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### EQUITY MARKETS

India	Change %			
	22-Jan	1-day	1-mo	3-mo
Sensex	36,445	(0.4)	2.0	7.7
Nifty	10,923	(0.4)	1.6	7.6
<b>Global/Regional indices</b>				
Dow Jones	24,404	(1.2)	8.7	(3.1)
Nasdaq Composite	7,020	(1.9)	10.9	(5.6)
FTSE	6,901	(1.0)	2.7	(0.8)
Nikkei	20,532	(0.4)	1.8	(6.7)
Hang Seng	27,005	(0.7)	4.9	6.5
KOSPI	2,117	(0.0)	2.7	0.5
<b>Value traded – India</b>				
Cash (NSE+BSE)	344		223	77
Derivatives (NSE)	5,554		9,584	8,713
Deri. open interest	3,568		3,673	3,797

#### Forex/money market

	Change, basis points			
	22-Jan	1-day	1-mo	3-mo
Rs/US\$	71.2	(2)	123	(200)
10yr govt bond, %	7.7	(6)	23	(40)

#### Net investment (US\$ mn)

	21-Jan	MTD	CYTD
FIs	119	(435)	(435)
MFs	68	760	760

#### Top movers

Best performers	Change, %			
	22-Jan	1-day	1-mo	3-mo
HDIL IN Equity	26	(0.8)	6.7	35.4
UNBK IN Equity	84	(2.7)	1.9	34.0
BPCL IN Equity	354	0.6	(5.6)	31.3
BOI IN Equity	98	(2.8)	(0.1)	29.8
CBK IN Equity	263	(1.7)	(0.8)	26.6

#### Worst performers

SUNP IN Equity	419	5.2	(1.5)	(27.2)
SAIL IN Equity	48	(2.2)	(8.8)	(24.8)
AL IN Equity	88	(2.9)	(16.5)	(21.1)
JSTL IN Equity	278	(2.3)	(9.7)	(20.0)
JSP IN Equity	138	(4.5)	(16.3)	(19.0)

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NEW RELEASE

BSE-30: 36,445

**FY2020 interim budget preview: outlining the priorities.** The interim budget would provide an opportunity for the government to outline its medium-term economic priorities, specifically with regards to improving farm/rural incomes. It would be important to continue its focus on overall infrastructure expansion, especially as private sector investments remain tepid and a nascent recovery hinges on government spending. We pencil in GFD/GDP of 3.2% in FY2020E after 3.5% for FY2019E.

### Sharp focus on the rural sector

The farm sector's structural problems encompassing (1) overemployment, (2) fragmentation of land holdings, (3) limited warehousing and processing facilities, (4) limited marketing infrastructure and (5) inadequate public investment have been further complicated with record productions recently, resulting in low crop prices and income. Large increases in MSPs have also not had the desired effect given the limited procurement capabilities. Thus the farm/rural sector will be the priority for the government in the interim budget. While we have not internalized the cost of stimulus in our estimates, depending on the scheme and coverage, we estimate the fiscal cost to be around 0.4-0.8% of GDP (details in next section). Bulk of the cost may have to be borne from FY2021 or later given that full-fledged rollout will take time. Further, the net impact may also be lower if certain existing schemes are subsumed within these measures.

### Intent of fiscal consolidation remains

In FY2019 the largest downside to revenues has been from the GST collections with the shortfall likely at around ₹1.4 tn. Even with the assumptions of (1) higher interim dividend from RBI and (2) divestment target being met, the FY2019 GFD/GDP is likely to be at 3.5% without large expenditure cuts. In order to meet the budgeted targets, the government will need to use levers such as (1) aggressive rollover of FY2019 expenditure and (2) amending the rules to use the unutilized portion of the compensation cess fund. Unless FY2019 budgeted GFD/GDP of 3.3% is met, we expect the FY2020 budgeted GFD/GDP at around 3.2% (compared to 3.1% as per the medium-term roadmap) (details in the next section).

### Upward pressure on yields likely to continue even as the RBI may cut repo rate

We expect the RBI to cut rates by 50 bps in 1H CY19 given the muted growth-inflation outlook. The RBI will probably first change its stance to 'neutral' in February and follow it up with rate cuts as inflation is expected to stay below 4% until August 2019. The RBI, however, will be watchful of DM monetary policies and crude price movements. While volatile crude oil prices and concerns on fiscal slippage may warrant some caution, the seemingly structurally benign food inflation along with softening growth (in 2HFY19) should help in capping the upside pressures, thereby creating space for the RBI to cut rates by 50 bps in 1H CY19.

Even as the monetary policy turns marginally accommodative along with the government adhering to the fiscal consolidation path, the bond markets will likely remain on the edge given the adverse demand-supply dynamics. While the net G-Sec borrowing is expected to be ₹270 bn higher than FY2019, the high redemption is expected to weigh on the gross borrowing. In the absence of any further switch/buybacks, the gross G-Sec borrowing could be around ₹6.7 tn compared to ₹5.3 tn in FY2019 implying slightly higher weekly issuances than FY2019. Further, the pace of OMO purchases is likely to fade in FY2020 (around ₹1 tn versus ₹3.36 tn in FY2019E) given the relatively favorable BOP conditions. We expect the 10-year yield to remain in the 7.0-7.7% range in FY2020.

### QUICK NUMBERS

- **FY2020E GFD/GDP likely at 3.2%; FY2019E GFD/GDP at 3.5%**
- **Expect a likely farm/rural stimulus of 0.4-0.8% of GDP**
- **FY2020E net tax revenue growth likely at 15%; expenditure growth at 10%**

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### Focus on farm/rural sector

The FY2020 interim budget will likely combine the following features: (1) providing a vision for the medium term, (2) revenue buoyancy amid uncertainty from GST collections, (3) focusing on the rural sector and infrastructure expansion and (4) continued fiscal consolidation. We note that while the government may not detail specific programs in the budget, it is likely to provide a direction to its policies and focus areas. This assumes importance as the economy moves into a phase of relatively slower growth and waning prospects for rural demand growth.

We look at some of the schemes that could be used to alleviate some of the stress in the rural/farm sector and the associated fiscal costs (on a gross basis). Given that some of the existing schemes may be subsumed under the new stimulus package, the net fiscal impact may be limited. While these measures may be useful to reduce some of the stress in the sector, these are unlikely to solve the structural issues related to (1) overemployment (or disguised employment) in the agriculture sector, (2) shifting labor to non-farm agricultural sector, (3) improvement in the farm-to-table value chain and (4) higher producer surplus for the farmers. We note that the government need not provide the entire amount on the schemes in the first year itself. The operational rollout will take time and as such the bulk of the cost may have to be borne from FY2021 or later.

- ▶ **Quasi-Universal Basic Income Scheme (QUBI).** The concept of an UBI in the context of India was outlined in the Economic Survey 2016-17. However, it is obvious that an UBI for the entire population (and even for the BPL population) will entail a prohibitively high fiscal outgo. In fact, without commensurate reduction in various transfers (subsidies and social programs), it might not be feasible to implement an UBI for the entire population. However, the government could target the poorest of the poor (possibly 40% of the BPL population) based on the SECC 2011.

We provide a hypothetical situation where the government provides ₹700 per month to the poorest of the population (around 120 mn people) to move them above the BPL levels. Even with such a restrictive outreach, the outgo could be around ₹1 tn (or 0.5% of GDP) (Exhibit 1).

**Exhibit 1: Transfers to poorest section of the population will likely entail a fiscal cost of Rs1 tn**  
Estimates of a quasi-universal basic income scheme, March fiscal year-ends

	2012		2020
	SECC	Census	Estimate
<b>Households (mn)</b>			
Total	245	250	281
Rural	180	169	190
Urban	65	81	91
<b>Population (mn)</b>			
Total	1,187	1,211	1,365
Rural	887	834	940
Urban	300	377	425
<b>Family size (X)</b>			
Total	4.8	4.9	4.9
Rural	4.9	4.9	4.9
Urban	4.6	4.7	4.7
<b>Cost to exchequer</b>			
Poverty rate (%)	22	22	22
Total BPL population (mn)	261	266	300
Target BPL population (%)	40	40	40
Poorest of poor (mn)	104	107	120
Transfer required (Rs/month/person)	450	450	702
<b>Fiscal cost (Rs bn)</b>	<b>564</b>	<b>575</b>	<b>1,012</b>
Nominal GDP (Rs bn)	87,363	87,363	209,509
<b>Fiscal cost/GDP (bps)</b>	<b>65</b>	<b>66</b>	<b>48</b>

Notes:

- (a) Poverty rate is assumed same as the Tendulkar Committee report.
- (b) We assume that only 40% of BPL population is targeted.
- (c) Rural-urban population and household breakup is our estimates.

Source: SECC 2011, Census 2010-11, Economic Survey 2016-17, Kotak Economics Research estimates

► **Direct farm investment.** The Telengana model of Rythu Bandhu has been much discussed as a solution to alleviating some of the farm distress, which has intensified over the past few years. While farm loan waivers are a suboptimal solution, the direct investment scheme has its own operational challenges. The central government would likely have to rely on the states for farm land records as well as issuance of proper identification records being issued to the beneficiaries. Operational issues aside, the government will also have to decide on the target farmers (marginal only or small/marginal/etc.) and amount of remuneration (for example whether well-irrigated areas in Punjab should have lower remuneration compared to a drought-prone area in Maharashtra). The center may also ask the states to share the costs though certain states (such as Telengana, West Bengal, Jharkhand, Odisha) have started similar schemes and may not necessarily share the costs.

As a hypothetical exercise based on the Agricultural Census 2010-11 data, we assume that the scheme encompasses only marginal farmers (around 92 mn holdings) covering around 35 mn ha. If the government provides a transfer of around ₹19,770/ha/year (or ₹8,000/acre/year), the fiscal cost would be around ₹693 bn (or 0.3% of GDP) (Exhibit 2). Similarly, encompassing the entire operational holdings would imply a fiscal cost of around ₹3 tn (or 1.5% of GDP). These costs could be slightly lower if we assume that the entire holdings are not cultivated in both kharif and rabi seasons.

**Exhibit 2: Around Rs700 bn likely to be required for direct farm investment scheme for marginal farmers**

Estimates of a direct farm investment scheme, March fiscal year-ends

<b>Land holdings</b>	
Total operational holdings (mn ha)	160
Number of holdings (mn)	138
- Marginal	93
- Small	25
- Semi-medium	14
- Medium	6
- Large	1
<b>Owned land by size (mn ha)</b>	
<b>Marginal (up to 1 ha)</b>	<b>35</b>
- Below 0.5	15
- 0.5 - 1.0	20
<b>Small (1-2 ha)</b>	<b>35</b>
Semi-medium (2-4 ha)	37
Medium (4-10 ha)	34
Large (more than 10 ha)	17
Total owned land	157
<b>Cost to exchequer</b>	
Direct investment rate (Rs/ha/year)	19,768
<b>Fiscal cost (marginal) (Rs bn)</b>	<b>693</b>
<b>Fiscal cost (marginal and small) (Rs bn)</b>	<b>1,377</b>
<b>Fiscal cost (all owned holdings) (Rs bn)</b>	<b>3,108</b>
Nominal GDP (Rs bn, FY2020E)	209,509
<b>Fiscal cost (marginal)/GDP (bps)</b>	<b>33</b>
<b>Fiscal cost (marginal and small)/GDP (bps)</b>	<b>66</b>
<b>Fiscal cost (all owned holdings)/GDP (bps)</b>	<b>148</b>

Notes:

- (a) Land holdings are assumed at same level as in Agricultural Census 2011.  
 (b) 1 ha = 2.471 acres.  
 (c) Operational holding area is assumed to be same in kharif and rabi season.

Source: Agricultural Census 2011, Kotak Economics Research estimates

- **Interest rate subvention for crop loans.** Currently, the government provides an interest rate subvention of 5% (2% normal subvention and 3% for loans, which are paid on time) for short-term farm loans up to ₹0.3 mn. The government may explore the avenue to increase the interest rate subvention to 4% from 2%. We estimate that the government may have to bear an additional fiscal cost of ₹90 bn (0.04% of GDP) (Exhibit 3). We note that the government had budgeted ₹150 bn towards interest rate subvention on farm loans in FY2019BE.

**Exhibit 3: Around Rs90 bn required for additional 2% interest rate subvention in the current scheme**  
Interest rate subvention for short-term crop loans up to Rs0.3 mn, March fiscal year-ends

	2016	2017	2018	2019E	2020E
Outstanding agriculture loans (Rs bn)	9,962	10,782	11,993	12,832	13,794
< Rs0.025 mn	275	245	245	263	282
Rs0.025-0.2 mn	3,824	4,098	4,491	4,806	5,166
Rs0.2-0.5 mn	2,550	2,808	3,060	3,274	3,520
> Rs0.5 mn	3,313	3,631	4,196	4,489	4,826
Estimated total loans upto Rs0.3 mn (Rs bn)	4,609	4,905	5,349	5,723	6,152
<b>Cost to exchequer</b>					
Interest subvention by government (Rs bn)	130	134	148	150	237
Incremental fiscal cost (Rs bn)	70	4	14	3	87
Nominal GDP (Rs bn)	137,640	152,537	167,731	188,407	209,509
Incremental fiscal cost/GDP (bps)	5.1	0.3	0.8	0.1	4.1

Notes:

- (a) We assume 20% of loans in Rs0.2-0.5 mn bracket is below Rs0.3 mn.
- (b) We assume 50-60% of the loans up to Rs0.3 mn are short-term loans.
- (c) We assume government announces a further 2% interest subvention.

Source: RBI, CEIC, Kotak Economics Research estimates

- ▶ **Zero premium crop insurance.** As part of the Pradhan Mantri Fasal Bima Yojana (PMFBY), the central and the state governments share most of the burden of the premiums. Data for the FY2017 kharif and rabi seasons (sowing of rabi in FY2017) indicate that farmers paid total premium of ₹43 bn against central and state governments paying ₹215 bn. In case the central government subsumes the farmers' premium, it will be an incremental cost of around ₹50-60 bn (or 0.02% of GDP) at the current coverage levels (Exhibit 4).

**Exhibit 4: Around Rs50-60 bn required for a zero premium crop insurance scheme**  
 Details of crop insurance scheme, March fiscal year-end, 2017

<b>Kharif 2017</b>	
Total farmers' insured (mn)	35
Area insured (mn ha)	34
- Area per farmer (ha)	1.0
Number of beneficiaries (mn)	14
<b>Farmers' premium (Rs bn)</b>	<b>30</b>
- Average premium/farmer (Rs)	2,203
State government premium (Rs bn)	84
Central government premium (Rs bn)	83
Total premium (Rs bn)	198
Claims paid (Rs bn)	172
- Average claims/farmer (Rs)	12,479
<b>Rabi 2016-17</b>	
Total farmers' insured (mn)	17
Area insured (mn ha)	19
- Area per farmer (ha)	1.1
Number of beneficiaries (mn)	4
<b>Farmers' premium (Rs bn)</b>	<b>13</b>
- Average premium/farmer (Rs)	3,620
State government premium (Rs bn)	24
Central government premium (Rs bn)	24
Total premium (Rs bn)	60
Claims paid (Rs bn)	57
- Average claims/farmer (Rs)	15,869
<b>Cost to exchequer</b>	
<b>Fiscal cost of farmers' premium (Rs bn)</b>	<b>43</b>
Nominal GDP (FY2020E)	209,509
<b>Fiscal cost of farmers' premium/GDP (bps)</b>	<b>2.1</b>

Source: Ministry of Agriculture, Kotak Economics Research estimates

### Key estimates for FY2020 union budget

We maintain that in the absence of significant expenditure cuts as well as windfall gains on the revenue side, the FY2019 GFD/GDP will be at 3.5% against budget estimate of 3.3%. The FY2020 interim budget will likely show a fiscal consolidation with GFD/GDP at 3.2% (Exhibit 5). The government will likely show net tax revenue (after devolution to states) growth at 15% and expenditure growth of 10%. Even if the government announces measures for the rural sector we believe that it will be a staggered implementation with limited implication in the FY2020 budget.

## Exhibit 5: GFD/GDP likely at 3.2% in FY2020

Major central government budgetary items, March fiscal year-ends, 2015-20E (Rs bn)

	2015	2016	2017	2018P	2019BE	2019E	2020E	Change (%)				
								2017/ 2016	2018P/ 2017	2019BE/ 2018P	2019E/ 2018P	2020E/ 2019E
<b>Receipts</b>												
1. Revenue receipts (2d + 3)	11,014	11,950	13,742	14,352	17,257	16,690	18,818	15	4	20	16	13
<b>2. Gross tax revenues (a + b)</b>	<b>12,449</b>	<b>14,556</b>	<b>17,158</b>	<b>19,192</b>	<b>22,712</b>	<b>21,536</b>	<b>24,808</b>	<b>18</b>	<b>12</b>	<b>18</b>	<b>12</b>	<b>15</b>
2.a. Direct taxes	6,989	7,458	8,539	10,077	11,552	11,606	13,605	14	18	15	15	17
2.a.1. Corporation tax	4,289	4,532	4,849	5,712	6,210	6,396	7,164	7	18	9	12	12
2.a.2. Income tax	2,583	2,876	3,646	4,082	5,290	5,105	6,381	27	12	30	25	25
2.a.3. Other taxes	117	50	43	283	52	105	60	(13)	553	(81)	(63)	(43)
2.b. Indirect taxes	5,459	7,098	8,620	9,115	11,160	9,930	11,203	21	6	22	9	13
2.b.1. Goods and Services Tax	—	—	—	4,347	7,439	6,080	7,260	—	—	71	40	19
2.b.1.1. CGST	—	—	—	2,033	6,039	4,680	6,000	—	—	197	130	28
2.b.1.2. IGST	—	—	—	1,688	500	500	300	—	—	(70)	(70)	(40)
2.b.1.3. Compensation cess	—	—	—	626	900	900	960	—	—	44	44	7
2.b.2. Customs duty	1,880	2,103	2,254	1,369	1,125	1,294	1,423	7	(39)	(18)	(6)	10
2.b.2.1. Basic duties	526	572	646	808	963	1,107	1,218	13	25	19	37	10
2.b.2.2. Others	1,354	1,532	1,608	562	162	186	205	5	(65)	(71)	(67)	—
2.b.3. Excise duty	1,900	2,881	3,821	2,586	2,596	2,481	2,520	33	(32)	0	(4)	2
2.b.4. Service tax	1,680	2,114	2,545	812	—	75	—	20	(68)	—	(91)	—
2.c Transfers to states, UTs and national funds	3,413	5,119	6,145	6,765	7,906	7,497	8,636	20	10	17	11	15
2.d Net tax revenues	9,036	9,438	11,014	12,427	14,806	14,039	16,172	17	13	19	13	15
3. Non-tax revenues	1,978	2,513	2,728	1,925	2,451	2,651	2,646	9	(29)	27	38	(0)
3.a. RBI's transfer of surplus	527	659	659	407	500	700	500	(0)	(38)	23	72	(29)
4. Non-debt capital receipts (a + b)	515	630	654	1,158	922	922	920	4	77	(20)	(20)	(0)
4.a Recovery of loans	137	208	176	156	122	122	120	(15)	(11)	(22)	(22)	(2)
4.b Other receipts (disinvestments)	377	421	477	1,002	800	800	800	13	110	(20)	(20)	0
<b>5. Total receipts (1 + 4)</b>	<b>11,529</b>	<b>12,580</b>	<b>14,396</b>	<b>15,510</b>	<b>18,179</b>	<b>17,612</b>	<b>19,738</b>	<b>14</b>	<b>8</b>	<b>17</b>	<b>14</b>	<b>12</b>
<b>Expenditure</b>												
6. Revenue expenditure	14,670	15,378	16,906	18,790	21,418	21,418	23,559	10	11	14	14	10
6.a. Interest payments	4,024	4,417	4,807	5,292	5,758	5,758	6,050	9	10	9	9	5
6.b. Subsidies	2,583	2,641	2,348	2,242	2,928	2,929	2,985	(11)	(5)	31	31	2
6.b.1. Food	1,177	1,394	1,102	1,003	1,693	1,693	1,700	(21)	(9)	69	69	0
6.b.2. Fertilizer	711	724	663	664	701	701	700	(8)	0	5	5	(0)
6.b.3. Oil	603	300	275	244	249	250	285	(8)	(12)	2	3	14
6.b.4. Other subsidies	92	223	308	331	285	285	300	38	7	(14)	(14)	5
6.c. Pay, allowances and pensions	3,091	3,301	3,996	4,414	4,791	4,791	5,214	21	10	9	9	9
6.c.1.a. Pay and allowances	2,155	2,334	2,682	2,940	3,107	3,107	3,293	15	10	6	6	6
6.c.1.b. Pensions	936	967	1,314	1,474	1,685	1,685	1,921	36	12	14	14	14
6.d. Agriculture and farmers' welfare	193	153	369	374	467	467	514	141	1	25	25	10
6.e. Education	689	672	720	800	850	850	897	7	11	6	6	6
6.f. Health and family welfare	306	322	377	514	528	528	554	17	36	3	3	5
6.g. Rural development	673	774	951	1,086	1,124	1,124	1,259	23	14	4	4	12
6.h. Others	3,111	3,097	3,338	4,069	4,971	4,970	6,087	8	22	22	22	22
<b>7. Capital expenditure</b>	<b>1,967</b>	<b>2,530</b>	<b>2,846</b>	<b>2,637</b>	<b>3,004</b>	<b>2,719</b>	<b>2,983</b>	<b>12</b>	<b>(7)</b>	<b>14</b>	<b>3</b>	<b>10</b>
7. a. Defence	831	836	915	955	996	896	986	9	4	4	(6)	10
7. b. Railways	301	350	452	434	531	478	525	29	(4)	22	10	10
7. c. Roads and Highways	166	275	412	508	594	594	684	50	23	17	17	15
7. d. Housing and urban affairs	74	106	165	153	164	140	147	56	(7)	7	(9)	5
7. e. Others	595	963	902	587	720	612	642	(6)	(35)	23	4	5
<b>8. Total expenditure (6 + 7)</b>	<b>16,637</b>	<b>17,908</b>	<b>19,752</b>	<b>21,427</b>	<b>24,422</b>	<b>24,137</b>	<b>26,543</b>	<b>10</b>	<b>8</b>	<b>14</b>	<b>13</b>	<b>10</b>
<b>Deficit</b>												
Primary deficit (PD)	1,084	911	549	624	485	767	754	(55)	14	(22)	23	(2)
Revenue deficit (RD)	3,656	3,427	3,164	4,438	4,160	4,728	4,741	3	40	(6)	7	0
<b>Gross fiscal deficit (GFD)</b>	<b>5,108</b>	<b>5,328</b>	<b>5,356</b>	<b>5,917</b>	<b>6,243</b>	<b>6,525</b>	<b>6,804</b>	<b>0</b>	<b>10</b>	<b>6</b>	<b>10</b>	<b>4</b>
Gross borrowings (dated securities)	5,920	5,840	5,830	5,451	5,350	5,353	6,373	3	(7)	(2)	(2)	19
Net market borrowing	4,531	4,406	4,082	4,055	3,916	3,918	4,294	(4)	(1)	(3)	(3)	10
Net market borrowing (adjusted for buyback)	—	4,041	3,497	3,485	3,451	3,693	3,894	5	(0)	(1)	6	5
Short-term borrowing (T-bills)	92	507	55	775	170	320	180	—	—	—	—	—
<b>Nominal GDP at market prices</b>	<b>124,680</b>	<b>137,640</b>	<b>152,537</b>	<b>167,731</b>	<b>187,223</b>	<b>188,407</b>	<b>209,509</b>	<b>10.8</b>	<b>10.0</b>	<b>11.6</b>	<b>12.3</b>	<b>11.2</b>
PD/GDP (%)	0.9	0.7	0.4	0.4	0.3	0.4	0.4					
RD/GDP (%)	2.9	2.5	2.1	2.6	2.2	2.5	2.3					
<b>GFD/GDP (%)</b>	<b>4.1</b>	<b>3.9</b>	<b>3.5</b>	<b>3.5</b>	<b>3.3</b>	<b>3.5</b>	<b>3.2</b>					

## Notes:

(a) 'Gross tax revenues' means revenues post refunds and 'net tax revenues' means gross tax revenues minus devolution to states.

(b) RBI's transfer of surplus for FY2019BE and FY2020E are our estimate.

(c) Pay and allowances include pay and allowances from Ministry of Railways.

Source: Ministry of Finance, Kotak Economics Research estimates

- ▶ **Corporate tax.** The government will likely budget corporate taxes growth at 12% in FY2020BE, in line with our estimate of 12% in FY2019E. This is in line with our nominal GDP growth estimate of 11.2% in FY2020. We estimate corporate tax collection at ₹7.2 tn in FY2020. The government had outlined its plan to reduce corporate tax but it is unlikely that any major changes to corporate tax rates will be announced in the interim budget. We note that net corporate tax collections have grown by 16% in 9MFY19.
- ▶ **Personal income tax.** The government could increase the exemption limit of income tax from the current level of ₹0.25 mn to incentivize consumption at the margin, especially at lower income levels. But it is unlikely to meaningfully reduce collections unless the successive tax slabs are also changed. We pencil in income tax growth of around 25% for FY2020, same as our FY2019 estimate. We estimate income tax collection at ₹6.4 tn in FY2020. We note that net income tax collections have grown by 14.8% in 9MFY19.
- ▶ **Goods and Services Tax.** The government is likely to garner ₹4.7 tn in FY2019 through CGST collections; significantly lower than ₹6 tn budgeted for FY2019. The CGST collection for 9MFY19 is around ₹3.4 tn, implying a run-rate of ₹378 bn (Exhibit 6). Overall GST collections are at ₹8.1 tn for 9MFY19, implying a run-rate of ₹900 bn and a required run-rate of ₹1.5 tn for the next three months to bridge the gap. We pencil in ₹6 tn as CGST collections in FY2020 along with ₹300 bn as unallocated IGST. We also await clarification on treatment of unallocated compensation cess, which can be an additional gain for the government (bill has been passed in the Lok Sabha). We believe that compliance will be tightened after the elections, especially as various returns are finalized and fully operational.

## Exhibit 6: GST run rate significantly behind their budgeted run-rate

Summary of GST collections (Rs bn)

	Mar-18	Apr-18	May-18	Jun-18	Jul-18	Aug-18	Sep-18	Oct-18	Nov-18
<b>Monthly collections (PIB press releases)</b>									
Center	325	288	316	579	370	306	490	351	439
Center GST (CGST)	187	159	160	159	153	153	165	168	164
Centre's share of IGST (C-IGST)	138	129	157	420	217	153	325	183	274
States	403	340	367	638	411	350	529	388	463
States' GST (SGST)	257	217	220	223	212	211	228	231	225
States' share of IGST (S-IGST)	146	123	147	415	200	140	301	157	238
Unallocated IGST	222	239	192	(335)	82	209	(92)	158	(33)
Compensation cess	86	73	81	84	76	80	80	80	79
<b>Total</b>	<b>1,035</b>	<b>940</b>	<b>956</b>	<b>965</b>	<b>940</b>	<b>944</b>	<b>1,007</b>	<b>976</b>	<b>947</b>
<b>FYTD collections (post refund adjustments)</b>									
Centre	521	971	1,383	1,563	1,975	2,421	2,759	3,193	3,531
- CGST	321	602	911	1,490	1,851	2,149	2,629	2,973	3,403
- Unallocated IGST	200	369	471	72	124	272	130	220	128
State	399	732	1,092	1,730	2,132	2,473	2,993	3,372	3,825
Compensation cess	85	157	237	317	391	469	548	627	704
<b>Total</b>	<b>1,004</b>	<b>1,860</b>	<b>2,712</b>	<b>3,609</b>	<b>4,498</b>	<b>5,364</b>	<b>6,300</b>	<b>7,192</b>	<b>8,061</b>
<b>FY2019BE</b>									
Centre									6,539
- Unallocated IGST									500
State									5,078
Compensation cess									900
<b>Total</b>									<b>12,517</b>
<b>Required run rate to meet FY2019BE</b>									
Centre	547	557	573	622	652	686	756	836	1,003
- Unallocated IGST	27	13	3	53	54	38	74	70	124
State	425	435	443	418	421	434	417	426	417
Compensation cess	74	74	74	73	73	72	70	68	65
<b>Total</b>	<b>1,047</b>	<b>1,066</b>	<b>1,089</b>	<b>1,113</b>	<b>1,145</b>	<b>1,192</b>	<b>1,243</b>	<b>1,331</b>	<b>1,485</b>
<b>FYTD19 run rate</b>									
Centre	521	486	461	391	395	404	394	399	392
- Unallocated IGST	200	185	157	18	25	45	19	28	14
State	399	366	364	432	426	412	428	421	425
Compensation cess	85	79	79	79	78	78	78	78	78
<b>Total</b>	<b>1,004</b>	<b>930</b>	<b>904</b>	<b>902</b>	<b>900</b>	<b>894</b>	<b>900</b>	<b>899</b>	<b>896</b>

Source: Ministry of Finance, CGA, PIB, Kotak Economics Research estimates

- ▶ **Non-tax revenues.** The government is likely to receive an additional dividend of around ₹300 bn from the RBI in FY2019. This is in addition to ₹400 bn received in August 2018. For FY2020 the government will budget around ₹500 bn as surplus transfer from the RBI. We await the outcome of additional transfers, if any, after the Jalan Committee's recommendation on RBI's Economic Capital Framework. We pencil ₹2.8 tn of overall non-tax revenues in FY2020E against ₹2.7 tn in FY2019E.
- ▶ **Disinvestments.** We expect the government to continue to focus on divestment of its stakes in various companies to bolster its overall revenues. While the government has garnered ₹338 bn till December 1, 2018, the REC, BHEL, and NHPC transactions along with expected SUUTI sales should ensure meeting of the target of ₹800 bn for FY2019. We note that the government has sufficient options to raise large amounts from divestments of its stakes in government and private companies. We expect the government to keep its divestment target at ₹800 bn in FY2020E.

