October 2019

MARKET OUTLOOK

2019-20

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MARKET OUTLOOK FOR OCTOBER 2019

The recent actions of the government have boosted investor sentiment in the midst of a slowdown and improved India's international competitiveness. The tax cut can be classified as a major reform, since it has the potential to alter India's competitive position, attract more manufacturing investments from abroad as well as revive the domestic private investment cycle. Automobiles, banks, consumer staples and global commodity sectors will see large earnings upgrades while electric utilities, IT and pharmaceutical sectors will see little or no earnings changes

While we expect market sentiment to sustain on the back of these announcements, especially for 'quality' stocks, market performance will depend on the extent of follow-up reforms which include: **Rate cut:** Given how low nominal rates are and with the US Federal Reserve cutting rates, there is scope for further rate cuts from the RBI. We are forecasting a 40 bps rate cut in October and total of 75 bps in the rest of FY20. **Privatization:** The government has so far relied on piecemeal sale of public sector companies to institutional investors. There is likely shift in this thinking with large public sector companies being put for privatization to strategic buyers. Apart from revenue implications for the government, this has potential to lift the return on capital of these companies. **Reforms** in factors of production (labor laws, land acquisition policies and approval).

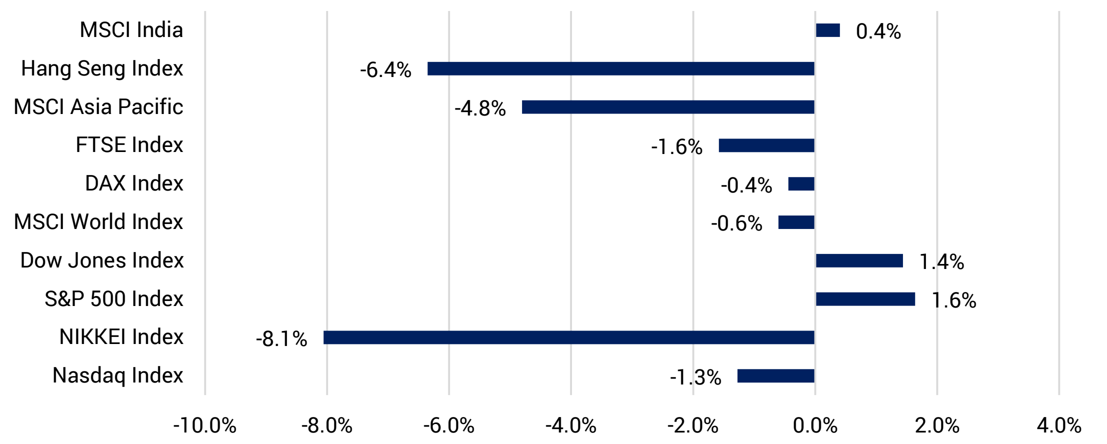
Normal monsoon would boost agricultural production, increase consumer demand and keep the inflation in check. The cumulative monetary and fiscal actions including acceleration in government spending and latest tax cuts should start improving growth prints in Q3FY20. In the Q1FY20 earnings season, net profit of the Nifty-50 Index increased by just 1.8% yoy while EBITDA declined 3.4% yoy. In Q1FY20 companies paid taxes based on the earlier rate. Hence we can expect higher earnings growth in the coming three quarters as excess paid in Q1 gets adjusted. The global & local slowdown is still a reality and could take time to reverse. Hopefully the lower base effect of revenues will lead to yoy growth from either Dec'19/Mar'20 quarter onwards.

FIIs will take this move on tax cut and other announcements, especially on the roll back of enhanced surcharge positively. We can expect bulk of the outflows seen post budget (i.e. ~USD 4.8 bn) to reverse in the coming months. The moves by other central banks like ECB and Fed are also positive for flows into emerging markets. Given better earnings prospect, India could stand out in the emerging markets and we can expect healthy flows in the coming weeks and months.

We were hoping for a 10% rise in Nifty earnings on account of the change in tax rates. However, our revised FY20 EPS for Nifty-50 after considering changes in other parameters like lower demand and issues such as Deferred Tax assets (especially in case of banks) & MAT goes up by just 2%. We now expect Nifty-50 EPS to rise by 17% in FY20 and by 21% in FY21 (still a CAGR of 19%). The bearish trend prevailing in the market since Budget is fading and investors are now looking forward to buy stocks in any market correction. Bulk of the EPS upgrade has got factored in frontline stocks. Investors need to get accustomed to the new prices to the extent of earnings upgrade (keeping valuations intact). We expect Nifty-50 to settle near the 11,500 mark (+/- 200 points) in the near future. We can expect Nifty-50 to go into a new high by Union Budget 2020.

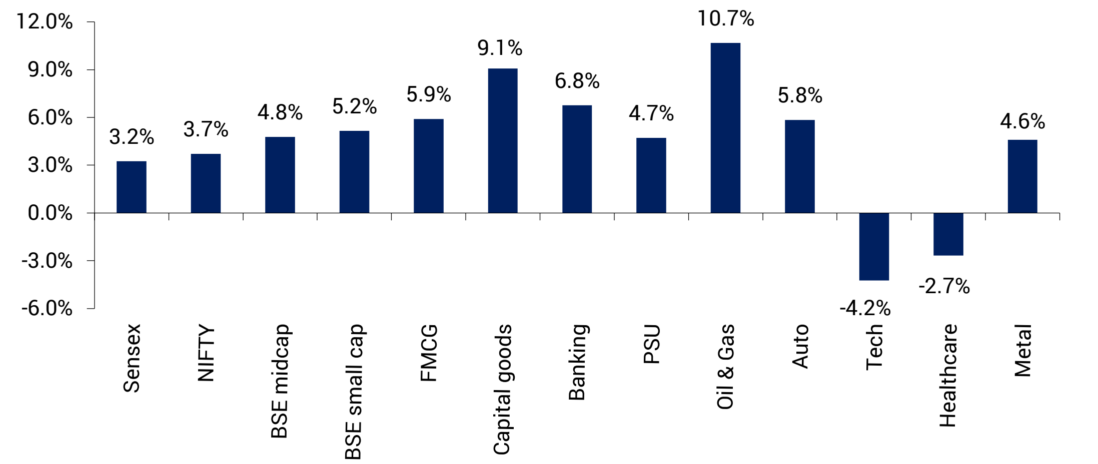
Considering the revised EPS estimates the Nifty-50 (at 11,537) trades at 18.1x one year forward estimates (i.e. on Sep'20E). On Financial year basis, the Nifty-50 trades at 20.3x FY20E and 16.5x FY21E. Higher net margins on account of lower taxes should lead to ~50-100 bps improvement in Nifty-50 RoEs (~14-15%). Considering higher earnings, improved RoEs and lower bond yields we do not see any major threat of de-rating in the Nifty-50/Indian equites from current levels.

1-year performance of benchmark global indices (%)



Source: Bloomberg

Market performance – sector wise (September 2019)



Source: Bloomberg

TOP INVESTMENT IDEAS

Recommended Stocks

Company	CMP* (Rs)	Target Price (Rs)	Potential Upside (%)	52 Week H/L (Rs)	Market Cap (Rs mn)
Gujarat Gas Ltd	175	194	10.9%	195 / 115	122,052
Himatsingka Seide Ltd	144	212	47.7%	278 / 119	14,134
PNC Infratech Ltd	191	264	38.3%	219 / 122	48,986
VIP Industries Ltd	479	555	15.8%	567 / 342	67,740
Voltamp Transformers Ltd	1,145	1622	41.7%	1265 / 726	11,582

*Source: Kotak Institutional Equities; Kotak Securities – Private Client Research; *CMP as on 30 September 2019.*

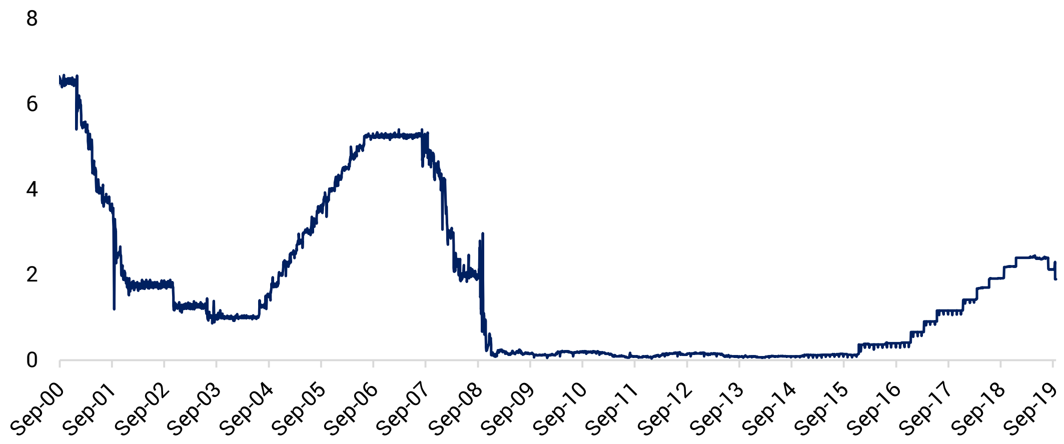
INTERNATIONAL MARKETS

US Fed cuts interest rates for second time since 2008

Citing the global economic outlook and "muted" inflationary pressures at home, the US Federal Reserve decided to lower interest rates by 25 bps point to meet a target borrowing rate of 1.75% to 2%.This action supports the Fed committee's view that sustained expansion of economic activity, strong labor market conditions, and inflation near the committee's symmetric 2% objective are the most likely outcomes, but uncertainties about this outlook remain. The cut was in line with the expectations of investors and economists, but the board showed it was not willing to schedule further cuts. This suggests most Fed officials still see a rebound in economic growth as their base case scenario, which means any further rate cuts would be limited,

The cut was criticized by Trump, who said that the Fed's "boneheads" should reduce rates to zero or lower. Trump is counting on a strong economy fueled by cheap money to boost his reelection chances next year.

Fed Fund rate situation (%)



Source: Bloomberg

Why does Fed policy matter for the rest of the world?

- One is that the US economy's performance is important for the rest of the World. If the Fed gets it wrong, the US could end up underperforming, which would be bad news for many other countries.
- The second point is that Fed policy can have an impact through financial markets by affecting currency exchange rates, interest rates and international flows of investment money.

US President Trump's impeachment inquiry creates temporary overhang

The United States House of Representatives would launch a formal impeachment inquiry against President Donald Trump, succumbing to mounting pressure from fellow Democrats. There are allegations that Trump may have abused his presidential powers and sought help from Ukrainian President Volodymyr Zelensky to investigate former Vice President Joe Biden, the current Democratic frontrunner, and help his own re-election. The formal impeachment inquiry into US President Donald Trump could hurt sentiments, as Trump has been a chief proponent for the stock market rally. The enquiry may also put break on US trade tensions with China, Japan and the European Union (EU).

Under the Constitution, the president, vice president and "all civil officers of the United States" can be removed from office for "treason, bribery, or other high crimes and misdemeanors". Only two US presidents have ever been successfully impeached and in neither instance was the president removed from office. Andrew Johnson was impeached in 1868 in the tumultuous aftermath of the American Civil War; and Bill Clinton in 1998 for issues including his relationship with White House intern Monica Lewinsky. Wall Street had successfully weathered the 1998 impeachment of Clinton, who was later acquitted by the Senate.

Trump believes that a formal impeachment inquiry by House Democrats would be positive for him and the Democrats would lose next year's elections if they pursue impeachment.

Trade War – some signs of abatement

The US has slapped tariffs on US$550 billion worth of Chinese products. China, in turn, has set tariffs on US$185 billion worth of US goods. Both sides have also threatened qualitative measures that affect US businesses operating in China. The smallest of openings in the US-China trade war has now appeared, potentially signaling a break in tensions between the two nations. In mid-September 2019, China released a list of 16 American products such as livestock, grease, and cancer drugs that would be exempt from new tariffs until September 2020. That won't make a big impact on the US economy, but it looked like a promising sign headed into planned US-China trade negotiations next month. President Donald Trump seemingly reciprocated with his own "gesture of good will." He announced the two-week delay of a 5% increase in tariffs, from 25% to 30%, on $250 billion of Chinese goods originally scheduled for October 1.

