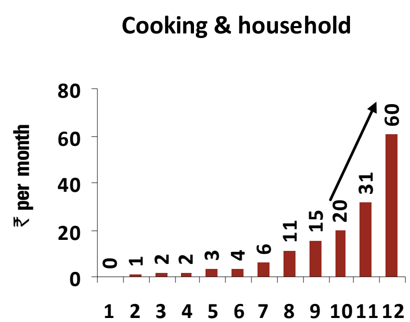
Personal Transport



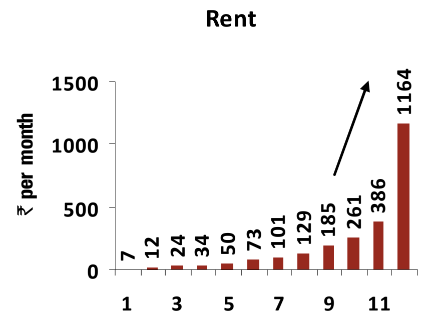


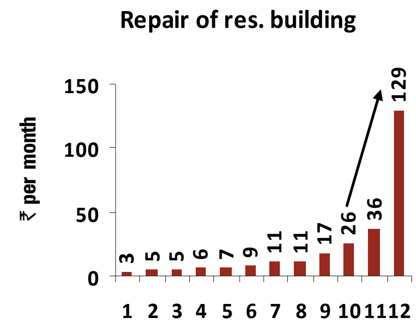
Jewellery ornaments & household appliances





Rent & repair of residential building





- As seen in the charts above, there is a huge jump in the monthly spend on cars & jeeps as we move from fractile 10 to 12 (52x) or 11 to 12 (18x). The increase in monthly spend on 2-W is not as exponential as we believe the penetration of 2-W among government employees would be high
- Jewellery ornaments (especially gold) witness sharp growth from fractile 10 to 12 (6x) or 11 to 12 (4x). Another segment that has historically exhibited growth during pay commissions is cooking & household appliances
- Another segment where we believe incremental income of government employees can get spent is repair of residential building (5x in fractile 10 to 12) and (4x in fractile 11 to 12). We also believe the trend exhibited in the 'Rent' chart will be seen in house purchase by government employees as 30% of government employees belong to the 50-60 age category. They will be planning for their post retirement life

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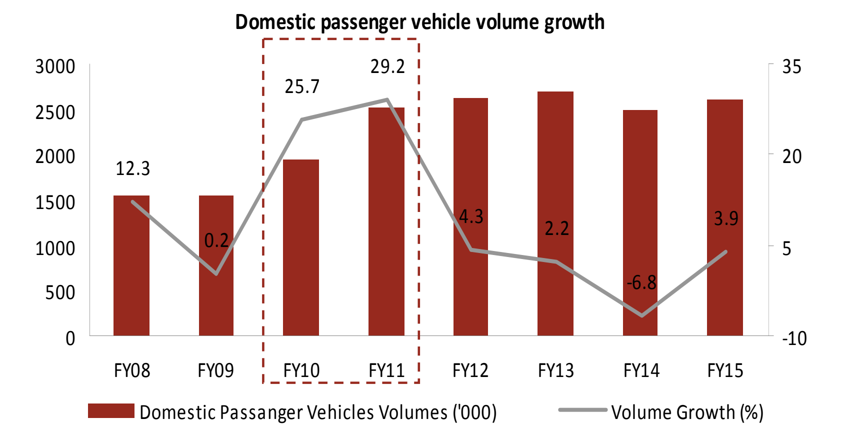
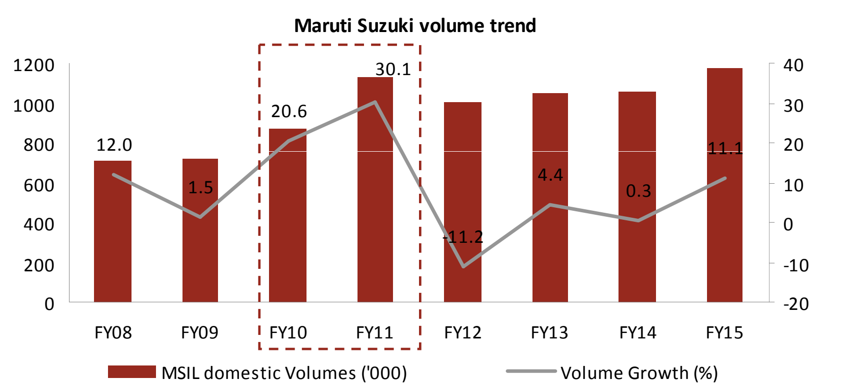
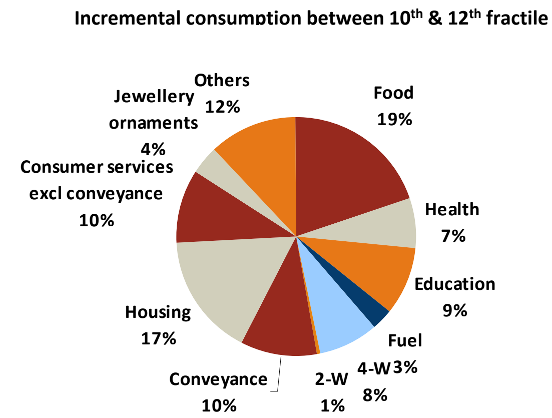
Source: NSS-68Tth Round ,ICICIdirect.com Research

Passenger vehicles - Biggest beneficiary of Pay commission





- At the time of the Sixth CPC, domestic PV sales grew at 27% CAGR while Maruti Suzuki (MSIL) sales grew at 25% CAGR in FY09-11
- MSIL sales to government employees increased from 4% in FY08 to 14% in FY11

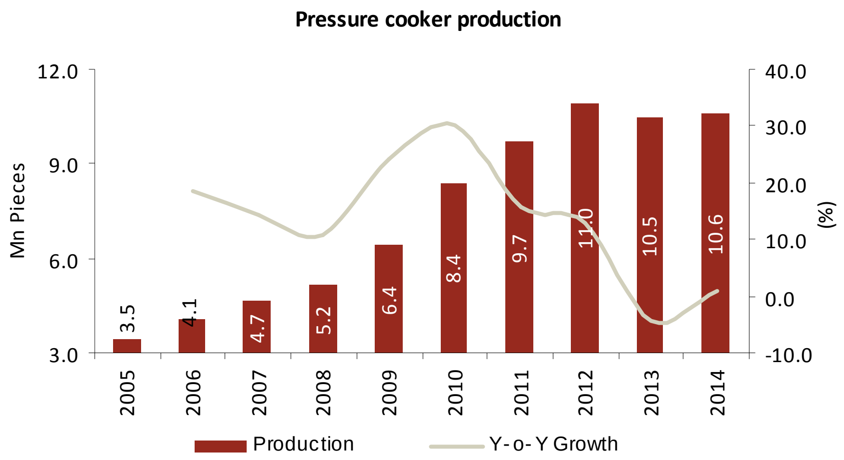


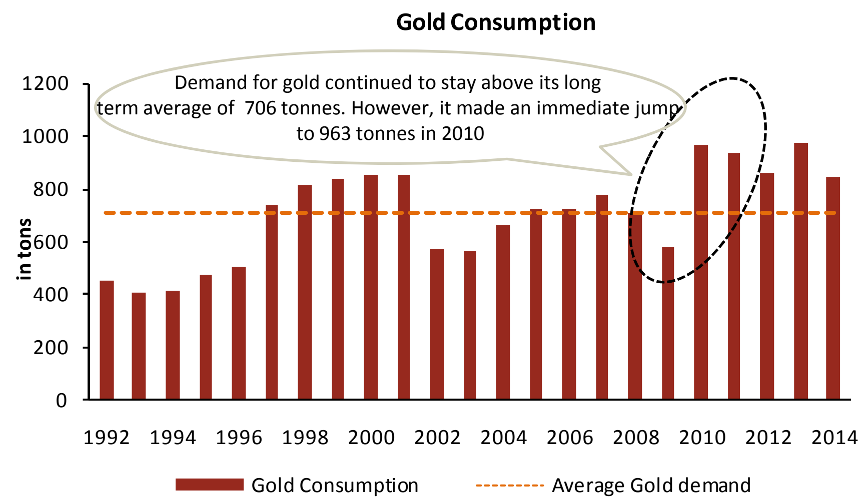
Estimated incremental demand of passenger vehicle over two years	
Increase in wage bill due to 7th CPC across governement (₹ crore) (A)	350000
Post tax incremental income (assuming tax rate of 15%) ₹ crore) (B=0.85*A)	297500
8% of incremental salary towards passenger vehicle (₹ crore) (C=0.08*B)	23800
Average purchase price per vehicle ₹ lakh) (D)	5.5
Incremental sales to government employees over two years (lakh units) (E=C/D)	4.3
Domestic sales of passenger vehicles in FY15 (lakh units)	26
Incremental demand over two years (%)	16.6

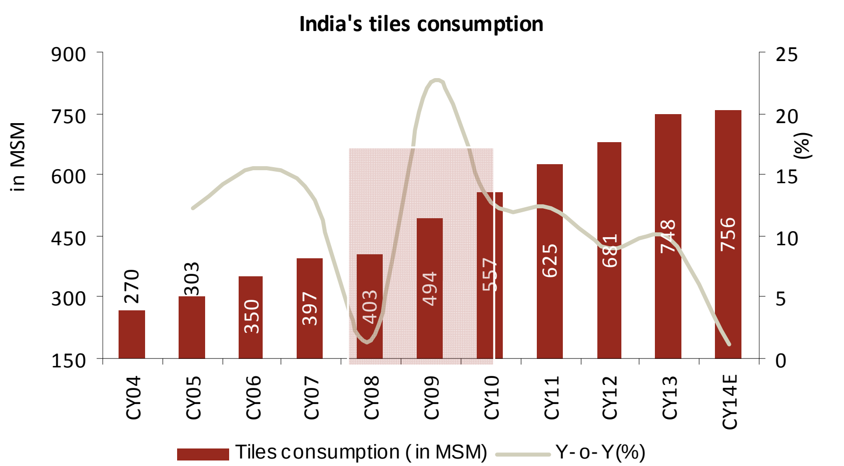
- Car purchase forms 8% of incremental expenditure as we move from fractile 10 to fractile 12
- Given that a first time buyer (government employee) will most likely opt for a small car (20% of PV sales) or compact hatchback/sedan (42% of PV sales), we have assumed ASP of ₹ 5.5 lakh per unit
- Based on our estimates, we believe the Seventh CPC will result in incremental demand of 16.6% spread over FY17, FY18

Source: Society of Indian Automobile Manufacters (SIAM) , Maruti Suzuki Annual Report, Seventh Central Pay Commission, NSS-68th Round, ICICIdirect.com Research

Other discretionary items to witness demand spurt as well





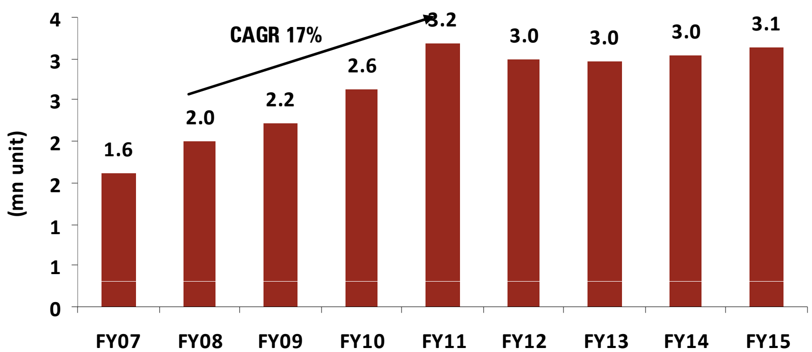


- In the last Sixth Pay Commission, discretionary items like gold, building materials and pressure cooker also witnessed a demand recovery
- In terms of jewellery, gold bucked the declining trend and started showing better demand absorption in FY08-10 as shown in the chart
- Similarly, building materials like the tiles industry also showed an impressive demand revival during the same period
- Furthermore, household items like the pressure cooker segment witnessed a strong uptick post the Sixth Pay Commission. It registered a CAGR of 23% in FY08-13
- With a proposed hike of 23.5% in the Seventh Pay Commission, we anticipate an uptick in consumer & household items demand, going ahead as well

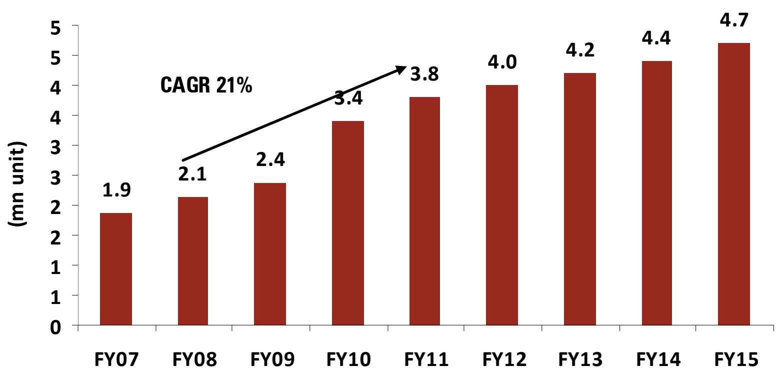
Source: World Gold Council, CSSPro, CSO, Kajaria Ceramics Presentation, ICICIdirect.com Research

White goods sales cheered post Sixth Pay Commission

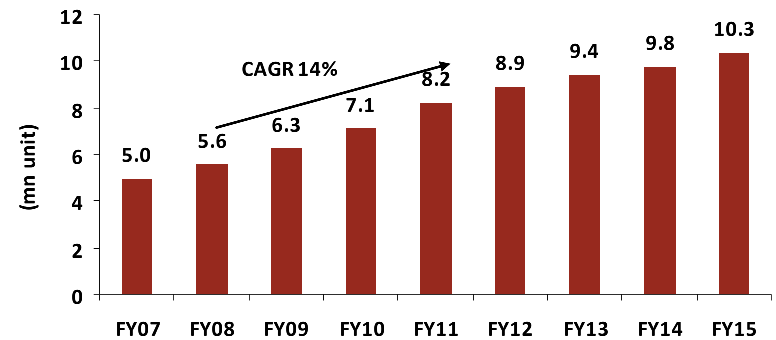
Room air conditioner (RAC) volume growth witnessed a CAGR of ~17% in FY08 -11 due to pent up demand from tier II & tier III cities. Additionally, rising aspiration levels pushed split AC volume sales at a CAGR of ~20% during the same period.