- ▶ **Revenue expenditure.** We have in the earlier section highlighted some of the farm/rural measures that the government might be looking at for FY2020. However, there is a fair chance that some of the current subsidies/transfers will be subsumed to balance out the transfers. Further, it is likely that these measures will have limited impact given that complete rollout of any pan-India measure will take some time. However, we factor in around 10% growth in revenue expenditure on FY2020.
  - **Agriculture and rural development expenditures.** We expect allocations to be skewed towards rural employment scheme, rural housing schemes, rural road connectivity schemes, rural and urban health missions, and irrigation projects. We pencil in 12% growth in rural development spends (MGNREGS, PMAY-Rural, and PMGSY) along with 10% growth in agriculture and farmers' welfare schemes (which could be around 25% including higher interest subvention).
  - **Subsidies.** We expect the government to budget a subsidy bill of ₹3 tn in FY2020 split between food (₹1.7 tn), fertilizer (₹700 bn) and fuel (₹285 bn). We estimate fuel subsidy for kerosene and LPG based on an average crude price of US\$72.5/bbl for FY2020.

However, some of the revenue expenditure items may undergo re-classification given that they could be subsumed under any farm/rural schemes that the government may announce.

- ▶ **Capital expenditure.** We expect the growth in capital expenditure to slow down to 3% in FY2019E given the lower-than-expected GST collections putting pressure on the government to reduce expenditure without much reduction in revenue expenditure. For FY2020E, however, we pencil in a growth of 10% in capital expenditure at ₹3 tn, with most of the expenditure likely on roads and railways. We pencil in 10% increase in expenditure on defense, 10% for railways, and 15% increase for roads and highways. However, it is also possible that the government may prefer to use the extra budgetary route for capex.
- ▶ **Market borrowing.** We estimate gross market borrowing of dated securities in FY2020E at ₹6.4 tn including redemptions at ₹2.1 tn (implying a net market borrowing of ₹4.3 tn). This compares with ₹5.35 tn of gross borrowing in FY2019E. The higher gross borrowing unless reduced through debt switches will continue to exert upward pressure on yields as the average weekly borrowing would be around ₹140 bn compared to ₹120 bn in FY2019. We estimate borrowings through T-bills at around ₹180 bn in FY2020.

**Serving it hot.** Rapid expansion of services into new cities backed by adequate availability of capital with multiple delivery companies is driving a massive scale-up of the food delivery business. We believe the size of the overall food delivery market (GMV) can increase 5X in the next three years, driven by user additions and higher ordering frequencies. Besides delivery companies, restaurants and food brands are also set to benefit from higher throughputs.

#### Food delivery market scaling up rapidly

India's food delivery market is scaling up rapidly—from a 15 mn order run-rate as of March 2018, the market has scaled up to ~65 mn orders currently, higher than earlier expected. We believe this has been on account of: (1) increased capital availability and its deployment into delivery infrastructure creation and customer acquisition, (2) addition of players such as UberEats and Foodpanda into the ecosystem and (3) rapid expansion into Tier-I/II cities. Continued investments into expansion and change in customer preferences can potentially drive a 5X increase in food delivery GMV in the next three years.

#### Delivery companies relying on scale to drive positive unit economics

The economics of the food delivery business is dependent on average order values (AOVs), commission rates, cost of delivery and customer acquisition costs. Scale should typically lead to better economics and drive down last-mile delivery costs, though this would need to be backed by a reduction in customer acquisition costs as well. The China example shows that even at a scale that is significantly larger than India, delivery companies are unable to make money owing to intense competition and consequently high promotion costs. In India, promotion costs could remain elevated for some time as companies invest to expand the market, as well as gain share in what is now a four-player market. Food delivery companies may eventually enter into adjacent businesses—Zomato, for instance, intends to enter into the food events space, while Swiggy intends to enter into other hyperlocal delivery businesses.

#### Food delivery currently a multi-player market driven by healthy PE/VC funds infusion

Food delivery companies have raised large rounds of funding in CY2018. Swiggy alone has raised US\$1.3 bn in funding, and counts Naspers, Tencent and Meituan Dianping (Tencent's Chinese delivery company) as investors. Zomato is a close competitor, and backed now by Alibaba, has raised US\$410 mn in CY2018. UberEats and Foodpanda are ramping up operations, driven by funds infusion by their respective parents, Uber Inc. and Ola. We believe Swiggy and Zomato are currently the largest delivery companies accounting for ~80% market share.

#### Expansion of the food delivery market can drive growth for food brands and QSRs

The rapid expansion of delivery infrastructure is enabling restaurants, QSR chains and even local eateries to get orders from customers and drive up their own revenues. The margin sharing tussle would continue, though large, well-known food brands such as Dominos, McDonalds, KFC etc. would be able to have superior bargaining power given their customer connect. Other food brands such as Freshmenu, Faasos can also benefit as they find a larger customer base, which gets increasingly used to food ordering as well as to trying new cuisines. Lastly, both Zomato and Swiggy are setting up their own cloud kitchens in order to improve the supply side. We believe this is necessary to keep pace with the breakneck speed at which deliveries are growing and the limited number of relevant restaurants present in India.

Kawaljeet Saluja

Garima Mishra

### Improving delivery reach creating its own demand

We believe that estimation of the size of food delivery market in India over the next few years is a function of the pace of expansion of food delivery companies to new areas and cities, as well as increasing frequency of ordering. It will get increasingly de-linked from the growth in the size of the dine-in market as: (1) delivery is not replacing dine-in, rather delivery companies are literally creating a completely new market, (2) the cloud kitchen model is catching up resulting in creation of kitchens in hitherto underserved areas and (3) extensive data of customers provides insight into their preferences and behavior, driving better targeting by food delivery companies.

China is a case in point—while the dine-in market is set to grow at a CAGR of 8% over 2016-21E, the online food delivery market is set to grow at a much higher CAGR of 55%, and is expected to be 7X the size of the dine-in market by 2021E. We believe this sharp growth is not only driven by increase in consumer demand, but also extreme convenience provided by food delivery companies at reasonable costs across major cities.

#### Exhibit 1: Food consumption enabled by delivery companies has significantly outpaced in-store restaurant dining market in China

Comparison of in-store dining and delivery market in China, March fiscal year-ends (RMB bn)

	2016	2017	2018E	2019E	2020E	2021E	2016-21 CAGR (%)
In-store dining	106	116	126	135	145	154	8
On-demand food delivery	126	305	479	662	872	1,117	55
Food delivery: in-store dining (X)	1.2	2.6	3.8	4.9	6.0	7.3	

Source: Meituan Dianping, Kotak Institutional Equities

The Indian delivery ecosystem is scaling up rapidly, with the current order run-rate pegged at 65 mn monthly orders—a sharp growth from 15 mn orders in March 2018. This growth has been primarily driven by Swiggy and Zomato, which are currently the two largest food delivery companies. Foodpanda and UberEats are also scaling up operations rapidly.

A key driver of further scale-up of these businesses is availability of capital. We believe at current scale and commission rates, these companies are making operating losses. They are also spending on customer acquisition, in order to grow their target market.

Growth in urban internet users, sustained deployment of funds by food delivery companies, as well as increased ordering frequencies by users can potentially drive a 5X increase in revenues of these companies in the next five years. In order to prepare a December 2021 estimate, we assume: (1) a substantial increase in user base and ordering frequencies, (2) an increase in commission rates as user gets charged directly for delivery and other services and (3) AOVs to decline over the same period as smaller cities contribute more to the delivery mix.

#### Exhibit 2: Revenues for food delivery companies can grow 6X in the next 5 years

Estimation of Indian food delivery market size, March fiscal year-ends, 2018, 2023E

	Dec-18	Dec-21
Number of internet users ordering food online (mn)	15	50
Number of orders placed in a month by an internet user (#)	4	8
Total number of food delivery orders (mn)	60	400
Average order value (Rs)	250	200
Estimated food delivery GMV - annualized (Rs bn)	180	960
Estimated food delivery GMV - annualized (US\$ bn)	2.6	13.7
Average commission rate (%)	15	20
Revenues of food delivery companies (US\$ mn)	386	2,743

Source: TRAI, IAMAI, Industry discussions, Kotak Institutional Equities estimates

### Delivery companies—scaling rapidly beyond metros

All delivery companies started their operations in metros such as Bangalore and Delhi, but have now scaled to a lot more cities. Delivery companies have expanded to 100+ cities; we estimate that top-10 cities would be contributing ~80% of volumes. At an industry size of 65 mn orders, this implies that metro cities are at a run-rate of 48-50 mn monthly orders. We believe this number can keep improving, while Tier-II/III cities will catch up as eat-out options remain limited and new order-in infrastructure gets created.

We believe food delivery volume sizing is more amenable to comparison with China than other e-commerce categories such as e-tail, as food is a key staple in any consumer's basket compared to the more discretionary nature of products sold by e-tailers.

### Demand for food delivery may drive an increase in number of eateries

India's restaurant landscape is fairly underdeveloped—Meituan has estimated the total number of restaurants in China at 8 mn, of which 25% are online—implying 2 mn restaurants have basic facilities such as phone and internet connectivity and can thus be termed 'serviceable'. Industry discussions reveal that India has only 0.2-0.3 mn organized restaurants. India has many more eateries, which are temporary in nature without a permanent phone number and address, and hence may not necessarily contribute to the home delivery market. Hence, for similar populations, China has a 7-10X higher restaurant availability on a per capita basis compared to India. Some of this difference in scale is understandable given differences in incomes and food preferences. However, we do believe that for the delivery business in India to sustain the current growth momentum, supply side will become a constraint, particularly in Tier-II/III cities. We thus expect food delivery companies to invest significantly in cloud kitchens (delivery only kitchens with no store-front). Extensive availability of consumer data on acceptable price points, cuisine and volumes can drive setting up of more relevant kitchens in a locality. This can also be a positive for companies such as Freshmenu and Faasos, which are investing in their cuisine and food brands. Established brands such as Dominos', McDonalds, already partner with delivery companies.

### Scale may drive a continuous improvement in unit economics in mature cities

Our discussions with industry participants reveal that the current focus is on expanding the size of the delivery market by rapidly adding restaurants and customers on the platform. To enable this, these platforms are not shying away from doling out discounts to win over customers. These companies are taking long-term bets on ordering growth, change in customer behavior and emergence of new suppliers and food brands to drive GMV growth.

**Revenues.** Revenues of delivery companies comprise commissions charged from restaurants, and increasingly a delivery fee/packaging fee charged from customers as well. Companies are also launching subscription customers to lock-in customers—for instance, Swiggy has launched Swiggy Super, a membership program permitting customers unlimited free deliveries, for subscription prices ranging from ₹49/month to ₹129/quarter. Our interactions with food companies and restaurants reveal that: (1) delivery companies charge 15-20% of AOV as commission and (2) most restaurants tie-up with multiple delivery companies as every incremental order for the eatery is beneficial given typically high gross margins in the food business. Assuming ₹250 as the AOV, and 15-20% commissions, we reckon delivery companies earn ₹38-50/order. Adding certain additional amount earned from customers, these companies may be making ₹50-60 per order on an average, not adjusted for discounts/cash-backs.

Zomato trailed Swiggy in revenues per order in FY2018—we believe this can be attributed to low commissions charged to restaurants (it charged zero commissions to ~70% of its restaurant partners in September 2017), when it seriously began scaling up its food delivery business. This has changed subsequently, though would have still impacted FY2018 take rates. Further, Zomato would have still had a decent proportion of restaurant delivered orders in FY2018, which resulted in lower revenues per order.

**Exhibit 3: Food delivery companies earned Rs40-70 per order in FY2018**

Comparison of revenue per order earned by delivery companies, March fiscal year-end, 2018

	Zomato	Swiggy
Food delivery revenues (Rs mn)	1,399	4,205
Estimated orders delivered (mn)	37	59
Revenue per order (Rs)	38	71

Source: Company, Kotak Institutional Equities

**Exhibit 4: Revenue per order is lower for restaurants-delivered orders**

Comparison of revenues earned per order for different delivery scenarios

	Delivered by restaurant partner	Delivered by third-party logistics partner
Number of orders delivered per month (mn)	2.8	0.2
Proportion of orders (%)	93.0	7.0
Per order		
AOV (Rs)	450	300
Take rate/ commission - (1) (%)	7	10
Delivery fee - (2) (Rs)	0	50
Total commission (Rs)	32	80

Source: Zomato, Kotak Institutional Equities

**Exhibit 5: Proportion of orders delivered by restaurants has fallen dramatically for Zomato**

Metrics on food delivery business disclosed by Zomato

	Jan-18	Oct-18
Monthly order run-rate (mn)	3.5	21.0
Proportion of orders fulfilled by Zomato's delivery network (%)	26	90

Source: Company, Kotak Institutional Equities

We believe AOVs for the industry are set to fall, as delivery companies target: (1) Tier-II/III cities where AOVs are typically low, (2) non-peak timings and meals such as breakfast, snacks, etc. which are lower AOVs, and (3) the more marginal customer.

In such a situation, we expect delivery companies to steadily increase take rates, possibly up to 25%, as well as charge the user up to ₹20 per order to ensure revenues per order sustain at levels similar to those in FY2018 for Swiggy.

**Exhibit 6: Higher take rates and other revenues required to sustain revenues per order**

Estimated components of total revenues per order, March fiscal year-ends

	2018E	2021E
AOV (Rs per order)	300	200
Commission rate (%)	20	25
Commission per order (Rs)	60	50
Other revenue (Rs)	10	20
<b>Total revenue per order (Rs)</b>	<b>70</b>	<b>70</b>

Source: Company, Kotak Institutional Equities

**Costs.** From a cost perspective, delivery cost is a key focus area, especially in older and more mature markets. Food delivery aggregators now employ 100,000+ delivery personnel (riders) in 70-100 cities. Due to the rapid expansion of delivery fleet, salaries commanded by riders have increased meaningfully. Even in non-metro cities such as Nashik, salaries of ₹20,000-30,000 per month are being offered by hiring agencies.

**Exhibit 7: Delivery personnel are being offered Rs25,000-30,000 a month by food delivery companies**  
Monthly salaries offered to food delivery personnel, December 2018

City	Monthly salary for full time rider
Kolkata	Rs 25,000
Chennai	Rs12,500 salary + Rs10,000 fuel allowance
Nashik	Rs20,000-30,000
Mumbai	Rs65/order including incentives

Source: Company websites, Job portals, Kotak Institutional Equities

The largest cost component is the cost of last-mile delivery. We believe this is the cost item that food delivery companies would seek to bring down, primarily by having the same delivery rider delivering higher number of orders a day. We estimate the current last-mile delivery cost at ₹70-75 per order—this can fall fairly dramatically as rider utilization improves. Improved utilization can more than offset potential increases in rider salaries.

**Exhibit 8: Last-mile order delivery cost is ~Rs70-75**  
Estimated order delivery costs for Tier-1 and Tier-2 cities

	Tier-I city	Tier-II city
Monthly salary paid to food delivery rider (Rs)	22,000	15,000
Number of orders delivered per day (#)	10	7
Direct rider cost per order (Rs)	73	71

Source: Company, Kotak Institutional Equities

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**Exhibit 9: Higher rider utilization can yield sharply better economics**  
Sensitivity of order delivery cost to rider salary and utilization

Monthly salary of a rider (Rs)	Number of orders delivered per day (#)				
	5	10	15	20	25
17,000	113	57	38	28	23
19,500	130	65	43	33	26
22,000	147	73	49	37	29
24,500	163	82	54	41	33
27,000	180	90	60	45	36

Source: Company, Kotak Institutional Equities

Average order values (AOVs), commission rates, variable operating costs (rider cost + communication and tech cost) as well as offers and discounts are key drivers of unit economics. Based on FY2018 financials of Swiggy and Zomato, we believe: (1) revenue per order does not cover for variable costs of delivery (payouts to delivery personnel + payment gateway cost + communication and tech cost) and (2) customer acquisition costs are fairly steep. Over a period of time, once the 'land grab' period subsides, we believe these companies would seek to improve profitability by: (1) charging extra for services (some of the aggregators have already started levying additional delivery and packing charges), (2) optimizing delivery costs as order densities improve and customer ordering behavior gets documented better and (3) diversifying into adjacent higher-margin businesses.

Assuming the current monthly delivery run-rate of 65 mn orders, we believe the delivery companies would be incurring ~US\$32 mn in monthly operating cash burn. Discounts, advertising and promotional expenses would be additional.

Interestingly, when we tried to order the same set of products from the same company (Freshmenu) on different portals (Swiggy, Zomato, Freshmenu), we arrived at different order values from all three portals. Both Swiggy and Freshmenu offered coupons, while all three platforms charged between ₹25-35 of packaging + delivery charges.

Exhibit 10: Food companies and aggregators have begun charging for delivery, though significant price variation exists between portals  
Comparison of order cost on different platforms

Swiggy	Zomato	Freshmenu
<p><b>FreshMenu</b> Lower Parel Worli</p> <p>Creamy Pepper Fusilli ₹200</p> <p>Achari Paneer Tikka Wrap ₹120</p> <p>Any suggestions? We will pass it on...</p> <p>Apply Coupon</p> <p>Don't Pay Delivery Fee On any order above ₹99 <b>GET SUPER</b></p> <p>Item Total ₹320.00 Offers Discount -₹128.00 Restaurant Packaging Charges ₹15.00 GST ₹9.60</p> <p>Delivery Charges ₹20.00</p> <p><b>TO PAY ₹237</b></p> <p>You have saved ₹128 on the bill</p>	<p><b>Your Order</b></p> <p>Achari Paneer Tikka Wrap 1 × ₹120.00 ₹120.00</p> <p>Creamy Pepper Fusilli 1 × ₹200.00 ₹200.00</p> <p>Subtotal ₹320.00 Delivery Charge ₹15.00 Packaging Charge ₹16.00 Taxes ₹16.80</p> <p><b>Total ₹367.80</b></p>	<p>Creamy Pepper Fusilli ₹149 ₹200</p> <p>Achari Paneer Tikka Wrap ₹99 ₹120</p> <p><b>Fresh CLUB 30 Days</b> Join Club to get minimum 10% OFF &amp; FREE DELIVERY for 1 month ₹49 <b>Add</b></p> <p><b>FRESHPASS</b> Save upto 23% extra with each order. <b>Know More</b></p> <p>Check available coupons</p> <p>Item Price ₹248.00 Packaging Fee + ₹15.00 Delivery Fee + ₹10.00 GST (5%) + ₹13.65 CGST (2.5%) ₹6.83 SGST (2.5%) ₹6.83</p> <p><b>Payable ₹287.00</b></p>

Source: Websites of Swiggy, Zomato, Freshmenu (data retrieved on January 9, 2019), Kotak Institutional Equities

Exhibit 11: Food delivery companies are pumping in ~US\$30 mn a month into their business  
Estimated operating cash burn incurred by food delivery companies

Total monthly orders (mn)	65
Per order revenue	(Rs)
Average order value	300
Average commission (%)	15
Other revenue	10
Revenue per order - (1)	55
Per order variable cost	(Rs)
Payments made to delivery rider	70
Other variable operating expense	20
Total variable expense per order - (2)	90
Average loss incurred per order = (1) - (2)	(35)
Estimated monthly operating cash burn (Rs mn)	2,275
Estimated monthly operating cash burn (US\$ mn)	32

Notes:

- (a) The above cash burn computation does not include costs of cash-back/discounts incurred by aggregators.  
(b) These are indicative average unit economics. Economics for denser metro cities would be more favorable.

Source: Company, Kotak Institutional Equities

### Indian food delivery landscape: multiple delivery and food brand companies driving strong growth

India's food delivery companies are quickly ramping up operations, with Zomato and Swiggy emerging as leading delivery companies, and UberEats and Foodpanda also joining the fray. Further, these delivery companies are also necessitating greater investments into food kitchens, with brands such as Freshmenu and Faasos scaling up fairly quickly.

#### Exhibit 12: Swiggy and Zomato are the largest delivery companies in India

Snapshot of key Indian food-tech companies

Type of business	Funds raised (US\$ mn)	Key investors	App downloads on Google Play (mn)	No. of cities present in (#)	FY2018 revenues (US\$ mn)	Estimated FY2018 orders delivered (mn)	Estimated current monthly order run-rate (mn)
Swiggy	1,471	Tencent, Naspers, DST Global, Meituan Dianping	10 mn +	65	69	59	25
Zomato	617	Alibaba, InfoEdge, Sequoia Capital India, Vy Capital, Temasek	10 mn +	100+	72	37	20-25
Foodpanda	na	Ola (ANI Technologies)	10 mn +	54	10	11	5
UberEats	na	Uber Inc.	na	28	na	na	na
Faasos	63	Sequoia Capital India, Sistema Asia Fund, Lightbox, Ru-Net Holdings, Evolve India	1 mn +	15	23	4	1.0
Freshmenu	22	Lightspeed Ventures, Zodius Capital	1 mn +	4	19	3	0.5
Box 8	12	Mayfield, Trifecta Capital	1 mn +	4	na		

Notes:

(a) Zomato's revenue figures are consolidated and include its international revenues.

Source: Venture Intelligence, company websites, MCA, Google Play, Industry discussions, Kotak Institutional Equities

We focus below on the different strategies these players have adopted as well as their reported financials.

#### Zomato—cornering a larger chunk of the food value chain

**Zomato.** Zomato started off as a restaurant advertising cum user review website. It also ventured into services such as table booking, restaurant PoS before eventually entering the food delivery space. Within food delivery, the company focused first on restaurant assisted food delivery, but later ventured into having its own delivery fleet to scale this business faster. Zomato intends to position itself across all aspects of the restaurant value chain, whether eat-in, or order-in. For this the company has several products such as: (1) **Zomato Gold.** This enables the customer to get one complementary dish or drink on eating out at select restaurants. Customers need to purchase Zomato Gold membership for an annual fee. This is valid only for dining in at restaurants, and not delivery. Per Zomato, the cost of the free food item provided to customers is borne fully by the restaurant; Gold helps improve footfalls as well as loyalty for the said restaurant. For instance, Mumbai has ~1,500 restaurants which have tied-up with Zomato Gold. We believe Zomato would continue to tie-up with more restaurants as its membership increases. (2) **Zomato Hygiene Ratings and Hyperpure.** In a bid to help customers decide on their food options, Zomato provides hygiene ratings in a few cities in India and Australia. Further, Zomato is also scaling up Hyperpure, its B2B restaurant ingredient supply chain business. (3) **Food delivery.** Albeit a late entrant, Zomato has scaled its delivery business to 100+ cities in a short period of time, and currently employs ~100,000 riders (monthly active riders). (4) **Zomaland.** A funfair concept comprising food and carnival-style games, to be launched in FY2019 in Delhi, Pune and Bangalore.

Overall, Zomato has consistently sought to increase the number of segments it is present in to capture a larger revenue pie of the food value chain. This will solve the problem of relatively lower growth in the advertising business; multiple products will also help improve stickiness of restaurants to its platform.

Zomato has also made acquisitions from time to time in order to improve its offering in segments such as delivery.

**Runnr.** Zomato acquired Runnr, a last-mile delivery company in September 2017. Runnr had a fleet of 1,500 riders at the time of acquisition. Runnr enabled Zomato to quickly ramp-up its own delivery fleet, in order to compete with Swiggy, which was the first mover in the food delivery segment.

**Tinmen.** This is Zomato's extension into the own kitchen model. Tinmen is a Hyderabad-based company which at the time of acquisition (also September 2017) was delivering ~30,000 orders a month from its own kitchens, with a focus on home-style meals. Zomato would use this model to expand with a similar offering in other cities also.

**Tonguestun.** Tonguestun is a Bangalore-based food aggregator for office canteens. At the time of the acquisition in September 2018, it worked with 1,500 offices and had 1,000 food providers on its platform.

**TechEagle Innovations.** Zomato recently (in December 2018) acquired TechEagle Innovations, which works exclusively on drone technology. The startup will help in creating a hub-to-hub delivery network powered by hybrid multi-rotor drones. Zomato envisages drone delivery as an important area of investment to enable automated last-mile delivery of food.

**Exhibit 13: Food delivery contributed 30% of revenues in FY2018**  
Key financials and operating metrics of Zomato, March fiscal year-ends, 2016-18 (Rs mn)

	2016	2017	2018
<b>Zomato (consolidated)</b>			
<b>Key financials</b>			
Revenues	1,757	3,323	4,664
Employee benefit expense	—	(2,869)	(2,905)
Advertising and promotion expense	—	(234)	(815)
Other expenses	—	(1,636)	(1,782)
Total expenses	—	(4,739)	(5,502)
EBITDA	(4,410)	(1,416)	(838)
Other income		671	187
Depreciation expense		(1,109)	(160)
Finance costs		(160)	(252)
PBT		(2,014)	(1,063)
<b>Revenue split by geography (Rs mn)</b>			
India	—	1,683	2,978
UAE	—	745	1,117
Rest of the world	—	894	825
Elimination	—	—	(257)
Total	—	3,323	4,664
<b>Revenue split by business segment (Rs mn)</b>			
Advertising sales revenue	1,685	2,476	2,874
Food delivery	72	586	1,399
Others	—	261	391
Total	1,757	3,323	4,664
<b>Estimated delivery run-rate</b>			
Food delivery revenue (Rs mn)	72	586	1,399
Average order value (Rs)	430	430	400
Average commission earned	9	9	10
Average commission per order (Rs)	37	37	38
Implied number of orders delivered (mn)	2	16	37

Source: Company, RoC, Tofler, Kotak Institutional Equities

**Exhibit 14: Delivery run-rate scaled dramatically in CY2018**

Data on delivery business disclosed by Zomato in October 2019 and implied metrics

	Jan-18	Oct-18
New users acquired per month (mn)	0.2	2.4
Number of cities present (#)	15	38
Number of restaurants on delivery platform	28,000	54,000
Monthly order run-rate (mn)	3.5	21.0
Proportion of orders fulfilled by Zomato's delivery network (%)	26	90
Number of own delivery executives	5,400	74,000
Average time to deliver an order (minutes)	39	33
Annualized GMV (US\$ bn)	0.21	1.00
Contribution of delivery to overall revenue (%)	35	65
<b>Other conclusions from the data</b>		
Implied AOV (Rs)	350	278
Delivery take rate (%)		17
Commission per order (Rs)		47
Own order run-rate per month (mn)	0.9	18.9
Orders delivered per delivery executive per day (#)	5.6	8.5
Assumed monthly compensation paid to a delivery executive (Rs)		18,000
Delivery executive cost per delivery (Rs)		70
Other variable cost per delivery (Rs)		12
Total variable cost per delivery (Rs)		82
Net margin per delivery (Rs)		(35)

Source: Zomato Blog, Kotak Institutional Equities estimates

**Swiggy—the execution engine**

Swiggy has emerged as one of India's largest food delivery companies, with operations in ~60 cities, and estimated monthly order run-rate of ~25 mn. While Swiggy entered the online food market later than Zomato, it pioneered food delivery in India. It has always delivered food using its own fleet (unlike Zomato which earlier relied on restaurant's own fleet) to drive customer experience as well as volumes (it allows only Domino's to deliver on its own). Over a period of time it has launched several concepts such as: (1) Swiggy Pop—this makes a specially curated menu for meals-for-one from select restaurants within a specified local area, (2) Swiggy Access—this provides access to select restaurant brands to functional kitchens situated at convenient locations within the city, (3) Swiggy Super—loyalty program offering free delivery and other exclusive offers to members, (4) The Bowl Company—cloud kitchen offering its own brand of food.