A Long Road Awaits

However, these actions does not mean beginning of the end of the trade war. China and U.S have yet to fundamentally change their overall stances on the trade war. China is happy striking a small deal with the U.S, reducing tariffs so it can import certain products in large quantities again, while U.S wants complete restructuring of the trade dynamics between the two nations. So, it is unlikely that the U.S and China will strike a comprehensive trade deal by the end of Trump's first term, as China doesn't trust Trump as a negotiating partner. China is more likely to wait to see if Trump loses in 2020. Should he win, though, China may be forced to come to some sort of agreement with the president or the destructive trade war will continue well into the future. U.S. and Chinese envoys are expected to meet early October for more talks aimed at ending a tariff war that threatens global economic growth.

Brexit: Boris Johnson defeated as MPs take control

The story of Brexit from UK:

- **Rebels take control:** UK lawmakers take control of the parliamentary agenda from the government on 2nd September after dealing Prime Minister Boris Johnson a major defeat in his first Commons vote. The Commons voted 328 to 301 to take control of the Brexit agenda, meaning they can bring forward a bill seeking to delay the UK's exit date.

- **Plan to block no-deal:** An alliance of opposition MPs and rebel Conservatives will try to pass a bill to prevent Johnson from taking the UK out of the EU without a deal. They will also force UK Prime Minister Boris Johnson to request an extension to Brexit until January 2020 if he cannot agree a new deal with the EU. Prime Minister Boris Johnson will have to request a Brexit extension from the EU on 19 October, pushing the deadline back to 31 January 2020 from 31st October 2019.

- **Agreement by all members of the EU:** Any extension offered to the UK has to be agreed to by all members of the EU - so there's no guarantee the UK will be offered one.

- **Election call:** After MPs voted in favour of extending the Brexit deadline, Prime Minister Boris Johnson tried to call an early election. But, opposition MPs and rebel Conservatives won't back an election until the law aimed at blocking a no-deal Brexit is implemented.

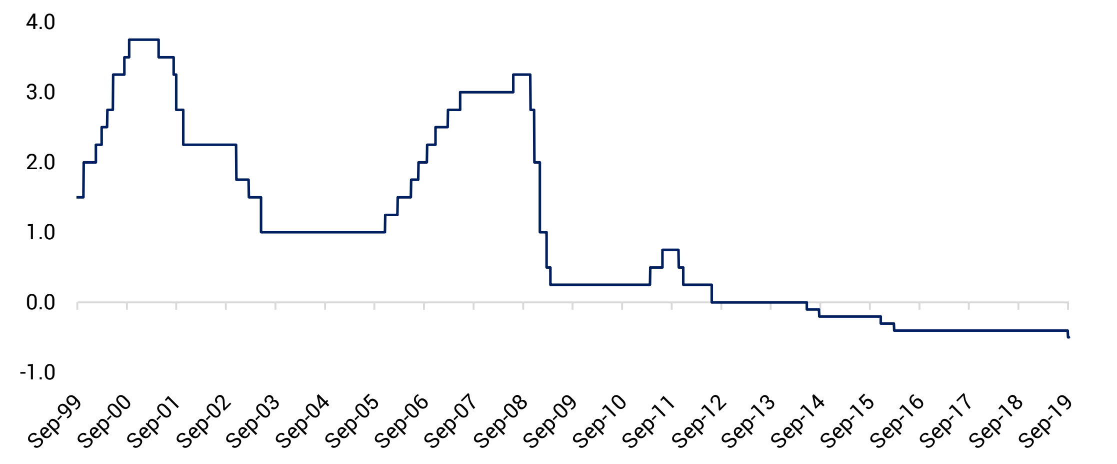
- **Impact of no deal Brexit:** Trade for UK with the EU will become more difficult and more costly, certain important items could be short in supply, there would be reduce choice of products and increase in prices, we can expect the UK Pound to depreciate and so on. However, it is hard to accurately predict the long and short term impact on the economy.

ECB introduces Quantitative Easing from Nov 1 at 20 bn Euro/month

The European Central Bank (ECB) announced a massive new bond-buying program on 13th September,2019 in a bid to stimulate the ailing euro zone economy. The central bank's quantitative easing (QE) program will entail 20 billion euros ($21.9 billion) per month of net asset purchases for as long as it deems necessary. The ECB also cut its main deposit rate by 10 basis points to -0.5%, a record low but in line with market expectations. ECB now expects interest rates to remain at their present or lower levels until it has seen its inflation outlook "robustly converge to a level sufficiently close to but below 2% within its projection horizon, and such convergence has been persistent."

A slowing euro zone economy, weak economic data, persistent low inflation and the U.S.-China trade war had all pointed toward the central bank being forced to inject stimulus. This will be the second round of QE from the ECB, the first coming four years ago in response to the chaotic fallout of the euro zone sovereign debt crisis.

ECB deposit rate (%)



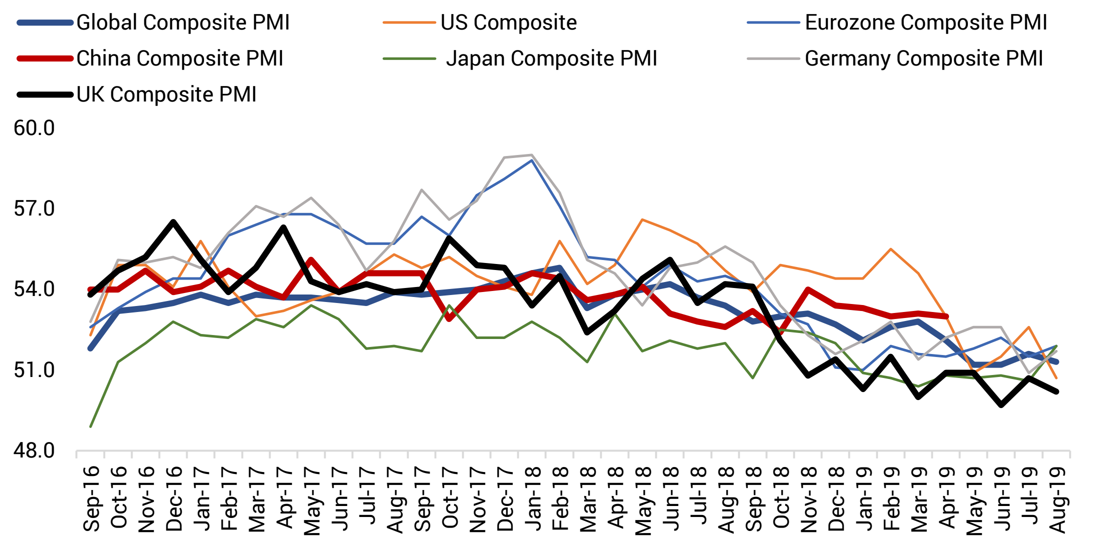
Source: Bloomberg

USD to remain firm

The flattening/inversion of yield curves across major economies have raised concerns of an imminent recession. We see diverging trends in economic activity. While the economic activity (manufacturing sector) in the Eurozone has been continuously weakening, Japan and UK (despite Brexit) have been stable, and the US has been fairly robust .Specifically, in the US we note that historically prior to any recession when the yield curve was inverting, the economic indicators had deteriorated quite sharply as well. Past recessions were preceded by extreme deterioration in economic activity. However, in this cycle we are not yet witnessing a sharp deceleration in data. In this context, we expect USD to relatively outperform other currencies as the need for aggressive monetary easing remains minimal in the US. We continue to factor in 50 bps of rate cut by the Fed in the rest of 2019.

At 49.5 in August 2019, up slightly from July's 81-month low of 49.3, the Global Manufacturing PMI remained below the neutral 50.0 mark for the fourth month running, its longest sequence in contraction territory since 2012. Over half of the nations covered by a JP Morgan survey had a PMI reading below the 50.0 mark. The steepest rates of decline were signaled for Germany. Among the largest industrial countries, growth was registered in the USA and China, whereas downturns were seen in the Eurozone and Japan.

PMI composites across economies

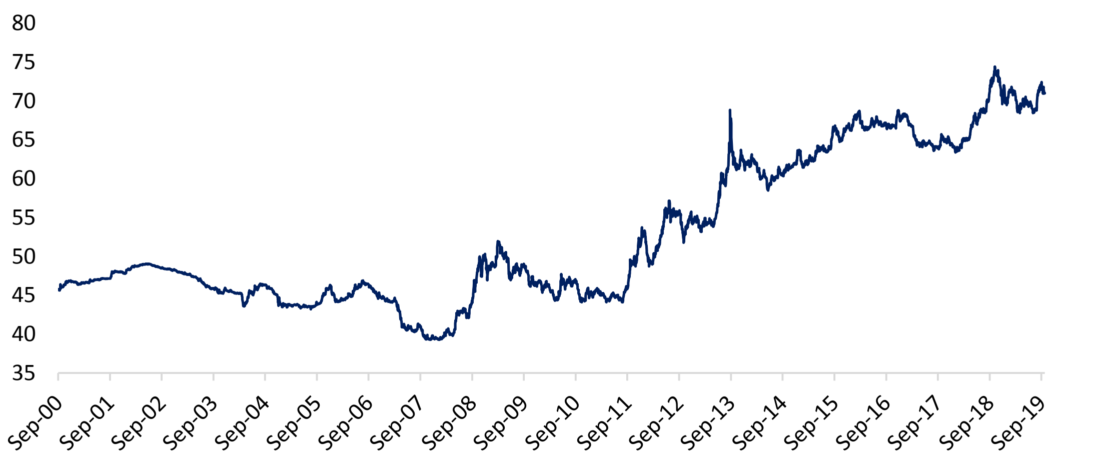


Source: Bloomberg

EM FX space likely to remain under pressure

EM FX outlook continues to be shaped by evolution of (1) policy responses to economic downturn, (2) US-China trade dispute, (3) China's currency path, and (4) oil price trajectory amid geopolitical risks. The recent attack on Saudi Arabia's oil facility has raised geopolitical risks significantly with oil importing countries being most vulnerable. For India, we continue to expect FY20 CAD/GDP at 1.9% and BOP surplus at US$12 bn assuming average crude price at US$65/barrel. Given the uncertainties, we expect INR to trade in a broad range of 69.5-74.5 through the rest of the FY20.

INR to USD



Source: Bloomberg

Oil on the boil-Attacks on Saudi oil facilities

The drone attacks on Saudi's critical oil infrastructure at Abqaiq and Khurais had impacted around 5.7 mn bpd of crude production, constraining even the surplus spare capacity of~2 mn bpd. The plants at Abqaiq have capacity of processing ~7 mn bpd of crude oil, while oil fields in Khurais have capacity of producing ~1.5 mn bpd of crude oil.

Temporary restoration

As on 27th September, Saudi Arabia had restored its oil production capacity to 11.3 mn bpd. Crude output from the Khurais field is now at 1.3 mn bpd and the Abqaiq plant is currently at about 4.9 mn bpd. Despite Aramco's efforts to assure the market, speculation persists that it will take months to repair the extensive damage caused by the attacks and restore full supply of 12 mn bpd. The current restoration has primarily come from spare capacity, drawing from huge oil inventories and offering other crude grades from other fields.

Further escalation of geopolitical tensions may add to supply woes

Any further escalation of geopolitical tensions in the middle-east region, which cannot be ruled out for now, may add to the woes of global oil supplies for now given lack of buffer from Saudi's significant spare production capacity. We note that crude supplies from Iran and Venezuela have already been curtailed significantly amid sanctions from the US, while supplies from Libya and Nigeria have also shown vulnerability to disruptions in the recent times.