India remains a highly under-penetrated market for washing machines (WM). However, the shift in consumption pattern towards aspirational products helped sharp volume and sales CAGR of 21% and 20%, respectively, in FY08 -11. Higher demand for fully automatic WMs, resulted in volume CAGR of 22% during the same period.



Under the consumer durable industry, refrigerators are relatively better penetrated than RAC and WM. The segment recorded volume CAGR of 14% in FY08-11 largely driven by growing urbanisation and trend of a nuclear family



Structural shift gets boost from higher disposable income

- In spite of recessionary pressure, white good products like room air conditioners, washing machines and refrigerators recorded a volume CAGR of 17%, 21%, 14%, respectively, in FY08-FY11. We believe volume growth would have been largely driven by pent up demand due to Sixth Pay Commission and lower penetration level of white goods in India
- Being discretionary category products, there was a lag in demand in the product categories. As a result, the major impact of the Sixth Pay Commission was seen only after a year. The white goods industry sales recorded a CAGR of 19% in FY08-11, compared to sales CAGR of ~15% in FY07-09

Source: Industry, ICICIdirect.com Research

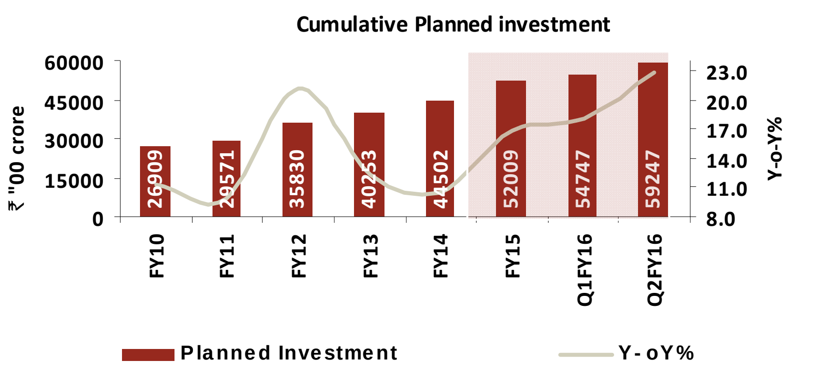
Pay Commission – Stocks, sectors set to benefit

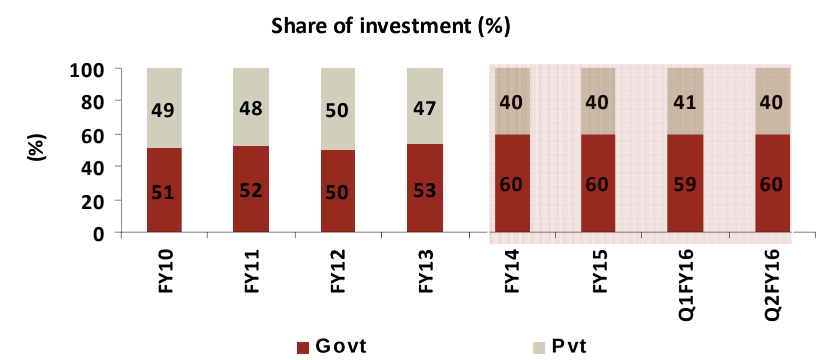
Sectors & Stocks to benefit	
Sectors	
Auto	Maruti Suzuki, Tata Motors
Cooking & household appliances	Bajaj Electricals,Havells India, Symphony, TTK Prestige, V-Guard Industries
Jewellery ornaments	Titan Company
Repair of residential building	Asian Paints, Kajaria Ceramics, Somany Ceramics, Century Ply
Rent (purchase of residence)	Mahindra Lifespace

Source: ICICIdirect.com Research

Government sowing seeds for Green Shoots in Capex recovery…..

Planned investments grew 16.9% YoY in FY15 and 20.5% YoY in H1FY16, thereby showing signs of green shoots in the investment cycle after witnessing subdued planned investment in FY13-14. However, the improvement in capex was only driven by the government as its share in investment has increased from ~50% in FY10 to ~ 60% in H1FY16. Furthermore, instances of stalled projects in the government vertical have come down sharply whereas the private sector is still seeing a slow recovery in stalled projects. In terms of segments, road, railways, water and power T&D lead the recovery, which will continue, going ahead, into FY17E as well. Out of total tenders floated in CY15, the share of the above segments comprised 61.9% of the overall tendering activity.





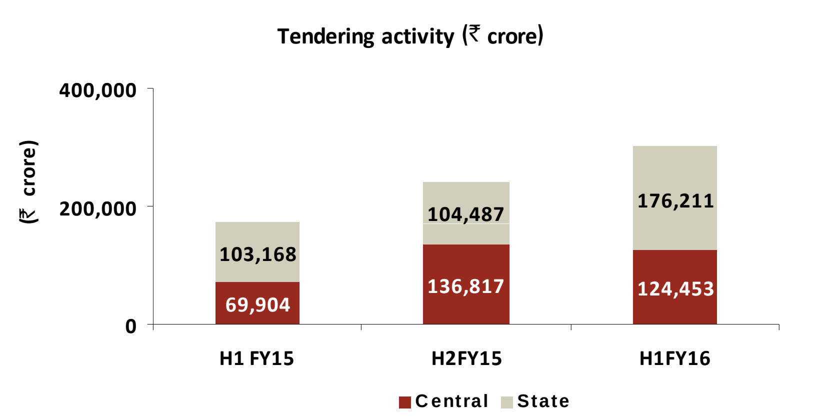
Stalled projects shrinking especially on government side

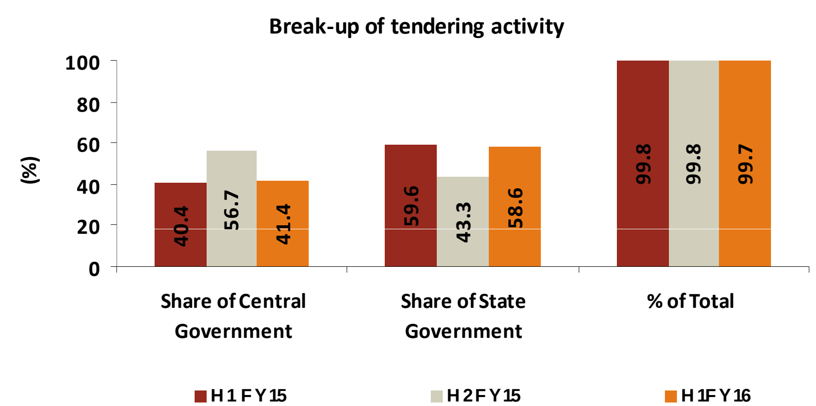
	FY14			FY15			H1FY16		
	Projects	₹ crore	Share (%)	Projects	₹ crore	Share (%)	Projects	₹ crore	Share (%)
Government	**242**	**102,243**	**30**	**129**	**59,597**	**30.1**	**54.0**	**24,538.0**	**23.1**
Central Government	69	85,110	25	39	33,502	25.0	9	4955	4.7
State government	173	17,133	5	90	26,095	5.0	45	19583	18.4
Private sector	**538**	**237,823**	**69.9**	**575**	**133,688**	**69.9**	**320.0**	**82,100.0**	**77.0**
Private (Indian)	517	165,242	48.6	539	131,924	48.6	314	73500	68.9
Private (Foreign)	21	72,581	21.3	36	1,764	21.3	6	8600	8.1
Total	**780**	**340,066**	**99.9**	**704**	**193,285**	**100.0**	**374.0**	**106,638.0**	**100.0**

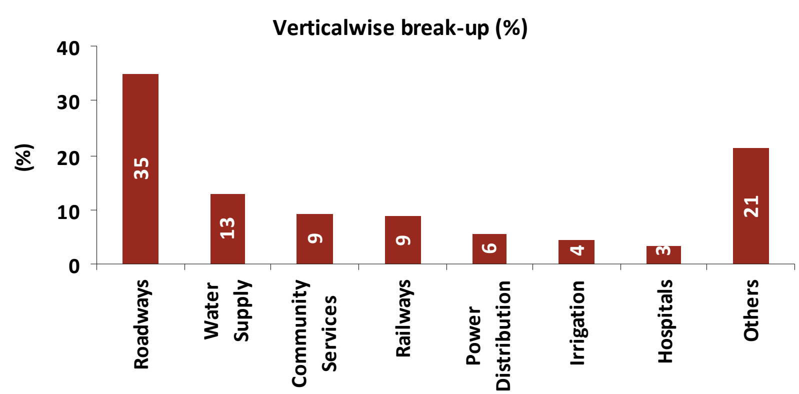
Source: Project Today, ICICIdirect.com Research

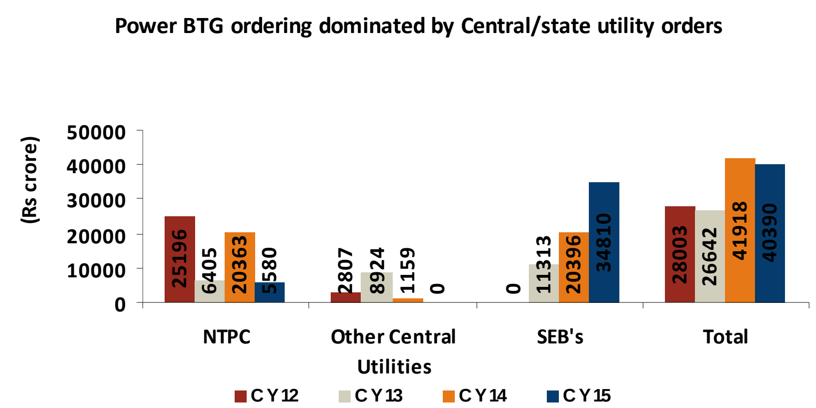
Pattern of tendering validates government onus to drive capex recovery

Excess capacity expansion drive across sectors like power, road, ports and others have bloated the balance sheets of private infrastructure players in India. In addition to this, issues like pending regulations/policy ambiguity and funding/input issues have left the private sector in a resurrection/remedy phase. The above is reiterated by the fact that from CY12-15, almost 100% of power BTG ordering, worth ₹ 137000 crore have been ordered out by government utilities. Secondly, the tendering activity of the last 18 months clearly indicates that capex from the government side will kick start and accelerate the cycle as more than 99% of tenders have been floated by government agencies. Going ahead, we believe sectors like power T&D, renewable, road, Railways and defence would be clear beneficiaries of the government's capital spending and will be the source of order inflows for EPC players.









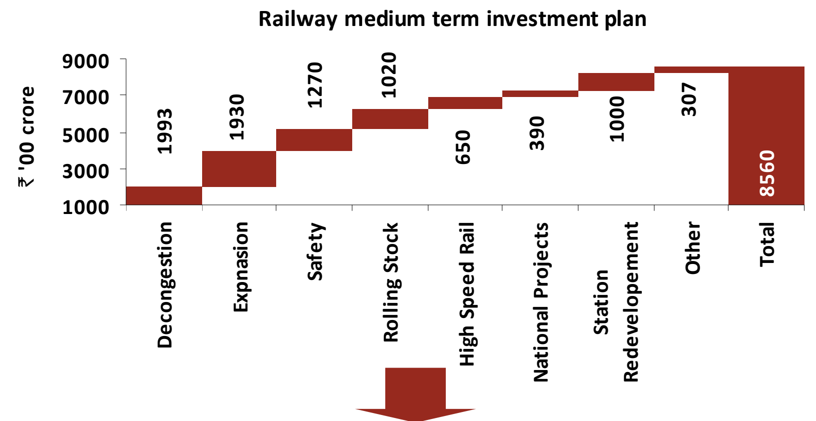
Source: Project Todayl, CICIdirect.com Research

Railway – Sounding the development bugle….