Swiggy's revenues have scaled substantially in the past two years to ₹4.4 bn in FY2018. As the first mover, we believed it earned decent commissions in FY2018 as it also began charging customers for deliveries. Revenue from customers comprised 19% of its revenues in FY2018. Scale-up in orders continues to be healthy—from an average of 5 mn orders a month delivered in FY2018, the company is currently delivering ~25 mn orders a month. In order to bolster its delivery fleet, Swiggy acquired Scootsy, an aggregator of premium listings.

**Shaping future growth strategy—Swiggy Dash and other initiatives**

Future growth strategy is simple—increase the number of transacting customers on platform, increase ordering frequencies (by continuously improving restaurant assortment, offering reasonable pricing and potentially targeting home style food) and geographic expansion.

In order to improve rider utilization and drive improved unit economics, we believe Swiggy is open to launching hyperlocal delivery services for other consumption categories such as medicines, groceries also (Swiggy Dash), which could potentially widen Swiggy's scope of delivery from food to a host of other high usage frequency categories.

**Exhibit 15: Revenues saw a steep increase in FY2018 driven by higher delivery volumes**

Key financials and operating metrics of Swiggy (Bundl Technologies), March fiscal year-ends, 2016-18 (Rs mn)

	2016	2017	2018
<b>Key financials</b>			
Revenues	201	1,331	4,420
Employee benefit expense	(543)	(922)	(1,908)
Advertising and promotion expense	(254)	(526)	(1,549)
Other expenses	(770)	(1,997)	(5,067)
Total expenses	(1,567)	(3,445)	(8,523)
EBITDA	(1,366)	(2,115)	(4,103)
Other income	35	126	263
Depreciation expense	(41)	(45)	(71)
Finance costs	—	(18)	(63)
PBT	(1,372)	(2,052)	(3,973)
<b>Revenue split by business segment (Rs mn)</b>			
Delivery commission from restaurants	166	1,100	3,367
Delivery charge from customers	35	209	838
Others	1	22	215
Total	201	1,331	4,420
<b>Estimated delivery run-rate</b>			
Food delivery revenue (Rs mn)	166	1,100	3,367
Average order value (Rs)	300	300	300
Average commission earned (%)	14	15	19
Average commission per order (Rs)	42	45	57
Implied number of orders delivered (mn)	4	24	59

Source: MCA, Tofler, Industry discussions, Kotak Institutional Equities

**UberEats and Foodpanda—jumping in the fray**

UberEats, funded by its parent, is seeking to make a mark in this frequency transaction category and has expanded rapidly to 37 cities. UberEats recently struck a deal with Café Coffee Day to exclusively deliver from the latter's 1,700 cafes and kitchens. The menu would be decided basis customer preferences local to the area, with the possibility of marketing the food under various brands.

Foodpanda has restarted operations post its sale by DeliveryHero to Ola (ANI Technologies). Per media reports, Foodpanda is looking to invest ₹4 bn and is looking to scale up operations again. Like Uber's interest in UberEats, Ola has claimed that it can target its existing user base for Foodpanda's delivery business.

**Exhibit 16: Foodpanda has lagged its peers in overall revenues and delivery run-rates**  
Key financials and operating metrics of Foodpanda, March fiscal year-ends, 2015-17 (Rs mn)

	2015	2016	2017
<b>Key financials</b>			
Revenues	46	377	614
Employee benefit expense	(64)	(355)	(310)
Advertising and promotion expense	(291)	(840)	(178)
Other expenses	(47)	(566)	(552)
Total expenses	(403)	(1,760)	(1,040)
EBITDA	(357)	(1,384)	(426)
Other income	1	1	7
Depreciation expense	(2)	(32)	(24)
Finance costs	—	(0)	(0)
PBT	(358)	(1,415)	(443)
<b>Estimated delivery run-rate</b>			
Food delivery revenue (Rs mn)	46	377	614
Average order value (Rs)	300	300	300
Average commission earned	14	15	19
Average commission per order (Rs)	42	45	57
Implied number of orders delivered (mn)	1	8	11

Source: MCA, Industry discussions, Kotak Institutional Equities

### Supply can create its own demand, leading to more food brands in India

We believe the delivery companies are creating a fair amount of demand for ordering in, in a category of universal consumption. As these companies ramp-up, they will spawn more restaurants, as the current stock of 0.2-0.3 mn restaurants will soon become insufficient to satisfy customer needs.

Pizza, as a category, remains a dominant one on food delivery platforms. We note that online is now a large channel for food brands—Jubilant has publicly disclosed that online is now 68% of its delivery sales and this proportion has been steadily rising over the past few quarters. Food companies such as Faasos and Freshmenu are also steadily scaling up—they operate predominantly on a cloud kitchen model (no dine-in), relying on their own and aggregators' delivery network to deliver to customers.

Assuming ₹300 AOV for both Freshmenu and Faasos in FY2018, we believe these companies together would have fulfilled 11-12 mn orders, accounting for 12-13% of total orders fulfilled by food delivery companies. While this proportion is still small, we see good potential for food brands such as these to grow further. Zomato and Swiggy are anyway building kitchens to be potentially utilized by such brands which can boost their expansion plans.

Both Faasos and Freshmenu are currently lossmaking, as they continue to expand in new geographies where kitchen economics may take time to stabilize. Over time, we believe they will keep fine-tuning their strategy to cater to a wider set of consumers as well as improving store economics.

**Freshmenu.** Value proposition of freshly cooked food, with some healthy options. With operations currently in Bangalore, Mumbai and Gurgaon, Freshmenu has successfully targeted both office goers and people at home. Its meals are tailored for one, and the menu keeps changing depending on the season and local demand. Its cuisine is predominantly non-Indian (Chinese, Mexican, Continental), though it has now also begin offering Indian options. All its options are sold under the Freshmenu brand. It does not have dine-in options at its kitchens, and utilizes both its own as well as third-party aggregators' delivery fleet to Future growth strategy involves geographical expansion and improving product assortment to cater to larger number of consumers.

**Exhibit 17: Steady revenue ramp-up driven by higher orders**

Key financials and operating metrics of Freshmenu, March fiscal year-ends, 2016-18 (Rs mn)

	2016	2017	2018
<b>Key financials</b>			
Revenues	317	709	1,223
Purchase of stock-in-trade	(278)	(536)	
Employee benefit expense	(213)	(331)	
Advertising and promotion expense	(51)	(144)	
Other expenses	(129)	(159)	
Total expenses	(671)	(1,170)	
EBITDA	(354)	(461)	
Other income	28	51	
Depreciation expense	(11)	(13)	
Finance costs	—	—	
PBT	(338)	(423)	(438)
<b>Estimated delivery run-rate</b>			
Food revenue (Rs mn)	317	709	1,223
Average order value (Rs)	350	350	350
Implied number of orders delivered (mn)	1	2	3

Source: Company, RoC, Tofler, Kotak Institutional Equities

**Faasos.** It originally sold wraps, with dine-in options at its outlets also. Faasos has since pivoted into the cloud kitchen model, similar to Freshmenu. It sells food under various food brands to cater to a wide audience, and different requirements—working lunch, dinner for family, etc. Its brands include Faasos (wraps), Behrouz (biryani), Oven Story (pizza), Firangi Bake (baked continental), Mandarin Oak (Chinese), Sweet Tooth (dessert). Faasos is looking at automating most jobs inside a kitchen, with a centralized kitchen taking care of recipes, ingredients and final taste of the product. Growth strategy involves launching of new brands in closer coordination with aggregators, improve throughput of new brands from existing kitchens and geographical expansion.

**Exhibit 18: Faaso's order count has been steadily growing**

Key financials and operating metrics of Faasos, March fiscal year-ends, 2016-18 (Rs mn)

	2016	2017	2018
<b>Key financials</b>			
Revenues	619	828	1,468
Purchase of stock-in-trade	—	(445)	(701)
Employee benefit expense	—	(576)	(664)
Advertising and promotion expense	—	(182)	(217)
Other expenses	—	(425)	(559)
Total expenses	—	(1,629)	(2,141)
EBITDA	—	(801)	(673)
Other income	—	63	22
Depreciation expense	—	(66)	(82)
Finance costs	—	(17)	(12)
PBT	(1,110)	(820)	(744)
<b>Estimated delivery run-rate</b>			
Food delivery revenue (Rs mn)	619	828	1,468
Average order value (Rs)	350	350	350
Implied number of orders delivered (mn)	2	2	4

Source: Company, RoC, Tofler, Kotak Institutional Equities

### Global examples: food delivery is in a ramp-up phase

The food delivery industry is growing at a rapid pace in other regions also, particularly China.

Unlike e-tail which ramped up meaningfully in late 1990s in the US and early 2000s in China, food delivery is still in a ramp-up phase in these countries. Grubhub, the prominent food delivery company in the US, reported average monthly deliveries of 38 mn in 3QCY18, with positive unit economics. Chinese food delivery market is highly competitive with Tencent-backed Meituan Dianping competing with Alibaba-backed Ele.me. Meituan Dianping reported ~600 mn monthly orders in 3QCY18, compared to Indian delivery market size of ~65 mn monthly orders in December 2018. Unit economics in China are still to stabilize, as these two large players fight it out among themselves to attain market leadership. Intense competition between these two companies has resulted in Meituan Dianping posting adjusted EBITDA loss of RMB1.2 bn in 3QCY18.

We looked at the various strategies deployed by these delivery companies. Each of them has struck partnerships and ventured into adjacent businesses to expand market opportunity and achieve better unit economics.

**Grubhub.** Grubhub is a US-based food delivery company which delivered 38 mn orders in 3QCY18. Grubhub has been rapidly expanding in Tier-II, Tier-III cities in the US and currently has operations in 1,700 cities.

In February 2018, Grubhub entered into an agreement with Yum Foods (owner of KFC, Taco Bell and Pizza Hut chain of restaurants). Under the agreement, Grubhub provides support in the US for the KFC and Taco Bell branded online delivery channels, along with access to its online ordering platform, logistics and last-mile support for delivery orders, and point-of-sale integration to streamline operations. KFC, Taco Bell and GrubHub also engage in joint marketing initiatives in order to boost online orders for these brands. We believe GrubHub earned an important food brand as part of this deal which made it easier to expand to smaller cities and towns in the US. We note that GRUB clocked an average of 10 mn orders a month in CY2017; both Zomato and Swiggy have already surpassed this count currently. Further, the key difference between US and Asia is the relatively large restaurant dine-in market and hence the late adoption of home delivery of food. GRUB has generated healthy 27-29% adjusted EBITDA margins in CY2015-17 primarily on account of healthy AOVs (which are ~7X that of India) and reasonable commissions. Further, limited competition has led to relatively limited spends on advertising and promotion expenses also, unlike India where cut throat competition among well-funded players has led to escalation in these expenses.

**Exhibit 19: Grubhub has generated healthy 27-29% EBITDA margins in the past 3 years**  
Key financial and operating metrics of Grubhub, December calendar year-ends, 2013-17

	2013	2014	2015	2016	2017	9MCY18
Active diners (mn)	3.4	5.0	6.7	8.2	14.5	16.4
Daily average grubs (#)	107,900	182,800	227,100	274,800	334,000	425,300
Gross food sales (US\$ mn)	1,015	1,787	2,354	2,998	3,784	3,680
AOV (US\$)	26	27	28	30	31	32.05
Reported revenues (US\$ mn)			362	493	683	720
Commission rate (%)			15	16	18	20
Adjusted EBITDA			105	145	184	192
Adjusted EBITDA margin (%)			29	29	27	27
Orders per diner (#)			12	12	8	9

Source: Company, Kotak Institutional Equities

**Meituan Dianping.** Meituan Dianping (Meituan) is a diversified O2O (offline to online) company which provides services such as food delivery, grocery and medicine delivery, ticket booking, ride sharing, etc. on its platform. Meituan's proposition is to take advantage of high frequency transactions such as food delivery, and monetize users better by offering them higher-margin categories such as rail and air tickets.

The scale of the Chinese market is large—in 3QCY18, Meituan delivered ~600 mn orders a month, compared to 65 mn a month in India in December 2018—a large difference in scale. The actual size of the Chinese market would be even higher as there are other competitors present. Given the high frequency transaction nature of customers as well as convenience offered by aggregators, Indian delivery companies would have a China-style market size in mind, in our view. Chinese market is now fairly deep, with aggregators servicing ~2,800 cities; by comparison, Indian delivery companies service 100-120 companies.

The Chinese delivery market is intensely competitive, with both Meituan and Ele.me competing with each other to gain share. Consequently, it is spending heavily on customer acquisition such as advertising, promotions and discounts. It posted positive unit economics in its food delivery business in CY2017, though still posted negative net margin per order owing to high sales and marketing expense (usually promotions and discounts).

**Exhibit 20: Meituan's food delivery business scaling up rapidly, with improving economics**  
Meituan's food delivery economics, December calendar year-end, 2017

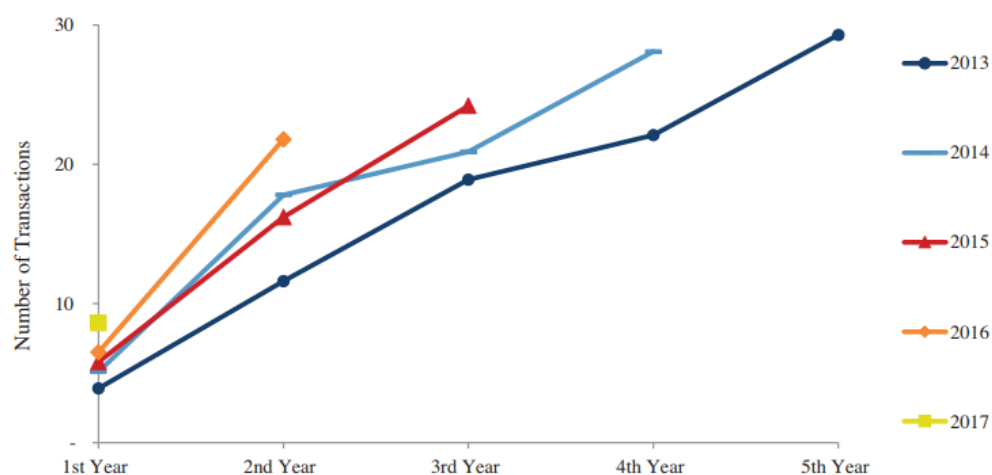
Number of transactions (mn)	4,090
Average transaction value (RMB)	42
Monetization rate (%)	12
Commission per order (RMB)	5.1
Opex per order	
-Delivery rider costs	4.5
-Other operating costs	0.2
Gross profit per order	0.4
Sales and marketing expense	1.1
Net margin per order	(0.7)

Source: Company, Kotak Institutional Equities

We believe at least some of the sales and marketing expense is towards customer retention, and driving frequency of use by offering cash-backs and discounts. Perhaps some of these expenses are driving higher ordering frequencies.

Data shared by Meituan shows that users who have spent 2+ years on its platform are transacting 20+ times a year on its platform. First time users who joined the platform in 2017 transacted ~8-9 times within their first year of joining, implying decent repeat buying behavior.

**Exhibit 21: Early user cohorts transact 20-30 times annually on Meituan**  
Number of transactions carried out by different user cohorts (#)



Source: Meituan Dianping Offer Document, Kotak Institutional Equities

### Valuations—to remain a function of growth for the time being

Valuations of Swiggy and Zomato have seen several upward revisions over the past few months, driven by steep growth in orders as well as multiple equity funding rounds. In December 2018, Swiggy announced a large funding round of US\$1 bn, in order to fund its expansion into new geographies and business lines.

#### Exhibit 22: Valuations have gone up, in tandem with strong growth

Details of recent funding raised by Zomato and Swiggy

Company	Funds raised	Date	Valuation	Order run-rate	Investors
	(US\$ mn)		(US\$ bn)	(mn per month)	
Zomato	210	Oct-18	2.0	21.0	Alibaba (Ant Financial)
	200	Feb-18	1.1	3.5	Alibaba (Ant Financial)
Swiggy	1,000	Dec-18	3.3	25.0	Naspers, Tencent, HillHouse Capital, Wellington Management
	210	Jun-18	1.2	na	Naspers, Coatue Management, DST Global, Others
	100	Feb-18	0.7	7-8	Meituan Dianping, Naspers, Others

Source: Zomato Blog, Venture Intelligence, Industry discussions, Kotak Institutional Equities

If one uses a very rough EV/GMV valuation metric to compare the valuations of food delivery companies, it would seem that Swiggy is possibly valued higher than its peers in other geographies. We reckon that the difference could be on account of much faster growth being seen in India, compared to other countries.

#### Exhibit 23: Swiggy's higher valuation multiples hinged on higher future growth prospects

Valuation comparison of food delivery companies

	Meituan Dianping	Delivery Hero	Grubhub	Swiggy
Period	3QCY18	3QCY18	3QCY18	4QCY18
Food delivery orders (mn)	1,785	103	38	75
Yoy growth in orders (%)	48	45	37	279
Monetization rate (%)	14	15	21	15
Food delivery revenue (US\$ mn)	1,719	232	247	40
Total GMV (US\$ bn)	22	2	1	0
Implied annualized GMV (US\$ bn)	90	6	5	1
Market cap./equity value (US\$ bn)	31	8	7	3
<b>EV/GMV (X)</b>	<b>0.4</b>	<b>1.3</b>	<b>1.5</b>	<b>3.1</b>

Notes:

(a) Meituan's GMV is aggregate of food delivery, travel and new initiatives.

Source: Companies, Bloomberg, Venture Intelligence, Kotak Institutional Equities estimates

### Key risks: higher competitive intensity and regulatory pressures

Food delivery is a low entry barrier business. Since food ordering is a high frequency transaction, this business may potentially attract new entrants, both in the delivery as well as kitchens business. While the incumbents have a first mover advantage, potential competition from well-funded players resulting in higher cash burn is a challenge.

Recent regulations put forth by the DIPP (Department of Industrial Policy & Promotion) restrict the way foreign-owned e-tailers have been functioning in India. Any similar restrictions on delivery companies, particularly those that may restrict expansion of their own kitchen business can be a negative. Already, restaurant owners are accusing delivery companies of offering heavy discounts, and should this snowball into something larger, it could potentially attract regulatory scrutiny.

Lastly, food delivery is a manpower-intensive business, requiring a large number of riders. As these companies grow, they will continue to require more riders. Further, each company is facing high attrition, requiring them to pay higher incentives to recruit and retain people. Inability to hire the requisite number of people can be a key challenge for companies.

**JANUARY 22, 2019**
**RESULT**

Coverage view: **Neutral**

Price (₹): **1,407**

Fair Value (₹): **1,225**

BSE-30: **36,445**

**Solid quarter as volume growth accelerates.** APNT reported a healthy quarter with a 20%+ standalone decoratives volume growth and sequential mix improvement. Jump in overheads on account of commissioning of the new plant and weak performance of subsidiaries did lead to a slightly weak margin print but we would not read much into the same. The underlying demand environment has picked up well and this should augur well for ST earnings prognosis in what is now a favorable-RM backdrop. Our EPS forecasts for FY2019-21E see a 2-3% upgrade. REDUCE stays as the stock is fully priced. Raise fair value to ₹1,225 from ₹1,140 factoring in upgrades and rollover.

**Company data and valuation summary**

Asian Paints

Stock data		Forecasts/Valuations			
		2019E	2020E	2021E	
52-week range (Rs) (high,low)	1,491-1,082	EPS (Rs)	24.3	30.5	36.2
Market Cap. (Rs bn)	1,349.2	EPS growth (%)	18.6	25.1	18.9
<b>Shareholding pattern (%)</b>		P/E (X)	57.8	46.2	38.8
Promoters	52.8	Sales (Rs bn)	194.4	227.9	264.3
FIs	14.9	Net profits (Rs bn)	23.4	29.2	34.8
MFs	3.1	EBITDA (Rs bn)	37.4	46.7	54.8
<b>Price performance (%)</b>	<b>1M</b>	<b>3M</b>	<b>12M</b>		
Absolute	1.3	17.2	19.6	EV/EBITDA (X)	35.8
Rel. to BSE-30	(0.6)	9.7	17.5	ROE (%)	26.1
				Div. Yield (%)	0.8

**3QFY19—solid volume-led growth and decent margin performance in view of RM headwinds**

- ▶ **Consolidated financials**—revenues grew 24% yoy to ₹52.9 bn, 3% above our estimate. Gross profit was up 21% yoy; gross margin declined 130 bps yoy and expanded 115 bps qoq to 41%. EBITDA increased 17% yoy to ₹10.4 bn, 2% below our estimate. EBITDA margins declined 120 bps yoy and expanded 280 bps qoq to 19.7% (KIE 20.9%). EBITDA margin was below our estimate due to higher-than-estimated increase in employee costs (+19% yoy partly due to capacity expansion and revaluation of gratuity provision) and higher-than-estimated other expenses (+26% yoy, partly due to higher advertising spends and capacity expansion). Recurring PAT was up 15% yoy to ₹6.3 bn, 8% below our estimate. TTM EPS stood at ₹22.6/share, up 11% yoy.
- ▶ **Standalone financials**—revenues grew 26% yoy to ₹45.4 bn, 4% above our estimate. We estimate 22% growth in decorative paints volumes (management indicated high double-digit growth). Gross profit was up 22% yoy; gross margins declined 150 bps yoy and expanded 125 bps qoq to 42.1%. EBITDA was up 20% yoy to ₹9.85 bn, broadly in line with our estimate. EBITDA margins declined 110 bps yoy and were up 315 bps qoq to 21.7%. Recurring PAT was up 19% yoy to ₹6.3 bn.
- ▶ **Aggregate subsidiary performance (consolidated less standalone)**—aggregate subsidiary performance was weak again with 22% yoy decline in EBITDA, fifth consecutive quarter of yoy decline largely led by weak performance of the international business.

**Raise FY2019-21E EPS estimates by 2-3%; stock fully priced**

We increase our FY2019-21E EPS by 2-3% as we tweak our revenue growth assumptions and bake in lower RM costs given fall in crude price. We note that costs associated with ongoing capacity expansion could keep a check on margin expansion in FY2020E even as we build healthy double-digit volume growth. We revise our DCF-based fair value to ₹1,225 (from ₹1,140). Our fair value estimate bakes in a long-term (23-year) explicit FCF CAGR of 14%+, terminal growth of 6.25% and WACC of 11%. CMP bakes in a stiffer ask rate.

Rohit Chordia

Jaykumar Doshi

Aniket Sethi

### Conference call takeaways

- ▶ **Commentary on demand**—management indicated that demand environment was stable but needs to be monitored in view of upcoming elections. There was no one-off in the strong top line growth in 3QFY19 other than some benefit of festive-season timing shift. The management indicated that growth was broad-based across regions. Saliency of low-value distemper paint was higher in the 3QFY19 versus base quarter but it was lower as compared to 2QFY19. Reduction in GST rate to 18% from 28% could have aided growth marginally as it narrowed the price gap versus unorganized competition. Rural growth exceeded urban growth as is the case, usually, ahead of festive season.
- ▶ **Pricing, RM inflation and margins**—APNT management increased prices by 1.7% in October 2018 (cumulative price increase of 7.3%; first in March, second in May and third hike of 2.35% in October). The management indicated that October and December price increases were not sufficient to fully offset the impact of high RM prices and weak rupee as at Nov 2018 levels. That said, easing of RM price and appreciation of rupee over the past couple of months has improved profitability outlook. The company will take another price increase if RM prices rise again.
- ▶ **Commissioning of new capacities**—first phase of Mysuru plant that was commercially commissioned in September 2018 is progressing well on its stabilizing. The upcoming facility at Vizag will be commissioned in 4QFY19. New facilities would reduce logistics costs and manufacturing costs to some extent.
- ▶ **Capex**— Standalone capex for the year would be ₹10 bn including ₹8 bn pertaining to Mysore and Vizag expansions (no change from previous guidance). Consolidated capex would be ₹12 bn. Capex will fall sharply in FY2020E.
- ▶ **Employee and other costs**—sharp increase in employee costs was pertaining to ongoing capacity expansion, increase in provisioning pertaining to gratuity and unpaid leaves. Other expenses were higher partly due to higher marketing expenses associated with select campaigns and partly due to commissioning on new facility
- ▶ **International business performance**—(1) Ethiopia continued to face challenges pertaining to currency availability for imports, (2) Egypt market continued to be weak due to sluggish economy, (3) Indonesia grew well aided by distribution expansion. Asian Paints added 100 Color Infinity stores this year taking total count to 175, and (4) overall profitability on international business was under pressure as it was difficult for Asian Paints to pass on RM increase by pushing higher prices in several markets given its weak positioning (Asian paints is not a leader in most of the overseas markets it operates in).
- ▶ **Industrial business**—in the industrial business, the automotive coatings JV (PPG-AP), witnessed good growth in the general industrial segment. However, the auto OEM segment witnessed subdued growth on the back of fall in production across auto OEMs. The industrial coatings JV (AP-PPG) continued to grow well led by good performance in the protective coatings—dealer segment and the powder segment. Both the businesses continued to face pressure from rising raw material prices and the price increases implemented in the market have not been enough to recover the margins fully. The management alluded to difficulty and delays in passing on RM costs in the auto segment as automotive OEMs are not doing so well. In other industrial businesses, the company has managed to take price increase to cover RM inflation.
- ▶ **Home improvement**—(1) Sleek (modular kitchen business) accounts for 1.5% of revenues and is growing at a good pace. The management believes that its understanding about the business and market has improved and performance has been healthy notwithstanding weak real estate environment (unlike paints, bulk of demand for

Sleek comes from new home constructions) and (2) Ess Ess (bath fittings) performance continued to be sluggish.

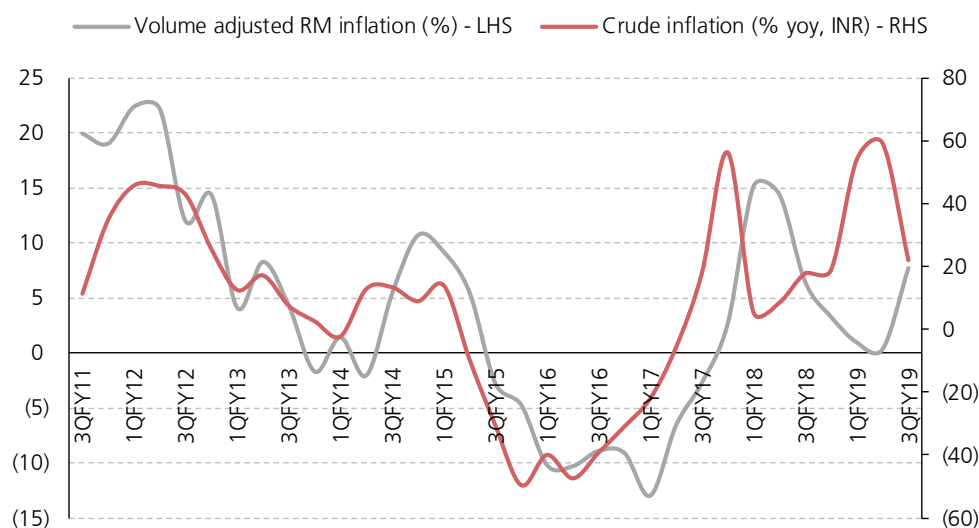
- **Other highlights**—(1) sequential increase in depreciation pertains to commissioning of new facility at Mysore. It will increase further in the March quarter on account of commissioning of Vizag facility, (2) outsourced production accounts for about 25-30% of volumes whereas in-house production accounts for 70-75% of volumes. Asian Paints usually produces low-value products at 3<sup>rd</sup> party facilities and often to save on freight costs. The management expects outsourced production to continue even after upcoming capacity expansion, (3) at present, the company is operating at capacity utilization of 80%, (4) Asian Paints would add about 3,000 dealers in FY2019 taking dealer count to about 65,000, (5) water-based paints account for more than 50% of sales, and (6) performance of the four AP homes is encouraging and the company is planning to add four more by mid FY2020E.