Short-term spike in crude prices, negative for downstream and positive for upstream and GAIL

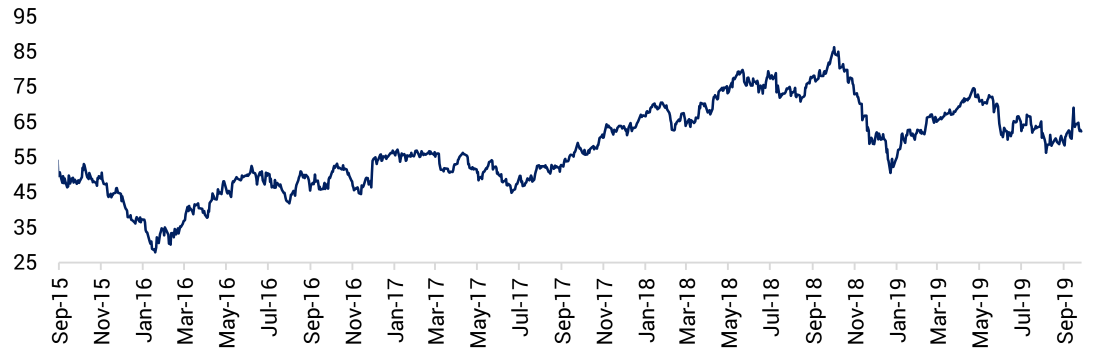
The spike in global crude prices, even though temporary, will be negative for downstream OMCs (BPCL, HPCL and IOCL) and Castrol. We do not rule out a possibility of moderation in marketing margins on auto fuels—a US$10/barrel rise in global crude and product prices may require OMCs to increase retail price of diesel and gasoline by Rs5-6/liter in the following fortnight. Sharp jump in global crude prices may also put pressure on refining margins amid slowing demand, besides increasing absolute quantum of fuel and loss. On the other hand, higher crude prices may be construed positively for upstream PSUs and GAIL.

Global oil demand-supply, before Saudi disruption (in mn bpd)

Particulars	2015	2016	2017	2018	2019E	2020E
Demand (mn bpd)	95.3	96.4	98.0	99.2	100.6	102.0
Supply (mn bpd)						
- Non OPEC	59.8	59.1	59.9	62.7	64.6	66.3
- OPEC	36.6	37.8	37.5	37.4	36.0	36.0
Total Supply	96.4	96.9	97.4	100.1	100.6	102.3
OPEC Crude capacity	35.2	35.9	34.9	34.9	32.5	33.0
Implied spare capacity	4.9	4.0	2.3	3.9	2.1	2.9

Source: IEA, Kotak Institutional Equities estimates

Brent crude (US$ per barrel)



Source: Bloomberg

DOMESTIC MARKETS

Indian stocks are currently experiencing positive sentiments. With the stimulus in place to revive growth, share prices are responding.

What is in favor of Indian equities?

- Direct stimulus via a reduction in the corporate tax rate from 30% to 22%
- Benign inflation
- Expectation of rate cut of 75 bps in the rest of FY20
- Estimated improvement in corporate confidence and capex
- Above normal Monsoon
- Strong domestic flows, currently averaging around US$1.5billion a month, which we believe is a structural uptrend with SIP contributing almost 2/3rd of domestic flows.
- PSU privatization

What is against Indian equities?

- Rising crude oil prices, which could put pressure on growth.
- Depreciating INR which can hurt imports
- Global slowdown
- No respite to banking NPA's

Government intent on investment-driven sustainable growth

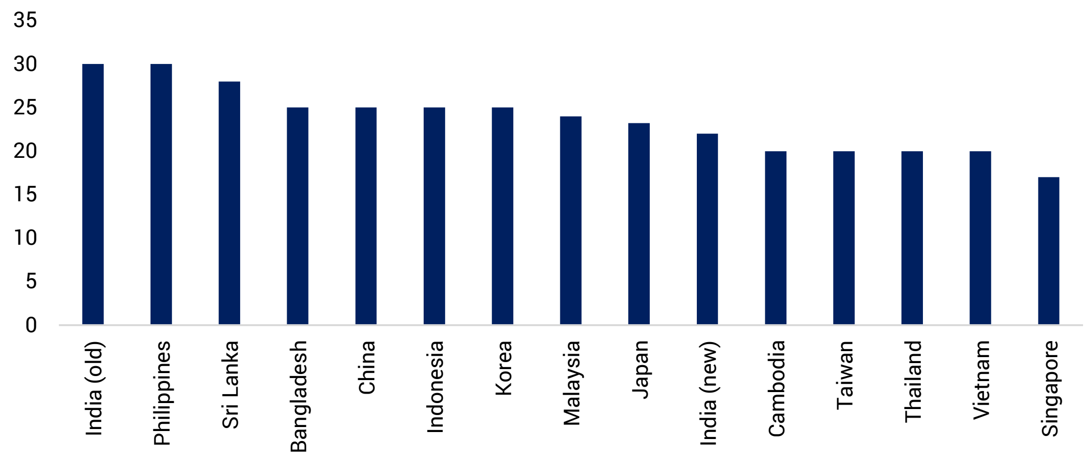
The government's decision to cut the corporate tax rate of domestic companies to 25.6% from 34.9% earlier emphasizes its pivot to investment-led growth model. Furthermore, a lower tax rate of 15% (without surcharges) for fresh investments by new manufacturing companies aims to make India competitive in manufacturing versus other Asian peers. As such, we rule out any further boost to consumption, especially given fiscal implications (0.7% of GDP) of the tax cut. The government has opted for a longer but a more sustainable model of economic growth, in our view.

Effective tax rate reduced sharply for domestic companies

Effective tax rates for domestic companies (%)	Previous tax regime (%)				New tax regime (%)			
	Tax	Surcharge	Cess	Effective Tax Rate	Tax	Surcharge	Cess	Effective Tax Rate
Turnover/gross receipts less than Rs4 bn								
Taxable income less than Rs10 mn	25	0	4	26	22	0	4	22.9
Taxable income more than Rs10 mn	25	7	4	27.8	22	7	4	24.5
Turnover/gross receipts more than Rs4 bn								
Taxable income less than Rs10 mn	30	0	4	31.2	22	0	4	22.9
Taxable income more than Rs10 mn but less than Rs100 mn	30	7	4	33.4	22	7	4	24.5
Taxable income more than Rs100 mn	30	12	4	34.9	22	12	4	25.6

Source: Union Budget, PIB, Kotak Institutional Equities

Corporate India will become more competitive (tax rate before surcharges %)



Source: Kotak Institutional Equities

Earnings upgrades not significant

We model net profits of the Nifty-50 Index to grow 17%/21% for FY20/FY21 (15%/19% prior) after the first round of earnings revisions post the corporate tax rate changes. On an aggregate basis, the lower-than-expected net profit growth for FY20 reflects (1) large outstanding deferred tax assets (DTAs) for corporate banks like Axis, ICICI and SBI, which we expect to be marked down by ~30% in FY20, (2) downward revision to volume and profitability assumptions in certain sectors seeing weak demand currently and (3) likely pass-through of benefits through price discounts. We do not model any change in estimates for IT/pharmaceuticals companies in Nifty-50 Index and see full pass-through of lower taxes for regulated electric utilities. We estimate banks, IT, Oil, gas & consumable fuels sectors to drive incremental profits of the Nifty-50 Index in FY20-22E

Break-up of net profits of the Nifty-50 Index across sectors

	Net profits (Rs bn)			Incremental profits			
				FY20E		FY21E	
	FY19	FY20E	FY21E	(Rs bn)	(%)	(Rs bn)	(%)
Automobiles & Components	211	188	238	(23)	(4)	49	5
Tata Motors	(18)	(9)	24	9	1	33	4
Banks	422	849	1,289	427	67	440	48
ICICI Bank	34	128	202	95	15	73	8
State Bank of India	9	263	444	255	40	180	20
Capital Goods	86	102	113	15	2	12	1
Commodity Chemicals	22	30	36	9	1	6	1
Construction Materials	65	107	129	41	7	22	2
Consumer Staples	197	244	275	47	7	31	3
Diversified Financials	209	261	292	51	8	31	3
Electric Utilities	210	224	250	13	2	26	3
Fertilizers & Agricultural Chemicals	19	22	31	3	1	8	1
Gas Utilities	63	69	73	6	1	4	0
IT Services	706	745	822	39	6	76	8
Media	16	19	21	4	1	1	0
Metals & Mining	292	232	305	(60)	(9)	73	8
Tata Steel	104	59	91	(45)	(7)	33	4
Oil, Gas & Consumable Fuels	1,108	1,163	1,236	55	9	74	8
Coal India	175	191	195	17	3	4	0
ONGC	302	302	301	0	0	0	0
Reliance Industries	391	448	512	57	9	64	7
Pharmaceuticals	71	84	106	13	2	22	2
Retailing	15	19	24	4	1	6	1
Telecommunication Services	(1)	(16)	17	(16)	(2)	33	4
Transportation	41	46	50	6	1	4	0
Nifty-50 Index	**3,753**	**4,386**	**5,306**	**634**	**100**	**919**	**100**
Nifty-50 change (%)	**12.0**	**16.9**	**21.0**				
Nifty-50 EPS (FF)	**480**	**567**	**700**				

Source: Kotak Institutional Equities estimates

Follow-up reforms to enable investments

While we expect market sentiment to sustain on the back of the announcements, especially for 'quality' stocks, market performance will depend on the extent of follow-up reforms such as: (1) reforms in factors of production (labor laws, land acquisition policies and approval processes), (2) reduced role of the government in business (privatization of government entities) and (3) review of ownership/operatorship and pricing frameworks to encourage greater private sector investment in basic infrastructure sectors. In our view, lower corporate tax rate is a necessary but not sufficient condition for investment in manufacturing.

List of tax measures announced

Companies not availing exemptions: With effect from FY20, any domestic company will have the option to pay income tax at the rate of 22% (plus surcharge and cess; effective tax rate at 25.6%) subject to the condition that they will not avail any exemption/incentive.

New manufacturing companies: With effect from FY20, any new domestic company incorporated on or after October 1, 2019 making fresh investment in manufacturing, will have an option to pay income tax at the rate of 15% (plus surcharge and cess; effective tax rate at 17.01%). This benefit is available to companies which do not avail of any exemption/incentive and commence their production on or before March 31, 2023.

Companies availing exemptions: Companies which continue to avail tax exemptions/incentives and continue to pay taxes at the pre-amended rates will pay at the revised tax rates after expiry of their tax holiday/exemption period.

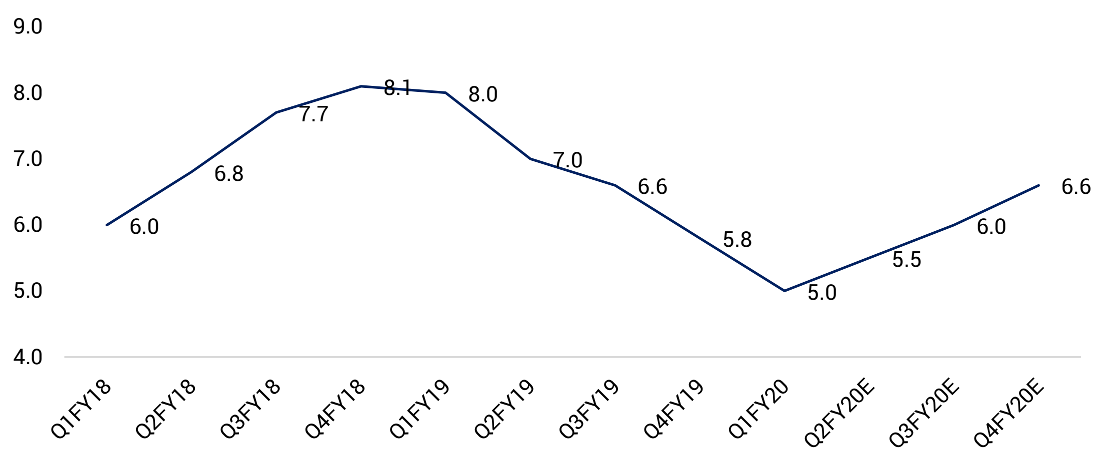
Surcharge on capital gains: The enhanced surcharge introduced in Budget FY20 shall not apply to capital gains, in the hands of an individual, HUF and Foreign Portfolio Investors (FPIs).