With the new ministry at the helm, Railways has realised the pain points and earmarked ₹ 101000 crore as the budgeted estimate for FY16. The incremental allocation (+52%) was the highest ever in the history of railways. Furthermore, the focus was to hasten existing projects and, at the same time, hasten the awarding as well as implementation of new projects. Crucial decisions for allowing FDI investments in railways were navigated faster, resulting in setting up of a ₹ 40000 crore locomotive project in association with global players. Unlike earlier, the Ministry of Railways is now urging state and private sector participation for station and infrastructure development. Furthermore, visionary projects like Bullet train and Diamond quadrilateral have gathered pace. Total expenditure of ₹ 856000 crore over the next five years is expected to open up multiple opportunities for sector players.

Key policy related news in Railway

Date	Event
Aug-14	The Cabinet approved a proposal to open up cash-strapped Railways to foreign investment by allowing 100% FDI in Railway infrastructure
Feb-15	For ths first time in the last decade, the Plan Budget in the railway budget has gone up by 52% to ₹ 1,00,011 crore in 2015-16. Furthermore, the Railway Ministry has also shared its medium-term perspective to invest ₹ 8.5 lakh crore to decongest and augment its network and improve passenger amenties and safety measures
Mar-15	In line with its strategy to tap alternative funding sources for its five year investment plans, Indian Railways has signed an agreement with LIC for a commitment to invest ₹ 1.5 trillion in railways over the next five years. Indian Railway is seeking fresh investments to help decongest the network, increase traffic output and generate adequate internal resources
Oct-15	In line with the commitment from LIC over the next five years, Indian Railway has received funds to the tune of ₹ 2000 crore
Oct-15	The Indian Railways has set the ball rolling for FDI after the limit was raised by the government in select railways verticals. Indian Railways has awarded contracts to global giants General Electric and Alstom for setting up electric and diesel locomotive factories in Marhora and Madhepura in Bihar.



Key beneficiary from Railway opportunities

Segment	Players
Rolling stock	Siemens, Titagarh Wagons, BEML, Texmaco Rail, Cimmco
Civil work	Texmaco Rail, L&T, Kalindee Rail

Dedicated Freight Corridor - Arriving in 2018!!!

The commissioning of the much awaited Dedicated Freight Corridor is expected to start in phases from 2018. Though the project has faced execution delay; the ramp up in the current awarding/execution is expected to adhere to the completion timeline. Land acquisition to the extent of 87% is already complete. Approximately, 66% of contracts on Eastern Freight Corridor (EFC) and 64% of the contracts on Western Freight Corridor (WFC) have already been awarded. With the completion of DFC, the railway share in freight transportation is expected to increase to 50% by FY20 from 36% in FY15.

Progress on DFC

	₹ crore	Acquired/Awarded
Land Cost	8067	~87% acquired
Construction cost	73392	~65% awarded
Total Project Cost	81459	

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

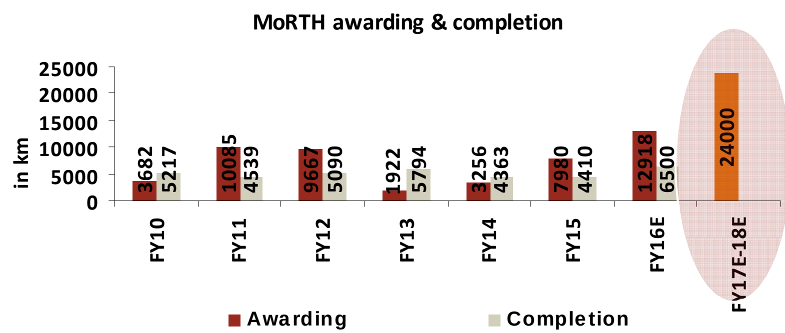
Roads - Bumpy ride over; accelerating on fast lane

In the past few years, awarding from the Ministry of Road Transport and Highways (MoRTH) had been on the slow track mainly on account of issues like land acquisition and delays in getting various clearances like environmental clearances. However, there have been key policy initiatives like premium rescheduling, conceptualisation of hybrid annuity model, possibility of one time fund infusion by NHAI in stuck projects, complete exit after two years of project completion, faster clearance, etc. With these initiatives, road awarding has been brought back on the fast track. From the awarding of 2000-3000 km in FY13-15, MoRTH has awarded 7980 km in FY15 and is looking to award 12,918 km in FY16.

Key policy related news in road vertical

Date	Event
May-14	The Cabinet has approved premium rescheduling of stressed road projects
Dec-14	The RBI has extended its flexible refinancing and repayment option for long-term infrastructure projects including stressed projects where the total exposure of lenders is >₹ 500 crore
Feb-15	The government is looking to award road development projects under the new 'hybrid annuity' model. Under this model, the government would provide 40% of the project cost to the developer while the remaining investment will have to be made by the developer
Aug-15	CCEA has permitted 100% equity exit after two years of completion for all BOT projects, irrespective of the year of award
Sep-15	The MoRTH has cleared amendments to the model concession agreement (MCA) for awarding projects on a BOT basis, which includes payment of premium to the start from fourth year of project completion and termination of projects that do not progress even after a year of award
Oct-15	The government is working to give one-time financial assistance to revive incomplete and languishing national highway (NH) projects left unfinished
Nov-15	The Cabinet has given its approval to NHAI to allow extension of the concession period for BOT projects languishing during the construction period due to causes not attributable to concessionaire
Nov-15	The government has allowed the Road Ministry to approve projects on its own if its construction cost is <₹ 1,000 crore to hasten the approval process

Going ahead, MoRTH is looking to award 12,918 km (including NHAI) in FY16E and ~24,000 km in FY17-18. This would provide significant uptick to the capex recovery as it would lead to awarding worth ~₹ 2.4 lakh crore over the next two years (assuming the thumb rule of ₹ 10 crore per km). In addition to its flagship NHDP programme, MoRTH is also looking to award roads under SARDP-NE (10,141 km), Bharat Mala (6000-7000 km) and "Char Dham Connectivity' (2500 km) projects. Hence, we believe the bumpy ride is over for the road vertical and awarding & execution could be accelerated on the fast lane. Nonetheless, land acquisition post LARR, 2013 may act as a key impediment for the road sector.



Key beneficiary from road opportunities

Segment	Players
EPC	L&T, PNC Infratech, KNR Construction, Simplex Infrastructure & NCC
BOT	Ashoka Buildcon and IRB Infrastructure

Source: MoRTH, Press reports, ICICIdirect.com Research
SARDP-NE – Special Accelerated Road Development Programme in North East, LARR- Land Acquisition Rehabilitation & Resettlement

Solar power: Becoming cynosure of all eyes amid challenges

- Installed capacity has grown at 207% CAGR in the last four years (from 35 MW in FY11 to ~3100 MW in FY15). Further, the government has already set out an ambitious plan of ramping up the capacity to 100000 MW of solar capacity by 2022, which will require investments of $80 billion or ₹ 504000 crore
- Thus, the above programme will create a huge business opportunity for solar equipment manufactures in India (modules and EPC). In our view, there will be ordering opportunities to the tune of ₹ 40000 crore per annum in FY17E- itself, which will further increase thereafter till FY21-22 . Out of these, a very minuscule opportunity will be available to the Indian manufacturing segment as 55% of the cost pertains to modules and cells wherein India lags behind. Hence, pure solar opportunity would arise from areas like civil. mounting structures, power conditioning unit, representing a ₹ 9000-10000 crore opportunity.

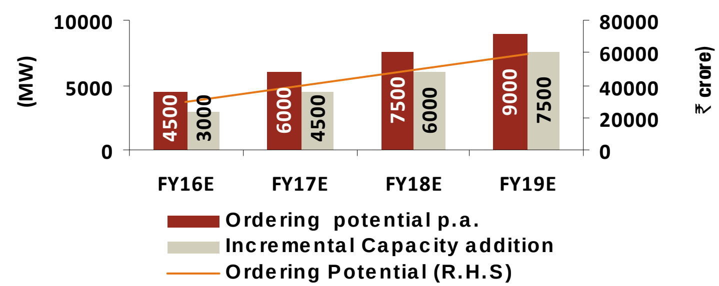
Aggressive solar capacity targets set up by various states

State	Target (MW)	Target Year
Rajasthan	25000	-
Maharashtra	7500	2019
Telengana	5000	2019
AP	5000	2019
Tamil Nadu	3000	2015
Jharkhand	2500	-
Karnataka	2000	2022
M.P.	1400	-

Solar power is becoming the cynosure of all eyes as private sector players (foreign and domestic) have signed MoUs worth 157000 MW to be installed by 2022

Significant opportunities in solar power capacity addition

Ordering opportunity: Solar power segment in FY16E-21E



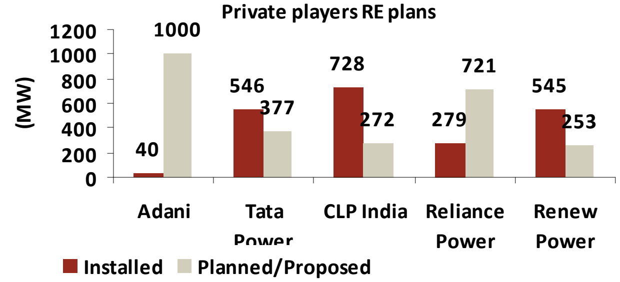
Fiscal/Policy Incentives that will drive capex in the sector
Direct tax benefit : Ten year tax holiday but MAT rate is applicable
Accelerated Depreciation (AD): Allowed to claim 80% of capex under AD, which reduce tax outgo
Priority sector lending: Investments under	15 crore under priority sector lending
Concessional Transmission: Priority in merit order dispatch/ no levy of interstate transmission charges/losses
Feed in tariffs; preferential tariffs provided by regulators based on 15-16% post tax RoE

Key impediments/challenges

- Solar module and cell manufacturing capacity at 2400 MW and 1200 MW are way below the requirement to achieve 100 GW of target by 2022.This may lead to import of equipments from countries like China, Taiwan thereby limiting opportunities for Indian players
- Ability of discoms to buy solar power until it reaches grid parity
- Changes in equipment technology can potentially delay the capacity addition cycle

Segment	Key Benficiaries
Module Manufacturers	Tata Power Solar, SunEdison, Indosolar, BHEL
EPC Opportunity	Tata Power Solar, L&T, SunEdison, Azure Powe, Mahindra Solar
Electrical Equipment	ABB, Siemens, Schneider Electric

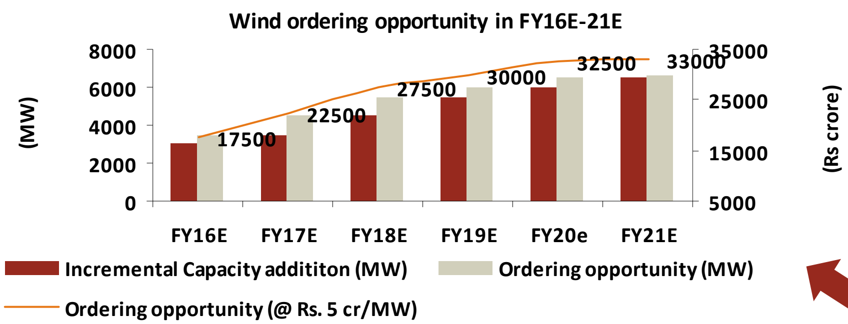
Private players RE plans



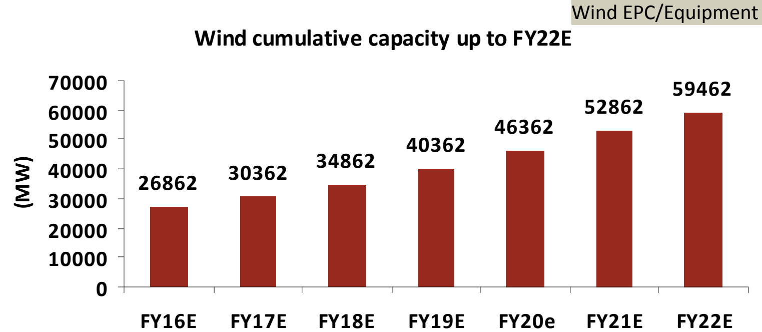
Source: MNRE, CEA, Ministry of Power , ICICIdirect.com Research

Wind power capex to continue to gain traction post re-instatement of incentives

- Annual wind installations grew at a CAGR of 29% from 1488 MW in FY09 to 3179 MW in FY12 on the back of various generation based incentives and fiscal advantages like accelerated depreciation. The removal of incentives in FY12-14 saw the annual market of wind installation decline to 2077 MW in FY14. However, the government has restored the incentives in FY15 wherein the market grew 11% YoY. Going ahead, it is estimated that the wind installation market will grow at a CAGR of 23% in FY15-17E/CY16E
- On an average, ordering potential of wind power equipment should be 4500 MW and 5500 MW for FY17E and FY18E, which will turn into an ordering potential of ₹ 22500 crore and ₹ 27500 crore, respectively, for wind power equipment manufacturers



Segment	Key Benficiaries in listed space
Wind Generators	Tata Power
Wind EPC/Equipment	Suzlon and Inox wind



Incentives that will drive capex in the sector

Accelerated depreciation : Depreciate 80% of the wind project cost in the first year of installation for tax purposes, subject to the project being commissioned before Thirtieth September of FY