Exhibit 1: Key changes to estimates, Asian Paints, March fiscal year-ends, 2019-21E

	Revised			Earlier			Change (%)		
	2019E	2020E	2021E	2019E	2020E	2021E	2019E	2020E	2021E
Revenues (Rs mn)	194,416	227,929	264,285	191,870	227,570	262,279	1.3	0.2	0.8
Revenue growth (%)	15.6	17.2	16.0	14.0	18.6	15.3			
EBITDA (Rs mn)	37,439	46,746	54,807	36,122	45,226	53,244	3.6	3.4	2.9
EBITDA margin (%)	19.3	20.5	20.7	18.8	19.9	20.3	43 bps	63 bps	43 bps
Net income (Rs mn)	23,351	29,222	34,758	22,978	28,563	33,650	1.6	2.3	3.3
<b>EPS (Rs/share)</b>	<b>24.3</b>	<b>30.5</b>	<b>36.2</b>	<b>24.0</b>	<b>29.8</b>	<b>35.1</b>	<b>1.6</b>	<b>2.3</b>	<b>3.3</b>
<b>Other assumptions</b>									
Gross margin (%)	41.7	42.7	42.8	41.2	42.0	42.3	48 bps	68 bps	48 bps
Volume growth (%)	14.3	14.5	13.5	11.0	14.5	12.0	325 bps	0 bps	150 bps

Source: Kotak Institutional Equities estimates

Exhibit 2: Reported volume-adjusted RM inflation converges with crude inflation in 3QFY19



Source: Company, Bloomberg, Kotak Institutional Equities

Exhibit 3: Interim consolidated results of Asian Paints, March fiscal year-ends (Rs mn)

	3QFY19	3QFY19E	3QFY18	2QFY19	(% change)			9MFY19	9MFY18	(% chg.)
					KIE Est	yoy	qoq			
Net operating revenue	52,940	51,216	42,605	46,391	3	24	14	143,233	123,410	16
Material cost	(31,250)	(30,234)	(24,610)	(27,924)	3	27	12	(84,097)	(71,465)	18
Gross profit	21,690	20,982	17,995	18,467	3	21	17	59,136	51,945	14
Gross margin (%)	41.0	41.0	42.2	39.8	0 bps	-127 bps	116 bps	41.3	42.1	-81 bps
Employee cost	(3,226)	(3,022)	(2,711)	(3,073)	7	19	5	(9,362)	(8,394)	12
Other expenditure	(8,034)	(7,265)	(6,373)	(7,553)	11	26	6	(22,758)	(19,975)	14
Total expenditure	(42,510)	(40,521)	(33,693)	(38,549)	5	26	10	(116,217)	(99,833)	16
EBITDA	10,430	10,695	8,912	7,842	(2)	17	33	27,016	23,577	15
EBITDA margin (%)	19.7	20.9	20.9	16.9	-119 bps	-122 bps	279 bps	18.9	19.1	-25 bps
Other income	452	646	497	633	(30)	(9)	(29)	1,702	1,814	(6)
Interest	(148)	(90)	(92)	(121)	64	61	22	(357)	(259)	38
Depreciation	(1,154)	(970)	(896)	(947)	19	29	22	(3,006)	(2,690)	12
Pretax profits	9,580	10,281	8,420	7,406	(7)	14	29	25,355	22,441	13
Tax	(3,263)	(3,397)	(2,913)	(2,427)	(4)	12	34	(8,460)	(7,533)	12
Recurring PAT	6,317	6,884	5,507	4,979	(8)	15	27	16,895	14,909	13
Extraordinary items	-	-	-	-	-	-	-	-	700	-
Minority interests/share of associates	39	60	40	(52)	(36)	(2)	(175)	(31)	(69)	(54)
Net profit (reported)	6,356	6,944	5,546	4,928	(8)	15	29	16,864	15,540	9
Recurring PAT post MI	6,356	6,944	5,546	4,928	(8)	15	29	16,864	14,840	14
Recurring EPS	6.63	7.24	5.78	5.14	(8)	15	29	17.58	15.47	14
Income tax rate (%)	34.1	33.0	34.6	32.8	101 bps	-54 bps	129 bps	33.4	33.6	-
Costs as a % of net operating revenue										
Material cost	59.0	59.0	57.8	60.2	-1 bps	126 bps	-117 bps	58.7	57.9	80 bps
Employee cost	6.1	5.9	6.4	6.6	19 bps	-27 bps	-53 bps	6.5	6.8	-27 bps
Other expenditure	15.2	14.2	15.0	16.3	99 bps	21 bps	-111 bps	15.9	16.2	-30 bps

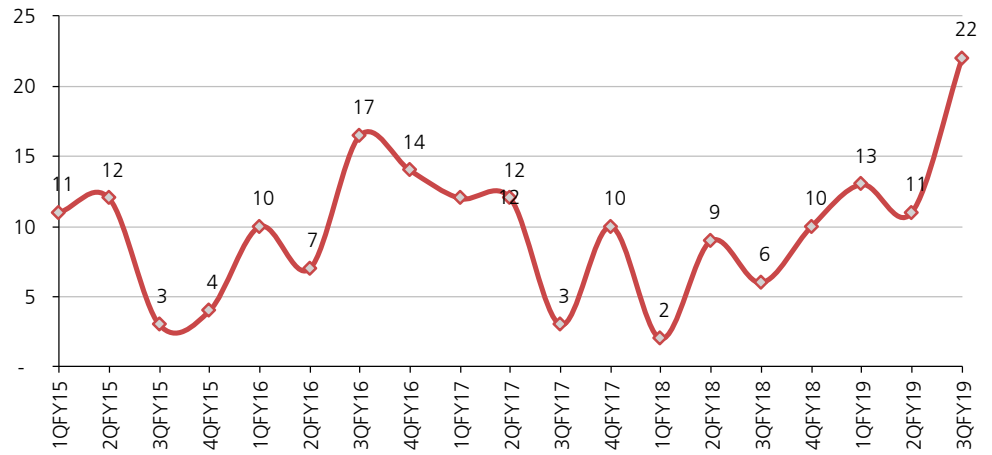
Source: Company, Kotak Institutional Equities

Exhibit 4: Interim standalone results of Asian Paints, March fiscal year-ends (Rs mn)

	3QFY19	3QFY19E	3QFY18	2QFY19	(% change)			9MFY19	9MFY18	(% chg.)
					KIE Est	yoy	qoq			
Net operating revenue	45,361	43,665	35,874	39,142	4	26	16	121,565	103,925	17
Material cost	(26,284)	(25,325)	(20,262)	(23,169)	4	30	13	(69,978)	(59,084)	18
Gross profit	19,076	18,339	15,613	15,973	4	22	19	51,586	44,841	15
Gross margin (%)	42.1	42.0	43.5	40.8	5 bps	-147 bps	124 bps	42.4	43.1	-72 bps
Employee cost	(2,280)	(2,087)	(1,897)	(2,155)	9	20	6	(6,592)	(5,978)	10
Other expenditure	(6,939)	(6,309)	(5,534)	(6,545)	10	25	6	(19,615)	(17,511)	12
Total expenditure	(35,503)	(33,722)	(27,693)	(31,869)	5	28	11	(96,185)	(82,572)	16
EBITDA	9,858	9,943	8,181	7,273	(1)	20	36	25,379	21,353	19
EBITDA margin (%)	21.7	22.8	22.8	18.6	-104 bps	-108 bps	315 bps	20.9	20.5	33 bps
Other income	663	786	684	717	(16)	(3)	(7)	2,068	2,183	(5)
Interest	(87)	(50)	(52)	(66)	74	67	31	(201)	(145)	39
Depreciation	(1,032)	(850)	(781)	(828)	21	32	25	(2,650)	(2,310)	15
Pretax profits	9,402	9,829	8,031	7,096	(4)	17	33	24,597	21,081	17
Tax	(3,092)	(3,244)	(2,742)	(2,281)	(5)	13	36	(8,046)	(7,047)	14
Recurring PAT	6,310	6,586	5,290	4,815	(4)	19	31	16,551	14,034	18
Extraordinary items	-	-	-	-	-	-	-	-	-	-
Net profit (reported)	6,310	6,586	5,290	4,815	(4)	19	31	16,551	14,034	18
Recurring EPS	6.58	6.87	5.51	5.02	(4)	19	31	17.25	14.63	18
Income tax rate (%)	32.9	33.0	34.1	32.1	-11 bps	-125 bps	74 bps	32.7	33.4	-72 bps
Costs as a % of net operating revenues										
Material cost	57.9	58.0	56.5	59.2	-6 bps	146 bps	-125 bps	57.6	56.9	71 bps
Employee cost	5.0	4.8	5.3	5.5	24 bps	-27 bps	-48 bps	5.4	5.8	-33 bps
Other expenditure	15.3	14.4	15.4	16.7	84 bps	-14 bps	-143 bps	16.1	16.8	-72 bps

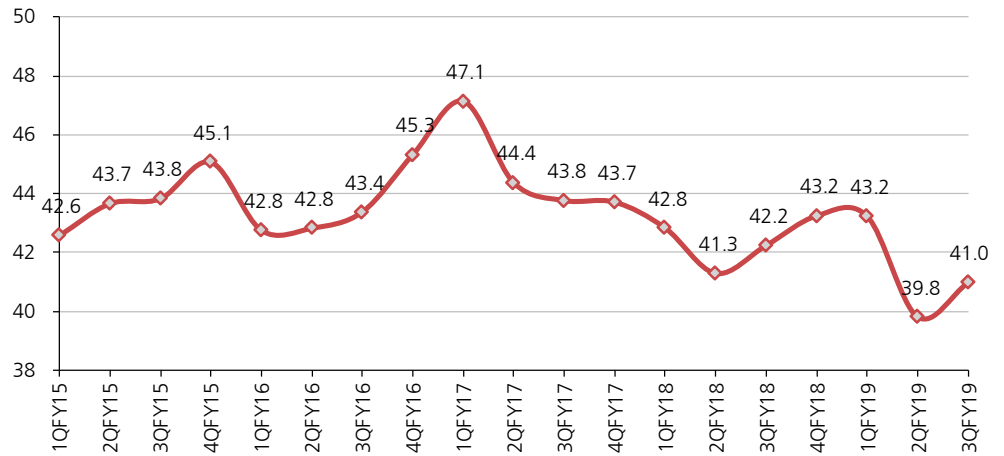
Source: Company, Kotak Institutional Equities

Exhibit 5: APNT delivered 'high double-digit volume growth'; 22%, per our estimate



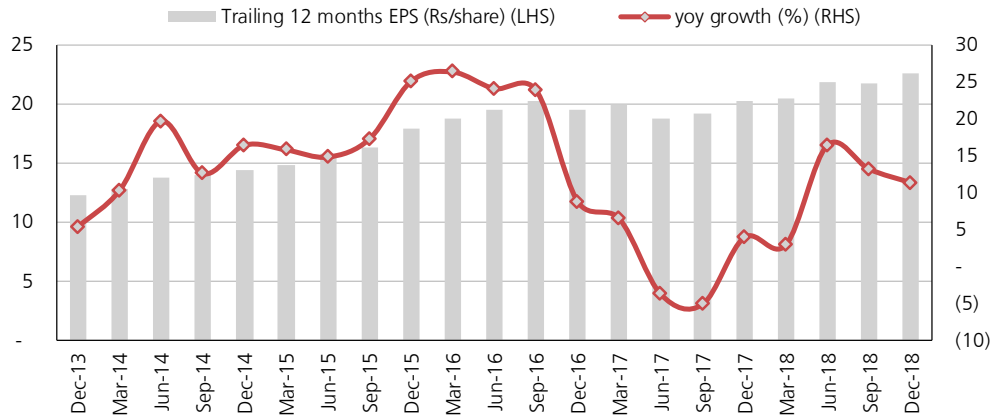
Source: Company, Kotak Institutional Equities

Exhibit 6: Gross margin was down 130 bps yoy due to RM inflation but improved 115 bps qoq



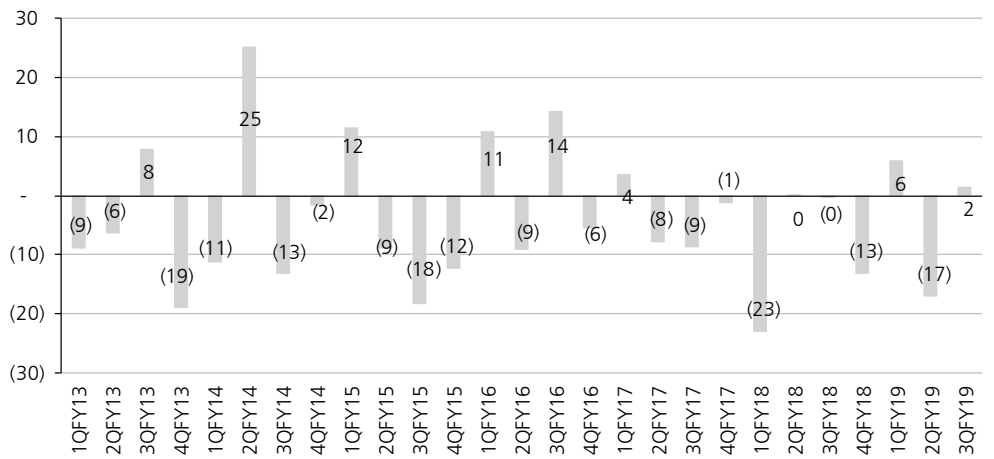
Source: Company, Kotak Institutional Equities

**Exhibit 7: TTM EPS growth stood at 11% yoy**  
TTM EPS growth trend



Source: Company, Kotak Institutional Equities

**Exhibit 8: Recurring PAT was marginally above consensus estimates this quarter**  
Quarterly earnings surprise trend vs consensus estimates



Source: Company, Kotak Institutional Equities

Exhibit 9: Asian Paints: consolidated profit model, balance sheet (as per Ind-AS from 2016), March fiscal year-ends, 2015-21E

	IGAAP			Ind-AS			
	2015	2016	2017E	2018	2019E	2020E	2021E
<b>Profit model (Rs mn)</b>							
Net sales	141,828	142,715	150,620	168,246	194,416	227,929	264,285
EBITDA	22,354	27,692	29,864	31,976	37,439	46,746	54,807
Other income	1,697	2,134	2,624	2,206	2,329	2,762	3,543
Interest	(348)	(407)	(300)	(351)	(445)	(354)	(310)
Depreciation	(2,659)	(2,756)	(3,348)	(3,605)	(4,202)	(4,920)	(5,074)
<b>Pretax profits</b>	<b>21,044</b>	<b>26,663</b>	<b>28,841</b>	<b>30,227</b>	<b>35,120</b>	<b>44,235</b>	<b>52,966</b>
Tax	(6,495)	(8,445)	(9,433)	(10,410)	(11,765)	(15,040)	(18,273)
Minority interest	(322)	(242)	(272)	(128)	(4)	27	65
Extraordinary items	(276)	(525)	259	700	—	—	—
<b>Net income</b>	<b>13,952</b>	<b>17,452</b>	<b>19,394</b>	<b>20,389</b>	<b>23,351</b>	<b>29,222</b>	<b>34,758</b>
<b>Recurring net income</b>	<b>14,227</b>	<b>17,976</b>	<b>19,136</b>	<b>19,689</b>	<b>23,351</b>	<b>29,222</b>	<b>34,758</b>
<b>Recurring EPS (Rs)</b>	<b>14.8</b>	<b>18.7</b>	<b>19.9</b>	<b>20.5</b>	<b>24.3</b>	<b>30.5</b>	<b>36.2</b>
<b>Balance sheet (Rs mn)</b>							
Total shareholder's equity	47,424	65,248	76,039	84,102	95,058	108,149	122,913
Total borrowings	4,099	3,037	5,455	5,208	4,674	4,174	3,674
Deferred tax liability	1,799	2,950	3,430	3,975	3,975	3,975	3,975
Minority interest	2,637	3,837	3,755	3,277	3,281	3,254	3,188
<b>Total liabilities and equity</b>	<b>55,959</b>	<b>75,072</b>	<b>88,679</b>	<b>96,562</b>	<b>106,988</b>	<b>119,552</b>	<b>133,750</b>
Net fixed assets	26,102	33,240	33,678	48,101	54,894	52,403	49,619
Goodwill	2,458	1,990	1,935	3,273	3,273	3,273	3,273
Investments	15,878	27,121	26,520	21,407	21,407	21,407	21,407
Cash	2,044	4,242	8,012	4,047	3,769	15,840	29,480
Net current assets	9,477	8,480	18,534	19,735	23,645	26,629	29,971
<b>Total assets</b>	<b>55,959</b>	<b>75,072</b>	<b>88,679</b>	<b>96,562</b>	<b>106,988</b>	<b>119,552</b>	<b>133,750</b>
<b>Free cash flow (Rs mn)</b>							
Operating cash flow, excl. working capital	16,379	20,452	21,301	21,931	27,206	33,368	38,316
Working capital	(4,502)	1,978	(6,028)	(797)	(3,911)	(2,983)	(3,342)
Capital expenditure	(4,377)	(8,022)	(6,672)	(14,088)	(10,996)	(2,429)	(2,290)
<b>Free cash flow</b>	<b>7,500</b>	<b>14,408</b>	<b>8,601</b>	<b>7,047</b>	<b>12,299</b>	<b>27,957</b>	<b>32,683</b>
<b>Growth</b>							
Revenue growth	11.5	NM	5.5	11.7	15.6	17.2	16.0
EBITDA growth	11.9	23.9	7.8	7.1	17.1	24.9	17.2
EPS growth	15.8	26.4	6.5	2.9	18.6	25.1	18.9
<b>Ratios (%)</b>							
Gross margin (%)	43.8	43.6	44.7	42.4	41.7	42.7	42.8
EBITDA margin (%)	15.8	19.4	19.8	19.0	19.3	20.5	20.7
Net profit margin (%)	10.0	12.6	12.7	11.7	12.0	12.8	13.2
RoE (%)	32.4	31.9	27.1	24.6	26.1	28.8	30.1
RoCE (%)	34.7	34.2	28.5	24.4	24.9	29.1	34.1
<b>Key assumptions (%)</b>							
Volume growth (%)	7.0	12.0	9.5	6.8	14.3	14.5	13.5
Realisation growth (%)	3.8	(3.4)	(1.8)	(4.8)	(0.2)	3.5	3.5

Note:

(1) FY2016/17 P&amp;L and forecasts based on IND-AS and hence not strictly comparable to pre-FY2016 financials which were based on IGAAP.

Source: Company, Kotak Institutional Equities estimates

JANUARY 22, 2019

#### RESULT

Coverage view: **Attractive**

Price (₹): **384**

Fair Value (₹): **435**

BSE-30: **36,445**

**Strong performance, remains best in class.** HDFC Life delivered 20% operating RoEV in 3QFY19 on the back of 20% yoy VNB growth. While APE growth was moderate at 11% yoy, the high-margin protection business rose to 17.3% of APE from 11.3% in 3QFY18. With most medium-term trends on track (increasing share of protection business, stable persistency, positive variance in mortality), we retain our positive stance and roll over our fair value to Rs435 (from Rs380); retain ADD.

#### Company data and valuation summary

HDFC Standard Life Insurance

Stock data		Forecasts/Valuations			
		2019E	2020E	2021E	
52-week range (Rs) (high,low)	548-354	6.5	8.1	9.8	
Market Cap. (Rs bn)	774.3	18.3	23.8	21.0	
<b>Shareholding pattern (%)</b>		P/E (X)	58.7	47.4	39.2
Promoters	80.8	NII (Rs bn)	118.1	140.8	169.0
FIs	8.4	Net profits (Rs bn)	13.1	16.3	19.7
MFs	1.8	BVPS	26.3	29.6	33.6
<b>Price performance (%)</b>		P/B (X)	14.6	13.0	11.4
Absolute	1M 3M 12M	ROE (%)	26.2	29.0	31.1
Rel. to BSE-30	(0.4) 5.0 0.0	Div. Yield (%)	0.4	0.5	0.6
	(2.3) (1.7) 0.0				

#### HDFC Life reports 18% growth in earnings

HDFC Life reported PAT of Rs2.5 bn (up 18% yoy) in 3QFY19. Growth in underwriting profits was strong at 18% to Rs1.8 bn despite high new business strain, Rs4.5 bn, up 61% yoy. ULIP, a segment in which new business strain is typically high, was 48% of total APE, lower than 53% in 2QFY19.

#### Net flows remain strong in 3QFY19

HDFC Life reported 41% growth in new business premium and 29% growth in overall premium in 9MFY19. Coupled with control over benefit payouts (down 4% yoy) and management expenses (up 14% yoy), net cash flows increased to Rs26.4 bn from Rs21 bn in 2QFY19 and Rs11 bn in 1QFY19. This trend may be volatile and hence it may not be accurate to track the same on a quarterly basis

#### VNB margin expands 175 bps yoy, down 90 bps qoq

HDFC Life's VNB margins expanded 175 bps yoy to 23.4%, down 90 bps qoq. Yoy margin expansion was driven by an increase in the share of high-margin products (non-par savings and protection). This was the key driver of 20% operating RoEV. During the quarter, the company reported positive operating variance of Rs0.9 bn (mostly in mortality). Positive investment variance of Rs2 bn (1.1% of EV) from favorable interest rate movement boosted RoEV to 25%.

#### Retain ADD with TP of Rs435

HDFC Life is the most profitable life insurance company with about 22% operating RoEV and 18% EVOP CAGR during FY2019-21E supported by VNB margins of 24-25%. The company has focused on innovating new products as required by the policyholders across savings, mortality/morbidity and longevity. Recent additions include a deferred annuity, guaranteed savings plan sold through the proprietary channel and joint life (ULIP) plan even as most competition is focusing on the protection businesses.

We are tweaking our EV estimates to building in marginally lower volumes in FY2019E, higher discounting rates and lower operating variances. We are rolling our TP to Rs435 from Rs380; at our TP the stock will trade at 3.4X December 2020E EV.

#### QUICK NUMBERS

- PAT up 18% yoy in 3QFY19
- VNB margins up 175 bps yoy in 3QFY19 to 23.4%
- APE up 11% yoy in 3QFY19

Nischint Chawathe

M B Mahesh CFA

Dipanjjan Ghosh

Shrey Singh

### ULIP growth moderate, non-par savings and protection rise

HDFC Life reported 11% growth in APE in 3QFY19 to Rs15.4 bn on the back of (1) 70% yoy growth in protection business and (2) 71% growth in non-par savings. Individual ULIP APE was up 12% yoy- the company will incrementally focus on increasing ticket size to drive growth in this segment. Non-par savings (individual) increased to 11.5% (up 210 bps qoq) from 6.5% in 3QFY18 (on the back of recently-launched annuity policies) while share of par policies declined by 565 bps to 16.4% in 2QFY19 (down 35 bps qoq). The company increased its protection business to 17.3% of APE in 3QFY19 from 11.3% in 3QFY18. Individual protection contributed to about 48% of protection APE in 3QFY19, of the balance 95% was credit protect and 5% was group protection.

### Bancassurance maintains dominance

Bancassurance business continues to be strong at 67% of individual APE in 3QFY19 (down 220 bps qoq and 465 bps yoy); HDFC group was 56% of individual APE. Share of direct business is at 16.6% (up 50 bps qoq and 300 bps yoy). HDFC Life continues to invest rapidly in the agency business with number of individual agents increasing to 97,483 in 9MFY19 from 71,430 in 9MFY18.

### 4Q is seasonally strong

We expect HDFC Life to deliver 25.4% VNB margin and 25.5% operating RoEV in 4QFY19E. This compares with 23.4% VNB margin and 19.8% operating RoEV in 3QFY19. Two reasons for higher operating RoEV in 4QFY19:

- ▶ The business tends to be seasonal and lumpy in 4Q with almost 50% higher volumes qoq; this will drive higher VNB and consequently operating RoEV. We expect yoy growth in APE to remain moderate at 18% in 4QFY19 as compared to 16% in 9MFY19 (11% in 3QFY19).
- ▶ Seasonally, VNB margins tend to improve in 4QFY19 likely due to some conservatism in assumptions which are released at the end of the year. The company reported 22.2% VNB margin in 9MFY18 and 25% VNB margins in 4QFY18; we expect the company to deliver 25.4% VNB margin versus 24% in 9MFY19.

**Exhibit 1: HDFC Life- quarterly summary**

March fiscal year-ends, 3QFY18-3QFY19, 2015-2018 (Rs mn)

	3QFY19	3QFY18	2QFY19	% change		9MFY19	9MFY18	YoY (%)	2019E	2018	YoY (%)
				3QFY18	2QFY19						
<b>Policyholder's account (Rs mn)</b>											
Premium	69,614	54,677	68,405	27	2	188,596	146,080	29	278,603	235,644	18
First	12,523	12,024	12,064	4	4	32,712	30,029	9	56,861	47,385	20
Renewal	33,090	28,052	32,308	18	2	89,199	75,426	18	142,407	122,148	17
Single	24,000	14,601	24,033	64	(0)	66,685	40,625	64	79,334	66,112	20
Net premium	68,977	54,200	67,776	27	2	186,765	144,710	29	276,572	233,710	18
Commissions (I)	2,623	2,625	2,637	(0)	(1)	7,241	6,663	9	12,446	10,749	16
First	1,778	2,126	1,874			5,070	5,449			8,702	
Renewal	555	361	444			1,339	962			1,550	
Single	289	138	319			832	252			497	
Operating expenses (II)	9,243	7,769	9,458	19	(2)	25,947	20,595	26	31,806	31,593	1
Expenses of management (I+II)	11,866	10,394	12,094	14	(2)	33,188	27,257	22	44,251	42,342	5
Other income and trf. to shareholders a/c	206	113	326	81	(37)	1,126	971	16	1,454	2,685	(46)
Provisions and service taxes	1,013	780	1,431	30	(29)	3,569	2,257	58	4,701	4,715	(0)
Benefits paid	29,940	31,200	33,625	(4)	(11)	92,990	87,004	7	147,790	131,114	13
Net flows	26,363	11,939	20,951	121	26	58,144	29,163	99	81,282	58,222	40
Income on investments	23,849	42,531	10,902	(44)	119	52,718	95,314	(45)	114,918	85,946	34
Change in liabilities	47,995	52,673	29,908	(9)	60	103,312	117,498	(12)	181,530	133,223	36
Surplus/deficit	2,217	1,797	1,946	23	14	7,551	6,979	8	14,670	10,946	34
Appropriations											
Transfer to shareholders account	1,769	1,499	2,341	18	(24)	7,310	6,057	21	12,470	10,022	24
FFA	447	298	(395)	50	NM	241	922	(74)	2,201	924	138
<b>Shareholders account</b>											
Transfer from policyholders	1,769	1,499	2,341	18	(24)	7,310	6,057	21	12,470	10,022	24
Total income	835	618	733	35	14	2,449	1,959	25	3,301	2,933	13
Investment income	835	618	733	35	14	2,356	1,829	29	3,171	2,803	13
Other expenses	20	7	54	181	(62)	98	119	(18)	139	126	11
Any other item	19	(53)	57			215	19		-	1,562	
PBT	2,565	2,162	2,963	19	(13)	9,446	7,878	20	15,632	11,267	39
Tax	109	89	93	22	16	318	256	24	2,501	177	1,310
PAT	2,456	2,073	2,870	18	(14)	9,128	7,622	20	13,131	11,090	18
Tax rate (%)	4.2	4.1	3.2			3.4	3.3		16.0	1.6	

Source: Company, Kotak Institutional Equities estimates

**Exhibit 2: 18% yoy growth in PAT in 3QFY19; similar to previous quarters**

PAT and solvency ratio for HDFC Life, March fiscal year-ends, 3QFY18-3QFY19, 2016-18 (Rs bn)

	3QFY18	2QFY19	3QFY19	YoY			2016	2017	2018	YoY (%)	
				(%)	9MFY18	9MFY19					
PAT	2.1	2.9	2.5	18	7.6	9.1	20	8.1	8.9	11.1	24
Underwriting profits	1.5	2.3	1.8	20	6.0	7.2	20	6.8	7.5	8.5	13
New business strain	(2.8)	(3.1)	(4.5)	61	(7.6)	(10.8)	42	14.5	14.6	19.1	31
Existing business surplus	4.3	5.4	6.3	47	13.6	18.0	32	(7.7)	(7.1)	(10.6)	49
Shareholder's surplus	0.6	0.6	0.7	19	1.6	1.9	20	1.3	1.4	2.6	82
Solvency (%)	191	193	191		191	191		198	192	192	

Source: Company, Kotak Institutional Equities

**Exhibit 3: 16% yoy growth in VNB**

March fiscal year-ends 2016-2018, 3QY18-3QFY19 (Rs bn)

	3QFY18	2QFY19	3QFY19	YoY(%)	9MFY18	9MFY19	YoY(%)	2016	2017	2018	YoY(%)
Savings APE	12.3	12.6	12.7	10	31.1	33.8	9	34.5	38.6	49.1	27
Protection APE	1.6	2.2	2.7	37	4.1	6.7	65	2.7	3.3	6.2	91
% of APE	11.3	14.8	17.3	257 bps	11.6	16.6	500 bps	7.3	7.8	11.3	350 bps
VNB	3.0	3.6	3.6	16	7.8	9.7	24	7.4	9.2	0.0	(100)
VNB margin (%)	21.7	24.3	23.4	66 bps	22.2	24.0	178 bps	19.9	22.0	0.0	-2200 bps
EV	144.69	163.8	174.0	17	144.7	174.0	20	102.3	124.7	0.0	(100)

Source: Company

**Exhibit 4: Focus on protection business**

March fiscal year-ends, 3QFY18-3QFY19, 2016-18 (% of total APE)