Buy-backs: Tax shall not be charged on the buy-back of shares for listed companies which have already made a public announcement of buy-back before July 5, 2019.

GDP: Gloomy start to FY20

GDP growth in 1QFY20 decelerated sharply to 5% on the back of weakness in private consumption and investment. With a deeper-than estimated trough and lack of significant impetus to the growth drivers in the near term, we further revise down our FY20 GDP growth estimate by 50 bps to 5.8%. On the policy front, after the dismal 1QFY20 growth performance and expectations of benign inflation, the MPC will likely have space to cut rates by up to 75 bps through the rest of FY20 (KIE estimates), with a cut of around 40 bps (KIE estimates) likely in the October MPC meeting itself.

Real GDP growth near multi-year low (%)

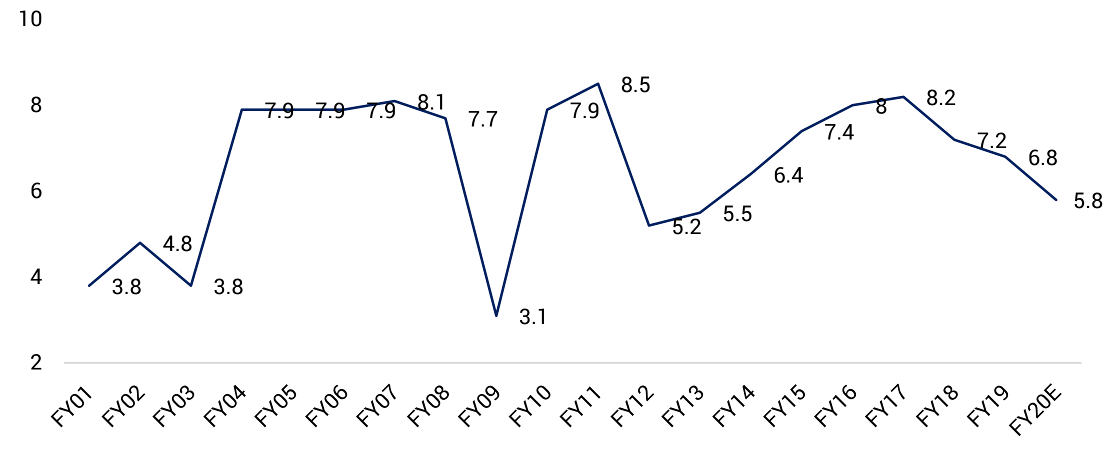


Source: Bloomberg, Kotak Institutional Equities

Revise down FY20 GDP growth by 50 bps to 5.8%

In the absence of any major impetus to growth, we had earlier revised down FY20 GDP growth estimate to 6.3%. With a deeper-than-anticipated trough, we further revise down GDP growth estimate to 5.8% (KIE estimates) .We believe that growth will likely recover on the back of (1) favorable base effects in 2HFY20, and (2) pickup in the pace of central government spending post elections. The surplus dividend of around Rs1.5 tn from the RBI will further aid the government in spending immediately.

Annual GDP trend - FY20 GDP growth likely at 5.8%



Source: Bloomberg, Kotak Institutional Equities

GST collections remain weak for August 2019

Based on the monthly PIB release, total GST collection was at Rs982 bn in August (Rs 1,021 bn in July)—growth of 4.5% over August 2018. Domestic GST collections growth continued to be higher at around 8.9%. CGST collection was Rs177 bn (July: Rs179 bn), SGST was Rs242 bn (Rs250 bn), IGST at Rs490 bn (Rs506 bn), and compensation cess was at Rs73 bn (Rs86 bn). After allocation from IGST, CGST for July was Rs409 bn (June: Rs372 bn) and SGST was Rs409 bn (May: Rs394 bn). The number of returns filed in July continued to remain around 7.58 mn.

We note that the 5MFY20 run rate of Rs903 bn implies a required run-rate of around Rs1.18 tn for the rest of FY20.At the current run rate, the government could see a shortfall of Rs820 bn in CGST.

Monthly GST collection (Rs bn)

Month	CGST	SGST	IGST	Cess	Total	Filings (mn)
18-Jun	160	220	495	81	956	6.5
18-Jul	159	223	500	84	965	6.6
18-Aug	153	212	499	76	940	6.7
18-Sep	153	211	501	80	944	6.7
18-Oct	165	228	534	80	1,007	6.7
18-Nov	168	231	497	80	976	7.0
18-Dec	164	225	479	79	947	7.2
19-Jan	178	248	512	87	1,025	7.3
19-Feb	176	242	470	85	972	7.3
19-Mar	204	275	504	83	1,066	7.6
19-Apr	212	288	547	92	1,139	7.2
19-May	178	245	499	81	1,003	7.2
19-Jun	184	253	478	85	999	7.4
19-Jul	179	250	596	86	1,021	7.6
19-Aug	177	242	490	73	982	7.6

Source: Ministry of Finance, Kotak Institutional Equities

RBI's surplus transfer and expenditure savings will be required to maintain budgeted GFD/GDP

The FY20 budget had assumed a RBI dividend of Rs900 bn. Accounting for the recent RBI surplus transfer, the government will have additional revenue of around Rs580 bn. However, the government will likely garner around Rs820 bn lesser from CGST if we assume the run rate remains around the current levels.

Overall Negative for fiscal

After accounting for a reduction in corporate tax rates, weak GST and income tax collections in FY20, the net tax shortfall is likely to be around Rs1.7 tn (0.8% of GDP)—Rs580 bn of which would be offset by extra dividend from the RBI. Improved profitability of PSUs as a result of tax rate cuts could also augment the dividend payout to the government. Additionally, there would be some expenditure cuts (such as in PM-KISAN), thereby limiting the fiscal slippage to Rs727 bn (0.3% of GDP) implying FY20 GFD/GDP at around 3.7% .Additionally, if PSUs are pushed to deploy the surplus, capex could be lower than budgeted. The government will likely deploy a mix of higher utilization of small savings, short-term borrowings, dated securities and lower buybacks to finance any fiscal slippage.

Privatization- room for raising resources

The government has met a good part of its fiscal requirements through divestments of its stakes in PSUs over FY14-19.However, we note that the space for divestments is shrinking as the government can only mobilize Rs1.2 tn by selling its direct exposure to listed entities up to 51% and Rs2.5 tn including indirect exposure through LIC and cross-holding of other PSUs. As such, this route of revenue mobilization may run out in 1-2 years. However, we note the government can raise significantly higher revenues through privatization (100% exit) of the non-financial PSUs (~Rs10 tn).

The government is unable to maximize the value of its CPSE ownership due to low valuations of PSU companies (de-rating of multiples of PSUs over the past few years), further accentuated by sale through ETFs. We believe the government can raise significantly higher amounts if it were to privatize the PSUs through (1) strategic sale of majority stake or (2) sale of its shares in tranches to institutional and retail investors with an explicit commitment to reduce its holding to below 50%. We would strongly argue against golden share or any form of residual government control as it would lead to valid concerns about continued government influence on the operations of the companies.

Privatisation options for Government

Company	Market Cap (Rs bn)	Govt holding %	Stake sale Entire (Rs bn)	Stake sale 51% (Rs bn)
ONGC	1,679	64.2	1,079	223
Coal India	1,221	71	867	244
NTPC	1,139	56.1	639	58
Indian Oil Corp.	1,306	52.2	681	15
Power Grid Corp.	996	55.4	552	43
BPCL	1,001	53.3	533	23
GAIL (India)	628	51.8	325	5
Container Corp.	354	54.8	194	13
Bharat Electronics	273	58.8	160	21
NMDC	274	72.3	198	58
Hindustan Aeronautics	249	90	224	97
NHPC	233	73.3	171	52
BHEL	181	63.2	114	22
Oil India	161	61.6	99	17
SAIL	142	75	106	34
State Bank of India	2,701	57.1	1,543	166
Bank of Baroda	382	63.3	241	47
GIC	346	85.8	297	120
Punjab National Bank	305	75.4	230	74
Power Finance Corp.	275	59	162	22
Bank of India	231	87.1	201	83
New India Assurance	175	85.4	149	60
Canara Bank	153	70.6	108	30
Allahabad Bank	116	79.4	92	33
UCO Bank	109	90.8	99	44
Corporation Bank	99	86.8	86	35
Union Bank of India	106	74.3	78	25
Indian Overseas Bank	94	92	86	38
Oriental Bank of Commerce	88	77.2	68	23
Syndicate Bank	81	76.2	61	20
Central Bank of India	82	91.2	75	33
Indian Bank	73	81.5	59	22
HUDCO	76	89.8	68	29
Bank of Maharashtra	69	87	60	25
United Bank of India	70	92.3	64	29
Andhra Bank	56	84.8	47	19
Total			**9,816**	**1902**

Source: Capitaline, Bloomberg, Companies, Kotak Institutional Equities

Government has set an aggressive enhanced target of Rs 1.05 trillion of disinvestment receipts for FY20. As part of its disinvestment or privatization strategy, the government has plans to sell majority stake in BPCL, Concor, SCI and Air India before the end of FY20. We believe, privatization will generate non-tax revenue and help government keep fiscal deficit in check projected at 3.3% of GDP. Privatization is not a piecemeal sale of minority stake but a full transfer of control. To help the privatization drive, government may lift restrictions on foreign ownership and other onerous conditions. This will complement the current effort in reviving investment.

IIP growth firms up to a three-month high

July IIP growth improved to 4.3% (Kotak: 2.3%, consensus: 2.3%, June: 1.2%) owing to both favourable momentum and base effect. Among the sectors, growth in mining and manufacturing went up by 4.9% and 4.2%, respectively, while growth in electricity slowed to 4.8%.Manufacturing growth was fueled by food products (23.4%), basic metals (17.3%), and chemicals and chemical products (6.4%). However, investment and consumption related weakness continued to be reflected in the tepid growth observed across the capital goods (-7.1%) and the consumer durables (-2.7%) segments. Intermediates and consumer non-durables, however, posted robust gains of 13.9% and 8.3%, respectively.

Sectoral Classification of IIP

	Mining (%)			Manufacturing (%)			Electricity (%)			General (%)		
	2018	2019	2020	2018	2019	2020	2018	2019	2020	2018	2019	2020
April	3	3.8	5.1	2.9	4.9	4	5.4	2.1	6	3.2	4.5	4.3
May	0.3	5.8	3.2	2.6	3.6	2.5	8.3	4.2	7.4	2.9	3.8	3.1
June	0.1	6.5	1.5	-0.7	6.9	0.2	2.1	8.5	8.2	-0.3	7	1.2
July	4.5	3.4	4.9	-0.1	7	4.2	6.6	6.6	4.8	1	6.5	4.3
August	9.3	-0.6		3.8	5.2		8.3	7.6		4.8	4.8	
September	7.6	0.1		3.8	4.8		3.4	8.2		4.1	4.1	
October	-0.2	7.3		2	8.2		3.2	10.8		1.8	1.8	
November	1.4	2.7		10.4	-0.7		3.9	5.1		8.5	8.5	
December	1.2	-1		8.7	2.9		4.4	4.5		7.3	7.3	
January	0.3	3.8		8.7	1.3		7.6	0.9		7.5	7.5	
February	-0.4	2.2		8.4	-0.3		4.5	1.3		6.9	6.9	
March	3.1	0.8		5.7	0.1		5.9	2.2		5.3	5.3	
Average	**2.5**	**2.9**		**4.7**	**3.7**		**5.3**	**5.2**		**4.4**	**4.4**	

Source: CEIC, Kotak Institutional Equities

Infra focus- government constitutes a task force

The government constituted a task force under the chairmanship of Secretary, Department of Economic Affairs to draw up a National Infrastructure Pipeline for each of the years from FY 2020-25. The pipeline will include Greenfield and brownfield projects costing above Rs10 mn. The task force will submit its report on the pipeline of projects for FY20 by October 31 and on indicative pipeline for FY21- 25 by December 31. The task force will also estimate the annual infrastructure investment/capital costs, guide the Ministries in identifying appropriate sources of financing, and suggest measures to monitor the projects so that cost and time overrun is minimized.