Generation based incentives (GBI): The government offers a ₹ 0.50/unit subsidy to developers for actual generation of power rather than simply setting up wind projects. This incentive is particularly useful for IPPs and private equity developers that have been using it for sustainable cash flow from the project and to boost IRRs. The cap on this incentive is 10 years or ₹ 1 crore/MW (subject to a maximum of ₹ 25 lakh/MW in a financial year), whichever comes earlier

Renewable purchase obligations (RPO): Helps to increase the RoEs of the project given the certain fixed percentage of generation gets qualified for RPO and is sold to SEBs/utilities

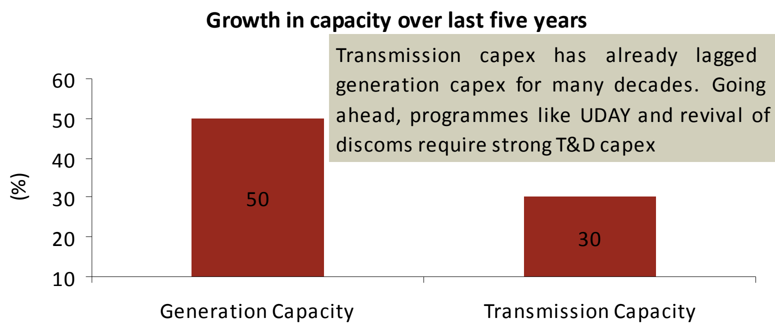
Clean energy classified as priority sector lending: This would enable banks to lend funds to wind projects at low interest rate

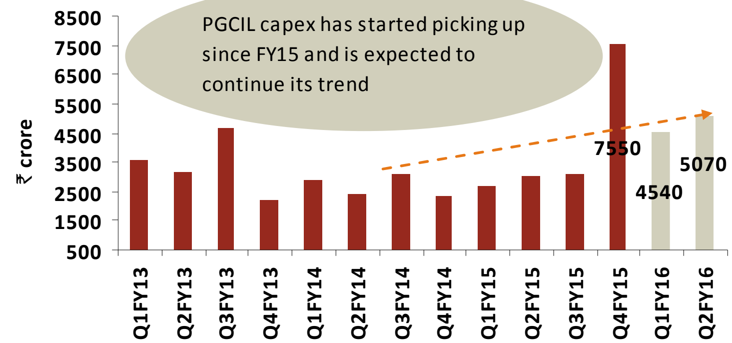
** Estimated figure of India and China for FY15 and CY14 respectively . Source: United Nations, PWC, BCG, Bloomberg, Reuters, ICICIdirect.com Research*

Power T&D to catch up to revive overall sector

T&D capex to be at forefront in power sector led by central and state utilities

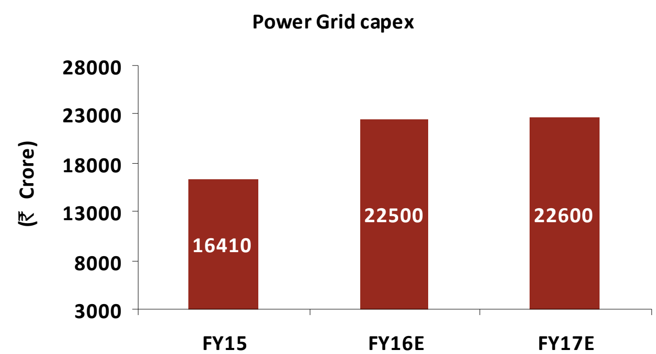
- Capex in the power segment will be primarily driven by investments in the transmission and distribution segment (T&D), which will be key for reducing AT&C losses of state electricity boards and, thereby, lead to their resurrection
- The onset of the above trend is clearly visible from the pick-up in ordering done by Power Grid, which has listed down investments of ₹ 100000 crore in the Twelfth and Thirteenth Five Year Plan. In H1FY16, Power Grid's ordering is up 67% YoY at ₹ 9610 crore
- Initiatives like UDAY and other government programmes wherein eight troubled SEBs have been registered will go a long way to initiate the process of revival of discoms over the next three to five years, which, in turn, will drive capex from the SEB's side as well





Transmission line network (ckm)	10th Plan	11th Plan	12th Plan
HVDC bipole lines	5872	9452	18892
765 Kv	1704	4164	31164
400 Kv	75722	114979	152979
220 Kv	197927	269571	379011

Transmission capex trends, in 12th plan, moving towards high end technology of 765 KV and HVDC segment, which will see a jump of 18x and 2x , respectively from Eleventh Plan



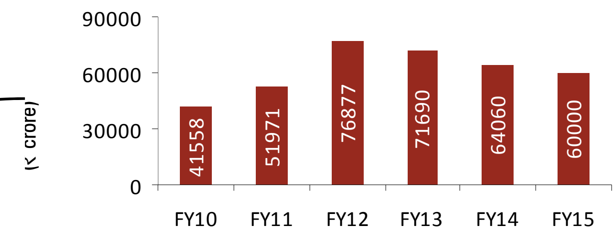
Source: CRISIL, Bloomberg, Reuters, ICICIdirect.com Research

Success of schemes like UDAY/ IDPS/DDUGJY for revival of discoms, capex …

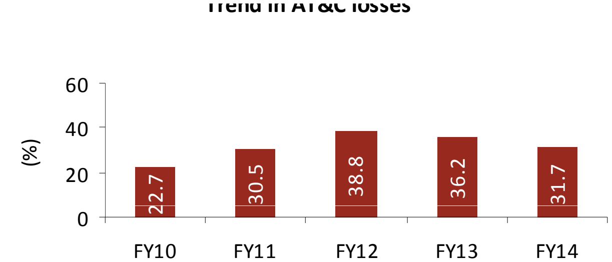
The Ujjwal Discom Assurance Yojana (UDAY) involves a massive bailout plan for debt ridden discoms, measures to reduce power thefts, align consumer tariff with generation cost and promote energy efficiency. As per the Power Ministry, the UDAY scheme; if implemented, can eventually lead to a saving of ₹ 1,80,000 crore annually and gradually improve the capex implementation power of SEB's. As of now, eight states have enrolled for the scheme.

Sailent features of UDAY Scheme
Improving operational efficiency of discoms
Lowering AT&C to 15% from current level of 30% over next three to four years. This would be done by undertaking various measures like compulsory smart metering, upgradation of transformers, meters, usage of LED bulbs
Reduction of cost of power
To be achieved through measures such as increased supply of cheaper domestic coal, coal linkage rationalisation, liberal coal swaps from inefficient to efficient plants
Reduction in interest cost of discoms'
75% of discom's debt will be transferred to the books of the state government while the balance 25% debt will be restructured by banks. This would lower the interest rate burden to ~9.5–10.0% on outstanding loans compared to the current rate of 12-13%. The debt reduction plan is likely to lower interest cost burden to the tune of Rs. 12000-14000 crore for state discoms
Enforcing financial discipline on discoms through alignment with state finances
Centre has made states directly accountable for improvement in operational efficiency and discoms' losses in future. It mentions that banks shall not be funding future losses of discoms, thus throwing the ball in the state's court for any discrepancies it undertakes against the scheme

Trend in losses of Discoms



Trend in AT&C losses



Deen Dayal Upadhyaya Gram Jyoti Yojna
Electrify all 18452 remaining un-electrified villages
System Strengthening:
•Power transformers: 14,491 nos.
•Distribution transformers: 3,17,068 nos.
•Conductors: 8,69,521 kms
•Energy Meters: 110,00,000 nos.
Total Outay approved includes Rs 75000 crore
Metering the un-metered
•Feeder/Boundary/ DTs : 11,92,658 nos.
•Energy Meters : 99,93,893nos

+

Integrated Power Development Scheme (IPDS)
Smart Metering and Tamper-proof meters at homes
Infrastructure upgradation in urban areas -Comprehensive sub T&D
Underground cabling & GIS Sub stations in densely populated areas
IT implementation for better customer service
Solar installations like rooftop solar panels also covered
Outlay of Rs. 65,424 crores

Source: Ministry of Power , ICICIdirect.com Research

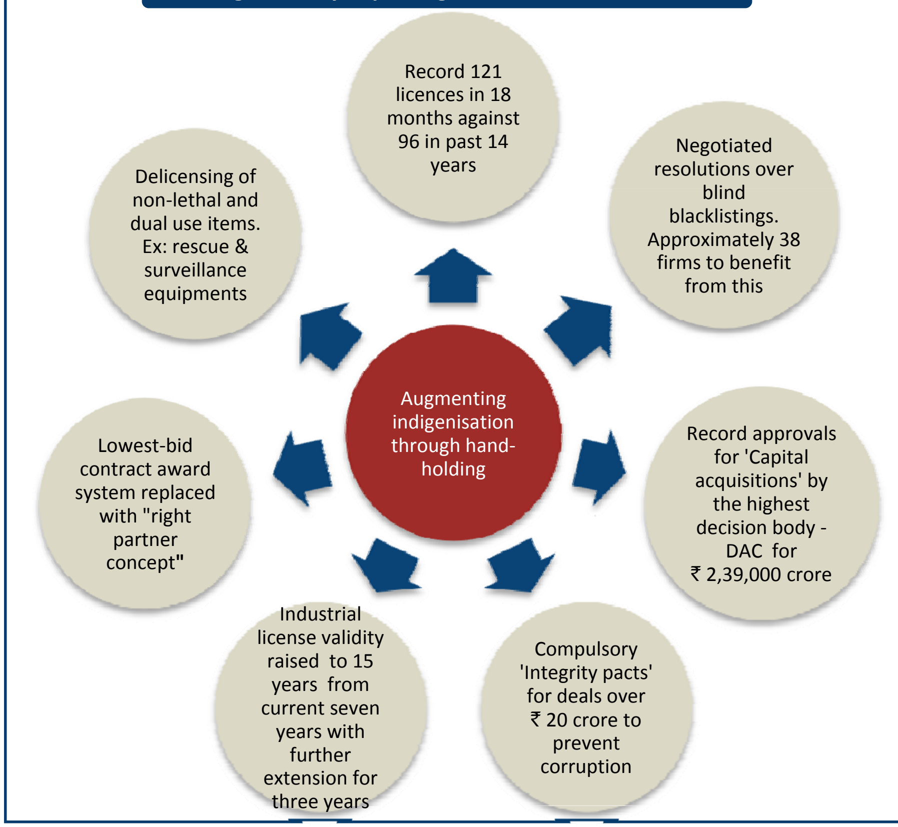
Defence: Giant wheel turning…

After facing a weak procurement cycle and snail-paced decision making in the past 10-15 years, the Indian defence sector is now witnessing heightened activity due to the current government strong resolve to equip defence forces with 'state-of-the art' weapons and reducing import dependence from the current 70% of the total requirements to 30%. Accordingly, a number of decisions have been taken by the current government across wide areas to:

1. Build capability of armed forces (Govt. to Govt. deals for quick transfer of technology, exclusive diplomacy panel for fast tracking bilateral relations)
2. Reduce import bill by building indigenous capabilities (Quick license approvals, selective de-licensing, liberalising FDI, right partner over L1 partner)
3. Encourage private sector participation with long term goal of exports (Swift project approvals, facilitating inter-country industry interactions, etc)

Turning wheel by bold policy changes and swift decision making

Turning wheel by improving business environment



Source: Media sources, ICICIdirect.com Research

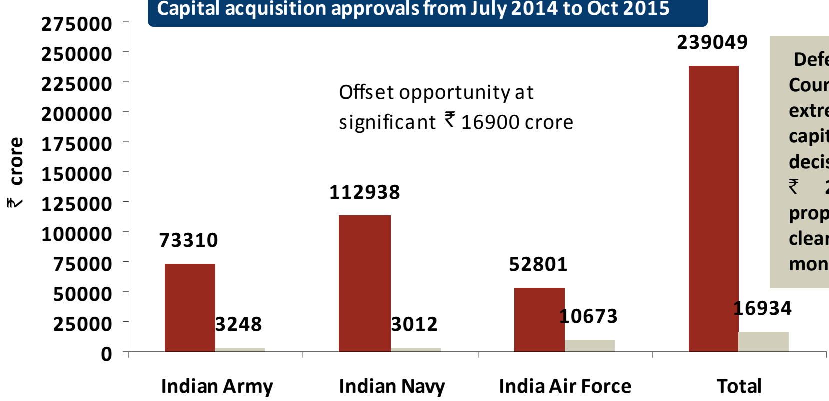
"Make in India" for Defence - More than nomenclature…

Defence manufacturing has been identified as a priority sector in the current government's flagship 'Make in India' scheme. While the nomenclature came into vogue last year, indigenous defence manufacturing has been a rather unsuccessful quest for decades. Approximately ₹ 2,39,049 crore worth of approvals have already been given by the Defence Acquisition Council (DAC) under the new government. In addition to this, six strategic and large projects have been identified where Indian private sector participation has been made mandatory. Besides the above-mentioned measures, formalising middleman role, creating working groups between countries, facilitating inter-country industry interactions through joint visits with policy makers, are few of the many measures that will go a long way in actualising defence manufacturing in India.

Six strategic areas indentified for mandatory "Private Sector' participation"

1. AIRCRAFT and their major systems.
2. WARSHIPS of stated displacements, submarines and their major systems.
3. ARMOURED fighting vehicles and their major systems.
4. COMPLEX WEAPONS that rely on guidance system.
5. C4ISTR (Command and Control System).
6. CRITICAL MATERIALS (special alloys and composites).