	3QFY18	2QFY19	3QFY19	YoY (%)	9MFY18	9MFY19	YoY (%)	2016	2017	2018	YoY (%)
<b>Product-wise break-up of APE (Rs bn)</b>											
Individual savings	10.6	11.7	11.7	11	28.3	31.3	10	34.5	35.9	46.0	28
ULIP	6.7	7.9	7.5	12	17.6	19.8	13	18.6	19.4	27.9	43
PAR	3.1	2.5	2.5	(17)	8.3	7.4	(12)	10.0	13.1	13.7	5
Non-par	0.9	1.4	1.8	96	2.4	4.1	71	3.0	3.4	4.4	31
Group savings	1.7	0.9	1.0	(40)	2.7	2.5	(9)	2.8	2.7	3.1	13
Protection	1.6	2.2	2.7	70	4.1	6.7	65	2.7	3.3	6.2	91
Individual protection	0.9	0.8	1.2	38	1.8	2.7	49				
Group protection	0.7	1.4	1.4	114	2.2	4.0	78				
<b>Share of total APE (%)</b>											
Individual savings	76.8	79.2	76.3	-4 bps	80.6	77.2	-335 bps	92.7	85.7	83.1	-3 bps
ULIP	48.2	53.1	48.4	-2 bps	50.0	49.0	-105 bps	50.1	46.4	50.4	4 bps
PAR	22.1	16.7	16.4	-7 bps	23.7	18.2	-559 bps	26.9	31.2	24.8	-6 bps
Non-par	6.5	9.4	11.5	5 bps	6.8	10.1	328 bps	8.1	8.0	8.0	0 bps
Group savings	11.9	6.0	6.5	-1 bps	7.8	6.2	-165 bps	7.6	6.5	5.6	-1 bps
Protection	11.3	14.8	17.3	5 bps	11.6	16.6	500 bps	7.3	7.8	11.3	4 bps

Source: Company, Kotak Institutional Equities

**Exhibit 5: Share of ULIPs via agency channels has decreased in 9MFY19**

Product mix based on individual APE, March fiscal year-ends, 2016-2018, 1HFY18-1HFY19, 9MFY18-9MFY19 (%)

	2016	2017	2018	Change (bps)	1HFY18	1HFY19	Change (bps)	9MFY18	9MFY19	Change (bps)
<b>Bancassurance</b>										
ULIP	66	61	64	300 bps	66	72	600 bps	67	71	400 bps
Participating	24	30	26	-400 bps	25	18	-700 bps	24	15	-900 bps
Non-participating protection	2	1	1	0 bps	1	2	100 bps	1	2	100 bps
Non-participating others	9	8	9	100 bps	8	8	0 bps	8	12	400 bps
<b>Agency</b>										
ULIP	25	26	33	700 bps	26	23	-300 bps	35	26	-900 bps
Participating	56	57	48	-900 bps	54	52	-200 bps	47	49	200 bps
Non-participating protection	13	11	11	0 bps	13	12	-100 bps	11	13	200 bps
Non-participating others	6	7	8	100 bps	8	12	400 bps	7	13	600 bps
<b>Direct</b>										
ULIP	45	48	54	600 bps	56	47	-900 bps	58	49	-900 bps
Participating	24	22	12	-1000 bps	12	8	-400 bps	11	6	-500 bps
Non-participating protection	23	18	21	300 bps	22	23	100 bps	21	21	0 bps
Non-participating others	8	13	13	0 bps	9	22	1300 bps	9	23	1400 bps
<b>Overall</b>										
ULIP	56	52	57	500 bps	58	59	100 bps	59	59	0 bps
Participating	30	35	28	-700 bps	29	23	-600 bps	28	20	-800 bps
Non-participating protection	5	4	5	100 bps	5	7	200 bps	5	7	200 bps
Non-participating others	9	9	9	0 bps	8	11	300 bps	8	14	600 bps

Source: Company, Kotak Institutional Equities

**Exhibit 6: Cost to average AUM declined**

Quarterly summary, March fiscal year-ends, 3QY18-3QFY19, 2017-18 (Rs mn)

	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	YoY (%)	9MFY18	9MFY19	YoY (%)	2017	2018	YoY (%)
<b>Key financials (Rs mn)</b>												
Premium	54,677	89,564	50,577	68,405	69,614	26	146,080	188,596	29	194,455	235,644	21
First year	12,024	17,356	8,124	12,064	12,523	11	30,029	32,712	9	36,570	47,385	30
Renewal	28,052	46,722	23,801	32,308	33,090	22	75,426	89,199	18	108,245	122,148	13
Single	14,601	25,487	18,652	24,033	24,000	41	40,625	66,685	64	49,640	66,112	33
APE	13,484	19,905	9,990	14,468	14,923	15	34,091	39,381	16	41,534	53,996	30
Commission (I)	2,625	4,087	1,982	2,637	2,623	7	6,663	7,241	9	7,920	10,749	36
First year	2,126	3,253	1,418	1,874	1,778	(8)	5,449	5,070	(7)	6,469	8,702	35
Renewal	361	588	340	444	555	27	962	1,339	39	1,377	1,550	13
Single	138	245	223	319	289	241	252	832	230	74	497	569
Operating expenses (II)	7,769	10,998	7,246	9,458	9,243	32	20,595	25,947	26	23,853	31,593	32
Expenses of management (I+II)	10,394	15,085	9,228	12,094	11,866	25	27,257	33,188	22	31,773	42,342	33
AUM (Rs bn)	1,044	1,066	1,096	1,132	1,177	14	1,044	1,177	13	917	1,066	16
<b>Key calculated ratios (%)</b>												
Cost/APE	25	23	27	26	25	112 bps	25	26	92 bps	21	24	283 bps
Cost/average AUM	4.1	5.7	3.4	4.3	4.1	36 bps	3.7	3.9	24 bps	3.8	4.3	44 bps
Net commission ratio	6.3	6.1	5.9	5.6	5.5	-70 bps	6.1	5.6	-45 bps	5.3	6.1	81 bps
First year	17.7	18.7	17.5	15.5	14.2	-322 bps	18.1	15.5	-265 bps	17.7	18.4	68 bps
Renewal	1.3	1.3	1.4	1.4	1.7	6 bps	1.3	1.5	23 bps	1.3	1.3	0 bps
Single	0.9	1.0	1.2	1.3	1.2	78 bps	0.6	1.2	63 bps	0.1	0.8	60 bps

Source: Company, Kotak Institutional Equities

**Exhibit 7: Improvement in persistency in most buckets**

Persistency in individual segment. March fiscal year-ends. 9MFY17-9MFY19 (%)

	9MFY17	FY2017	9MFY18	FY2018	9MFY19
13th month	83.0	84.0	86.4	87.1	86.4
25th month	73.2	75.4	76.9	77.4	79.8
37th month	62.7	65.2	68.9	70.9	71.9
49th month	60.2	58.9	60.4	62.2	65.7
61st month	60.2	56.8	53.5	51.0	50.1

Source: Company, Kotak Institutional Equities

**Exhibit 8: Higher operating RoEV in 4Q**

March fiscal year-ends. 3QFY18-4QFY19E, 2019E (Rs bn)

	3QFY18	4QFY18	3QFY19	4QFY19E	2019E	Comments
Opening EV	140.1	144.7	163.8	174.0	152.1	
VNB	NA	NA	3.6	6.0	15.7	
Expected return in force	NA	NA	3.7	3.7	14.4	
Operating variance	NA	NA	0.9	1.3	3.5	Unwinding at 8.7% in 4QFY19E
Investment variance	NA	NA	2.0	0.3	(0.5)	Includes economic and investment variance
Dividend payout				(2.2)	(2.2)	
Closing EV	144.7	152.1	174.0	183.1	183.1	
EVOP	NA	NA	8.2	11.1	33.7	
RoEV	NA	NA	24.9	20.8	20.4	
Operating RoEV	NA	NA	20.0	25.4	22.1	
Other details						
APE	14.4	19.9	15.4	23.6	64.1	18% growth in 4QFY19E
VNB	3.0	5.0	3.6	6.0	15.7	
VNB margins (%)	20.8	25.1	23.4	25.4	24.5	

Source: Company, Kotak Institutional Equities

**Exhibit 9: Mixed trends in persistency for most products**

Product and channel-wise persistency, March fiscal year-ends, 2017-3QFY19 (%)

	Product-wise persistency				Channel-wise persistency		
	Par	Non-par	Non-par (others)	ULIP	Agency	Banca	Direct and others
<b>2017</b>							
13th month	75	75	89	82	86	81	80
25th month	65	73	86	72	79	72	74
37th month	59	70	81	62	55	65	66
49th month	56	75	95	58	56	59	61
61st month	56	74	93	56	52	58	58
<b>2018</b>							
13th month	78	73	92	85	89	84	78
25th month	69	67	85	76	80	75	73
37th month	60	65	84	68	76	65	69
49th month	57	66	82	60	55	62	63
61st month	54	73	93	47	50	50	56
<b>1QFY19</b>							
13th month	77	73	92	85	88	83	80
25th month	70	66	85	77	78	75	75
37th month	60	67	85	69	77	68	72
49th month	56	58	80	61	55	63	65
61st month	53	69	94	45	51	48	56
<b>2QFY19</b>							
13th month	76	86	92	84	88	82	86
25th month	70	83	87	78	81	76	85
37th month	60	79	85	70	77	68	81
49th month	56	65	80	61	59	64	75
61st month	53	65	95	45	51	47	62
<b>3QFY19</b>							
13th month	76	86	92	83	88	82	85
25th month	71	82	88	78	82	76	84
37th month	60	80	84	70	73	68	80
49th month	56	67	80	63	66	64	76
61st month	52	64	89	44	48	48	63

Source: Company, Kotak Institutional Equities

**Exhibit 10: Share of bancassurance remains high at 67%**

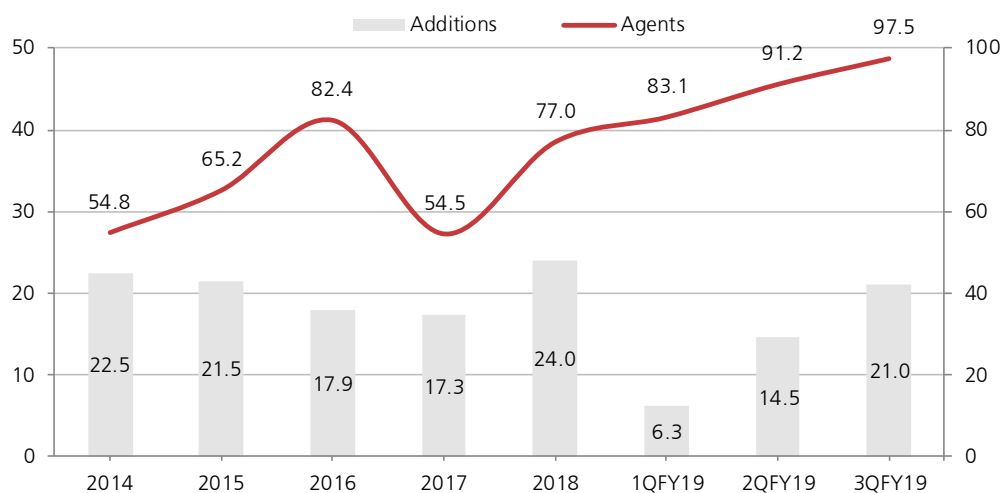
Channel-wise total individual new business premium, March fiscal year-ends, 3QY18-3QFY19, 2015-18 (%)

	3QFY18	2QFY19	3QFY19	(change)	9MFY18	9MFY19	(change)	2015	2016	2017	2018	(change)
Individual agents	12	11	11	-164 bps	11	11	0 bps	13	12	12	11	-100 bps
Bancassurance	71	69	67	-464 bps	70	67	-300 bps	73	75	72	71	-100 bps
Direct	14	16	17	299 bps	14	17	300 bps	9	9	11	14	300 bps
Brokers and others	3	4	4	63 bps	5	4	-100 bps	5	4	5	5	0 bps

Source: Company, Kotak Institutional Equities

**Exhibit 11: Individual agent addition has remained strong in 2019YTD**

Individual agents for HDFC Life, March fiscal year-ends, 2014-3QFY19 (# 000')



Source: LIC Council, Company

**Exhibit 12: Interest rate sensitivity increased in 1HFY19**  
Sensitivity of VNB and EV, March fiscal year-ends, 2017-1HFY19 (%)

	2017		2018		1HFY19	
	VNB	EV	VNB	EV	VNB	EV
<b>Interest rates and assets</b>						
Interest and discount rates up 100 bps	0.4	(1.9)	0.3	(1.8)	0.9	(2.0)
Interest and discount rates down 100 bps	(1.4)	1.9	(1.7)	1.9	(2.3)	2.1
Interest and discount rates up 200 bps	0.0	(3.8)				
Interest and discount rates down 200 bps	(4.1)	3.7				
Equity values up 10%	(1.4)	(2.0)				
Equity values down 20%	(2.6)	(4.1)				
Implied swaption volatilities up 25%	(0.2)	(0.1)				
Implied equity volatilities up 25%	(0.5)	(0.1)				
<b>Expenses</b>						
Maintenance expense up 10%	(2.2)	(0.8)	(2.2)	(0.6)	(2.2)	(0.6)
Maintenance expense down 10%	2.2	0.8	2.2	0.6	2.2	0.6
Acquisition expense up 10%	(15.1)	NA	(14.2)	NA	(15.3)	NA
Acquisition expense down 10%	15.1	NA	14.2	NA	15.3	NA
<b>Policy/ premium discontinuance rates</b>						
Discontinuance rate up 10%	(5.8)	(1.8)			(3.5)	(1.6)
Discontinuance rate down 10%	6.2	1.9			3.7	1.7
Discontinuance rate up 50%	(25.9)	(7.9)				
Discontinuance rate down 50%	36.1	11.2				
<b>Insurance risk</b>						
Mortality and morbidity rates up 5%	(4.3)	(0.7)	(5.2)	(0.8)	(6.0)	(0.9)
Mortality and morbidity rates down 5%	4.3	0.7	5.2	0.8	6.0	0.9
<b>Required capital</b>						
Set equal to MRC less FFA in participating func	0.8	0.1				
<b>Taxation</b>						
Assumed tax rate up 25%	(13.0)	(6.9)	(14.4)	(7.6)	(14.0)	(6.4)
Assumed tax rate up 34.6%	(24.8)	(13.2)				

Source: Company, Kotak Institutional Equities

**Exhibit 13: We expect ~20% operating RoEV and VNB margin of 24-25% for HDFC Life**

Key metrics and RoEV movement, March fiscal year-ends, 2012-2021E (Rs bn)

	2012	2013	2014	2015	2016	2017	2018	2019E	2020E	2021E
<b>APE</b>	27.9	32.8	25.4	29.5	36.1	41.9	55.3	64.1	75.7	89.3
YoY (%)		17.6	(22.6)	16.1	22.4	16.1	32.0	16.0	18.0	18.0
<b>VNB</b>	4.7	6.0	6.6	7.4	7.4	9.2	12.8	15.7	18.2	21.4
YoY (%)		27.7	10.0	12.1		24.3	39.1	22.8	15.6	18.0
<b>EV movement</b>										
Opening EV	42.1	48.2	58.7	69.9	88.9	102.3	124.7	152.1	183.1	220.8
Methodology changes	(0.1)	0.6	1.6	3.5						
Assumption change				0.1		1.2	1.6			
<b>VNB</b>	4.7	6.0	6.6	7.4	7.4	9.2	12.8	15.7	18.2	21.4
Acquisition expense overrun	(1.9)	(1.5)	(2.5)	(1.5)						
Expected return in force	3.0	3.9	4.4	6.1	8.1	9.6	10.4	14.4	17.0	20.5
Operating variance	1.2	0.6	(0.1)	(0.3)	3.2	2.2	2.0	3.5	4.0	4.2
Tax changes	0.2		1.1							
<b>EVOP</b>	6.9	9.6	11.1	15.3	18.7	22.2	26.8	33.7	39.2	46.2
Investment variance	(1.0)	0.9	1.3	4.6	(3.1)	2.5	2.6	(0.5)	1.0	1.0
Dividend payout			(1.2)	(1.7)	(2.2)	(2.4)	(2.0)	(2.2)	(2.5)	(2.9)
<b>Closing EV</b>	48.2	58.7	69.9	88.1	102.3	124.6	152.1	183.1	220.8	265.0
<b>Key ratios (%)</b>										
VNB margins	10.4	13.2	16.4	17.4	20.5	22.0	23.1	24.5	24.0	24.0
RoEV		21.8	19.1	26.0	16.2	21.8	22.0	20.4	20.6	20.1
Operating RoEV		19.9	18.9	21.9	21.2	21.7	21.5	22.1	21.4	20.9

Source: Company, Kotak Institutional Equities estimates

**Exhibit 14: We expect HDFC Life to deliver overall VNB margin of 24-25%**  
VNB margins in individual business, March fiscal year-ends, 2016-2021E (Rs bn)

	2016	2017	2018	2019E	2020E	2021E
APE	36.1	41.9	55.3	64.1	75.7	89.3
Protection	2.5	3.4	6.2	7.7	9.5	11.2
Savings	33.6	38.5	49.1	56.5	66.2	78.2
VNB post overrun	7.4	9.2	12.8	15.7	18.2	21.4
VNB margins post overrun (%)	20.5	22.0	23.1	24.5	24.0	24.0
Protection (assumed)	100	80	80	80	75	75
Savings	14.5	16.9	15.9	16.9	16.7	16.7

Source: Company, Kotak Institutional Equities estimates

**Exhibit 15: HDFC Life will trade at 3.4X EV at our appraisal value-based price target**  
Calculation of appraisal value for HDFC Life, March fiscal year-ends, 2019-2021E (Rs bn)

	2019E	2020E	2021E
Embedded value (EV, Rs bn)	183	221	265
Value of new business (VNB, Rs bn)	16	18	21
New business multiple (NBM, X)	29.6	29.6	29.6
Structural value (SV= VNB X NBM, Rs bn)	466	538	635
Appraisal value (AV= EV + SV, Rs bn)	649	759	900
Appraisal value/ EV (X)	3.5	3.4	3.4
Appraisal value/ VNB (X)	41.3	41.8	42.0
Value of HDFC at 51.7% stake and 10% holding company discount (Rs bn)	302	353	419
Value of HDFC (Rs/ share)	181	212	252
Value of HDFC Life (Rs/ share)	324	379	449

Source: Company, Kotak Institutional Equities estimates

**Exhibit 16: HDFC Life trades at 3.5X FY2020E EV**

Valuation comparison of life insurance companies in India, March fiscal year-ends, 2018-2021E (Rs bn)

	Rating	FV (Rs)	Price (Rs)	Market cap. (Rs bn)	EVOP (Rs bn)				Embedded value (Rs bn)				VNB margin (%)				Price/EV (X)				Price/EVOP (X)				Operating RoEV (%)			
					2018	2019E	2020E	2021E	2018	2019E	2020E	2021E	2018	2019E	2020E	2021E	2018	2019E	2020E	2021E	2018	2019E	2020E	2021E	2018	2019E	2020E	2021E
HDFC Life	ADD	435	384	774	27	34	39	46	152	183	221	265	23	25	24	24	5.1	4.2	3.5	2.9	29	23	20	17	22	22	21	21
ICICI Prudential Life	BUY	480	345	495	37	32	37	43	188	210	241	278	17	18	19	19	2.6	2.4	2.1	1.8	13	16	13	12	23	17	18	18
Max Life	BUY	510	436	117	14	15	18	20	75	87	101	116	20	20	20	20	2.2	1.9	1.6	1.4	12	11	9	8	21	20	20	20
SBI Life	BUY	790	620	620	30	35	43	50	191	217	257	304	16	18	18	18	3.2	2.9	2.4	2.0	21	18	15	12	18	18	20	20

Source: Company, Kotak Institutional Equities estimates

JANUARY 23, 2019

#### RESULT

Coverage view: **Cautious**

Price (₹): **15,918**

Fair Value (₹): **11,750**

BSE-30: **36,445**

**Low costs aid a good quarter.** Shree Cement's EBITDA increased 25% yoy to Rs7.1 bn (+37% qoq), higher than our estimate. Strong earnings were aided by 29% qoq increase in EBITDA/ton to Rs1,060/ton (+2% yoy) aided by lower other expenses and volume growth of 11% yoy. The company commissioned a 3 mtpa clinker capacity in Karnataka in 3Q and total capacity is on track to increase by 20% (45 mtpa) by FY2021E. We believe the existing overcapacity in the industry and aggressive capacity addition by SRCM and peers will cap industry profitability. We maintain SELL with unchanged fair value of Rs11,750. Stock is expensive at 20X/14X FY2019/20E EBITDA.

#### Company data and valuation summary

Shree Cement

##### Stock data

52-week range (Rs) (high,low)	19,290-13,100
Market Cap. (Rs bn)	554.5

##### Shareholding pattern (%)

Promoters	64.8
FIs	12.8
MFs	6.2

##### Price performance (%)

	1M	3M	12M
Absolute	(7.2)	10.3	(13.9)
Rel. to BSE-30	(9.0)	3.3	(15.4)

##### Forecasts/Valuations

	2019E	2020E	2021E
EPS (Rs)	338.7	511.8	642.3
EPS growth (%)	(14.7)	51.1	25.5
P/E (X)	47.0	31.1	24.8
Sales (Rs bn)	116.7	141.1	164.9
Net profits (Rs bn)	11.8	17.8	22.4
EBITDA (Rs bn)	26.7	36.8	43.5
EV/EBITDA (X)	20.0	14.1	11.4
ROE (%)	12.7	17.0	18.2
Div. Yield (%)	0.3	0.3	0.3

#### 3QFY19 earnings—earnings beat led by higher realizations, lower other expenses

Shree Cement's earnings were higher than our estimate—the company reported revenues of Rs27.8 bn (+21% yoy, +8% qoq), EBITDA of Rs7.1 bn (+25% yoy, +37% qoq) and net-income of Rs3 bn (-10% yoy, +32% qoq) against our estimate of Rs27bn, Rs6.1 bn and Rs2.2 bn, respectively. Cement volumes increased 11% yoy to 5.9 mn tons (+5% qoq). The earnings beat was led by (1) higher-than-expected realizations—realizations increased 1% qoq to Rs4,315/ton (+5% yoy), and (2) lower costs—cost per ton declined 5% qoq to Rs3,250/ton (+6% yoy). The sequential cost decline is mostly due to lower other expenses (Rs3.9 bn, -26% qoq). We believe, lower other expenses were partially aided by reversal of Fx losses incurred in 1QFY19—note that INR/US\$ rate appreciated by 4% (closing rate) in 3QFY19 and SRCM had Rs21.3 bn of Fx liabilities (March 2018). Net-income of Rs3 bn (+32% qoq, -10% yoy) was aided by a lower tax rate of 18.5% (24% for FY2018). The company's tax rates continue to oscillate in a wide range.

#### Capacity expansion on track—total capacity to increase by 20% by FY2020-end

Shree Cement completed the integrated commissioning of the Karnataka plant in December 2018 with commissioning of a 3 mtpa clinker capacity. Note that the company had already commissioned the grinding unit in Karnataka in June 2018. Also, the company expects to commission the grinding units with capacity of (1) 3 mtpa in Odisha, and (2) 2.5 mtpa in Jharkhand in FY2020. Shree Cement's grinding capacity will increase to ~45 mtpa by FY2021 end from 37.8 mtpa now—the new capacities will be entirely outside its traditional markets in North and will be located in East (5.5 mtpa) and West (2 mtpa). Shree Cement, which had almost 75% of its 25.6 mtpa capacity in North as recently as FY2016 will only have ~53% of capacity in North by March 2021 as new capacity additions are entirely in new regions.

#### We maintain SELL on expensive valuations; fair value unchanged at Rs11,750/share

Our FY2019-21E estimates factor volume CAGR of 10%, EBITDA CAGR of 18%—we model EBITDA/ton to increase from Rs962/ton in FY2019E to Rs1,208/ton in FY2021E led by price increases. However, there can be downside risks to our estimates given overcapacity and large capacity additions in the cement industry. We keep our fair value unchanged at Rs11,750 and maintain SELL on expensive valuations—stocks trades at 20X/14X FY2019/20E EV/EBITDA.

Abhishek Poddar

Murtuza Arsiwalla

Prayatan Mahajan

Exhibit 1: SRCM's EBITDA increased 25% yoy led by volume growth of 11% yoy and increase in EBITDA/ton (+12% yoy)  
Interim results of Shree Cement, March fiscal year-ends, 2017-2019E (Rs mn)

	3QFY19	3QFY19E	3QFY18	2QFY19	(% chg.)			9MFY19	9MFY18	(% chg.)	FY2019E
					KIE	yoy	qoq				
<b>Net sales</b>	<b>27,806</b>	<b>27,008</b>	<b>22,962</b>	<b>25,866</b>	<b>3</b>	<b>21</b>	<b>8</b>	<b>84,371</b>	<b>69,693</b>	<b>21</b>	<b>116,696</b>
Raw material costs	2,050	1,908	1,569	1,683				6,142	5,409		8,433
Power & fuel costs	6,591	6,269	5,055	6,143				19,817	13,746		26,728
Freight costs	6,513	6,262	5,948	5,863				20,895	17,572		28,416
Personnel costs	1,666	1,726	1,466	1,700				5,074	4,392		6,897
Other costs	3,887	4,771	3,228	5,279				14,395	10,474		19,541
Total expenditure	(20,706)	(20,937)	(17,266)	(20,669)				(66,321)	(51,593)		(90,015)
<b>EBITDA</b>	<b>7,101</b>	<b>6,072</b>	<b>5,696</b>	<b>5,197</b>	<b>17</b>	<b>25</b>	<b>37</b>	<b>18,050</b>	<b>18,101</b>	<b>(0)</b>	<b>26,681</b>
EBITDA (%)	26	22	25	20				21	26		23
Other income	553	900	873	514				2,003	3,175		3,008
Interest	(593)	(625)	(207)	(618)				(1,773)	(916)		(2,406)
Depreciation	(3,361)	(3,328)	(2,100)	(3,295)				(9,711)	(6,664)		(12,976)
<b>Pre-tax profits</b>	<b>3,700</b>	<b>3,019</b>	<b>4,262</b>	<b>1,798</b>	<b>23</b>	<b>(13)</b>	<b>106</b>	<b>8,569</b>	<b>13,696</b>		<b>14,307</b>
Tax	(456)	(755)	(928)	(315)				(1,048)	(3,846)		(2,505)
Deferred tax	(230)	—	—	791				561	—		—
<b>Net income</b>	<b>3,013</b>	<b>2,264</b>	<b>3,333</b>	<b>2,275</b>	<b>33</b>	<b>(10)</b>	<b>32</b>	<b>8,082</b>	<b>9,849</b>	<b>(18)</b>	<b>11,801</b>
Extraordinary	—	—	—	(1,781)				(1,781)	—		(1,781)
<b>Reported income</b>	<b>3,013</b>	<b>2,264</b>	<b>3,333</b>	<b>493</b>	<b>33</b>	<b>(10)</b>	<b>511</b>	<b>6,301</b>	<b>9,849</b>	<b>(36)</b>	<b>10,020</b>
<b>EPS (Rs/share)</b>	<b>86.5</b>	<b>65.0</b>	<b>95.7</b>	<b>65.3</b>				<b>232.0</b>	<b>282.7</b>		<b>338.7</b>
<b>Segment results</b>											
<b>Revenues</b>											
Cement	25,594		21,936	24,071	17	6		78,359	66,685	18	110,310
Power	5,026		3,496	4,424	44	14		14,555	10,387	40	18,921
Gross turnover	30,620		25,432	28,495	20	7		92,914	77,072	21	129,231
Inter segment	(2,814)		(2,470)	(2,629)	14	7		(8,542)	(7,379)	16	(12,535)
<b>Net sales</b>	<b>27,806</b>		<b>22,962</b>	<b>25,866</b>	<b>21</b>	<b>8</b>		<b>84,371</b>	<b>69,693</b>	<b>21</b>	<b>116,696</b>
<b>EBIT</b>											
Cement	1,720		2,249	235	(24)	631		2,555	7,189		
Power	2,025		1,453	1,681	39	20		5,813	4,766		
<b>Total</b>	<b>3,744</b>		<b>3,702</b>	<b>1,916</b>	<b>1</b>	<b>95</b>		<b>8,368</b>	<b>11,955</b>	<b>(30)</b>	
Interest	(593)		(207)	(618)	186	(4)					
Others	548		767	500	(29)	10					
<b>PBT</b>	<b>3,700</b>		<b>4,262</b>	<b>1,798</b>	<b>(13)</b>	<b>106</b>					
<b>EBIT margin (%)</b>											
Cement	7		10	1				3	11		
Power	40		42	38				40	46		
<b>Total</b>	<b>13</b>		<b>16</b>	<b>7</b>				<b>10</b>	<b>17</b>		

Source: Company, Kotak Institutional Equities estimates

### Changes in our estimates

Exhibit 6 highlights key changes in our estimates.