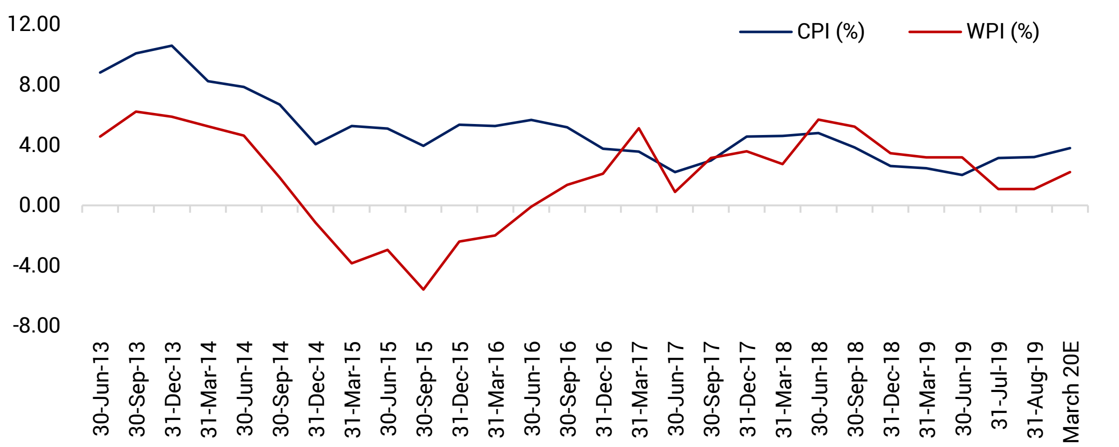
CPI inflation continues to firm up gradually, but remains comfortable

August CPI inflation inched higher to 3.21% (Kotak: 3.23%, consensus: 3.32%, July: 3.15%) led by higher food prices, but remains muted owing to a favourable base effect .On a sequential basis, CPI inflation went up by 0.5% mom (0.9% in July) with the momentum coming from increase in food prices, albeit at a slower pace (0.9% mom as against 1.6% in July).While prices of vegetables, pulses and cereals posted sequential gains of 4.4%, 0.7% and 0.6%, respectively, prices of fruits, and meat and fish fell by 0.5% and 1.3%, respectively. High frequency data suggests that food prices have continued to soften in September. Meanwhile, fuel and light inflation fell by 1.7%.

Also WPI inflation remains muted

Even though food prices continue to inch higher, WPI inflation remained muted owing to lower core and fuel inflation. Both CPI and WPI inflation will likely remain benign in the near term given the tepid growth and muted commodity prices. In this context, MPC's acknowledgement to consider growth as the highest priority strengthens our belief of another 75 bps cut through the rest of FY20.

Inflation relatively muted



Source: CEIC, Kotak Economic Research

Expect MPC to cut rates by up to 75 bps through the rest of FY20

August CPI inflation remains well below the RBI's target of 4% and is likely to remain benign in the near term given the weak growth impulses. We expect CPI inflation and core inflation trajectory to trend towards 3.9% and 3.8%, respectively by March 2020. Moderating core inflation should offset the impact of higher food prices, keeping the headline number in check. After a dismal growth performance in 1QFY20 and with inflation staying benign, MPC's focus will remain on addressing the weakening growth trajectory. We expect the MPC to cut the repo rate by up to 75 bps through the rest of FY20—including a cut of around 40 bps in the October policy—with focus remaining on transmission.

Exports decline, trade deficit narrows

Trade deficit in August came in lower at US$13.4 bn as against US$17.9 bn in the same period last year. August exports at US$26.1 bn implied a growth of -6.1% against US$27.8 bn in August 2018. The major commodities which contributed towards the decline in exports were meat, dairy and poultry products -28%, plastic and linoleum -16.9%, man-made yarn/fabrics -13.6%, petroleum products -10.7% and engineering goods -9.4%. Meanwhile, imports witnessed growth of -13.5% to US$39.6 bn against US$45.7 bn in August 2018. The key sectors registering negative growth in August were coal, coke and briquettes -23.8%, organic and inorganic chemicals -15%, petroleum, crude and products -8.9%, machinery, electrical & non-electrical goods -8.8%, and electronic goods -4.1%.

A sharp contraction in gold as well as non-oil non-gold merchandise imports led to the considerable shrinking of the merchandise trade deficit in August. Available trends suggest that the current account deficit is likely to decline to $10-11 billion in September 2020, on the back of moderate crude oil prices, a weak appetite for gold imports at current prices as well as subdued domestic demand.

Monthly foreign trade for India in US $ bn

						FYTD (Apr - Aug)		Chg (%)
Date	**Aug-19**	**Aug-18**	**Jul-19**	**YoY**	**MoM**	**2020**	**2019**	**YoY**
Exports	26.1	27.8	26.3	-6.0	-0.8	134.0	136.0	-1.4
Oil exports	3.3	3.7	3.7	-10.7	-9.0	19.0	20.0	-5.8
Non - Oil exports	22.8	24.1	22.7	-5.3	0.6	115.0	116.0	-0.7
Imports	39.6	45.7	39.8	-13.4	-0.5	206.0	219.0	-5.6
Oil imports	10.9	11.9	9.6	-8.9	13.3	55.0	59.0	-6.1
Non - Oil imports	28.7	33.8	30.2	-15.0	-4.8	151.0	160.0	-5.5
Gold imports	1.4	3.6	1.7	-62.0	-20.0	15.0	15.0	-3.0
Trade Balance	**-13.5**	**-17.9**	**-13.4**			**-73.0**	**-83.0**	

Source: Bloomberg, Kotak Institutional Equities

Silver lining is above normal monsoon at 5.9%

The total seasonal rainfall across India has surpassed the Long Period Average (LPA) as defined by the India Meteorological Department (IMD). The LPA is the 50-year average rainfall in India from 1951 to 2000, which is 887.5 mm. The countrywide average rainfall from June 1 to September 25th was 911 mm—5.9% more than the normal as on date.

Seasonal Rainfall Scenario in mm (01 June to 25th Sept, 2019)

Region	Actual	Normal	% Deviation from LPA
All India	**911**	**860**	**5.9**
East & Northeast	1143	1368	-16.4
Northwest India	544	593	-8.3
Central India	1195	958	24.7
South Peninsula	807	698	15.6

Source: IMD

Above normal monsoon is critical in the following ways:

- There is an expectation that farmers will have a bumper crop this year and would drive rural growth. It has the potential to drive rural consumption and would be healthy for companies concentrating on rural markets like two wheelers, FMCG, consumer durables, paints and retail.
- Above normal monsoon is a downside risk to inflation and provides RBI with plenty of cushion against WPI and CPI in FY20/21
- Above normal monsoon also leads to high farm production which will lower raw material costs for companies that make packaged foods including HUL, Britannia, GSK Consumer, ITC and Nestle.

Other developments - Assembly Elections 2019

The Election Commission (EC) has announced the schedule for elections in Maharashtra and Haryana . The polling will take place across on 21 October and counting for both the states will happen on 24 October. Both the states will witness elections in single phase. The model code of conduct (MCC), which provides a level playing field in elections, comes into effect immediately.

Full Schedule

Issue of notification	27-Sep
Last day for filing nomination	4-Oct
Scrutiny of nominations	5-Oct
Withdrawal of nominations	7-Oct
Date of poll	21-Oct
Counting of votes	24-Oct

Source: Election Commission of India

BJP is currently in power in both Maharashtra and Haryana. We estimate a direct contest in Haryana between BJP and Congress, while in Maharashtra the contest will be between alliance of ruling BJP-Shiv Sena and Congress-Nationalist Congress Party (NCP) alliance. The forthcoming assembly elections are crucial as it is the first set of assembly elections since the Lok Sabha polls in May,2019.

2014 Assembly election seats outcome

Maharashtra	Seats	Haryana	Seats
Congress- NCP	83	Congress	15
ShivSena-BJP	185	BJP	47

Source: Election Commission of India

GST lowered for hotel Industry

The GST council has decided to tax hotels on rates varying from 0 to 18%, depending on their tariffs. With this, the hotel industry has been removed from the 28% tax slab, the highest under the GST regime. The GST Council has also agreed to lower tax rates on outdoor catering to 5% (without Input tax credit) from 18% (with the option to avail input tax credit).Additionally, the GST Council has reportedly decided to increase the tax rate for caffeinated drinks to 28% from 18%. An additional 12% cess would also be imposed on such beverages.

GST rates relief for Hotels

Room Tariff	Earlier	New
Upto Rs 1000	0	0
From Rs 1000 to Rs 7500	18%	12%
Above Rs 7500	28%	18%

Source: GST Council of India

Measures to boost the housing and exports sectors

The government announced measures to boost the housing and exports sectors, some of which were: (1) easing of ECB norms to facilitate low cost funds for affordable home buyers, (2) Rs200 bn corpus (of which the government would contribute Rs100 bn) for last mile funding of healthy housing projects which are non-NPA and non-NCLT, (3) overhaul of the tax refund schemes for exporters, and (4) priority sector tag for export credit which will improve exporters' access to credit along with expanding the scope of the Export Credit Insurance Scheme which should provide higher insurance cover to banks providing working capital for exports.

Sectoral Happenings

Automobiles

Auto companies are likely to struggle due to significant increase in regulatory cost in FY21, which will likely increase cost of ownership. The income levels are likely to increase by mid-single digits and customers will likely defer purchases to FY22 in our view. Commercial vehicle demand is also likely to remain weak due to weak freight demand while if private sector investment picks up, it will be give a boost to truck demand but will likely play out over the medium term. Auto companies will thus increase discounts to protect volumes and market share. We don't forecast positive impact of recent corporate tax cuts on our earnings estimates.

We advise investors to be cautious in the sector and take selective bets across the OEM space. We like Ashok Leyland, Escorts and M&M due to attractive valuations. We expect automotive demand to recover (double-digit yoy volume growth) in FY22 and have started valuing the stocks on March 2022 earnings estimates and discount them to March 2021 to capture the upside we expect in FY22. Hence, one needs to have a two year approach while investing in auto sector.

Auto ancillaries

We expect margins for auto ancillaries in the OEM segment to remain weak as auto OEMs remain under pressure due to weak retail demand. We expect auto ancillary companies to pass on some of the benefits from ETR cut to OEMs as their bargain power in the segment remains low. Companies that derive higher share of business from the replacement segment will be the major beneficiaries due to the ETR cut. We like Amara Raja Batteries, Balkrishna Industries and Varroc Engineering from this space.

Banks

We would want to be less optimistic on the sustainable impact of this tax change on long-term RoE of banks. We believe banks prefer to work with a target RoE in mind and this is unlikely to change. In the short term, there would be some positive impact, especially for public banks that have been struggling with higher NPLs and lower RoEs. However, the medium-to-long-term benefits are unlikely to translate to higher RoEs as we believe that the competitive forces would result in consumers taking a higher share of this benefit. We like SBI, ICICI bank and Federal bank.