Capital acquisition approvals from July 2014 to Oct 2015



Defence Acquisition Council has been extremely proactive with capital acquisitions decisions. A total of ₹ 2,39,049 worth of proposals have been cleared over past 18 months

Large projects approved by Defence Acquisition Council

Category	₹ crore
36 Rafales	36000
Transport aircrafts (Avro replacements)	17500
Air Guns (L70 & Zu23)	16900
22 Apache & 15 Chinook helicopters	16250
110 Naval utility helicopter	15000
Military Planes	13000
8 P8I patrol aircrafts	9000
Support fleets for navy	9000
Integrated Air command & control systems	8000
48 Mi-17 V5 helicopter	7000
Two radar mounted aircraft	5100
200 Army light utility helicopter	5000
Refits, 4 Kilo class submarines	5000
7 Akash Squadrons	4700
Avionics & Engines of Ilyushin Fleet	4250
2 regiments of Pinaka	3300
Ghatak engine for Unmanned combat aerial vehicle	3000
4 multipurpose ocean tugs	2800
Israel Heron drones/ UAVs	2600

Source: MoD, ICICIdirect.com Research, Media

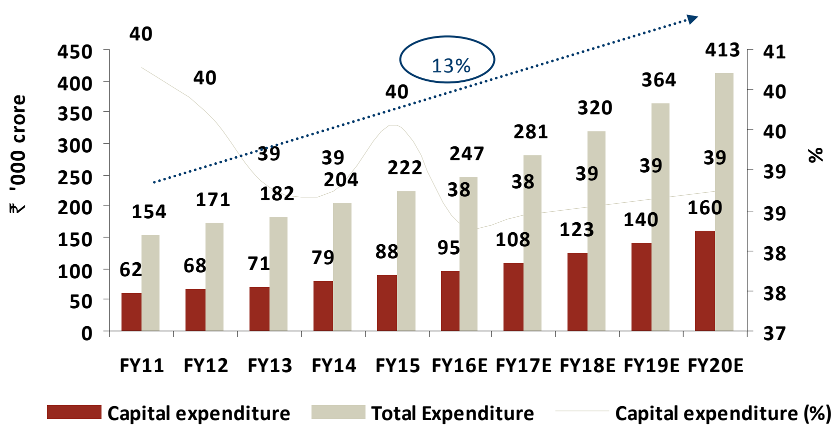
"Make in India" for defence –₹ 8,00,000 crore opportunity in making

Self-reliance in defence production is currently estimated to be less than 35%. From FY08-15, capital expenditures for Indian defence forces have increased at 13% CAGR. We believe the same will at least grow at a CAGR ~13% in FY16E-24E, if not more. With a series of steps taken, we believe indigenisation levels will gradually move northwards. Assuming 40% indigenisation for FY16E-18E, 50% for FY19E-20E, 55% for FY21E, 60% for FY22E-23E and 70% for FY24E, we believe "Make in India" in defence is an ₹ 8,00,000 crore opportunity in the making.

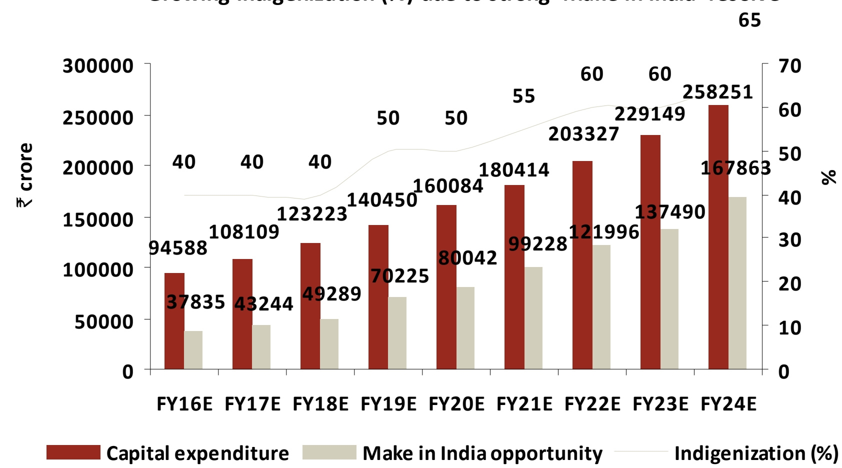
₹ crore	FY16E	FY17E	FY18E	FY19E	FY20E	FY21E	FY22E	FY23E	FY24E	Total
Capital expenditure	94588	108109	123223	140450	160084	180414	203327	229149	258251	1497596
Make in India opportunity	37835	43244	49289	70225	80042	99228	121996	137490	167863	807212
Indigenization (%)	40	40	40	50	50	55	60	60	65	54

Statements from MoD suggest the government plans to increase indigenisation levels to 70% by FY24E. As highlighted, even at 54%

Approximately 39% of total expenditure on defence is capital expenditure. It has grown at 13% CAGR over FY11-15 and is likely to grow at same rate till FY20E.



We believe all domestic companies (private and public) will benefit from the upcoming opportunity …



Source: The finance commission XIV report, ICICIdirect.com Research

Multi-year opportunity with good mass, execution to be key!

Multi-year opportunity, early movers to get an advantage

- Statements from Ministry of Defence (MoD) indicate that India does not intend to slow down its purchase plan despite already engaging in a decade of intensive acquisitions. The indicative list suggests a shopping that is even bigger
- With a stable government in place and its commitment to modernisation and indigenisation of armed forces, we believe the acquisition programmes will be executed in a more or less time bound manner

Acquisition plan of armed forces at ~₹ 12 lakh crore (FY16-22E)

Segment	Category	Size ($ bn)	Size (₹ crore)
Air	Helicopters	12.5	82500
	Missile systems	16	105600
	Transport and other Aircrafts	15.65	103290
	Fighter aircrafts	56.64	373824
Land	Artillery	5.28	34848
	Helicopters	0.75	4950
	Missiles	0.75	4950
	Tanks and Vehicles	16.35	107910
	Air defence systems	5.1	33660
	Others	9.32	61512
Navy	Helicopters	15	99000
	Navalised aircraft	5.32	35112
	Submarines	8.5	56100
	Warships	14.6	96360
	Others	1.35	8910
Total		183.11	1208526

- Number of private players along with existing state players have geared up for the opportunity. Few large players who have already build competence are likely to be the biggest beneficiaries.

Major companies to benefit...

Companies to benefit	Area of competency / Opportunity
Bharat Electronics Ltd	Defense Electronics, Electro-optics, Avionics, N/W & communication systems,etc
TATA Group (TAL,TATA Power,TATA Motors,etc)	Aerospace, Electronic and information warfare, precision technologies, surveillance technologies, unmanned aerial vehicles (UAVs), missile systems, advance materials, defence electronics, combat and tactical vehicles, etc
Larsen & Toubro	Shipbuiding, naval vessels, Missile systems,etc
Mahindra Group	Military vehicles, artillery systems, underwater armaments
Reliance Infra (Reliance defence)	Manufacturing of aircraft, Helicopters, UAVs, All Terrain Combat Vehicles (ATCV), Night vision devices, sensors, etc
Pipavav defence and offshore	Shipbuiding, naval vessels, MRO
Reliance Industries	Aerospace, Homeland security
Dynamatic Technologies	Precision electronics, Homeland security, Aerospace
Bharat Earth Movers ltd	Specialised Vehicles, Missile Systems
Ashok Leyland	Defence vehicles, Power solutions
Bharat Forge	Weapon Items, Ammunition Items, Armoured vehicles
Astra Microwave Products Ltd	Defence electronics, radars
Solar Industries, Premier Explosives	Explosives, Bi-modular charge systems
Walchandnagar Industries	Critical submarine and warship components
HAL, Bharat Dynamics & other DPSUs	Aircraft, helicopters, engines and their accessories, Missile & Weapons systems.
Government Shipyards	Design, Engineering, Ship building - all types

Source: FICCI, ICICIdirect.com Research

Market Strategy 2016

1	Introduction
2	Where are markets headed in 2016?
3	Top Picks for 2016
4	Sectoral Views
5	Volatility in earnings growth and market performance
6	Government to drive capex , consumption (Seventh Pay Commission) and reforms
7	Conundrum of global events
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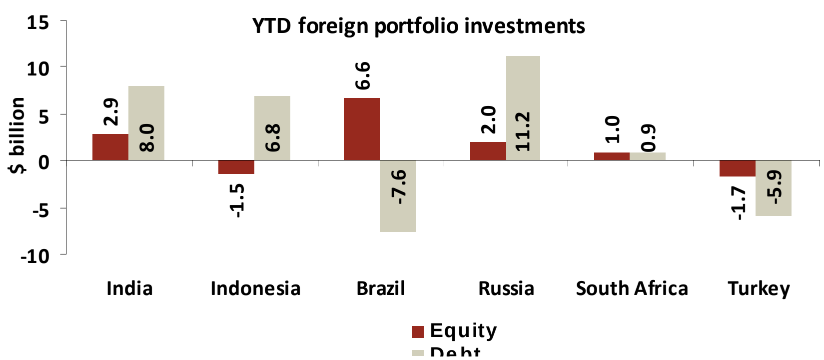
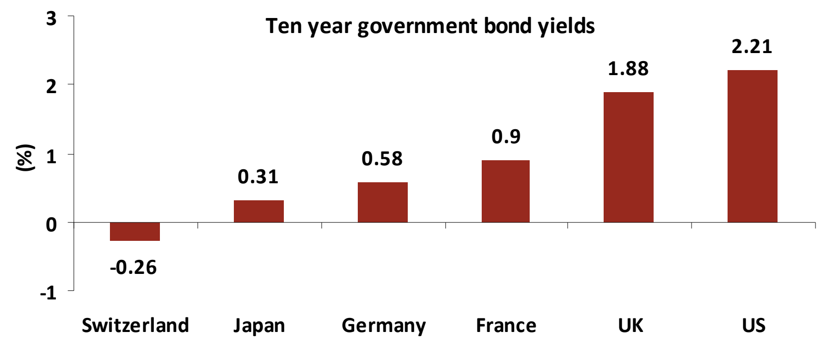
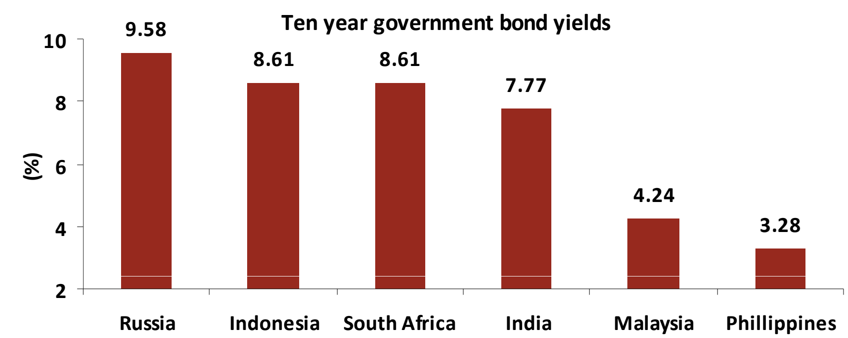
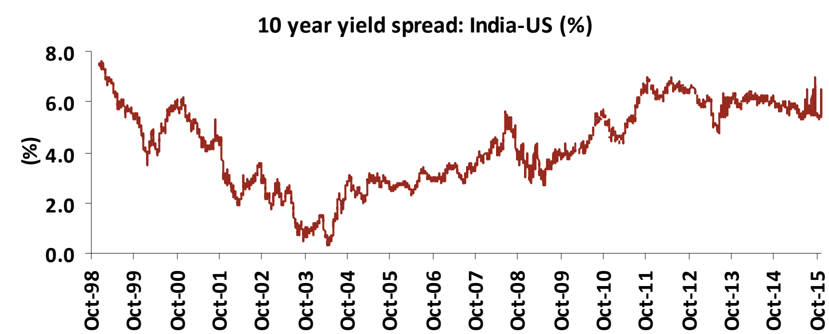
What could dictate asset allocation – Fed lift-off or trajectory of hike?