We keep our volumes, profitability and EBITDA estimates for FY2019-21E unchanged. We estimate EBITDA of Rs26.7 bn, Rs36.8 bn and Rs43.5 bn for FY2019E, FY2020E and FY2021E. We tweak our depreciation, other income and tax rates resulting in (1)-2% change in our EPS estimate. We estimate EPS of 339, Rs512 and Rs642 for FY2019E, FY2020E and FY2021E.

### Other key highlights

- ▶ **EBITDA improves for cement and power operations.** Cement EBITDA/ton (adjusted for external power sales) increased 29% qoq to Rs1,060/ton (+2% yoy)—we estimate cement costs to have declined by 5% qoq to Rs3,250/ton (+6% yoy) due to lower other expenses. Overall, we estimate cement EBITDA (adjustment for external power sales) to have increased by 35% qoq to Rs6.3 bn (+13% yoy) and external power EBITDA to have increased by 45% qoq to Rs821 mn (+219% yoy) on the back of increase in external power sales by 12% qoq to 446 mn units (+63% yoy) and higher power realizations.
- ▶ The company declared an interim dividend of Rs25/share, record date: 30th January 2019.

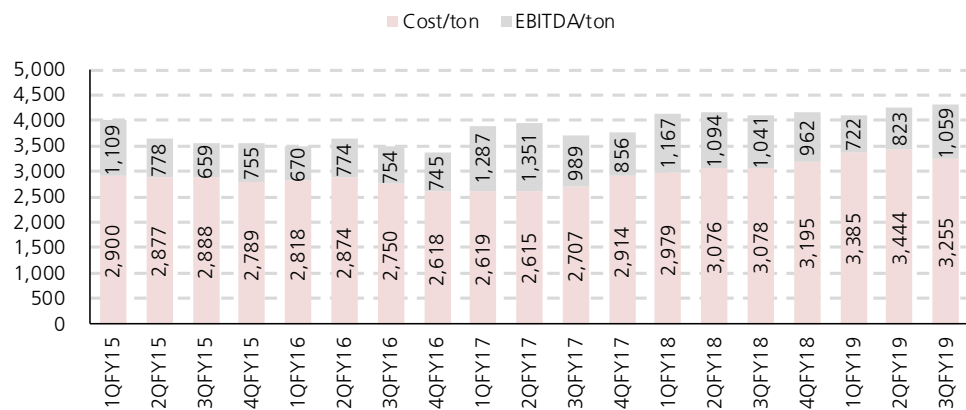
- **Capacity—grinding and clinker capacity.** Shree Cement's grinding capacity will increase to 45 mtpa by FY2021E post commissioning of three new plants —two plants in East of 5.5 mtpa capacity and another in Pune of 2 mtpa. The company's clinker capacity includes (1) 15.4 mtpa in North, (2) 5.2 mtpa in East, and (3) 2.8 mtpa in Karnataka. The company will not be adding another clinker capacity for new grinding units. The 5.2 mtpa clinker capacity (with some debottlenecking: 2-3%) will cater to 14 mtpa of grinding capacity in East (effective production will be close to 12.5 mn tons).

**Exhibit 2: Shree Cement's cement volume increased 11% yoy while external power sales increased by 63% yoy**  
Key operational metrics of SRCM for cement and power business, March fiscal year-ends, 2018-2019E (Rs mn)

	3QFY19	3QFY18	2QFY19	Growth (%)		9MFY19	9MFY18	Change (%)	FY2019E
				yoy	qoq				
<b>Cement</b>									
Sales (mn tons)	5.9	5.3	5.6	11	5	18.6	16.1	15	25.6
Revenues (Rs mn)	25,594	21,936	24,071	17	6	78,359	66,685	18	110,310
EBITDA (Rs mn)	6,284	5,545	4,644	13	35	15,974	17,753	(10)	24,633
<b>Realization (Rs/ton)</b>	<b>4,315</b>	<b>4,120</b>	<b>4,268</b>	<b>5</b>	<b>1</b>	<b>4,222</b>	<b>4,144</b>	<b>2</b>	<b>4,306</b>
Adjusted profitability (Rs/ton)	1,059	1,041	823	2	29	861	1,103	(22)	962
<b>Power</b>									
External sale (mn units)	446	273	400	63	12	1,297	852	52	1,601
<b>Realization (Rs/kwh)</b>	<b>5.0</b>	<b>3.8</b>	<b>4.5</b>	<b>32</b>	<b>10</b>	<b>4.6</b>	<b>3.5</b>	<b>31</b>	<b>4.0</b>
External EBITDA (Rs mn)	821	257	567	219	45	2,105	866	143	2,048

Source: Company, Kotak Institutional Equities

**Exhibit 3: Shree Cements' EBITDA/ton increased 29% yoy to Rs1,059/ton**  
EBITDA/ton and cost/ton for Shree Cements, March fiscal year-ends, 2015-19 (Rs/ton)



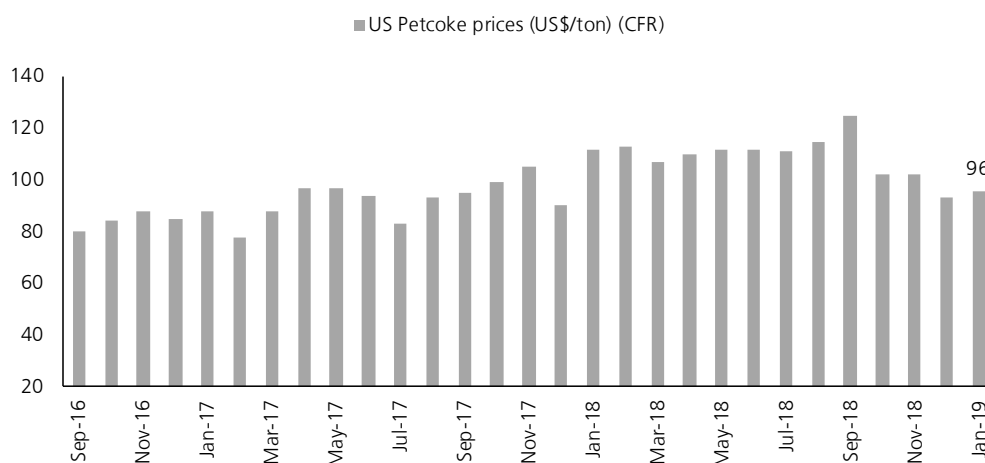
Source: Company, Kotak Institutional Equities

**Exhibit 4: Shree Cement's new capacity additions are in East, South and West regions**  
SRCM's cement capacity at various locations, March fiscal year-ends, 2014-2021E (Rs mn)

	2014	2015	2016	2017	2018	2019E	2020E	2021E
Beawar, Rajasthan	3.0	3.0	3.0	3.6	3.6	3.6	3.6	3.6
Ras, Rajasthan	5.0	7.0	7.0	7.0	7.0	7.0	7.0	7.0
Khushkhera, Rajasthan	3.0	3.0	3.0	3.5	3.5	3.5	3.5	3.5
Suratgarh, Rajasthan	1.2	1.2	1.2	1.8	5.4	5.4	5.4	5.4
Laksar, Uttarakhand	1.8	1.8	1.8	1.8	1.8	1.8	1.8	1.8
Jobner, Rajasthan (Jaipur)	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5
Panipat, Haryana	—	1.5	1.5	1.5	1.5	1.5	1.5	1.5
<b>North</b>	<b>15.5</b>	<b>19.0</b>	<b>19.0</b>	<b>20.7</b>	<b>24.3</b>	<b>24.3</b>	<b>24.3</b>	<b>24.3</b>
Bulandsahar, Uttar Pradesh	—	—	2.0	2.0	2.0	2.0	2.0	2.0
Raipur, Chhattisgarh	—	2.6	2.6	3.0	3.0	3.0	3.0	3.0
<b>Central</b>	<b>—</b>	<b>2.6</b>	<b>4.6</b>	<b>5.0</b>	<b>5.0</b>	<b>5.0</b>	<b>5.0</b>	<b>5.0</b>
Aurangabad, Bihar	2.0	2.0	2.0	3.6	5.6	5.6	5.6	5.6
Cuttack, Odisha	—	—	—	—	—	—	3.0	3.0
Jharkhand	—	—	—	—	—	—	2.5	2.5
<b>East</b>	<b>2.0</b>	<b>2.0</b>	<b>2.0</b>	<b>3.6</b>	<b>5.6</b>	<b>5.6</b>	<b>11.1</b>	<b>11.1</b>
Karnataka	—	—	—	—	—	2.8	2.8	2.8
<b>South</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>2.8</b>	<b>2.8</b>	<b>2.8</b>
Pune	—	—	—	—	—	—	—	2.0
<b>South</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>2.0</b>
<b>Cement capacity (mtpa)</b>	<b>17.5</b>	<b>23.6</b>	<b>25.6</b>	<b>29.3</b>	<b>34.9</b>	<b>37.7</b>	<b>43.2</b>	<b>45.2</b>

Source: Company, Kotak Institutional Equities estimates

**Exhibit 5: Pet-coke prices declined in recent months and will aid costs from 4QFY19**  
US pet coke prices (CFR basis), 2016 –2019 (US\$/ton)



Source: Company, Kotak Institutional Equities

Exhibit 6: Shree Cement, changes in estimates, March fiscal year ends, FY2019-2021E

	Revised estimate			Previous estimate			Change (%)		
	2019E	2020E	2021E	2019E	2020E	2021E	2019E	2020E	2021E
<b>Volume and realizations (mn tons, Rs/ton)</b>									
Cement sales (mn tons)	25.6	30.1	34.3	25.6	30.1	34.3	0	0	0
Realization (Rs/ton)	4,306	4,466	4,616	4,306	4,466	4,616	0	0	0
Adjusted EBITDA (Rs/ton)	962	1,152	1,208	962	1,152	1,208	0	0	0
<b>Earnings estimates (Rs mn)</b>									
Revenues	116,696	141,102	164,895	116,696	141,102	164,895	0	0	0
EBITDA	26,681	36,811	43,522	26,681	36,811	43,522	0	0	0
PAT	11,801	17,831	22,377	11,525	17,928	22,473	2	(1)	(0)
EPS	339	512	642	331	515	645	2	(1)	(0)

Source: Company, Kotak Institutional Equities estimates

Exhibit 7: We factor in a 15% CAGR volume growth for SRCM over the next three years

Key assumptions in the earnings model for SRCM, March fiscal year-ends, 2017-21E

	2016	2017	2018	2019E	2020E	2021E	Growth (%)				
							2017	2018	2019E	2020E	2021E
<b>Cement segment</b>											
Volumes (mn tons)	14.2	20.6	22.5	25.6	30.1	34.3	11	9	14	18	14
Realization (Rs/ton)	3,491	3,817	4,316	4,306	4,466	4,616	9	13	(0)	4	3
Total revenues (Rs mn)	55,678	85,943	98,331	116,696	141,102	164,895	18	14	19	21	17
EBITDA (Rs mn)	13,203	25,132	24,728	26,681	36,811	43,522	50	(2)	8	38	18
Adjusted profitability (Rs/ton)	773	1,125	1,077	962	1,152	1,208	46	(4)	(11)	20	5
<b>Power segment</b>											
External volumes (MU)	1,739	1,658	1,197	1,601	1,601	1,601	(28)	(28)	34	0	0
Realization (Rs/kwh)	3.4	3.5	3.6	4.0	4.1	4.2	(1)	5	10	2	2
Total revenues (Rs mn)	5,954	5,724	4,330	6,386	6,514	6,644	(29)	(24)	47	2	2

Source: Company, Kotak Institutional Equities estimates

Exhibit 8: Our fair value of Rs11,750/share is based on 10X FY2020E EBITDA  
Shree Cement, Valuation details, March 2020E financials

	FY2020E
<b>Cement</b>	
Adjusted EBITDA (Rs mn)	34,730
EV/EBITDA (X)	10
EV (Rs mn)	363,594
Net cash (Rs mn)	34,519
<b>Equity value (Rs mn)</b>	<b>398,112</b>
<b>Power</b>	
Equity value (Rs mn)	11,271
<b>Total (Rs mn)</b>	<b>409,383</b>
No. of shares	34.8
<b>Value (Rs/share)</b>	<b>11,750</b>

Source: Company, Kotak Institutional Equities estimates

Exhibit 9: Shree Cement, Profit model, balance sheet and cash flow model, March fiscal year-ends, 2016-2021E (Rs mn)

	2016	2017	2018	2019E	2020E	2021E
<b>Profit model (Rs mn)</b>						
Net sales	55,678	85,943	98,331	116,696	141,102	164,895
<b>EBITDA</b>	<b>13,203</b>	<b>25,132</b>	<b>24,728</b>	<b>26,681</b>	<b>36,811</b>	<b>43,522</b>
Other income	1,201	3,617	3,891	3,008	3,400	4,713
Interest	(751)	(1,294)	(1,353)	(2,406)	(2,406)	(2,406)
Depreciation	(9,084)	(12,146)	(8,994)	(12,976)	(14,029)	(15,994)
<b>Profit before tax</b>	<b>4,569</b>	<b>15,308</b>	<b>18,272</b>	<b>14,307</b>	<b>23,775</b>	<b>29,835</b>
Extra-ordinary items	530	—	—	(1,781)	—	—
Current tax	(1,231)	(3,263)	(4,466)	(2,505)	(4,755)	(5,967)
Deferred tax	682	1,346	36	-	(1,189)	(1,492)
<b>Net profit</b>	<b>4,550</b>	<b>13,391</b>	<b>13,842</b>	<b>10,020</b>	<b>17,831</b>	<b>22,377</b>
<b>Adjusted PAT</b>	<b>4,019</b>	<b>13,391</b>	<b>13,842</b>	<b>11,801</b>	<b>17,831</b>	<b>22,377</b>
<b>Earnings per share (Rs)</b>	<b>115.4</b>	<b>384.4</b>	<b>397.3</b>	<b>338.7</b>	<b>511.8</b>	<b>642.3</b>
<b>Balance sheet (Rs mn)</b>						
Equity	61,802	76,981	88,968	96,916	112,675	132,980
Borrowings	8,629	12,926	34,030	34,030	34,030	34,030
Current liabilities	17,459	21,753	28,420	28,551	33,853	39,022
<b>Total liabilities</b>	<b>87,889</b>	<b>111,661</b>	<b>151,418</b>	<b>159,497</b>	<b>180,559</b>	<b>206,032</b>
Fixed assets	33,147	33,096	50,163	54,187	53,158	47,164
Investments	23,661	42,426	56,343	51,343	66,343	81,343
Cash	2,830	1,110	1,209	3,582	2,205	10,905
Other current assets	25,617	29,953	38,572	45,255	54,910	64,169
Deferred tax asset	2,634	5,077	5,131	5,131	3,942	2,450
<b>Total assets</b>	<b>87,889</b>	<b>111,661</b>	<b>151,418</b>	<b>159,497</b>	<b>180,559</b>	<b>206,032</b>
<b>Free cash flow (Rs mn)</b>						
Operating cash flow excl. working capital	12,374	25,292	26,350	22,996	33,049	39,862
Working capital changes	(2,059)	(509)	(1,131)	(6,551)	(4,354)	(4,090)
Capital expenditure	(7,348)	(12,947)	(25,263)	(17,000)	(13,000)	(10,000)
<b>Free cash flow</b>	<b>2,968</b>	<b>11,836</b>	<b>(43)</b>	<b>(555)</b>	<b>15,696</b>	<b>25,772</b>
<b>Ratios</b>						
Book value (Rs/share)	1,774	2,210	2,554	2,782	3,234	3,817
RoAE (%)	7.0	19.3	16.7	12.7	17.0	18.2
RoACE (%)	5.6	14.2	11.2	8.6	12.3	13.2
<b>CRoCI (%)</b>	<b>13.2</b>	<b>29.8</b>	<b>32.1</b>	<b>27.2</b>	<b>28.5</b>	<b>29.0</b>

Source: Company, Kotak Institutional Equities estimates

**JANUARY 22, 2019**
**RESULT**

Coverage view: **Attractive**

Price (₹): **345**

Fair Value (₹): **480**

BSE-30: **36,445**

**Protection continues to rise even as volumes remain weak.** ICICI Prudential Life continued to focus on the protection business (9.9% of its APE in 3QFY19) driving about 16.3% VNB margin. Volatility in capital markets led to 2% APE decline in 3QFY19 and reduced 13th month persistency to 84.8% in 9MFY19 from 86.3% in 5MFY19. While near-term headwinds persist, increasing share of high-margin protection APE and stable operating trends drive our positive view. Retain BUY; roll over fair value to ₹480 from ₹450.

**Company data and valuation summary**

ICICI Prudential Life

Stock data				Forecasts/Valuations			
				2019E	2020E	2021E	
52-week range (Rs) (high,low)	461-301			EPS (Rs)	8.9	10.3	12.3
Market Cap. (Rs bn)	495.3			EPS growth (%)	(21.0)	15.6	19.8
<b>Shareholding pattern (%)</b>				P/E (X)	38.7	33.5	27.9
Promoters	78.7			NII (Rs bn)	106.6	143.1	153.4
FII	8.9			Net profits (Rs bn)	12.8	14.8	17.7
MFs	3.7			BVPS	52.9	61.2	71.1
<b>Price performance (%)</b>				P/B (X)	6.5	5.6	4.9
Absolute	1M	3M	12M	ROE (%)	18.1	18.1	18.7
	5.6	9.0	(21.2)	Div. Yield (%)	0.4	0.5	0.6
Rel. to BSE-30	3.5	2.1	(22.5)				

**Protection business at 9.9% of APE**

ICICI Prudential Life continued to focus on the protection business (9.9% of APE in 3QFY19, up 223 bps qoq and 600 bps yoy). APE declined 2% yoy led by drop in participating policies and higher ticket-size ULIPs on account of tepid performance in capital markets. Share of protection was 8.63% for 9MFY19. Calculated VNB margin for 3QFY19 dropped to 16.3% (down 110 bps qoq and 120 bps yoy) as the company cut its annual volume estimates during the quarter.

**Near-term APE muted, remain assertive on medium-term VNB growth; retain BUY**

- ▶ **Muted volumes in the near term.** ICICI Prudential Life struggled on APE growth in 3QFY19 (2% yoy decline) but has guided to improve in 4QFY19E. We build in 5% APE decline in FY2019E followed by 18% growth in subsequent two years.
- ▶ **Rise in protection share to improve VNB margins over medium term.** We expect VNB margins at 18.3% in FY2020E from 17% in 9MFY19 due to the following: (1) increasing share of protection business—up to 8.6% in 9MFY19, secularly growing from 2.7% in FY2016; the company has been growth across all three segments of protection, viz. individual, group and credit life and (2) improvement in persistency assumptions. While persistency has seen deterioration in 3QFY19, it remains above initial assumptions. We consequently expect VNB to deliver 21% CAGR during FY2019-21E.
- ▶ **EVOP growth to remain strong over medium term, retain BUY.** We are tweaking our EVOP forecasts to factor lower VNB margin in FY2019E to reflect higher expenses assumptions and lower investment variance on the back of recent rally in bond markets. Post the revision in estimates, we expect the company to deliver 17% EVOP CAGR during FY2019-21E and 18% medium-term operating RoEV. At our fair value (rolled over to ₹480), the company will trade at 2.6X EV and 17X EVOP December 2020E. Lower margins in the protection business due to heightened competition and drop in APE on the back of slowdown in ULIPs owing to weakness in capital markets are key risks to our forecasts.

**QUICK NUMBERS**

- **PAT declined 34% yoy in 3QFY19**
- **APE down 2% yoy in 3QFY19; VNB margin down 110 bps qoq to 16.3% in 3QFY19**
- **Protection mix up 223 bps qoq to 9.9% of total APE in 3QFY19**

Nischint Chawathe

M B Mahesh CFA

Dipanjan Ghosh

Shrey Singh

### **PAT down 34% yoy**

ICICI Prudential Life reported PAT of ₹3 bn, down 34% yoy, largely on the back of new business strain in protection business, MTM hit on investments and higher expenses during the period. New business strain was higher owing to increase in share of protection and annuity businesses that require higher initial reserving. The rise in expenses was on account of investment in advertisement and other marketing strategies—up 2.2X yoy in 3QFY19. New cash flows to business (post expenses and commissions) increased to ₹31 bn from ₹11 bn in 3QFY18 and ₹29 bn in 2QFY19.

### **Persistency ratios decline marginally**

ICICI Prudential Life reported 13th month persistency (excluding single premium) of 84.1% in 8MFY19, down from 85.5% in 9MFY18 and 86.3% in 5MFY19. A slowdown in capital market investments over the past few months has led to deterioration in persistency mostly from the high ticket affluent segment. We continue to expect an upgrade in persistency assumptions over the medium term. Management highlighted that the 13<sup>th</sup> month ratio inched up to 84.8% in 9MFY19. This is still higher than 82% built in its assumption for calculation of VNB margins. Longer buckets have reported an improvement yoy.

### **Growth to moderate over medium term**

The management's focus will be on mom growth in volume over the next few months. We expect its APE growth to remain muted over near term and are building in a 5% decline in APE for FY2019E. We continue to build in 18% APE growth in FY2020E and FY2021E; its medium-term growth is linked to demand for ULIPs, which in turn has linkages to capital markets. As such, this remains a bit challenging to forecast. The credit protect business can have upside if the bank's retail business accelerates.

### **Protection growth steady**

ICICI Prudential Life reported 1.5X yoy growth in protection APE in 3QFY19 (up 1X yoy in 9MFY19), increasing the share of protection to 9.9% of APE, up from 3.9% yoy (up 450 bps yoy in 9MFY19 to 8.6%). We believe growth in this segment to be the key value driver for the company. We expect protection to be 8.6% in FY2019E and 10.3% in FY2020E. The line of business will likely contribute to 45% of its total VNB in FY2020E. The management remains positive on all segments of protection, viz. individual, group and credit protect although it does not share the break-up between the three segments.

### **Capital consumption high; dividend payouts may lower**

ICICI Prudential Life's solvency ratio declined to 224% in 3QFY19 from 234% in 2QFY19 and 252% in 3QFY18 on the back of high growth in the protection business. The company has two tools to manage solvency—(1) reduce dividend payouts (the company did not pay interim dividend) and (2) raise tier-II capital up to 25% of net worth. As of now, the company does not envisage capital issuance.

Exhibit 1: ICICI Prudential Life - quarterly summary  
March fiscal year-ends, 3QFY18-3QFY19 (₹ mn)

			(% change)		9MFY19	9MFY18	YoY(%)	2019E	2018	YoY(%)	
	3QFY19	3QFY18	2QFY19	3QFY18							2QFY19
Premium	75,664	68,556	76,819	10	(2)	207,661	183,398	13	319,590	270,688	18
First	16,438	19,339	18,394	(15)	(11)	47,419	53,349	(11)		73,562	
Renewal	50,071	45,390	51,027	10	(2)	138,574	117,094	18		178,570	
Single	9,154	3,827	7,399	139	24	21,669	12,956	67		18,556	
APE	17,354	19,722	19,133	(12)	(9)	49,586	54,644	(9)		75,417	
Net premium	74,830	67,951	76,012	10	(2)	205,220	181,549	13	316,880	268,107	18
Commissions (I)	3,671	3,773	3,951	(3)	(7)	10,418	9,567	9	15,844	14,033	13
First	2,675	2,828	2,851	(5)	(6)	7,523	7,067	6		10,245	
Renewal	893	845	995	6	(10)	2,601	2,280	14		3,441	
Single	103	100	105	3	(2)	295	220	34		347	
Operating expenses (II)	5,785	5,211	6,585	11	(12)	18,322	14,252	29	22,182	20,299	9
Expenses of management (I+II)	9,456	8,984	10,536	5	(10)	28,739	23,819	21	38,026	34,332	11
Other income and trf. to shareholders	1,176	175	(21)	572	NM	2,276	509	347	1,598	1,453	10
Provisions and service taxes	1,865	1,758	1,884	6	(1)	5,508	4,849	14	9,052	6,928	31
Benefits paid	33,245	46,852	35,014	(29)	(5)	97,654	127,253	(23)	207,106	172,808	20
Net cash flows	31,439	10,533	28,557	198	10	75,594	26,137	189	64,294	55,492	16
Income on investments	10,478	65,442	12,278	(84)	(15)	45,968	128,748	(64)	98,295	112,615	(13)
Change in liabilities	38,663	72,602	38,833	(47)	(0)	113,296	143,994	(21)	155,139	154,475	0
Surplus/deficit	3,254	3,372	2,003	(3)	62	8,266	10,892	(24)	7,450	13,632	(45)
Appropriations											
Transfer to shareholders	2,662	2,742	1,479	(3)	80	6,605	8,926	(26)	6,705	10,892	(38)
FFA	593	631	524	(6)	13	1,662	1,966	(15)	745	2,740	(73)
Shareholders account											
Transfer from policyholders	2,662	2,742	1,479	(3)	80	6,605	8,926	(26)	6,705	10,892	(38)
Total income	1,384	2,162	1,431	(36)	(3)	4,215	4,929	(14)	8,310	7,444	12
Investment income	1,382	2,160	1,426	(36)	(3)	4,204	4,923	(15)	8,261	7,396	12
Other expenses	90	93	85	(4)	6	274	272	0	1,254	388	224
Any other item	981	-	(208)			1,698	-		-	753	
PBT	2,975	4,810	3,032	(38)	(2)	8,847	13,582	(35)	13,760	17,196	(20)
Tax	8	289	24	(97)	(68)	55	790	(93)	963	997	(3)
PAT	2,968	4,521	3,009	(34)	(1)	8,793	12,792	(31)	12,797	16,198	(21)
Tax rate (%)	0	6	1			1	6		7	6	

Source: Company, Kotak Institutional Equities estimates

Exhibit 2: Share of protection business up 600 bps yoy and 223 bps qoq to 9.9% in 3QFY19  
APE break-up, March fiscal year-ends, 2017-2018, 3QFY18-3QFY19 (₹ bn)

	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	(% chg.)	9MFY18	9MFY19	(% chg.)	2017	2018	(% chg.)
APE	20.1	22.1	14.0	19.9	19.6	(2)	55.8	53.4	(4)	66.3	77.9	18
Savings APE	19.3	20.0	12.8	18.3	17.7	(8)	53.5	48.8	(9)	63.6	73.5	15
Protection APE	0.8	2.2	1.1	1.5	2.0	146.8	2.3	4.6	100.4	2.6	4.5	71
% of APE	3.9	9.8	8.2	7.7	9.9	600 bps	4.1	8.6	451 bps	3.9	5.7	180 bps
VNB	3.5	5.2	2.4	3.5	3.2	(9)	7.7	9.1	19	6.7	12.9	93
VNB margin (%)	17.5	23.5	17.5	17.4	16.3	-115 bps	13.7	17.0	328 bps	10.1	16.5	645 bps
IEV	NA	188	NA	192	NA		NA	NA		161.8	187.9	16

Note:  
(1) VNB and VNB margin for 4QFY18 excludes impact of assumption changes.