Information Technology

Average rates of GBP, EUR and AUD have depreciated 2%, 3% and 3% against USD, respectively Q2FY20 to date compared to average rates of Q1FY20. This results in estimated cross-currency headwinds of 30-70 bps for quarterly revenue growth of IT companies in Q2FY20. Baking these changes in our models results in incremental 20-60 bps cross-currency headwinds to US$ revenue growth in FY20E for IT companies under our coverage. We bake in KIE economist's revised INR/USD rates of 71-74 from 70-72 earlier for FY20-22E. Revised INR/USD estimates and cross-currency headwinds to revenue growth effectively result in 10-50 bps increase in EBIT margin assumptions and 0-4% increase in EPS estimates for FY20-22E for various companies. INR depreciation benefits IT companies through – (1) increase in margins. As a rule of thumb, 1% depreciation in INR against USD aids EBIT margin by 20-30 bps and NOPAT by 2-3%, and (2) linear improvement in INR EPS from translation of USD P&L to INR P&L. The extent of benefits from INR depreciation varies across companies and is a function of (1) hedging policy, (2) EBIT margin level, (3) onsite-offshore revenue mix and (4) exposure to India business. We see, near-term earnings upsides for Infosys, TCS and Mindtree.

We see modest to negligible positive impact in FY20E to IT companies of tax rate cut, since many avail of tax exemption on SEZ profits in India. However, the benefit will be material in the medium term once the SEZ benefit fades away.

Construction Materials

Pricing - Our channel checks with dealers suggest all-India cement prices have declined by 1-2% mom to Rs344/bag in September 2019 after a 2% mom fall in August. The September price correction, although lesser than previous months, is the fourth consecutive cut after prices peaked in May 2019. We note that the current cement prices are down 6% from May 2019 peak whereas 2QFY20 prices are down -4%qoq on a pan-India basis. Further, we hear that the non-trade segment has seen sharper price cuts than trade due to weak demand during the quarter.

Demand - Our channel checks with cement companies and dealers suggest that demand recovered with growth of 1-2% yoy in July. However, given floods and delays in various projects, August witnessed a 0-2% yoy decline in demand on a pan-India basis. With this, 1HFY20E is poised for 0-1% yoy demand decline and with our expectation of 5-6% yoy demand growth in 2HFY20E, FY20E should see 3% yoy growth. Given the fiscal challenges of the government and slowdown in the economy, we see more downside risk than upside risk to our 2HFY20E demand recovery expectations.

Cement companies in our coverage benefit from the tax cut but given the fragmental industry should see partial pass through of benefits. We see demand concerns persisting in the short term given high dependence on government expenditure. Also, we see the risk of higher capacity additions in FY22-23E as companies would look to monetize on tax incentive on new manufacturing units. We maintain a cautious stance on the cement sector on expensive valuations

Consumer staples

The government's intent behind tax cut is clearly is to drive accelerated investments in manufacturing. If this were to happen, potential higher job creation, increase in GDP growth pace and associated multiplier effects could mean a sharp acceleration in consumer demand. This move just about prevents any downgrades in revenues and earnings estimates for the Consumer companies that would have otherwise happened. We are currently refraining from baking in any demand acceleration at this point. The possibility can create a positive narrative and drive multiples further.

We expect the consumer companies to retain a bulk of the benefits arising out of the sharp reduction in corporate tax rates. We expect companies such as Dabur, Marico, GCPL and Bajaj Consumers to opt for status quo, i.e. continuing to avail exemptions while staying at a marginal tax rate of 30% given that their current ETR is below 25.6%. For the rest from our coverage universe, we raise FY20-22E EPS estimates by 0-18%.

Capital Goods

The capital goods sector continues to go through prolonged phase of slowdown led by weak capex cycle as investment in power generation and private sector capex has not improved. In recent months, the liquidity crisis and NBFC funding issues have further deferred the revival in Capex cycle. Having said that, the government's move to reduce tax rates and measures to infuse liquidity in the system should be read as positive for the sector. There is potential of some manufacturing shifting from China to India. Companies with high exposure to domestic manufacturing/ exports-oriented companies and those operating at full tax rates will be key beneficiaries (Thermax, Carborundum Universal, ABB and Siemens), in our view

Pharma

Pharmaceuticals will see little or no impact of the corporate tax rate. We expect 19% and 27% growth in the net profits of the pharmaceuticals sector in FY20 and FY21 on the back of (1) pickup in new launches of generic products in the US from 2HFY19, which will drive US generic revenues and overall, revenues and profits, (2) strong increase in revenues of Sun's specialty products, which would drive its overall revenues and (3) steady growth in domestic pharmaceutical revenues. We expect US generic revenues to recover sharply over FY20-21 on the back of new launches although the timing of the launches is still somewhat uncertain, which may push back the recovery in revenues and profits. The revival in US generic revenues from 2QFY19 has continued over the past three quarters. We note that FY19 profits of the sector were hurt by several one-off items related to the changes to its distribution channel in India. FY18 profits of the generic pharmaceutical companies were affected significantly by weak US generic revenues due to continued pricing pressure in the case of certain FTF products and delays in launches of new products.

Metals and Mining

Lower taxes will not drive meaningful change in the balance sheets of metal companies and concerns on high leverage remains. Also, with domestic prices driven by import parity and fungible geographic sales mix, we see regional prices and global demand as key drivers for the sector. Lower tax is a welcome move but unlikely to re-rate sector multiples. Further, given stretched balance sheets, we do not expect any further capex by our coverage companies in FY20-22E beyond what is already announced. We continue to see value in select stocks like Tata Steel (strong domestic cash flows, deleveraging and growth visibility) and Hindalco (high contribution from non-commodity businesses, structural margin expansion at Novelis and strong FCF generation).

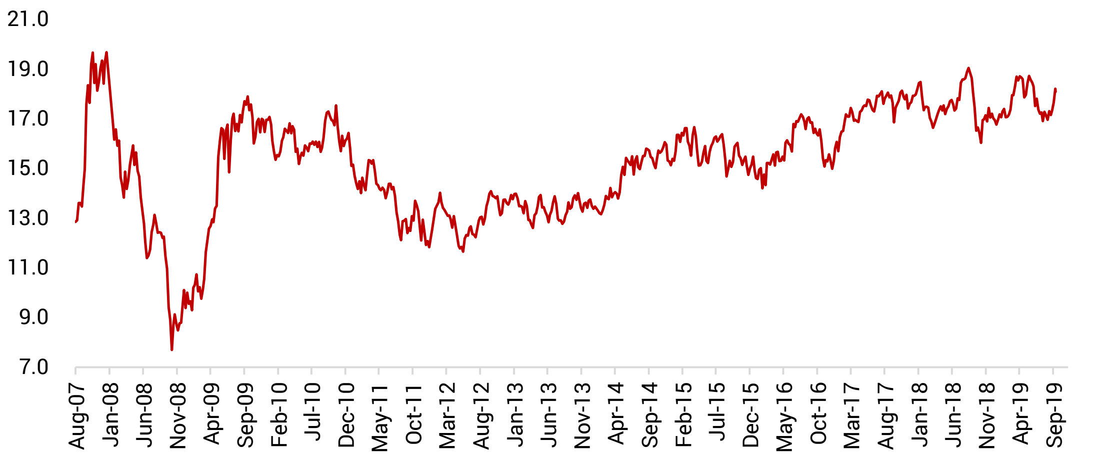
Oil and Gas

The spike in global crude prices in the month of September, even though temporary, will be negative for downstream OMCs (BPCL, HPCL and IOCL) and Castrol. We do not rule out a possibility of moderation in marketing margins on auto fuels—a US$10/barrel rise in global crude and product prices may require OMCs to increase retail price of diesel and gasoline by Rs5-6/liter in the following fortnight. Sharp jump in global crude prices may also put pressure on refining margins amid slowing demand, besides increasing absolute quantum of fuel and loss. On the other hand, higher crude prices may be construed positively for upstream PSUs and GAIL.

Post tax-cut, the earnings upgrade is material (2-17%) for all except RIL, whose tax rate was already lower including exemptions. The government's announced stimulus may require it to consider higher disinvestments of PSUs in the near term to manage likely higher fiscal deficit—it may continue to act as an overhang on energy sector PSUs (except HPCL), which are directly owned by the government. A strategic divestment such as privatization, being recently speculated by media, could have been positive but it may be difficult to implement on an accelerated timeline.

Based on Bloomberg consensus estimates the Nifty-50 is trading at 18.1x on a 1 Year Fw PE. Valuations are still on the higher side even after considering the tax benefits likely to come in FY20.

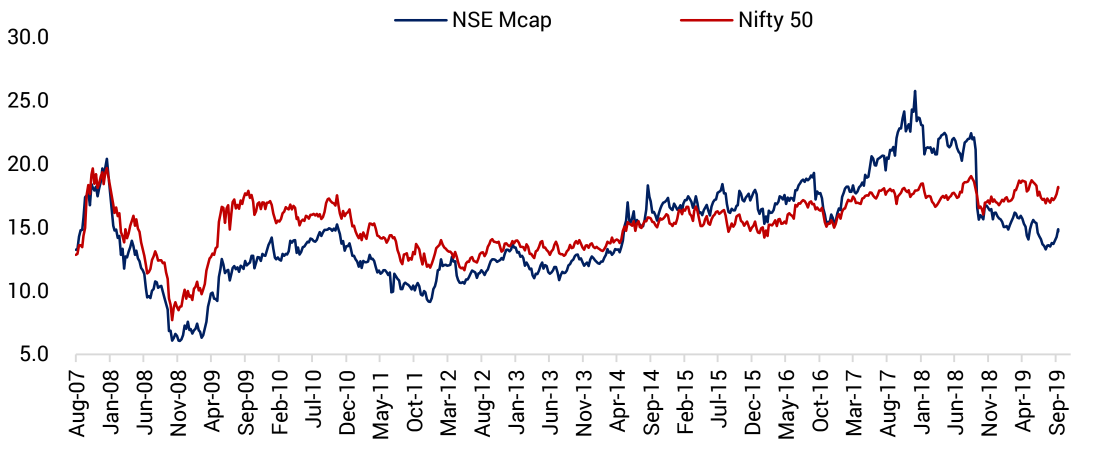
One Year Rolling Fw PE chart of Nifty-50



Source: Bloomberg

Based on Bloomberg consensus estimates the one year Fw PE of NSE Mid Cap Index stands at 14.7x as compared to 18.1x of the Nifty-50 Index.

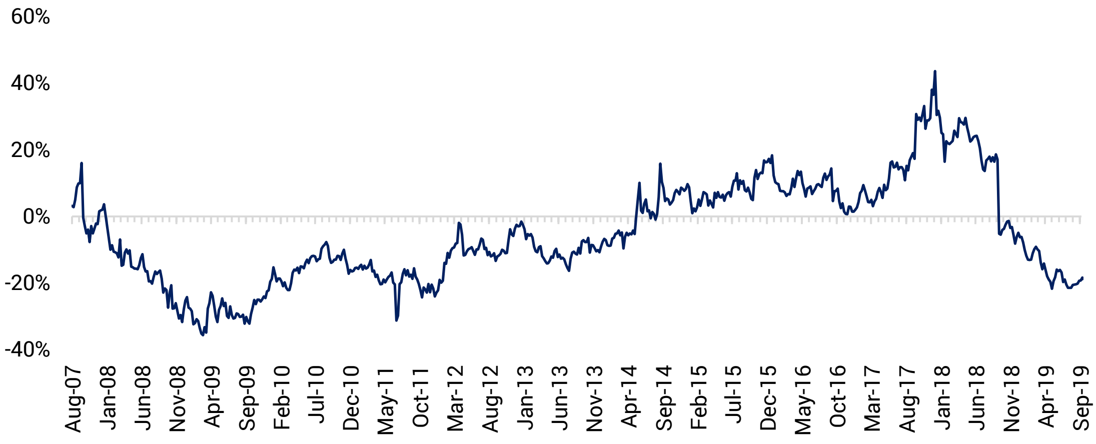
One Yr Fw PE chart: Nifty-50 Vs Mid Cap 100 Index



Source: Bloomberg

Based on Bloomberg consensus estimates the NSE Mid Cap Fw PE now trades at a 19% discount to the Nifty-50 Fw PE. The discount is closer to the lower end of its historic band (i.e. 12 Yr range).