- Despite Fed lift-off – the first rate hike since June 2006 – concerns being a near-term overhang, we believe the trajectory of rate hike could dictate asset allocation strategies. India could get a disproportionate share owing to growth prospects (equity), higher coupon yielding fixed income assets and a conducive policy framework. Historically, global benchmark interest rates follow a long term cycle of upward and downward trends. Yields on government securities of major developed markets have been moving southwards for over three decades now
- The yield on the US 10 year has declined from 15% in 1982 to near 2% currently, leading to moderating returns from fixed income allocation on these sovereign bonds. Considering this trend, the direction of the next global interest rate cycle is likely to be upwards. Therefore, the plausible scenario for the next few years is that developed market sovereign bonds will generate very low or perhaps negative returns over a medium-term perspective. This could alter fixed income allocation both on an absolute basis as well as from an asset allocation perspective.
- As a result, investors are likely to increase their investment and exposure to higher coupon yielding fixed income assets like corporate bonds and structured products. Emerging markets and India, in particular, are still offering adequate coupon on sovereign securities and are, therefore, attractive for global fixed income allocation, as already seen from record inflows in domestic fixed income of around US$36 billion over the last two years





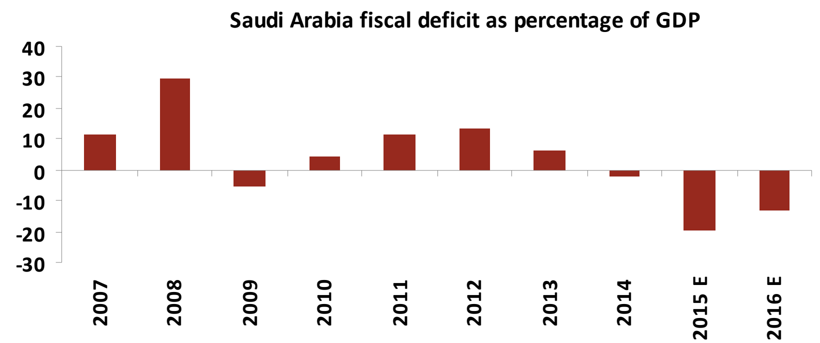


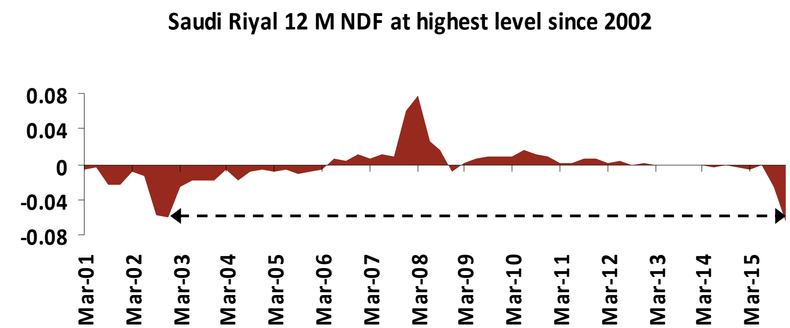


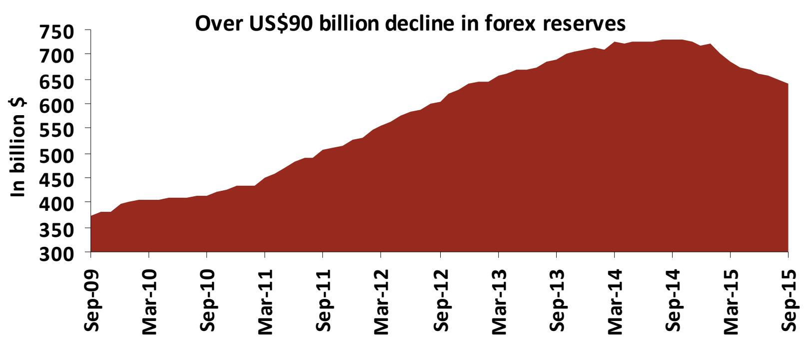
Source: Bloomberg,ICICIdirect.com Research

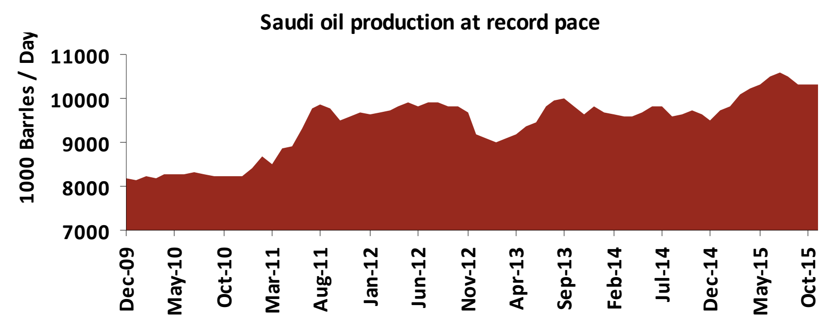
Geopolitical tension, lower crude may reset Saudi Riyal currency peg…

- With crude likely to remain "lower for longer"; the biggest risk emerging from petro-dollar states like Saudi Arabia and other oil producing countries is a sudden drought in oil based funding. The same is getting reflected in depleting forex reserves and adverse fiscal and current account situation. This situation is nowhere more prominent than in Saudi Arabia, where oil contributes over 56% of GDP. Saudi Arabia's Budget deficit for 2015 is expected to come in between 16% and 20%. For the first time in over a decade, it faces a deficit on the current account as well
- Note, Saudi Arabia, has already used 12% of its forex reserves out of its record US$731 billion dollar as of August 2014 (to US$642 billion) to support economy spending and protecting is currency peg to dollar. Further, Saudi Arabia is not relenting on cutting production (to counter US shale production and Russian oil supply). Interestingly, the currency market is suggesting the Saudi Riyal could weaken sharply in response to the changes in fiscal and economic conditions
- For reference, the non-deliverable forwards are suggesting a sharp depreciation in value of Saudi Riyal as the spread is at its 12-year high. If crude oil prices fall further towards US$30 per barrel or stays lower for longer then it reduces the chances of a US$SAR peg holding at current levels. Same stress is also visible on three-month ATM implied volatility, which is suggesting increasing odds of a de-peg in coming months





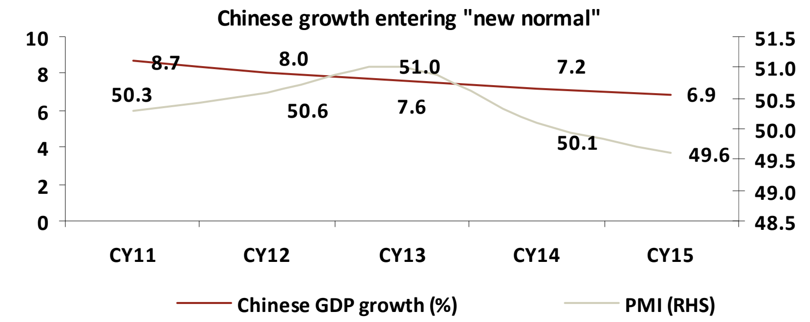


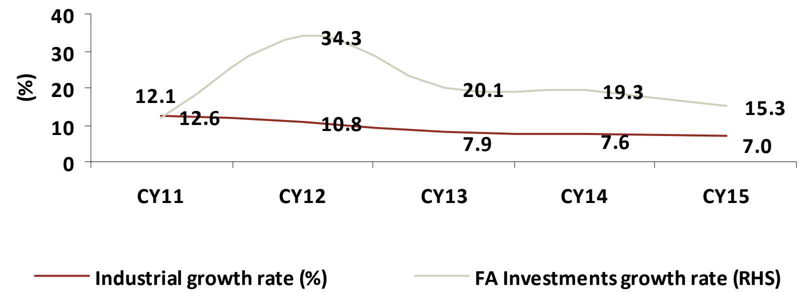


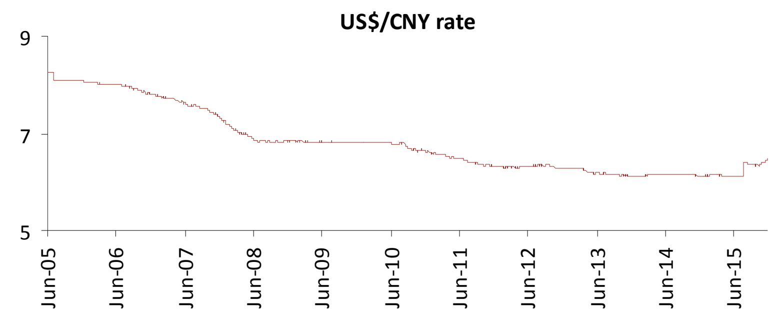
Source: Bloomberg, Reuters, ICICIdirect.com Research

Chinese conundrum: Soft landing desirable but negative surprises loom large

- After almost 15 years of rapid expansion, Chinese exports dropped leading to a slowing of GDP growth. As growth enters a ‘new normal’, it also reflects a change in stance of the Chinese government to re-balance the economy. The Chinese government's Twelfth Five-Year Plan, adopted in March 2011 emphasises continued economic reforms and the need to increase domestic consumption to make the economy less dependent in future on fixed investments, exports and heavy industry
- China is the No. 1 exporter in the world. Chinese exports in the last two decades grew more than 10% per annum out of which there were six years when growth was more than 20%. The exceptions were 2008 and 2009 during the financial crisis. Exports constitute ~23% of GDP. The global slowdown has also affected exports growth as the main destinations for Chinese exports - the US (17% of overall Chinese exports), European Union (16%), Asean countries (10%) and Japan (7%) have all witnessed a slowdown in recent times
- Consequently, the Chinese government is contemplating a shift from a factory economy to a more stable consumption driven economy. China’s economy expanded 6.9% YoY in Q3CY15. For CY14, YoY growth was at 7.4%, the slowest in 24 years. It was also the first time that China has missed its official growth target, falling just short of the official goal of 7.5%. From a healthy 9.4% average GDP growth between 1997 and 2006, growth rose to 14.2% in 2007 but has been collapsing since then, from 9.8% in the December 2010 quarter to 7% in the March 2015 quarter. Very high levels of investment have been part of the story with gross capital formation nearly 46% of GDP for nearly two decades. This created huge capacity in the manufacturing space
- However, the recent devaluation of the Yuan and interference in the stock market indicates 1) a circumspect government policy, 2) pseudo currency depreciation and rising apprehension that China is likely to come up with downside shocks and stresses for the rest of the world. Historically, China pegged, de-pegged and re-pegged (official “fix”) its currency to achieve export competitiveness and accelerate growth. The Renminbi’s addition to the elite basket of currencies could imply pseudo depreciation given the expectations of a stronger dollar





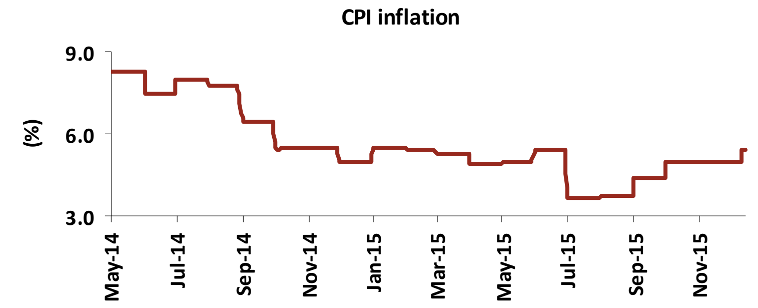


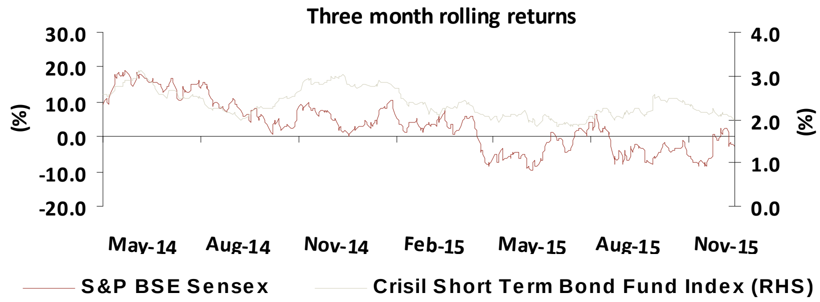
Source: Bloomberg, ICICIdirect.com Research

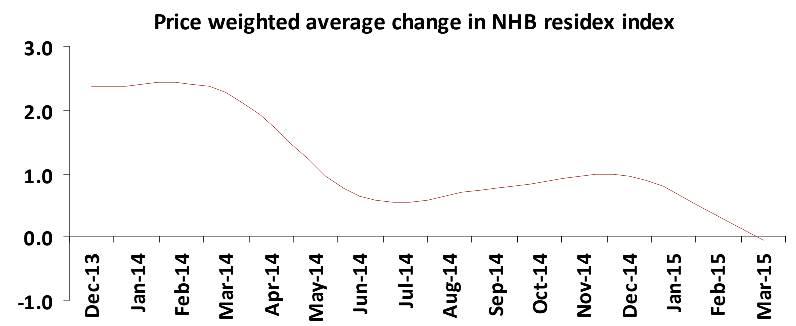
Low inflation may moderate return expectations: Equity better placed…

Time to accumulate equity as markets at cusp of growth

- The Indian economy is structurally shifting from high-inflation to low-inflation. This could have a significant impact on all asset classes. Noticeably, asset classes that did well historically (like real estate), could likely underperform while financial assets could outperform
- Over time, financial savings as a percentage of household saving have declined to ~40% vs. ~50%+ while savings in physical assets like real estate and gold rose sharply. Note, the US QE programme, since 2008, provided support to gold even as the dollar remained subdued. However, a rate hike in the US has led to a dollar rally and moderation in gold prices. Recent initiatives by the government and RBI imply a structural shift at retaining inflation below 5%. This, in turn, could lead to a revival in productive financial savings
- Rising inflation has other cascading effects: input costs like material, labour and fuel rose sharply. Companies were unable to pass these on to end consumers due to weak demand. Note, lower sales impact margins given fixed and interest costs remained high. However, this could change with lower commodity and crude price, which could accelerate consumption leading to higher capacity utilisation and rising margins
- Going ahead, with inflation pressures subsiding, real estate returns could moderate while equities could be the asset class to benefit the most from recent developments. As a reminder, the all-India residential property price index has increased a modest ~4% in the last year
- Further, returns from bonds could also be reasonable as total return from a bond consists of risk-free return – derived from the yield of a 10-year government security – plus some premium for default risk. Yields on government security could moderate given the expectation of 50-75 bps rate cut in CY16, after a 125 bps rate cut bounty in CY15
- Finally, there could be enough reasons to accumulate equities. The key is lower prices of crude and other commodities that could moderate inflation expectations. Crude, in general, has fallen substantially. India could be a key beneficiary given crude is the largest component of the country's import basket. Lower crude prices could ease the fiscal position and lead to lower inflation, which is intuitively beneficial for equities