Source: Company, Kotak Institutional Equities

Exhibit 3: ICICI Prudential Life will trade at 2.6X EV at our appraisal value-based fair value  
Calculation of appraisal value for ICICI Prudential Life, March fiscal year-ends, 2020-2021E

	2020E	2021E
Embedded value (EV, Rs bn)	241	278
New business value (NBV, Rs bn)	15.9	19.1
New business multiple (NBM, X)	23	23
Structural value (SV= NBV X NBM, Rs bn)	367	439
Appraisal value (AV= EV+SV, Rs bn)	608	717
Appraisal value/EV (X)	2.5	2.6
Value of ICICI Prudential Life (Rs/share)	423	499
Value of ICICI Prudential Life (Rs/share)- December 2020E	480	

Source: Company, Kotak Institutional Equities estimates

**Exhibit 4: ICICI Prudential Life trades at 2.1X price/EV FY2020E**

Valuation comparison across life insurance companies, March fiscal year-ends, 2018-2021E

	Rating	FV (Rs)	Price (Rs)	Market cap. (Rs bn)	EVOP (Rs bn)				Embedded value (Rs bn)				VNB margin (%)				Price/EV (X)				Price/EVOP (X)				Operating RoEV (%)			
					2018	2019E	2020E	2021E	2018	2019E	2020E	2021E	2018	2019E	2020E	2021E	2018	2019E	2020E	2021E	2018	2019E	2020E	2021E	2018	2019E	2020E	2021E
HDFC Life	ADD	435	384	774	27	34	39	46	152	183	221	265	23	25	24	24	5.1	4.2	3.5	2.9	29	23	20	17	22	22	21	21
ICICI Prudential Life	BUY	480	345	495	37	31	37	43	188	210	241	278	17	18	18	19	2.6	2.4	2.1	1.8	13	16	13	12	23	17	18	18
Max Life	BUY	510	436	117	14	15	18	20	75	87	101	116	20	20	20	20	2.2	1.9	1.6	1.4	12	11	9	8	21	20	20	20
SBI Life	BUY	790	620	620	30	35	43	50	191	217	257	304	16	18	18	18	3.2	2.9	2.4	2.0	21	18	15	12	18	18	20	20

Source: Company, Bloomberg, Kotak Institutional Equities estimates

**Exhibit 5: We expect 17-18% operating RoEV for ICICI Prudential Life**

Key metrics and RoEV movement, March fiscal year-ends, 2015-2021E (₹ bn)

	2015	2016	2017	2018	2019E	2020E	2021E	Comments
<b>APE</b>	47.4	51.7	66.3	77.9	74.0	87.3	103.1	We assume 18% APE growth
Yoy growth (%)	0	9.0	28.1	17.6	(5.0)	18.0	18.0	
<b>VNB</b>	2.7	4.1	6.7	12.9	13.0	15.9	19.1	21% CAGR between FY2019-21E
Yoy growth (%)	0	52.7	61.5	93.1	0.7	23.1	19.6	
<b>EV movement</b>								
Opening Embedded Value (EV)	117.8	137.0	138.8	161.8	187.9	210.1	241.0	
Methodology changes	1.6	1.8	0.0	7.6	0.0	0.0	0.0	
Economic assumption change	(4.2)	(0.7)	0.0	0.0	0.0	0.0	0.0	
VNB	6.4	4.1	6.7	12.9	13.0	15.9	19.1	
Acquisition expense overruns	(3.7)	0.0	0.0	0.0	0.0	0.0	0.0	
Expected return in force	11.7	12.6	12.2	13.7	16.3	18.7	21.4	Unwinding at 8.9%
Operating variance	2.1	4.5	4.1	2.6	2.0	2.5	2.5	Better persistency and mortality
Investment variance	15.1	(6.2)	5.8	1.1	(2.5)	1.0	2.0	We factor moderate capital gains
Dividend payout	(9.8)	(14.4)	(6.3)	(11.9)	(6.6)	(7.3)	(7.9)	
<b>Closing EV</b>	137.0	138.8	161.2	187.9	210.1	241.0	278.1	
<b>Ratios (%)</b>								
VNB margins	5.7	8.0	10.1	16.5	17.5	18.3	18.5	Protection business will drive margins
RoEV	16.4	1.3	16.2	16.5	11.8	14.7	15.4	
Operating RoEV	15.4	16.7	16.5	22.7	16.7	17.7	17.9	

Source: Company, Kotak Institutional Equities estimates

**Exhibit 6: Sensitivities have dropped in FY2018**

Sensitivity to VNB and EV, March fiscal year-ends, 2015-2018 (%)

	VNB				EV			
	2015	2016	2017	2018	2015	2016	2017	2018
Reference rate up 100 bps	1.7	(5.7)	(5.2)	(4.9)	(2.4)	(2.5)	(2.0)	(2.1)
Reference rate down 100 bps	(3.0)	5.7	5.5	5.2	2.6	2.6	2.1	2.2
Discontinuance rate up 10%	(16.0)	(12.3)	(10.6)	(8.6)	(1.0)	(1.1)	(1.1)	(1.3)
Discontinuance rate down 10%	18.0	12.7	10.9	9.1	1.2	1.2	1.2	1.4
Management expenses up 10%	(5.8)	(6.4)	(5.5)	(3.5)	(0.8)	(1.1)	(1.1)	(1.0)
Management expenses down 10%	5.8	6.4	5.4	3.5	0.8	1.0	1.1	1.0
Mortality up 10%	(5.9)	(3.2)	(6.1)	(5.4)	(0.7)	(0.4)	(0.8)	(1.0)
Mortality down 10%	5.9	3.2	6.1	5.5	0.7	0.4	0.8	1.0

Source: Company, Kotak Institutional Equities

**Exhibit 7: We expect protection business at 9-12% of APE and drive 45-50% of VNB**

Contribution of APE and VNB of the pure protection business, March fiscal year-ends, 2016-2021E

	2016	2017	2018	2019E	2020E	2021E
Protection APE (%)	2.7	3.9	5.7	8.6	10.3	11.8
Protection APE (Rs bn)	1.4	2.6	4.5	6.4	9.0	12.2
YoY (%)	83.9	86.3	71.5	42.5	41.6	35.7
Protections VNB (Rs bn)	1.3	2.3	4.0	5.4	7.2	9.8
YoY (%)	106.9	86.3	71.5	34.6	33.3	35.7
Protection VNB/total VNB (%)	30.5	35.1	31.2	41.7	45.2	51.2

Source: Company, Kotak Institutional Equities estimates

**Exhibit 8: ULIPs down 600 bps yoy to 79% while protection moved up 600 bps**

Product mix, March fiscal year ends, 2017-2018, 3QFY18-3QFY19 (%)

	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	(bps change)	9MFY18	9MFY19	(bps change)	2017	2018	(bps change)
Savings	96	90	92	92	90	-595 bps	96	91	-451 bps	96	94	-180 bps
ULIP	85	79	80	84	79	-600 bps	83	81	-195 bps	84	82	-217 bps
PAR	10	9	10	7	9	-138 bps	12	8	-323 bps	10	11	123 bps
Non-par	0	1	1	1	1	43 bps	0	1	39 bps	1	1	-57 bps
Group	1	1	1	1	2	101 bps	1	1	29 bps	1	1	-28 bps
Protection	4	10	8	8	10	600 bps	4	9	451 bps	4	6	180 bps

Notes:

- 1) Protection includes retail and group protection products.
- 2) Group excludes group protection products.

Source: Company, Kotak Institutional Equities

**Exhibit 9: Share of bancassurance rises 260 bps yoy to 57% of APE**

Channel-wise APE, March fiscal year ends, 2017-2018, 3QFY18-3QFY19 (%)

	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	(bps change)	9MFY18	9MFY19	(bps change)	2017	2018	(bps change)
Agency	25	23	22	22	20	-458 bps	26	21	-486 bps	23	25	214 bps
Bancassurance	53	53	56	57	57	356 bps	52	57	442 bps	57	52	-463 bps
Corporate agents and brokers	15	11	12	12	11	-341 bps	14	12	-288 bps	12	14	148 bps
Direct	6	7	7	5	6	-5 bps	6	6	9 bps	6	6	-11 bps
Others (including group protec	1	6	4	4	6	465 bps	2	5	323 bps	2	3	112 bps

Source: Company, Kotak Institutional Equities

**Exhibit 10: Share of ULIPs has dropped across most channels**

Channel-wise product mix, March fiscal year ends, 2015-2018 (%)

	2015	2016	2017	2018
<b>Bancassurance</b>				
ULIP	88.4	88.9	92.1	89.8
Par	10.0	9.1	5.3	7.3
Non-par	0.1	—	0.4	0.2
Protection	1.5	2.0	2.2	2.7
<b>Agency</b>				
ULIP	78.5	76.4	79.5	81.8
Par	19.2	19.6	14.2	13.5
Non-par	1.0	0.8	2.0	0.4
Protection	1.3	3.2	4.3	4.3
<b>Direct</b>				
ULIP	90.5	84.3	85.3	88.0
Par	2.8	7.7	5.0	4.3
Non-par	4.7	3.6	3.2	2.4
Protection	2.0	4.4	6.5	5.3
<b>Corporate agents and brokers</b>				
ULIP	62.0	47.4	46.5	36.8
Par	2.4	0.5	0.4	0.5
Non-par	34.4	49.0	44.1	49.9
Protection	1.2	3.1	9.0	12.8

Source: Company, Kotak Institutional Equities

**Exhibit 11: Persistency ratio improvement at ICICI Life across most buckets except 13<sup>th</sup> month**

Retail persistency (including single premium), March fiscal year ends, 2014-2018, 9MFY18, 8MFY19 (%)

Persistency (%)	2014	2015	2016	2017	9MFY18	2018	8MFY19
13 <sup>th</sup> month	71.5	79.0	82.4	85.7	85.5	86.8	84.1
25 <sup>th</sup> month	68.4	65.9	71.2	73.9	75.4	78.3	76.7
37 <sup>th</sup> month	57.3	64.3	61.6	66.8	66.6	68.8	68.7
49 <sup>th</sup> month	20.3	54.4	62.2	59.3	61.1	64.2	63.2
61 <sup>st</sup> month	12.7	14.5	46.0	56.2	53.6	54.5	55.6

Source: Company, Kotak Institutional Equities

**Exhibit 12: Persistency ratio improved across most channels in FY2018**

Channel-wise persistency, March fiscal year ends, 2014-2018 (%)

	2014	2015	2016	2017	2018	2014	2015	2016	2017	2018
<b>Agency</b>						<b>Bancassurance</b>				
13 <sup>th</sup> month	70	78	85	88	90	75	80	81	84	85
25 <sup>th</sup> month	65	63	69	NA	NA	72	70	72	NA	NA
37 <sup>th</sup> month	45	60	58	NA	NA	76	68	65	NA	NA
49 <sup>th</sup> month	20	42	58	56	59	18	75	66	63	65
61 <sup>st</sup> month	12	15	35	NA	NA	13	12	64	NA	NA
<b>Corporate agency</b>						<b>Direct sales</b>				
13 <sup>th</sup> month	62	71	80	80	89	75	86	88	88	88
25 <sup>th</sup> month	71	59	66	66	NA	70	70	79	79	NA
37 <sup>th</sup> month	42	68	56	56	NA	47	66	65	65	NA
49 <sup>th</sup> month	20	37	67	67	58	31	42	64	64	63
61 <sup>st</sup> month	14	14	30	30	NA	13	24	34	34	NA

Source: Company, Kotak Institutional Equities

**Exhibit 13: Cost to average AUM ratio down 12 bps yoy**

March fiscal year ends, 2017-2018, 3QFY18-3QFY19 (₹ mn)

Key financials (Rs mn)	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	YoY (%)	9MFY18	9MFY19	YoY (%)	2017	2018	YoY (%)
Premium	68,556	87,289	55,179	76,819	75,664	10	183,398	207,661	13	223,540	270,688	21
First year	19,339	20,213	12,587	18,394	16,438	(15)	53,349	47,419	(11)	63,446	73,562	16
Renewal	45,390	61,476	37,476	51,027	50,071	10	117,094	138,574	18	144,907	178,570	23
Single	3,827	5,600	5,116	7,399	9,154	139	12,956	21,669	67	15,187	18,556	22
<b>APE</b>	<b>19,722</b>	<b>20,773</b>	<b>13,099</b>	<b>19,133</b>	<b>17,354</b>	<b>(12)</b>	<b>54,644</b>	<b>49,586</b>	<b>(9)</b>	<b>64,965</b>	<b>75,417</b>	<b>16</b>
Commission (I)	3,773	4,466	2,796	3,951	3,671	(3)	9,567	10,418	9	7,589	14,033	85
First year	2,828	3,178	1,996	2,851	2,675	(5)	7,067	7,523	6	4,601	10,245	123
Renewal	845	1,161	713	995	893	6	2,280	2,601	14	2,903	3,441	19
Single	100	127	87	105	103	3	220	295	34	85	347	308
Operating expenses (II)	5,211	6,048	5,952	6,585	5,785	11	14,252	18,322	29	23,572	20,299	(14)
<b>Expenses of management (I)+(II)</b>	<b>8,984</b>	<b>10,513</b>	<b>8,748</b>	<b>10,536</b>	<b>9,456</b>	<b>5</b>	<b>23,819</b>	<b>28,739</b>	<b>21</b>	<b>31,161</b>	<b>34,332</b>	<b>10</b>
AUM (Rs bn)	1,383	1,395	1,427	1,461	1,500	8	1,383	1,500	8	1,229	1,395	14
<b>Key calculated ratios (%)</b>												
<b>Cost/premium</b>	<b>13.80</b>	<b>12.78</b>	<b>17.30</b>	<b>15.02</b>	<b>14.02</b>	<b>23 bps</b>	<b>13.87</b>	<b>15.27</b>	<b>140 bps</b>	<b>14.85</b>	<b>13.52</b>	<b>-133 bps</b>
<b>Cost/average AUM</b>	<b>2.67</b>	<b>3.03</b>	<b>2.48</b>	<b>2.92</b>	<b>2.55</b>	<b>-12 bps</b>	<b>2.43</b>	<b>2.65</b>	<b>22 bps</b>	<b>2.75</b>	<b>2.62</b>	<b>-13 bps</b>
<b>Net commission ratio</b>	<b>5.79</b>	<b>5.43</b>	<b>5.53</b>	<b>5.63</b>	<b>5.45</b>	<b>-35 bps</b>	<b>5.57</b>	<b>5.54</b>	<b>-3 bps</b>	<b>3.62</b>	<b>5.52</b>	<b>191 bps</b>
First year	19.51	22.09	22.21	21.48	22.33	283 bps	17.93	21.97	404 bps	11.96	19.08	711 bps
Renewal	1.86	1.89	1.90	1.95	1.78	-8 bps	1.95	1.88	-7 bps	2.00	1.93	-8 bps
Single	2.62	2.27	1.69	1.42	1.12	-150 bps	1.70	1.36	-34 bps	0.56	1.87	131 bps

Notes:

(1) Net commission ratio: commission/(total premium-0.9 X single premium).

(2) Cost/average AUM: annualised expenses of management/average AUM during the period.

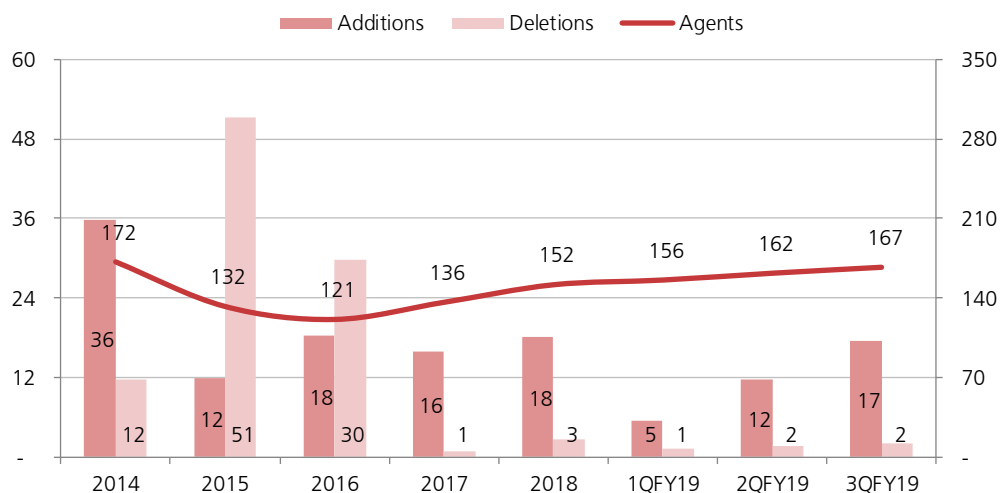
Source: Company, Kotak Institutional Equities

**Exhibit 14: Debt AUMs stable at 53%**  
 March fiscal year ends, 2017-2018, 3QFY18-3QFY19 (₹ bn)

	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	YoY (%)	2017	2018	YoY (%)
Linked mix	1,383	1,395	1,427	1,461	1,500	8	1,229	1,395	14
Linked	983	975	997	1,016	1,037	5	879	975	11
Non linked	400	420	429	445	463	16	350	420	20
Equity mix	1,383	1,395	1,427	1,461	1,500	8	1,229	1,395	14
Equity	719	656	671	687	705	(2)	575	656	14
Debt	664	740	756	774	795	20	654	740	13

Source: Company, Kotak Institutional Equities

**Exhibit 15: Net individual agents continue to rise**  
 Individual agents, March fiscal year ends, 2014-2018, 1QFY19-3QFY19 (# '000)



Source: LIC Council

**Exhibit 16: New and old estimates**

Comparison of old and new EV estimates of ICICI Prudential Life, March fiscal year-ends, 2019-2021E (₹ bn)

	New estimates			Old estimates			New versus old (%)		
	2019E	2020E	2021E	2019E	2020E	2021E	2019E	2020E	2021E
Opening Embedded value (EV)	188	210	241	188	210	241	0	0	(0)
Methodology/ assumption changes									
Economic assumption change									
VNB	13	16	19	13	16	19	(3)	(1)	0
Expected return in force									
Operating variance	2	3	3	2	3	3	0	0	0
Tax changes	0	0	0	0	0	0			
Economic/investment variance	(3)	1	2	(3)	1	2	(17)	0	0
Dividend payout	(7)	(7)	(8)	(7)	(7)	(8)	0	0	0
Closing EV	210	241	278	210	241	278	0	(0)	(0)
EVOP	31	37	43	32	37	43	(1.2)	(0.6)	(0.0)
RoEV (%)	12	15	15	12	15	15	7 bps	-11 bps	0 bps
Operating RoEV (%)	17	18	18	17	18	18	-20 bps	-11 bps	0 bps
APE	74	87	103	74	87	103	0	0	0
VNB post overrun	13	16	19	13	16	19	(3)	(1)	0
VNB margins post overrun (%)	18	18	19	18	19	19	-50 bps	-25 bps	0 bps

Source: Company, Kotak Institutional Equities estimates

JANUARY 22, 2019

**RESULT**

Coverage view: **Cautious**

Price (₹): 711

Fair Value (₹): 520

BSE-30: 36,445

**Impressive topline growth but margins below expectations.** Havells reported 3QFY19 EBITDA of ₹2.95 bn (+12% yoy), which was 3% ahead of our estimates. Revenue growth was strong at 28% yoy led by (1) high-teens industry revenue growth (aided by low base) and (2) expansion of product portfolio in existing segments, market share gain and successful entry into new categories. We believe that Havells has built an impressive franchise, which will help it deliver double-digit earnings growth over the medium term. Valuations, however, are very expensive (43X FY2020E EPS); SELL stays.

**Company data and valuation summary**

Havells India

**Stock data**

52-week range (Rs) (high,low)	729-450		
Market Cap. (Rs bn)	445.0		
<b>Shareholding pattern (%)</b>			
Promoters	59.5		
FIs	25.8		
MFs	4.8		
<b>Price performance (%)</b>			
	1M	3M	12M
Absolute	2.9	20.7	28.7
Rel. to BSE-30	0.9	13.1	26.4

**Forecasts/Valuations**

	2019E	2020E	2021E
EPS (Rs)	13.4	16.5	19.6
EPS growth (%)	21.1	23.3	18.4
P/E (X)	53.0	43.0	36.3
Sales (Rs bn)	102.7	118.7	136.4
Net profits (Rs bn)	8.4	10.3	12.2
EBITDA (Rs bn)	12.5	15.5	18.2
EV/EBITDA (X)	34.3	27.5	23.0
ROE (%)	21.1	22.9	23.7
Div. Yield (%)	0.7	0.8	1.0

**Strong revenue growth across segments; profitability a tad below estimates though**

- ▶ Havells reported 3QFY19 EBITDA of ₹2.95 bn (+12% yoy), which was 3% ahead of our estimates led by stronger-than-expected revenue growth partly offset by lower EBITDA margin. Revenues increased by 28% yoy (KIE: 15% yoy), which was driven by (1) 29% yoy growth in erstwhile Havells business (9% above estimates) and (2) 22% yoy growth in Lloyd revenues (35% ahead of estimates).
- ▶ The company reported strong double-digit revenue growth across segments—(1) 34% yoy growth in ECD segment aided by market share gains and ramp-up of new categories such as water purifiers, water heaters, etc., (2) 21%/31% yoy growth in switchgear/cables and wires segments led by low base, increased traction in industrial segments and some pick-up in demand from residential segment and (3) 29% yoy growth in lighting segment revenues.
- ▶ EBITDA margin came in at 11.7% (down 160 bps yoy and 30 bps qoq), which was 110 bps below our estimates. The miss in EBITDA margin was due to (1) higher revenue mix from low-margin Lloyd business and weaker EBITDA margin in the Lloyd business (2.6% versus estimate of 5%) and (2) commodity cost pressures and delayed price hikes in ECD segment. The company reported PAT of ₹1.96 bn (+9% yoy), which was in line with our estimates.

**Expect the company to deliver 21% EPS CAGR over FY2019-21E**

Havells has a well-diversified product portfolio and it has built a strong brand and distribution network over the years, which should enable it to penetrate deeper into existing categories and expand presence in newer segments. We believe that Havells has the potential to deliver strong double-digit revenue growth over the medium term. We build in 21% EPS CAGR over FY2019-21E led by (1) 15% revenue CAGR and (2) 110 bps expansion in EBITDA margin.

**Earnings estimates unchanged; SELL stays on expensive valuations**

While we like the company's strong franchisee and premium brand positioning across segments, expensive valuations drive our SELL rating on the stock. DCF-based fair value revised to ₹520 (from ₹490) on rollover to Dec 2020 EPS and marginal increase in long-term growth assumptions.

Nishit Jalan

Hitesh Goel

Rishi Vora

### More details on reasons for revenue growth and segmental performance

- ▶ **Strong industry growth, portfolio expansion and market share gains driving growth.** Revenues of ex-Lloyd business are up 25% yoy in 9MFY19 partly due to low base (revenues were up 8% yoy in 9MFY18) driven by strong double-digit growth across segments except lighting segment revenues. On a two-year basis, 9MFY19 revenues have grown at 16% CAGR led by (1) 9-10% growth in industry revenues, (2) strong growth in premium segments (such as premium fans where Havells has 40%+ market share) where Havells has stronger presence, (3) expansion of portfolio across segments such as switchgears and cables and wires—increase in focus in B2B segments, which are growing at faster pace, (4) ramp-up of revenues across segments such as domestic appliances, water heaters, etc. where Havells had relatively lower market share and (5) entry into newer product categories such as water purifiers, personal grooming products, etc.
- ▶ **Strong demand from B2B segments and pick-up in residential segment driving growth in switchgear and cables and wires segments.** Revenues in the switchgear segment grew by 21% yoy while cables and wires business revenues increased by 31% yoy (24-25% volume growth) in 3QFY19. Demand in both these segments were aided by (1) stronger growth in B2B segments due to government-led initiative in electrification and infrastructure and increased focus of the company in industrial switchgear segment and (2) pick-up in demand from residential segment (up 20% yoy) on a low base of last year.
- ▶ **Core lighting revenues grew by 18% yoy in 3QFY19.** Overall lighting segment revenues for the company grew by 29% yoy in 3QFY19—(1) core lighting segment revenues grew by 18% yoy aided by strong double-digit industry growth and (2) EESL/B2G project business revenues increased by almost 200% yoy to ₹506 mn versus ₹171 mn in 3QFY18 (tends to be lumpy in nature—revenues down 55% yoy in 9MFY19).
- ▶ **Another strong quarter in electrical consumer durables (ECD) segment.** Electrical consumer durable segment revenues increased by 34% yoy in 3QFY19 (+36% yoy in 9MFY19), which was driven by (1) high-teens revenue growth in premium fans segment due to premiumization trend in the industry (Havells is present only in premium fans segment and has 40%+ market share in this segment), (2) significant growth in domestic appliances and water heaters due to strong festive season and relatively lower presence of Havells in home appliances segment so far (this sub-segment can continue to grow at 20%+ for the company over the next 2-3 years) and (3) entry into newer categories such as water purifiers last year and personal grooming products (entered two years back).
- ▶ **Strong revenue growth in Lloyds business but disappointing profitability.** Revenues of Lloyd business grew by 22% yoy despite weak industry demand. As per the management, there was strong growth in washing machine and television revenues while AC revenues were up marginally on yoy basis. We note that the growth has come at the expense of profitability (higher offers given to reduce dealer inventory levels) as EBITDA margin was low at 2.6%; down 420 bps yoy.
- ▶ **Delayed price hikes impact profitability in ECD segment.** Profitability in lighting and switchgear segment was largely steady on qoq basis while there was an improvement in cables and wires segment. Contribution margin in ECD segment declined by 420 bps yoy (down 190 bps qoq) and was 260 bps below our estimates due to delay in price hikes required to pass on input cost pressures. We expect the segmental margins to improve in 4QFY19 due to recent softening in commodity prices.

**Exhibit 1: Revenue growth surprised positively but this was partly offset by lower-than-expected EBITDA margin**  
Interim results of Havells, March fiscal year-ends (₹ mn)

					Change (%)								
	3QFY19	3QFY19E	3QFY18	2QFY19	3QFY19E	3QFY18	2QFY19	9MFY19	9MFY18	Yoy (%)	FY2019E	FY2018	Yoy (%)
<b>Net revenues</b>	<b>25,184</b>	<b>22,500</b>	<b>19,658</b>	<b>21,910</b>	<b>11.9</b>	<b>28.1</b>	<b>14.9</b>	<b>73,058</b>	<b>56,037</b>	<b>30.4</b>	<b>102,703</b>	<b>81,386</b>	<b>26.2</b>
Total expenditure	(22,239)	(19,627)	(17,036)	(19,285)	13.3	30.5	15.3	(64,364)	(49,121)	31.0	(90,210)	(70,893)	
Material consumed	(15,751)	(13,657)	(11,863)	(13,519)	15.3	32.8	16.5	(45,478)	(34,080)	33.4	(63,368)	(49,808)	
Employee expenses	(2,108)	(2,070)	(1,625)	(2,034)	1.8	29.7	3.7	(6,111)	(4,860)	25.7	(8,056)	(6,497)	
Other expenses	(4,380)	(3,900)	(3,547)	(3,733)	12.3	23.5	17.3	(12,775)	(10,181)	25.5	(18,786)	(14,588)	
Of which A&P spend	(915)	(741)	(786)	(741)	23.4	16.4	23.4	(2,813)	(2,030)	38.6	(3,999)	(3,076)	
<b>EBITDA</b>	<b>2,946</b>	<b>2,873</b>	<b>2,622</b>	<b>2,625</b>	<b>2.5</b>	<b>12.3</b>	<b>12.2</b>	<b>8,693</b>	<b>6,916</b>	<b>25.7</b>	<b>12,493</b>	<b>10,493</b>	<b>19.1</b>
<b>Margins (%)</b>	<b>11.7</b>	<b>12.8</b>	<b>13.3</b>	<b>12.0</b>				<b>11.9</b>	<b>12.3</b>		<b>12.2</b>	<b>12.9</b>	
Depreciation	(353)	(395)	(363)	(391)	(10.6)	(2.7)	(9.8)	(1,095)	(1,048)		(1,496)	(1,395)	
<b>EBIT</b>	<b>2,593</b>	<b>2,478</b>	<b>2,259</b>	<b>2,234</b>	<b>4.6</b>	<b>14.8</b>	<b>16.1</b>	<b>7,598</b>	<b>5,868</b>	<b>29.5</b>	<b>10,997</b>	<b>9,098</b>	<b>20.9</b>
<b>Margins (%)</b>	<b>10.3</b>	<b>11.0</b>	<b>11.5</b>	<b>10.2</b>				<b>10.4</b>	<b>10.5</b>		<b>10.7</b>	<b>11.2</b>	
Other income	331	350	278	343	(5.5)	19.1	(3.7)	966	913		1,310	1,170	
Interest expenses	(36)	(40)	(55)	(37)	(11.0)	(35.2)	(2.7)	(98)	(156)		(160)	(240)	
PBT	2,888	2,788	2,482	2,540	3.6	16.4	13.7	8,467	6,624		12,147	10,028	
Extraordinaries	—	—	210	—				—	210		—	119	
Reported PBT	2,888	2,788	2,692	2,540	3.6	7.3	13.7	8,467	6,834		12,147	10,147	
Tax	(931)	(864)	(748)	(754)	7.7	24.5	23.4	(2,620)	(1,967)		(3,766)	(3,022)	
<b>Reported PAT</b>	<b>1,957</b>	<b>1,924</b>	<b>1,944</b>	<b>1,786</b>	<b>1.7</b>	<b>0.7</b>	<b>9.5</b>	<b>5,847</b>	<b>4,868</b>		<b>8,382</b>	<b>7,125</b>	
<b>Adjusted PAT</b>	<b>1,957</b>	<b>1,924</b>	<b>1,797</b>	<b>1,786</b>	<b>1.7</b>	<b>8.9</b>	<b>9.5</b>	<b>5,847</b>	<b>4,721</b>	<b>23.9</b>	<b>8,382</b>	<b>7,042</b>	<b>19.0</b>
Number of shares (mn)	625	625	625	625				625	625		625	625	
<b>Adjusted EPS (Rs)</b>	<b>3.1</b>	<b>3.1</b>	<b>2.9</b>	<b>2.9</b>	<b>1.7</b>	<b>8.9</b>	<b>9.5</b>	<b>9.4</b>	<b>7.6</b>	<b>23.9</b>	<b>13.4</b>	<b>11.3</b>	<b>19.0</b>
<b>Key ratios (%)</b>													
RM as % of sales	62.5	60.7	60.3	61.7				62.2	60.8		61.7	61.2	
Employee cost as % of sales	8.4	9.2	8.3	9.3				8.4	8.7		7.8	8.0	
Other expenditure as % of sales	17.4	17.3	18.0	17.0				17.5	18.2		18.3	17.9	
Effective tax rate	32.2	31.0	27.8	29.7				30.9	28.8		31.0	29.8	
<b>Segmental Revenues</b>													
Switchgear	4,162	4,200	3,443	4,231	(0.9)	20.9	(1.6)	12,434	10,130	22.7	17,034	14,077	21.0
Cable and Wires	8,203	7,700	6,256	7,665	6.5	31.1	7.0	23,367	18,313	27.6	32,372	26,002	24.5
Lighting and fixtures - India	3,695	3,100	2,871	2,856	19.2	28.7	29.4	9,134	8,337	9.6	12,951	11,563	12.0
Electrical consumer durables	5,552	4,850	4,158	4,579	14.5	33.5	21.2	14,890	10,956	35.9	20,690	15,602	32.6
Lloyd	3,572	2,650	2,930	2,579	34.8	21.9	38.5	13,232	8,300	59.4	19,656	14,141	39.0
<b>Total</b>	<b>25,184</b>	<b>22,500</b>	<b>19,658</b>	<b>21,910</b>	<b>11.9</b>	<b>28.1</b>	<b>14.9</b>	<b>73,058</b>	<b>56,036</b>	<b>30.4</b>	<b>102,703</b>	<b>81,385</b>	<b>26.2</b>
<b>Contribution</b>													
Switchgear	1,631	1,638	1,380	1,628	(0.4)	18.2	0.2	4,808	4,049	18.7	6,609	5,572	18.6
Cable and Wires	1,294	1,309	1,070	1,070	(1.2)	20.9	20.9	3,642	3,063	18.9	5,115	4,380	16.8
Lighting and fixtures - India	1,089	899	818	847	21.1	33.1	28.6	2,647	2,358	12.2	3,756	3,356	11.9
Electrical consumer durables	1,412	1,358	1,230	1,250	4.0	14.8	13.0	4,029	2,940	37.1	5,664	4,202	34.8
Lloyd	531	424	480	476	25.3	10.7	11.6	2,378	1,401	69.8	3,676	2,683	37.0
Unallocable	(3,033)	(2,800)	(2,441)	(2,694)	8.3	24.3	12.6	(8,939)	(7,030)	27.2	(12,512)	(9,926)	26.1
<b>Overall contribution</b>	<b>2,923</b>	<b>2,828</b>	<b>2,537</b>	<b>2,577</b>	<b>3.4</b>	<b>15.2</b>	<b>13.4</b>	<b>8,564</b>	<b>6,780</b>	<b>26.3</b>	<b>12,307</b>	<b>10,267</b>	<b>19.9</b>
<b>Contribution margin (%)</b>													
Switchgear	39.2	39.0	40.1	38.5				38.7	40.0		38.8	39.6	
Cable and Wires	15.8	17.0	17.1	14.0				15.6	16.7		15.8	16.8	
Lighting and fixtures - India	29.5	29.0	28.5	29.6				29.0	28.3		29.0	29.0	
Electrical consumer durables	25.4	28.0	29.6	27.3				27.1	26.8		27.4	26.9	
Lloyd	14.9	16.0	16.4	18.5				18.0	16.9		18.7	19.0	
Unallocable as % of sales	12.0	12.4	12.4	12.3				12.2	12.5		12.2	12.2	