Mid Cap Fw PE -Discount to Nifty-50 FW PE



Source: Bloomberg

Gujarat Gas Ltd (GGL)

Analyst: Sumit Pokharna, (Email: sumit.pokharna@kotak.com; Contact: +91 22 6218 6438)

CMP (Rs)	Target Price (Rs)	Potential Upside (%)	52 Week H/L (Rs)	Mkt Cap (Rs mn)
175	194	10.9%	195 / 115	122052

Key Highlights:

- Gujarat Gas Limited continues as the largest city gas distribution company in India and have ~1.695 lacs square kms of licensed area under coverage.
- GGL is focusing on connecting new consumers, geographical expansion, focus on CNG segment, retaining existing & new users and maximizing margins. The strategy of volume growth led earnings increase will support long-term growth earnings of the company. We believe this is prudent strategy considering GGL has take-or-pay contract with long-term LNG supplier. Further, it blends cheap spot and long term LNG volumes to make average lower.
- Modest CNG gas sales volume growth was supported by 63 new CNG stations in FY19. CNG is a strong profitable segment given uninterrupted supply of cheap domestic gas.
- In March'19, the National Green tribunal has ordered to ban the use of coal based gasifies in Morbi, Gujarat. Pursuant to this, industries shifted to alternative fuel such as natural gas. GGCL got benefited due to this.
- Margin improvement and strong revenue visibility makes us positive on its growth prospects. Additionally, strong free cash flow and healthy return ratios also provide high comfort.
- In FY19, the Company received license to operate in 7 districts in the State of Punjab, 2 districts in the State of Haryana, 4 districts in the State of Rajasthan and 5 districts in the State of Madhya Pradesh.
- In FY19, GGL connected ~1 lakh household customers and added 63 new CNG stations. Sales volume have grown 6% in the residential and 10% in transport (CNG).
- RoE is expected to improve with better capacity utilization, higher volumes, margin improvement, etc.
- We value GGL at 15.4x PE (25% discount to its peers) based on EPS of Rs.12.6 for FY21E.

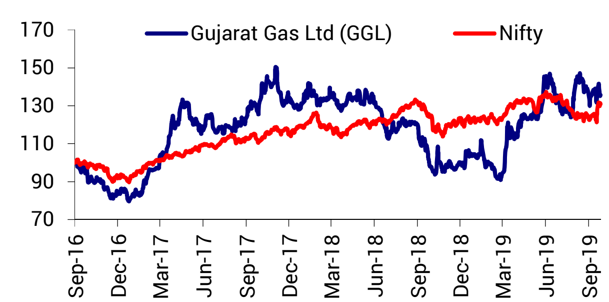
Financials (Rs mn)*	FY19	FY20E	FY21E
Sales	77,544	104,832	106,450
Growth (%)	25.6	35.2	1.5
EBITDA	9,898	16,059	16,824
EBITDA margin (%)	12.8	15.3	15.8
PBT	5,956	12,114	13,126
Net profit	4,185	7,995	8,663
Adjusted EPS (Rs)	6.1	11.6	12.6
Growth (%)	45.2	90.2	8.6
P/E (x)	*29.1*	*15.3*	*14.1*
ROE (%)	20.7	31.4	26.6
ROCE (%)	14.7	22.6	22.6
Debt/equity ratio(x)	0.9	0.4	0.2

*Source: Kotak Insitutional Equities; *Consolidated*

Financials (Rs mn)*	Q1-FY19	Q1-FY20	% Chg
Revenues	17,651	26,146	48
EBITDA	2,486	4,665	88
EBITDA Margin (%)	14.1%	17.8%	
PAT	1,214	2,337	93
PAT Margin (%)	6.9%	8.9%	
EPS (Rs)	1.8	3.4	93

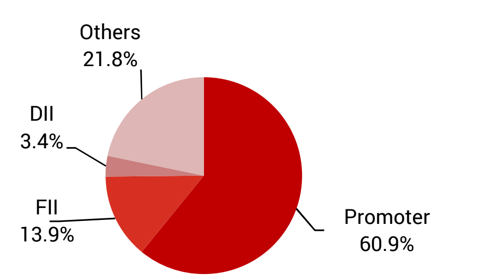
Source: Kotak Insitutional Equities

Price Performance (3 Years)



Source: Bloomberg

Share Holding Pattern (%)



Source: Bloomberg

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Himatsingka Seide Ltd

Analyst: Pankaj Kumar (Email: pankajr.kumar@kotak.com; Contact: +91 22 6218 6434)

CMP (Rs)	Target Price (Rs)	Potential Upside (%)	52 Week H/L (Rs)	Mkt Cap (Rs mn)
144	212	47.7%	278 / 119	14134

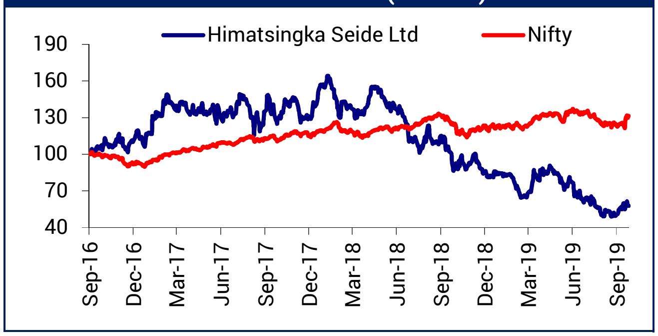
Key Highlights:

- Himatsingka Seide Ltd (HSL) is a vertically integrated home textile player with manufacturing facilities in India and has retail and distribution businesses in North America, Europe and Asia.
- HSL is focused on building a strong brand portfolio through owned and licensed brands contributing 75-80% of its revenue. It has license to manufacture, source and distribute home textiles brands such as Calvin Klein Home, Tommy Hilfiger Home, Barbara Barry, etc in major geographies such as North America, Europe, etc.
- Going forward, the company intends to add more brands as part of its long term growth strategy and enhancing its market share in branded home textiles segment.
- HSL has emerged as a global leader in track and trace capabilities with regard to the cotton value chain. This helps in delivering quality products to its customers.
- HSL is at the final stage of its capex with deleveraging going to be the core focus of the company. We expect the company's net debt to equity to improve from 1.7x in FY19 to 1.2x in FY21E.
- The company's strategy to consolidate home textiles portfolio and sweating new capacities of Terry towel would help it in achieving operating leverage and improve operating cash flows.
- The central government revised incentive scheme will positively impact margins of home textiles exporters in FY20E.
- We expect high single digit growth in revenue in the next two years based on the volume growth in bed linen business, contribution from terry capacity and from new licenses acquired in the last one year.
- At our target price, the stock is valued at 9x FY21E EPS, which is at a discount to its last five years average forward PE of 11.6x.

Financials (Rs mn)*	FY19	FY20E	FY21E
Sales	26,177	28,647	31,294
Growth (%)	16.4	9.4	9.2
EBITDA	5,433	6,151	6,746
EBITDA margin (%)	20.8	21.5	21.6
PBT	3,080	2,587	3,121
Net profit	1,968	1,925	2,322
Adjusted EPS (Rs)	20.0	19.5	23.6
Growth (%)	(2.4)	(2.2)	20.6
P/E (x)	*7.2*	*7.3*	*6.1*
BV (Rs/share)	144.3	159.8	178.4
Dividend / share (Rs)	5.0	4.1	4.9
ROE (%)	11.3	10.7	11.7
ROCE (%)	14.9	12.9	13.9
Net cash (debt)	(25,399)	(25,229)	(21,503)

*Source: Company; Kotak Securities - Private Client Research *Consolidated*

Price Performance (3 Years)

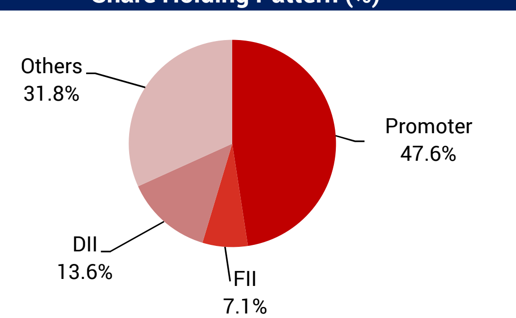


Source: Bloomberg

Financials (Rs mn)*	Q1-FY19	Q1-FY20	% Chg
Revenues	5,826	6,395	9.8
EBITDA	1,155	1,381	19.6
EBITDA Margin (%)	19.8%	21.6%	
PAT	446	453	1.5
PAT Margin (%)	7.7%	7.1%	
EPS (Rs)	4.5	4.6	1.5

*Source: Kotak Securities - Private Client Research; *Consolidated*

Share Holding Pattern (%)



Source: Bloomberg

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PNC Infratech Ltd.

Analyst: Pankaj Kumar (Email: pankajr.kumar@kotak.com; Contact: +91 22 6218 6434)

CMP (Rs)	Target Price (Rs)	Potential Upside (%)	52 Week H/L (Rs)	Mkt Cap (Rs mn)
191	264	38.3%	219 / 122	48986

Key Highlights:

- PNC Infratech Ltd (PNC) is present in the business of construction and infrastructure development with expertise in highways, bridges, flyovers, airport runways, development of industrial areas, etc.
- PNC is executing road projects on EPC contract basis and is also operating 6 BOT projects, 1 OMT project and developing 7 HAM road projects.
- PNC has robust total order book of Rs. 119 bn (including HAM projects where appointed date not yet received) which is 3.8x its FY19 revenue, gives strong revenue growth visibility for the next 2-3 years.
- It has 7 HAM projects of costing Rs. 88.97 bn out of which six are in construction phase while in balance one, it has achieved financial closure and is awaiting appointed date.
- PNC has infused Rs. 2.8 bn equity in HAM projects and further requires Rs 5.5 bn of equity in 7 HAM projects in the next 2-3 years.
- The company does not see any major problem in meeting equity commitment in HAM projects as it has strong cash generation and has low net debt.
- PNC reported robust Q1-FY20 standalone revenue growth of 79.7% YoY driven by strong execution of its EPC and HAM projects. The company expects strong execution to continue in Q3 and Q4 FY20 as well. But, due to heavy monsoon, execution may slow down in Q2FY20.
- PNC has maintained guidance of over 45-50% YoY growth in FY20E revenue with EBITDA margins of 13.5-14% based on strong order book and execution timeline.
- The EPC business (adjusted for Rs. 41 per share value of BOT) is available at a PE of 10.7x and 7.6x based on FY20E and FY21E EPS of Rs. 12.2 and Rs. 17.5 per share, respectively.
- We have Buy rating on the stock with SOTP based target price of Rs. 264, (EPC valued at 12x FY21E EPS & BOT/HAM valued at 1x BV)

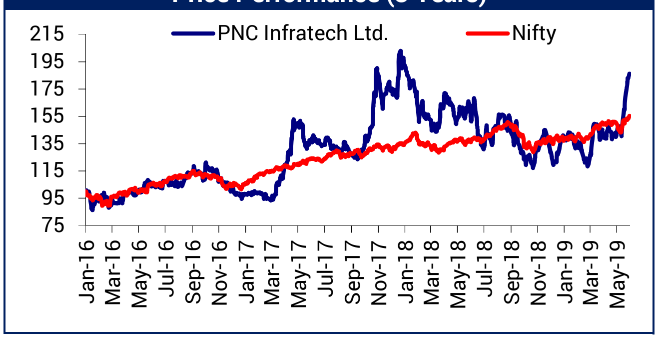
Financials (Rs mn)*	FY19	FY20E	FY21E
Sales	30,965	45,923	59,580
Growth (%)	66.8	48.3	29.7
EBITDA	4,569	7,413	8,350
EBITDA margin (%)	14.8	16.1	14.0
PBT	3,436	5,980	6,405
Adj Net profit	9	13	19
Adjusted EPS (Rs)	49.5	40.0	40.8
Growth (%)	49.5	29.1	43.7
P/E (x)	*3.9*	*4.8*	*4.7*
BV (Rs/share)	82.5	99.2	117.2
Dividend / share (Rs)	0.6	0.6	0.6
ROE (%)	12.3	14.5	17.2
ROCE (%)	16.5	22.6	21.6
Net cash (debt)	(1,218)	(4,011)	(4,123)