Source: Bloomberg, National Housing Bank, ICICIdirect.com Research

Market Strategy 2016

1	Introduction
2	Where are markets headed in 2016?
3	Top Picks for 2016
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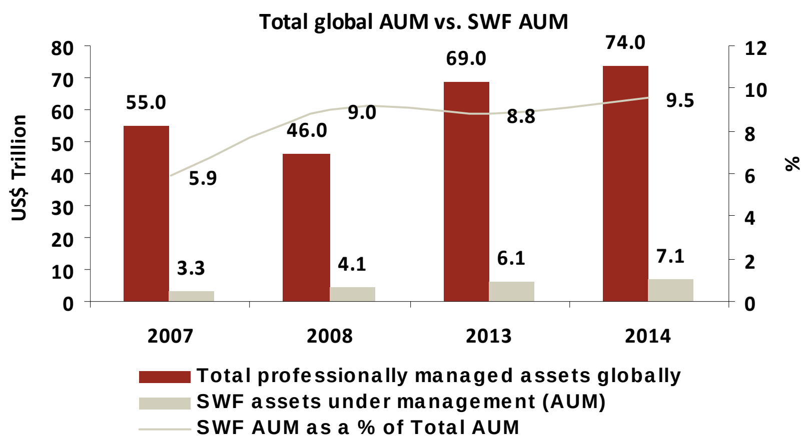
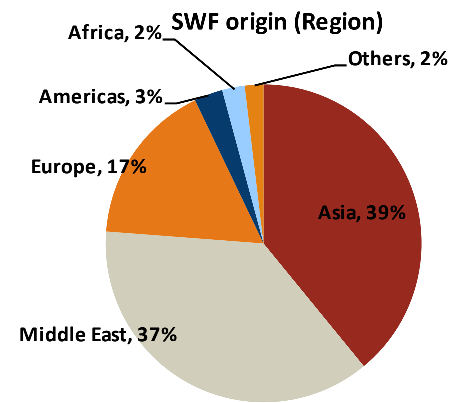
7	Conundrum of global events
8	What can alter India's favourable position

Sovereign Welfare funds…too big to ignore!!

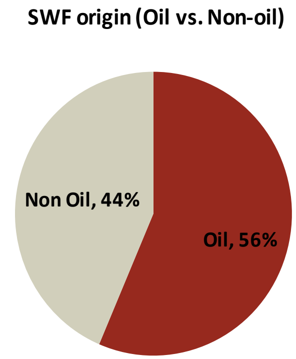
Out of the total professionally managed assets globally i.e. US$74 trillion as of CY14, sovereign welfare funds (SWF) comprise a prominent 9.5% share with total assets under management at US$7.1 trillion (CY14). Top SWFs with assets >US$100 billion comprise more than 80% of SWF assets



Top SWFs (assets >US$100 billion)				
S.No	Country	SWF Name	; (US$ billion)	Origin
1	Norway	Governement Pension Fund	825	Oil
2	UAE	Abu Dhabi Investment Authority	773	Oil
3	China	China Investment Corporation	747	Non Oil
4	Saudi Arabia	SAMA Foreign Holdings	669	Oil
5	Kuwait	Kuwait Investment Authority	592	Oil
6	China	SAFE Investment Company	547	Non Oil
7	China - Hong Kong	Hong Kong Monetary Authorirty Portfolio	418	Non Oil
8	Singapore	Governement of Singapore Invt. Corp.	344	Non Oil
9	Qatar	Qatar Investment Authority	256	Oil
10	China	National Security Fund	236	Non Oil
11	Singapore	Temasek Holdings	194	Non Oil
12	UAE	Investment Corporation of Dubai	183	Non Oil
13	UAE	Abu dhabi investment council	110	Oil



In terms of origin by geography, Asia tops the chart with total share at 39% with China being the major contributor, followed by oil & gas majors in the Middle East region. Amid a weak global economy and a sharp decline in oil prices, the role of SWF based economies will be key. In terms of origin (economies depending on oil vs. non-oil); oil SWFs top the chart with total share at 56% vs. non oil whose share is at 44%



Source: BCG, SWF Institute, ICICIdirect.com Research

SWFs (Oil originated)…increasing investments in India…potential risk

SWFs (Oil originated) investments in Indian equity markets

Government Pension fund (Norway), Abu Dhabi Investment Authority (UAE) & Kuwait Investment Authority (Kuwait) are active investors in Indian equity markets. Their investments in India have increased 63% in last seven quarters to ₹ 34509 crore as of September 2015 vs. ₹ 21222 crore as of December 2013.

SWF's investments in India

SWF	Units	Dec'13	Mar'14	June'14	Sept'14	Dec'14	Mar'15	June'15	Sept'15
SWF- Norway	₹ crore	8087	9451	11418	10287	12089	12932	13552	12934
SWF-Kuwait	₹ crore	0	0	108	152	159	517	278	301
SWF - Abu Dhabi	₹ crore	13135	12760	12546	13786	14670	16617	18233	21274

Based on >1% Shareholding disclosed to Stock Exchanges on Quarterly Basis

Decline in crude price; muted fiscal situation in oil originated SWF's economy

A sharp decline in crude oil prices has strained the fiscal situation in oil-based economies globally. Hence, oil producers are now reporting budgetary fiscal deficits. Fiscal break-even crude price and current fiscal deficits of major oil producing countries are:

Key macroeconomic variables of oil producing countries

Country	Fiscal break-even crude price ($/barrel)	Fiscal deficit (% of GDP)	Oil production (million barrels/day)
Kuwait	46.7	1.2	2.8
Qatar	62.1	4.5	0.7
UAE	68.9	-5.5	3.0
Iraq	75.3	-23.1	3.7
Iran	98.0	-2.9	3.3
Saudi Arabia	98.3	-21.6	10.1
Algeria	110.2	-13.9	1.2
Libya	142.2	-79.1	0.4

Thus, declining crude prices coupled with a deteriorating fiscal balance have put at risk the investments of oil originated SWFs in India. Oil producing SWF countries, however, with a high fiscal breakeven crude price i.e. Saudi Arabia at US$ 98.3/barrel have minimal equity exposure to India.

Positional update on oil SWFs

Over the last six months, SWFs have been active in the Indian equity markets. Their positional update is :

Increased allocation to sectors: IT- software, refineries, pharmaceuticals, capital goods

Reduced allocation to sectors: Textiles, finance, hotels, agrochemicals

Major positional changes of oil SWFs over the last 6 months

Top Buys		Top Sells	
Company	Sector	Company	Sector
Infosys	IT - Software	Ashok Leyland	Automobile
Adani Ports	Infrastructure	Marico	FMCG
Reliance Industries	Refineries	Voltas	Diversified
Havells India	Electrical equipment	HPCL	Refineries
L&T Fin. Holdings	Finance	KPIT Technologies	IT - Software
Axis Bank	Banks	IRB Infra	Infrastructure

Top current holdings

The top current holding of the two most important oil originated SWFs in India, which are susceptible to a sell-off in case SWFs wind up their positions from India are:

Government pension fund global – SWF Norway

S.No	Company	Investment Value (₹ crore)	Mcap (₹ crore)	Holding (%)
1	Axis Bank	1641	118000	1.4
2	Bajaj Auto	1022	67000	1.5
3	Tech Mahindra	843	54000	1.6
4	Ashok Leyland	605	26000	2.3
5	Hero MotoCorp	528	48000	1.1

Abu Dhabi Investment Authority – SWF UAE

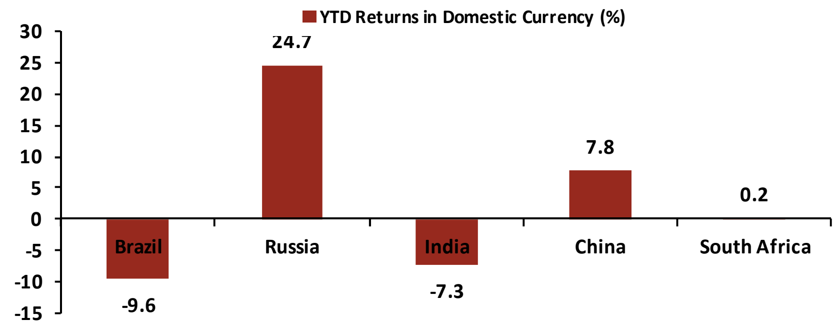
S.No	Company	Investment Value (₹ crore)	Mcap (₹ crore)	Holding (%)
1	Infosys	6521	266000	2.5
2	Reliance Industries	5356	279000	1.9
3	HDFC	2539	191000	1.3
4	L&T	1367	135000	1.0
5	Dr Reddy's	1355	71000	1.9

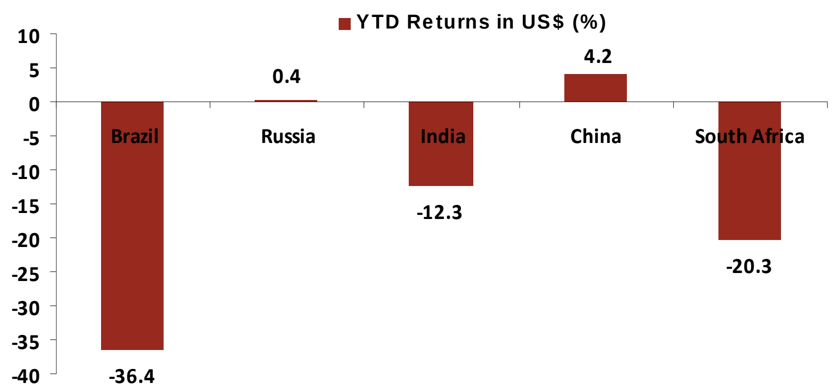
Source: IMF, Capitaline, ICICIdirect.com Research

BRICS…quantum of foreign investments slows down…India potentially at risk

BRICS: Equity markets underperform across the board

In CY14, equity markets across the board (BRICS) remained subdued with muted YTD returns, partly due to domestic macroeconomic headwinds and partially due to a slowdown in foreign investment inflows. Even if some markets like Russia & China reported positive returns YTD in terms of their domestic currency, the same gets nullified if returns are dollar adjusted.

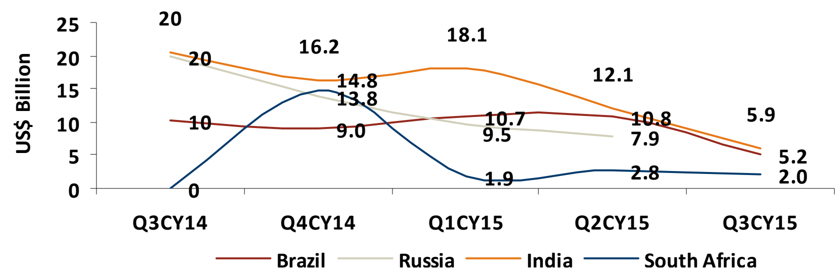




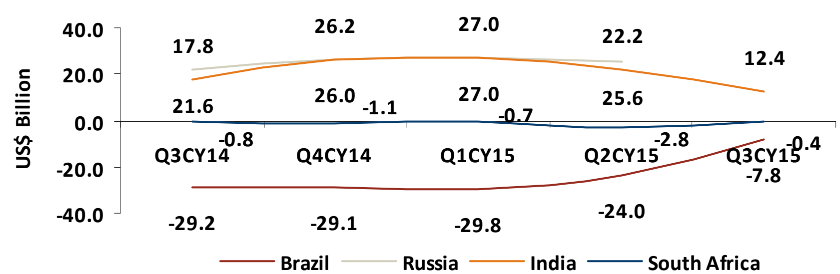
Foreign equity investments down substantially: India worst hit

Foreign equity investments have slowed down considerably in YTD CY15 with India the worst hit among BRICS countries ex-China. On a TTM basis, equity investments in India at the end of quarter in Q1CY15 were at US$ 18.1 billion while the same at the end of Q3CY15 was at US$ 5.9 billion. The same holds true even on the debt front. TTM investments in debt as of Q1CY15 and Q3CY15 were at US$ 27 billion and US$ 12.4 million, respectively. Thus, a decline in quantum of foreign portfolio investments in India poses a risk to the Indian capital markets and shows its lack of appeal to foreign investors vis-à-vis the capital markets of other BRICS countries

BRICS - Ex China equity foreign investments (equity)



BRICS - Ex China equity foreign investments (debt)



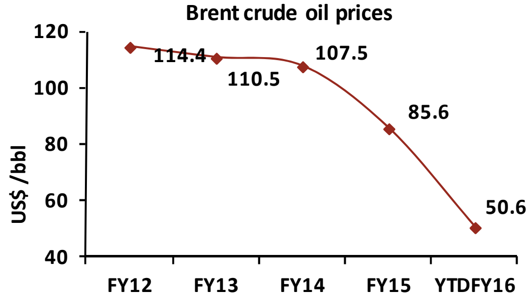
Source: Bloomberg, ICICIdirect.com Research

Fall in crude prices…. places India in sweet spot!!!!

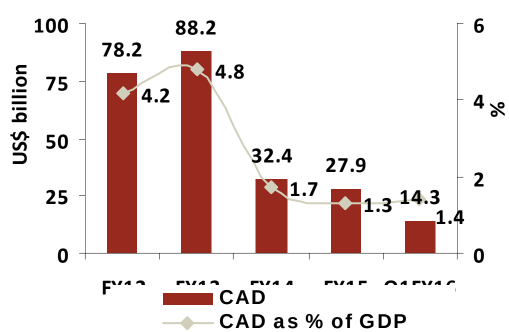
India's current account balance in comfort zone

- A sharp fall in Brent crude oil prices over the last two years due to lower world GDP growth and surplus oil supply has placed India in a comfortable position
- Improvement in trade balance has led to decline in India's current account deficit from 4.8% in FY13 to 1.3% in FY15

Brent crude oil prices



CAD declines due to lower oil prices

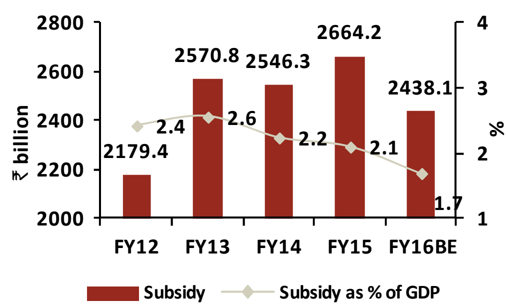


- India's total subsidy outgo has remained relatively stable in the last two years despite higher food subsidy due to a decline in oil subsidy burden of the government. As a result, India's subsidy as percentage of GDP declined from 2.6% in FY13 to 1.7% in FY15

Government's subsidy to decline in FY16E

Subsidy (₹ bn)	FY12	FY13	FY14	FY15	FY16BE
Food	728.2	850.0	920.0	1226.8	1244.2
Fertiliser	700.1	656.1	673.4	707.0	729.7
Petroleum	684.8	968.8	853.8	602.7	300.0
Others	66.2	95.9	99.1	127.8	164.2
Total	2179.4	2570.8	2546.3	2664.2	2438.1

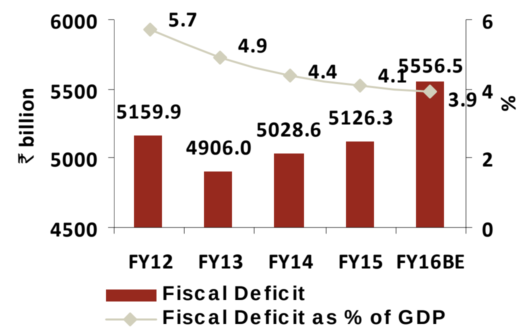
Subsidy as percentage of GDP to decline due to lower oil subsidy



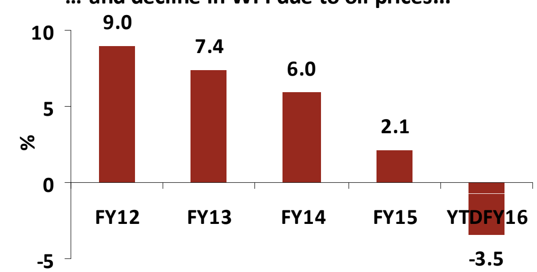
Oil prices mainly contribute to improvement in India's macroeconomic variables

- A declining fiscal deficit and inflation at comfortable levels mainly due to lower oil prices has led to lowering of repo rates from the RBI. This has led to a revival in the economy and placed India in a sweet spot among major global economies, which are experiencing deteriorating fundamentals

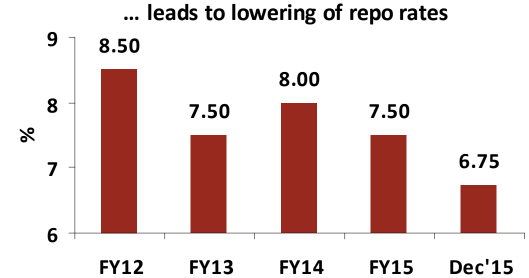
Improving fiscal deficit data…



… and decline in WPI due to oil prices…



… leads to lowering of repo rates



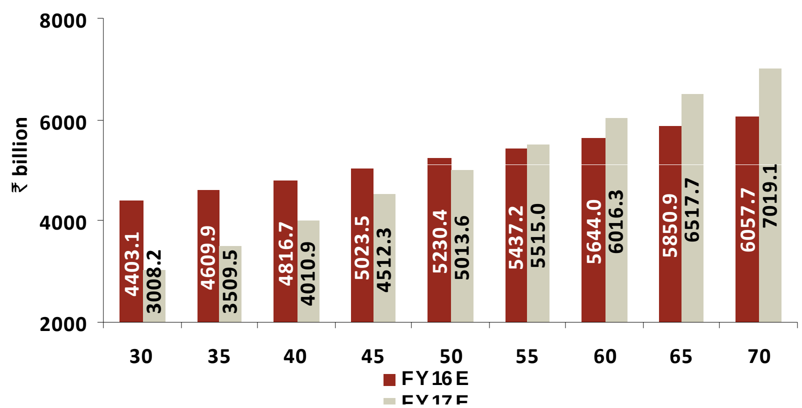
*Source: Bloomberg, RBI, PPAC, ICICIdirect.com Research * Budgetary Subsidy and Fiscal Deficit estimates are based on crude oil price assumption of US$ 60/barrel*

What if the tide reverses….impact of upside in commodities

Increasing oil prices to worsen current account balance

- India's current oil import bill is estimated at ~₹ 5.4 lakh crore for FY16E and is the major contributor to our trade and current account balance
- Based on our analysis in constant currency terms, every US$10/bbl increase in crude price increases our import bill by ~ ₹ 1 lakh crore annually while our current account deficit worsens by ~64 bps annually

Net oil imports under various oil price scenarios

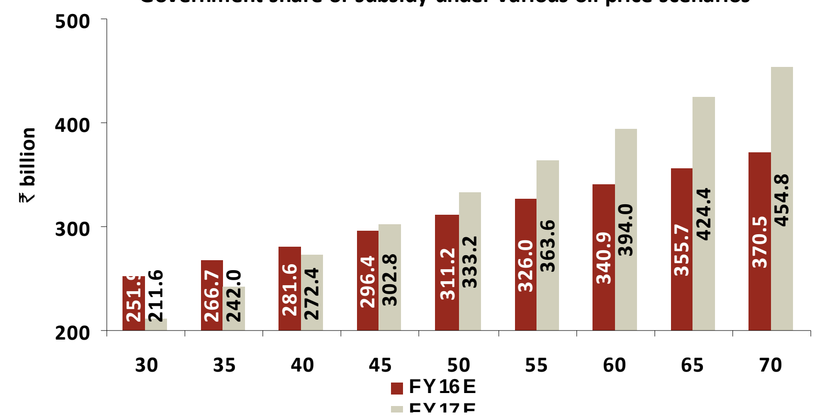


CAD as percentage of GDP under various oil price sceanarios *(Ceteris Paribus)*		
Brent crude oil prices ($/bbl)	FY16E	FY17E
30	0.5	-0.5
35	0.6	-0.2
40	0.8	0.1
45	0.9	0.4
50	1.1	0.8
55	1.2	1.1
60	1.3	1.4
65	1.5	1.8
70	1.6	2.1
75	1.8	2.4

However, fiscal deficit to have minimal impact

- Increase in oil prices will have minimal impact on fiscal deficit on account of deregulation of diesel, DBT for LPG and increase in excise duty on petrol and diesel
- Based on our analysis of the government's share of subsidy under various oil price scenarios in constant currency terms, a US$10/bbl increase in oil prices will increase the fiscal deficit by ~₹ 6,000 crore, 1.1% of estimated fiscal deficit of FY16E, 0.05% of India's GDP (FY16E) , respectively

Government share of subsidy under various oil price scenarios



Higher oil price - domestic currency to weaken; inflation to rise

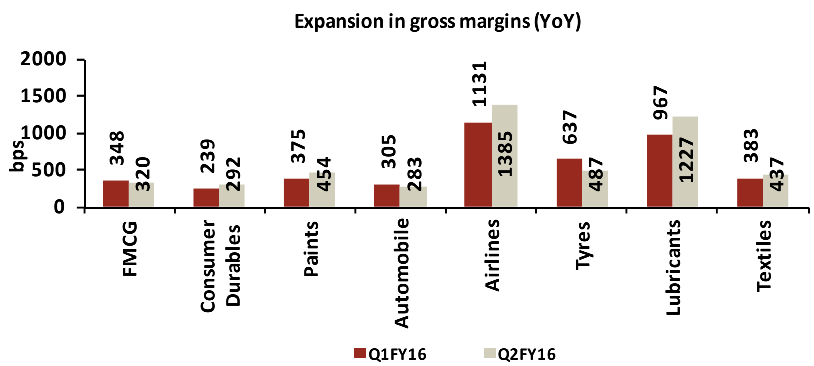
- An increase in oil prices is also expected to lead to a depreciation in the domestic currency on account of the worsening current account deficit, which will have a ripple effect on the otherwise stable fiscal situation. As per our analysis, for every unit depreciation of the rupee against the US$, the fiscal deficit would increase by ~₹ 1,350 crore
- An increase in oil prices is also expected to lead to an inflationary environment domestically, resulting in higher prices of all essential commodities since it is used in all transportation media. It may limit further rate cuts by the RBI (or may result in monetary tightening) leading to a muted business environment domestically

Source: RBI, ICICIdirect.com Research

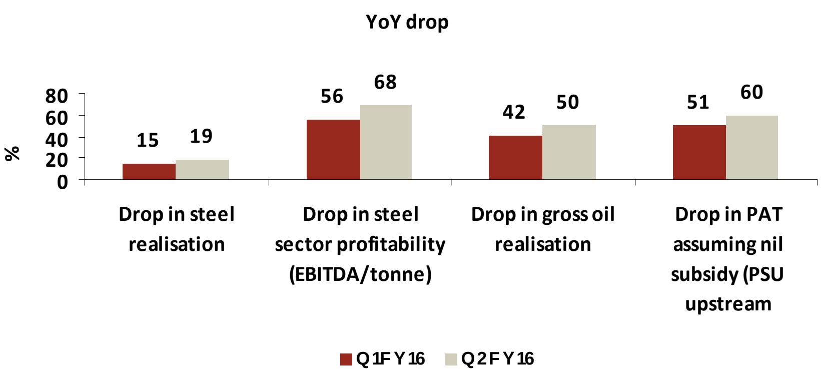
Fall in crude..immensely benefits airlines, lubricants...what if tide reverses???

Fall in crude: Benefits key oil input sectors….

Q2FY16 was another quarter of strong gross margin expansion across sectors YoY as companies realised benefits from a global fall in commodity prices viz. crude, crude derivatives, metals – ferrous, non ferrous, rubber and cotton. The crude price fall benefited airlines, lubricants industry immensely while the consequent fall in crude derivates benefited the paints sector.



…but lead to substantial losses for its key producers



If tide were to reverse…commodity producers to swing back in action…

If commodity prices reverse globally over the next year due to ample liquidity, the sectors that have witnessed a huge drop in earnings will benefit the most. We believe PSU upstream companies will benefit in a significant manner in response to an increase in crude oil prices. The main beneficiary would be OIL and ONGC in our coverage universe

Sensitivity of PSU upstream PAT to change in oil prices (ceteris paribus)

Brent Crude ($/bbl)	30	35	40	45	50	55	60	65	70	75
OIL (Increase in PAT, %)	-79	-62	-44	-26	-13	Base Case	13	26	39	47
ONGC (Increase in PAT, %)	-100	-78	-56	-35	-17	Base Case	17	34	52	65

…while input players may report subdued profitability

Key sectors that benefited the most from a drop in global crude prices were airlines, lubricants and paints. We believe the same will be hardest hit in terms of profitability, if the downward trajectory of crude price were to reverse. The lubricants and airlines sector are, however, more sensitive to crude prices vis-à-vis paints.

Sensitivity of paint companies' PAT to change in oil prices (ceteris paribus)

	Bear case	Base case	Bull case
Crude price ($/bbl)	75.0	55.0	35.0
RM to sales (%)	60.0	55.5	51.0
EBITDA margin (%)	16.3	18.8	21.0

Sensitivity of lubricant companies' PAT to change in oil prices (ceteris paribus)

Brent Crude ($/bbl)	30	35	40	45	50	55	60	65	70	75
Lubricants (Inc in PAT,%)	39.7	31.1	22.4	13.8	5.2	Base Case	-12.0	-20.6	-32.9	-37.9

Sensitivity of airline companies' POM to change in oil prices (ceteris paribus)

Brent Crude ($/bbl)	30	35	40	45	50	55	60	65	70	75
OPM (%)	13.6	12.7	10.9	8.5	7.9	6.9	5.4	4.7	3.4	2.2
Increase in OP (%)	97.1	84.1	58.0	23.2	14.5	Base Case	-21.7	-31.9	-50.7	-68.1

Source: ICICIdirect.com Research

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