*Source: Company; Kotak Securities - Private Client Research *Standalone*

Financials (Rs mn)*	1QFY19	1QFY20	% Chg
Revenues	7,355	13,218	79.7
EBITDA	1,294	1,796	38.7
EBITDA Margin (%)	17.6%	13.6%	
Adj. PAT	772	1,001	29.6
Adj. PAT Margin (%)	10.5%	7.6%	
Adj. EPS (Rs)	3.0	3.9	29.6

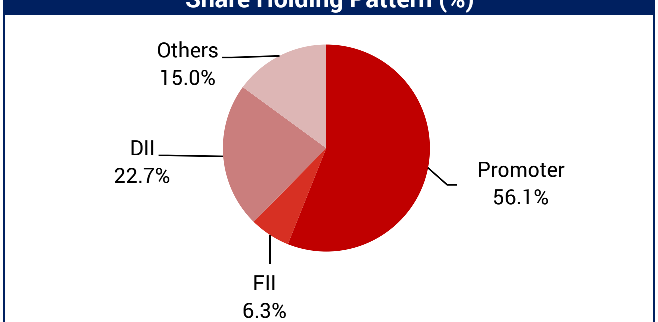
*Source: Kotak Securities - Private Client Research; *Standalone*

Price Performance (3 Years)



Source: Bloomberg

Share Holding Pattern (%)



Source: Bloomberg

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VIP Industries Ltd (VIP)

Analyst: Amit Agarwal, CFA (Email: agarwal.amit@kotak.com; Contact: +91 22 6218 6439)

CMP (Rs)	Target Price (Rs)	Potential Upside (%)	52 Week H/L (Rs)	Mkt Cap (Rs mn)
479	555	15.8%	567 / 342	67740

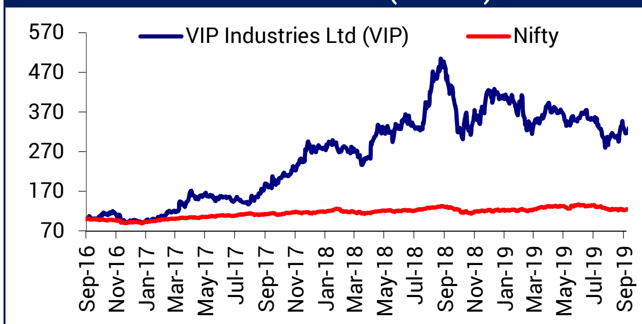
Key Highlights:

- VIP Industries reported strong topline growth of ~27% in FY19 amidst strong consumer demand, stabilisation of the GST rate at 18%, wider acceptance of fashionable and high-end luggage, consumer upgradation from un-branded to branded luggage and personalisation of luggage.
- However, depreciating rupee, volatile crude prices impacted the demand and profitability. The demand was impacted by slowdown in air-travel.
- In categories, polycarbonate luggage and duffel/duffel trolleys were important growth drivers in FY19.
- The Hypermarket channel continues to witness the strongest growth amongst channels. New product introductions in brand V.I.P was widely accepted by consumers for their contemporary designs and faith of consumers on the brand for its quality led to a very high growth in the brand
- In sales and distribution, VIP has about 1,000 dealers and 100 distributors (reaching 1,000 retailers), and 250 exclusive brand outlets, 250 franchisees and 1,000 modern trade outlets. The total point of sales are about 11,000
- VIP has been continuously focusing on strong brand visibility of its products. The company's brands include Carlton, VIP Bags, Skybags, Aristocrat, Alfa and Caprese. Historically, the company has been spending around 5-6% (percentage of sales) on ad spends to increase its brand visibility and we expect the trend to continue over FY19 to FY21E.
- Due to increasing labour costs and other reasons such as strengthening of the Yuan vs. INR, the company decided to reduce dependency on China in the long run and has setup a manufacturing facility in Bangladesh through its wholly owned subsidiary for manufacturing soft luggage.
- VIP is currently looking at expanding its footprint in newer geographies. Currently, it exports to countries such as UK, Europe, UAE, Qatar, Kuwait and the Asia Pacific.
- For VIP, we estimate situation to remain strong. We continue to estimate a revenue CAGR of 11% and earnings CAGR of 24% over FY19 to FY21E with strong operating margins and return ratios. Recommend BUY with a TP of Rs 555 at 37x FY21E earnings.

Financials (Rs mn)*	FY19	FY20E	FY21E
Sales	17,847	19,482	21,819
Growth (%)	26.6	9.2	12.0
EBITDA	2,137	2,570	2,902
EBITDA margin (%)	12.0	13.2	13.3
PBT	2,078	2,512	2,844
Net profit	1,391	1,879	2,127
Adjusted EPS (Rs)	9.8	13.3	15.0
Growth (%)	8.9	35.1	13.2
P/E (x)	*48.8*	*36.1*	*31.9*
BV (Rs/share)	39.6	48.0	57.6
EV/EBITDA	27.3	22.8	20.2
ROE (%)	24.8	27.7	26.1
ROCE (%)	35.5	35.5	33.6
Dividend payout (%)	43.1	36.4	36.2

*Source: Kotak Securities - Private Client Research *Standalone*

Price Performance (3 Years)

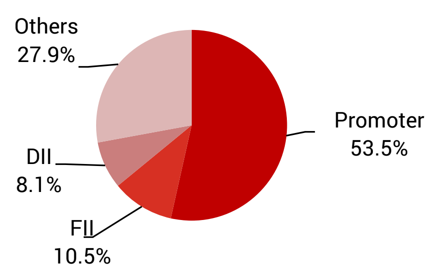


Source: Bloomberg

Financials (Rs mn)*	1QFY19	1QFY20	% Chg
Revenues	5,178	5,642	9.0
EBITDA	911	1,251	37.3
EBITDA Margin (%)	17.6%	22.2%	
PAT	599	833	39.1
PAT Margin (%)	11.6%	14.8%	

*Source: Kotak Securities - Private Client Research *Standalone*

Share Holding Pattern (%)



Source: Bloomberg

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Voltamp Transformers Ltd

Analyst: Sanjeev Zarbade (Email: sanjeev.zarbade@kotak.com; Contact: +91 22 6218 6424)

CMP (Rs)	Target Price (Rs)	Potential Upside (%)	52 Week H/L (Rs)	Mkt Cap (Rs mn)
1145	1622	41.7%	1265 / 726	11582

Key Highlights:

- Voltamp has a manufacturing capacity of 13000 MVA capable of making transformers upto 160 MVA, 220 KV, class for many applications covering most segments of users including industrial, utility and buildings.
- The company caters to a wide spectrum of transformer users in various industries like: petrochemical, oil refining, cement, paper and pulp, pharmaceuticals, automobiles, steel, power plant, building, metro rail applications, mining and minerals and many others.
- From our discussion with the management, it sounded optimistic on the current business scenario and is witnessing higher orders enquiries in the market than in earlier quarters.
- Order book at the end of August 2019 stands at ~ Rs 5.1 bn. The management is fairly positive on the level of order book, which gives it a good revenue visibility for the remainder of the fiscal.
- The Company continued to focus on optimizing its working capital to improve cash position. The company could leverage its cash availability position to get better terms from suppliers
- Treasury investments and cash at the end of Q1FY20 stood at Rs 4.36 bn (Rs 3.8 bn in FY19)
- In FY19, the company delivered 30% growth in revenue, the highest in FY08. Going into FY20E, the company is in a comfortable position in terms of order book. It is thus targeting double digit growth in volumes terms.
- Valuations are attractive compared to peers and more so considering that management remains prudent and has been able to preserve quality of balance sheet even through years of industry distress. Voltamp remains one of the best stocks to play future upturn in industrial demand.
- Reiterate **BUY** with a target price of Rs 1622, valuing the core EPS (Rs 80 per share) of the stock at 14x FY21E and adding value of the treasury and investments (Rs 499 per share in FY21E)

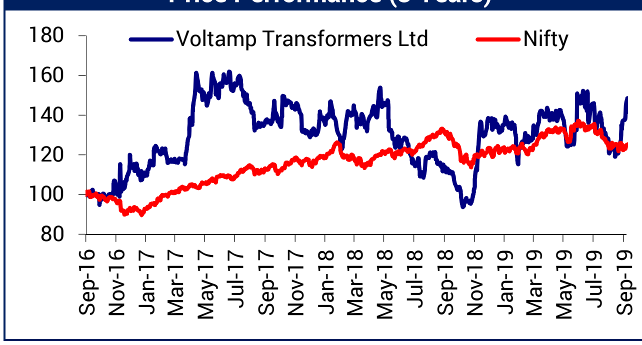
Financials (Rs mn)*	FY19	FY20E	FY21E
Sales	8,288	9,138	10,208
Growth (%)	29.7	10.3	11.7
EBITDA	936	1,040	1,190
EBITDA margin (%)	11.3	11.4	11.7
PBT	1,221	1,320	1,491
Net profit	843	982	1,109
Adjusted EPS (Rs)	83.5	97.2	109.8
Growth (%)	14.7	16.5	13.0
P/E (x)	*13.7*	*11.8*	*10.4*
BV (Rs/share)	680.5	751.4	834.8
EV/EBITDA	8.7	7.5	6.0
ROE (%)	12.9	13.6	13.9
ROCE (%)	12.9	13.6	13.8
Dividend payout (%)	27.0	23.0	21.0

*Source: Kotak Securities - Private Client Research *Consolidated*

Financials (Rs mn)*	1QFY19	1QFY20	% Chg
Revenues	1,659	1,873	12.9
EBITDA	165	206	24.8
EBITDA Margin (%)	9.9%	11.0%	
PAT	150	169	12.7
PAT Margin (%)	9.0%	9.0%	

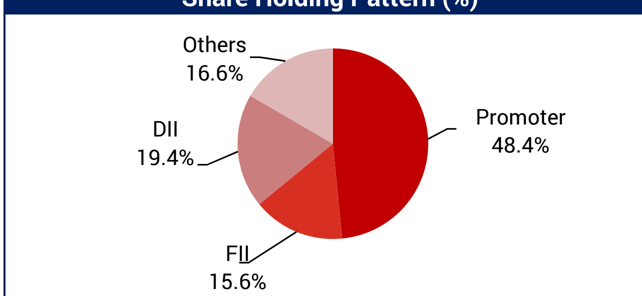
*Source: Kotak Securities - Private Client Research *Standalone*

Price Performance (3 Years)



Source: Bloomberg

Share Holding Pattern (%)



Source: Bloomberg

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BUY	–	We expect the stock to deliver more than 15% returns over the next 12 months
ADD	–	We expect the stock to deliver 5% - 15% returns over the next 12 months
REDUCE	–	We expect the stock to deliver -5% - +5% returns over the next 12 months
SELL	–	We expect the stock to deliver < -5% returns over the next 12 months
NR	–	**Not Rated.** Kotak Securities is not assigning any rating or price target to the stock. The report has been prepared for information purposes only.
SUBSCRIBE	–	We advise investor to subscribe to the IPO.
RS	–	**Rating Suspended.** Kotak Securities has suspended the investment rating and price target for this stock, either because there is not a Sufficient fundamental basis for determining, or there are legal, regulatory or policy constraints around publishing, an investment rating or target. The previous investment rating and price target, if any, are no longer in effect for this stock and should not be relied upon.
NA	–	**Not Available or Not Applicable.** The information is not available for display or is not applicable
NM	–	**Not Meaningful.** The information is not meaningful and is therefore excluded.
NOTE	–	Our target prices are with a 12-month perspective. Returns stated in the rating scale are our internal benchmark.

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