Source: Company, Kotak Institutional Equities estimates

**Exhibit 2: Revenues of ex-Lloyd and Lloyds businesses grew by 29% and 22% yoy respectively in 3QFY19**  
Quarterly breakdown of Havells overall revenues and EBITDA, March fiscal year-ends (₹ mn, %)

	3QFY19	3QFY19E	3QFY18	2QFY19	Change (%)			9MFY19	9MFY18	Yoy (%)	FY2019E	FY2018	Yoy (%)
					3QFY19E	3QFY18	2QFY19						
<b>Total revenues</b>	<b>25,184</b>	<b>22,500</b>	<b>19,658</b>	<b>21,910</b>	<b>11.9</b>	<b>28.1</b>	<b>14.9</b>	<b>73,058</b>	<b>56,037</b>	<b>30.4</b>	<b>102,703</b>	<b>81,386</b>	<b>26.2</b>
- Havells ex-Lloyd	21,613	19,850	16,728	19,331	8.9	29.2	11.8	59,826	47,737	25.3	83,047	67,245	23.5
- Lloyd	3,572	2,650	2,930	2,579	34.8	21.9	38.5	13,232	8,300	59.4	19,656	14,141	39.0
<b>Total EBITDA</b>	<b>2,946</b>	<b>2,873</b>	<b>2,622</b>	<b>2,625</b>	<b>2.5</b>	<b>12.3</b>	<b>12.2</b>	<b>8,693</b>	<b>6,915</b>	<b>25.7</b>	<b>12,493</b>	<b>10,493</b>	<b>19.1</b>
- Havells ex-Lloyd	2,853	2,741	2,422	2,541	4.1	17.8	12.3	7,942	6,385	24.4	11,118	9,226	20.5
- Lloyd	93	133	200	84	(29.8)	(53.5)	10.7	751	530	41.7	1,376	1,267	8.6
<b>Overall EBITDA margin</b>	<b>11.7</b>	<b>12.8</b>	<b>13.3</b>	<b>12.0</b>				<b>11.9</b>	<b>12.3</b>		<b>12.2</b>	<b>12.9</b>	
- Havells ex-Lloyd	13.2	13.8	14.5	13.1				13.3	13.4		13.4	13.7	
- Lloyd	2.6	5.0	6.8	3.3				5.7	6.4		7.0	9.0	

Source: Company, Kotak Institutional Equities estimates

**Exhibit 3: We expect ex-Lloyds revenues to grow at 15% CAGR over FY2019-21E**

Annual breakdown of Havells overall revenues and EBITDA, March fiscal year-ends (₹ mn, %)

	2017	2018	2019E	2020E	2021E	CAGR (%)	
						2017-2019E	2019-21E
<b>Total revenues</b>	<b>61,558</b>	<b>81,464</b>	<b>102,703</b>	<b>118,730</b>	<b>136,379</b>	<b>29.2</b>	<b>15.2</b>
- Havells ex-Lloyd	61,558	67,323	83,047	95,536	109,010	16.2	14.6
- Lloyd	—	14,141	19,656	23,194	27,369		18.0
<b>Total EBITDA</b>	<b>8,182</b>	<b>10,434</b>	<b>12,493</b>	<b>15,468</b>	<b>18,175</b>	<b>23.6</b>	<b>20.6</b>
- Havells ex-Lloyd	8,182	9,167	11,118	13,381	15,438	16.6	17.8
- Lloyd	—	1,267	1,376	2,087	2,737		41.0
<b>Overall EBITDA margin (%)</b>	<b>13.3</b>	<b>12.8</b>	<b>12.2</b>	<b>13.0</b>	<b>13.3</b>		
- Havells ex-Lloyd	13.3	13.6	13.4	14.0	14.2		
- Lloyd		9.0	7.0	9.0	10.0		

Source: Company, Kotak Institutional Equities estimates

**Exhibit 4: Our FY2019-21E earnings estimates are largely unchanged**

Earnings revision table, March fiscal year-ends, 2019-21E (₹ mn, %)

	New estimates			Old estimates			Change (%)		
	2019E	2020E	2021E	2019E	2020E	2021E	2019E	2020E	2021E
Revenues	102,703	118,730	136,379	98,146	114,690	131,739	4.6	3.5	3.5
EBITDA	12,493	15,468	18,175	12,402	15,499	18,145	0.7	(0.2)	0.2
EBITDA (%)	12.2	13.0	13.3	12.6	13.5	13.8			
PAT	8,382	10,333	12,230	8,284	10,335	12,164	1.2	(0.0)	0.5
<b>EPS (Rs)</b>	<b>13.4</b>	<b>16.5</b>	<b>19.6</b>	<b>13.3</b>	<b>16.5</b>	<b>19.5</b>	<b>1.2</b>	<b>(0.0)</b>	<b>0.5</b>

Source: Kotak Institutional Equities estimates

## Exhibit 5: Expect strong double-digit revenue growth across segments in FY2019-21E

Revenue and contribution margin assumptions by segments, March fiscal year-ends, 2014-21E (₹ mn, %)

	2014	2015	2016	2017	2018	2019E	2020E	2021E
<b>Segmental net revenues</b>								
Cables & Wires	19,264	21,904	21,865	23,794	26,002	32,372	36,257	40,608
Electrical Consumer Durables	8,534	10,283	11,264	13,784	15,602	20,690	24,837	28,988
Lloyd					14,141	19,656	23,194	27,369
Lighting & Fixtures	7,207	7,410	7,930	9,710	11,563	12,951	15,023	17,276
Switchgears	12,192	12,790	12,724	14,065	14,078	17,034	19,419	22,138
<b>Total revenue</b>	<b>47,197</b>	<b>52,387</b>	<b>53,783</b>	<b>61,353</b>	<b>81,386</b>	<b>102,703</b>	<b>118,730</b>	<b>136,379</b>
<b>Yoy growth (%)</b>								
Cables & Wires		13.7	(0.2)	8.8	9.3	24.5	12.0	12.0
Electrical Consumer Durables		20.5	9.5	22.4	13.2	32.6	20.0	16.7
Lloyd						39.0	18.0	18.0
Lighting & Fixtures		2.8	7.0	22.4	19.1	12.0	16.0	15.0
Switchgears		4.9	(0.5)	10.5	0.1	21.0	14.0	14.0
<b>Total revenue</b>		<b>11.0</b>	<b>2.7</b>	<b>14.1</b>	<b>32.7</b>	<b>26.2</b>	<b>15.6</b>	<b>14.9</b>
<b>Segmental revenue mix (%)</b>								
Cables & Wires	40.8	41.8	40.7	38.8	31.9	31.5	30.5	29.8
Electrical Consumer Durables	18.1	19.6	20.9	22.5	19.2	20.1	20.9	21.3
Lloyd	—	—	—	—	17.4	19.1	19.5	20.1
Lighting & Fixtures	15.3	14.1	14.7	15.8	14.2	12.6	12.7	12.7
Switchgears	25.8	24.4	23.7	22.9	17.3	16.6	16.4	16.2
<b>Total revenue</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>
<b>Contribution from segments</b>								
Cables & Wires	2,110	2,657	3,089	3,256	4,380	5,115	6,164	6,903
Electrical Consumer Durables	2,304	2,580	2,864	3,494	4,202	5,664	6,798	7,931
Lloyd					2,683	3,676	4,523	5,474
Lighting & Fixtures	1,787	1,969	1,909	2,651	3,356	3,756	4,357	5,010
Switchgears	4,032	4,390	5,006	5,610	5,572	6,609	7,573	8,634
<b>Total contribution</b>	<b>10,233</b>	<b>11,595</b>	<b>12,868</b>	<b>15,011</b>	<b>20,193</b>	<b>24,820</b>	<b>29,414</b>	<b>33,952</b>
Unallocable expenses	(4,012)	(4,957)	(5,675)	(6,623)	(9,926)	(12,512)	(14,279)	(16,068)
<b>Overall EBIT</b>	<b>6,220</b>	<b>6,638</b>	<b>7,194</b>	<b>8,388</b>	<b>10,267</b>	<b>12,307</b>	<b>15,136</b>	<b>17,885</b>
<b>Segmental contribution mix (%)</b>								
Cables & Wires	20.6	22.9	24.0	21.7	21.7	20.6	21.0	20.3
Electrical Consumer Durables	22.5	22.2	22.3	23.3	20.8	22.8	23.1	23.4
Lloyd					13.3	14.8	15.4	16.1
Lighting & Fixtures	17.5	17.0	14.8	17.7	16.6	15.1	14.8	14.8
Switchgears	39.4	37.9	38.9	37.4	27.6	26.6	25.7	25.4
<b>Total contribution</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>
<b>Contribution margin (%)</b>								
Cables & Wires	11.0	12.1	14.1	13.7	16.8	15.8	17.0	17.0
Electrical Consumer Durables	27.0	25.1	25.4	25.3	26.9	27.4	27.4	27.4
Lloyd					19.0	18.7	19.5	20.0
Lighting & Fixtures	24.8	26.6	24.1	27.3	29.0	29.0	29.0	29.0
Switchgears	33.1	34.3	39.3	39.9	39.6	38.8	39.0	39.0
<b>Contribution margin (%)</b>	<b>21.7</b>	<b>22.1</b>	<b>23.9</b>	<b>24.5</b>	<b>24.8</b>	<b>24.2</b>	<b>24.8</b>	<b>24.9</b>
Unallocable expenses as % of sales	(8.5)	(9.5)	(10.6)	(10.8)	(12.2)	(12.2)	(12.0)	(11.8)
<b>Overall EBIT</b>	<b>13.2</b>	<b>12.7</b>	<b>13.4</b>	<b>13.7</b>	<b>12.6</b>	<b>12.0</b>	<b>12.7</b>	<b>13.1</b>

Source: Company, Kotak Institutional Equities estimates

## Exhibit 6: Our DCF-based fair value is ₹520

DCF valuation of Havells, March fiscal year-ends, 2018-35E (₹ mn)

	2018	2019E	2020E	2021E	2022E	2023E	2024E	2025E	2033E	2034E	2035E
<b>FCFF calculation</b>											
Net revenue	81,464	102,703	118,730	136,379	156,835	180,361	202,004	226,245	511,574	552,500	596,700
Revenue growth (%)	32.3	26.1	15.6	14.9	15.0	15.0	12.0	12.0	8.0	8.0	8.0
EBITDA	10,434	12,493	15,468	18,175	21,173	24,349	27,271	30,543	69,062	74,587	80,554
EBITDA margin (%)	12.8	12.2	13.0	13.3	13.5	13.5	13.5	13.5	13.5	13.5	13.5
Operating tax expense	(2,754)	(3,409)	(4,239)	(4,983)	(5,827)	(6,705)	(7,525)	(8,433)	(19,161)	(20,682)	(22,312)
NOPLAT	6,275	7,588	9,436	11,091	12,969	14,923	16,750	18,770	42,649	46,035	49,663
Depreciation	1,405	1,496	1,793	2,100	2,378	2,721	2,996	3,341	7,252	7,870	8,579
Change in working capital	2,702	(34)	(1,205)	213	271	312	287	322	503	543	587
Capital expenditure	(15,892)	(5,000)	(2,500)	(2,600)	(3,871)	(4,132)	(3,706)	(4,502)	(6,973)	(8,475)	(9,248)
Free cash flow to the firm	(5,511)	4,050	7,524	10,805	11,747	13,824	16,327	17,930	43,431	45,973	49,581
<b>Key assumptions and value drivers</b>											
Tax rate (%)	31	31	31	31	31	31	31	31	31	31	31
Gross FATR (%)	5.2	5.0	5.1	5.3	5.3	5.3	5.4	5.4	5.4	5.4	5.3
NWC ex-cash as % of sales	(3.5)	(2.7)	(1.3)	(1.3)	(1.3)	(1.3)	(1.3)	(1.3)	(1.3)	(1.3)	(1.3)
<b>DCF valuation</b>											
Terminal growth rate (%)	5.0										
WACC (%)	11.5										
<b>EV and target price calculation</b>											
Sum of discounted FCF	158,239										
PV of terminal value	152,282										
Enterprise value	310,521										
Net debt/(cash)	(15,500)										
Equity value	326,021										
Target price (Rs/share)	522										

Source: Company, Kotak Institutional Equities estimates

## Exhibit 7: We expect Havells to deliver 21% EPS CAGR over FY2019-21E

Consolidated financial summary of Havells, March fiscal year-ends, 2012-21E (₹ mn)

	2012	2013	2014	2015	2016	2017	2018	2019E	2020E	2021E
<b>Profit model</b>										
Total income	65,182	72,479	81,858	85,694	76,126	61,558	81,464	102,703	118,730	136,379
<b>EBITDA</b>	<b>6,573</b>	<b>6,744</b>	<b>7,425</b>	<b>7,211</b>	<b>7,580</b>	<b>8,182</b>	<b>10,434</b>	<b>12,493</b>	<b>15,468</b>	<b>18,175</b>
Interest (expense)/income	(1,281)	(1,232)	(741)	(640)	(544)	(133)	(248)	(160)	(160)	(160)
Depreciation	(949)	(1,097)	(1,155)	(1,387)	(1,344)	(1,205)	(1,405)	(1,496)	(1,793)	(2,100)
Other income	414	279	413	505	866	1,382	1,179	1,310	1,460	1,810
<b>Pretax profits</b>	<b>4,757</b>	<b>4,694</b>	<b>5,941</b>	<b>5,690</b>	<b>6,559</b>	<b>8,225</b>	<b>9,960</b>	<b>12,147</b>	<b>14,976</b>	<b>17,725</b>
Extraordinary items	—	1,944	—	—	8,621	(949)	(312)	—	—	—
<b>Reported PBT</b>	<b>4,757</b>	<b>6,638</b>	<b>5,941</b>	<b>5,690</b>	<b>15,180</b>	<b>7,276</b>	<b>9,648</b>	<b>12,147</b>	<b>14,976</b>	<b>17,725</b>
Tax	(1,058)	(824)	(1,478)	(1,836)	(2,193)	(2,288)	(3,038)	(3,766)	(4,642)	(5,495)
Minority interest	5	—	—	—	18	(44)	14	—	—	—
<b>Profit after tax</b>	<b>3,704</b>	<b>5,814</b>	<b>4,463</b>	<b>3,854</b>	<b>13,005</b>	<b>4,945</b>	<b>6,624</b>	<b>8,382</b>	<b>10,333</b>	<b>12,230</b>
<b>Adjusted PAT</b>	<b>3,704</b>	<b>4,453</b>	<b>4,463</b>	<b>3,854</b>	<b>6,970</b>	<b>5,609</b>	<b>6,842</b>	<b>8,382</b>	<b>10,333</b>	<b>12,230</b>
<b>EPS (Rs)</b>	<b>5.9</b>	<b>7.1</b>	<b>7.2</b>	<b>6.2</b>	<b>11.2</b>	<b>9.0</b>	<b>10.9</b>	<b>13.4</b>	<b>16.5</b>	<b>19.6</b>
<b>Balance sheet</b>										
Total equity	9,556	14,420	16,660	18,182	30,277	32,768	37,292	42,143	48,123	55,201
Deferred tax liability and minority interest	557	481	468	(137)	1,058	1,259	2,193	2,193	2,193	2,193
Total borrowings	9,795	9,785	10,506	4,191	855	2,083	1,424	1,350	1,350	1,350
Long-term provisions	3,174	3,132	3,889	4,524	127	100	247	239	239	239
Current liabilities	18,672	16,761	21,801	20,980	11,560	13,714	24,918	27,880	30,523	34,956
<b>Total liabilities and equity</b>	<b>41,754</b>	<b>44,579</b>	<b>53,324</b>	<b>47,740</b>	<b>43,876</b>	<b>49,925</b>	<b>66,074</b>	<b>73,805</b>	<b>82,428</b>	<b>93,939</b>
Cash	2,336	4,736	8,817	9,530	14,680	19,745	15,620	16,850	20,918	27,710
Current assets	24,847	24,594	28,059	22,417	14,696	15,302	21,851	24,847	28,695	32,915
Fixed assets plus intangibles	14,571	15,250	16,448	15,793	14,500	14,878	28,603	32,107	32,814	33,314
<b>Total assets</b>	<b>41,754</b>	<b>44,579</b>	<b>53,324</b>	<b>47,740</b>	<b>43,876</b>	<b>49,925</b>	<b>66,074</b>	<b>73,805</b>	<b>82,428</b>	<b>93,939</b>
<b>Free cash flow</b>										
Operating cash flow, excl. working capital	5,753	7,764	6,962	5,474	6,328	7,102	8,298	8,728	10,826	12,680
Working capital changes	(1,234)	(1,419)	1,719	4,152	(1,015)	1,135	2,702	(34)	(1,205)	213
Capital expenditure	(1,716)	(1,750)	(1,764)	(1,739)	8,326	(2,344)	(11,717)	(5,000)	(2,500)	(2,600)
<b>Free cash flow</b>	<b>2,803</b>	<b>4,595</b>	<b>6,918</b>	<b>7,887</b>	<b>13,638</b>	<b>5,893</b>	<b>(717)</b>	<b>3,694</b>	<b>7,121</b>	<b>10,293</b>
<b>Ratios (%)</b>										
EBITDA margin	10.1	9.3	9.1	8.4	10.0	13.3	12.8	12.2	13.0	13.3
Debt/equity	1.0	0.7	0.6	0.2	0.0	0.1	0.0	0.0	0.0	0.0
Net debt/equity	0.8	0.4	0.1	(0.3)	(0.5)	(0.5)	(0.4)	(0.4)	(0.4)	(0.5)
RoE	46.0	32.3	28.7	22.1	18.0	18.8	19.8	21.1	22.9	23.7
<b>RoCE</b>	<b>37.6</b>	<b>29.8</b>	<b>26.4</b>	<b>26.9</b>	<b>29.9</b>	<b>35.2</b>	<b>35.3</b>	<b>30.9</b>	<b>34.2</b>	<b>38.6</b>

Source: Company, Kotak Institutional Equities estimates

**JANUARY 22, 2019**
**RESULT**

 Coverage view: **Neutral**

 Price (₹): **554**

 Fair Value (₹): **350**

 BSE-30: **36,445**

**Strong quarter led by market share gains.** TVS reported strong 3QFY19 results as EBITDA grew by 31% yoy. EBITDA margin improved to 8.1% in 3QFY19 (+30 bps yoy) led by operating leverage benefit. We expect EBITDA margin to remain range-bound due to slowdown in two-wheeler industry growth (5% CAGR over FY2018-21E) led by price rise on account of stricter safety norms and increase in competitive intensity. We believe valuations at 30X FY2020E EPS are expensive. Reiterate SELL (fair value unchanged).

**Company data and valuation summary**

TVS Motor

**Stock data**

52-week range (Rs) (high,low)	730-479
Market Cap. (Rs bn)	263.3

**Shareholding pattern (%)**

Promoters	57.4
FIs	18.4
MFs	10.3

**Price performance (%)**

	1M	3M	12M
Absolute	(3.3)	7.3	(22.5)
Rel. to BSE-30	(5.1)	0.5	(23.9)

**Forecasts/Valuations**

	2019E	2020E	2021E
EPS (Rs)	14.6	17.7	19.1
EPS growth (%)	4.7	21.6	7.7
P/E (X)	38.0	31.2	29.0
Sales (Rs bn)	181.3	200.1	224.7
Net profits (Rs bn)	6.9	8.4	9.1
EBITDA (Rs bn)	14.7	17.2	18.4
EV/EBITDA (X)	18.9	16.0	14.8
ROE (%)	22.4	23.5	21.9
Div. Yield (%)	0.8	1.0	1.0

**Strong quarter aided by strong volume growth and improving realizations; margin improves yoy**

TVS Motor reported 3QFY19 EBITDA of ₹3.76 bn (+31% yoy), which was 12% ahead of our estimates due to higher ASPs and better-than-expected EBITDA margin. Revenues increased by 26.6% yoy (3% above estimates) led by (1) 20% yoy volume growth driven by strong growth in both domestic and export markets and (2) 5.7% increase in ASPs yoy. ASPs increased by 2.7% qoq due to (1) 2.1% ASP increase in domestic markets led by 0.6% increase in prices and a better product mix and (2) 5.6% ASP increase in export markets led by 2.8% gain in foreign exchange and a better product mix. EBITDA margin came in at 8.1% (+30 bps yoy and down 50 bps qoq), which was above our estimate of 7.4% led by lower-than-expected employee cost (up only 2% yoy). On a yoy basis, gross margin declined by 310 bps due to increase in raw materials cost, which was partly offset by price increases and a richer product mix. Post the implementation of two-wheeler safety norms in April 2019, we believe the company will find it difficult to increase prices due to increase in costs to customers, which will put downward pressure on the margins of the company. The company reported net profit of ₹1.78 bn (+16% yoy), which was 20% ahead of our estimates due to lower-than-expected interest expenses and higher-than-expected EBITDA. Other income declined by 90% yoy to ₹140 mn in 9MFY19. Volume growth was 19.8% yoy in 3QFY19. Domestic volume growth was 18.8% yoy in 3QFY19 and export volumes grew by 24.6% yoy.

**TVS' domestic market share improves by 130 bps qoq in 3QFY19**

Market share of TVS in the domestic two-wheeler industry was 16.3% in 3QFY19 (+130 bps qoq) led by 240 bps qoq increase in market share in the scooter segment. Ntorq scooter has been received well by customers and helped the company gain market share. Hero Motocorp is going to launch Hero Maestro Edge 125 in 4QFY19, which will directly compete with TVS Ntorq, Suzuki Burgman Street and Aprilia SR 125. We expect competitive intensity to escalate in the 125cc scooter segment.

Hitesh Goel

Nishit Jalan

Rishi Vora

### Fine-tune FY2018-21E standalone EPS; reiterate SELL

We have kept our FY2018-21E EPS estimate largely unchanged. The stock is extremely expensive at 30X FY2020E EPS. We have built 11% EPS CAGR over FY2018-21E. Reiterate SELL rating; SoTP-based fair value is unchanged at ₹350 as we roll over to December 2020E (from September 2020E earlier).

### Conference call takeaways

- ▶ **Demand expected to pick up in 4QFY19.** The company highlighted that demand slowed down in 3QFY19 due to increase in vehicle prices owing to insurance cost and liquidity crisis. The company is hopeful of demand recovery going ahead and expects 4QFY19 to be better than 3QFY19. We are more cautious on industry growth outlook and expect 5% CAGR for industry growth over FY2019-21E. The company will look to gain share in the domestic market led by success of new launches and continued strong traction in the scooter segment. Dealer inventory levels are around 4-5 weeks for the company while for the two-wheeler industry, inventory levels are higher.
- ▶ **Price increases and cost pressures.** The company had taken another 0.6% price increase in 3QFY19 (0.9% price increase in 1HFY19). The company will look to further reduce costs through value engineering, localization, platform consolidation, other cost-reduction efforts (lower marketing spend to sales), etc. to improve profitability going ahead. Commodity costs are coming off but regulatory costs such as ABS/CBS-related cost will increase from 4QFY19 onwards.
- ▶ **Capex and investments in subsidiaries.** The company reiterated its FY2019E capex guidance at ₹8 bn; the capex will be largely incurred towards product development and upgrading products to meet new emission norms. The company has a manufacturing capacity of 4.8 mn units; therefore, there is no need to invest on capacity expansion next year. The company will invest ₹2-2.5 bn in subsidiaries in FY2019, it has invested ₹1.95 bn in 9MFY19, which includes ₹900 mn in TVS Credit Motor Services, ₹479 mn in TVS Indonesia and ₹253 mn in TVS Motor Singapore. The company will seed start-ups from the investment in TVS Motor Singapore. The company hardly generates any free cash flow as it invests the free cash generated from operations in subsidiaries.
- ▶ **Performance of TVS Credit Services.** Loan book of TVS Credit Services (engaged into financing of vehicles) was ₹80 bn at the end of December 2018 (₹70 bn in September 2018). Net profit was ₹1.4 bn in 3QFY19 and ₹0.2 bn in 2QFY19 (₹1.1 bn in FY2018). Net worth of TVS Credit Services was ₹8.9 bn in FY2018. TVS Motor holds around 85% stake in TVS Credit Services.
- ▶ **Other key points.** (1) Export revenues were ₹10.6 bn in 3QFY19 (₹11.4 bn in 2QFY19) and export realization (USD:INR) was 71.5 in 3QFY19 compared to 69.5 in 2QFY19, (2) finance penetration for the company is around 50% (increased by 3% over the last one year). TVS Credit finances 52% of vehicles financed of TVS Motor. As per the company, retail financing availability is much better in 3QFY19, (3) the company has increased the price of its models by up to ₹300 in January 2019, (4) in FY2018, the company had incurred fair valuation gain of TVS Credit Services worth ₹580 mn and one-time CST benefit from the Karnataka government worth ₹100 mn, which resulted in higher other income, (5) other expenses are not comparable yoy as freight expense (which was a part of other expense in FY2018) is netted off from the revenue in FY2019 as per Ind-AS and (6) the company has invested in a new start-up business via its Singapore subsidiary, which will look for opportunities in the auto segment.

Exhibit 1: 3QFY19 EBITDA was 12% higher than our estimate due to higher ASPs and better-than-expected EBITDA margin  
TVS Motor, standalone interim results, March fiscal year-ends (₹ mn)

	3QFY19	3QFY19E	3QFY18	2QFY19	(% chg.)			9MFY19	9MFY18	Yoy (%)	FY2019E	FY2018	Yoy (%)
					3QFY19E	3QFY18	2QFY19						
<b>Volumes (units)</b>	<b>989,787</b>	<b>989,787</b>	<b>826,285</b>	<b>1,088,374</b>									
Net realisations (Rs/vehicle)	47,121	45,863	44,597	45,880	2.7	5.7	2.7	45,988	43,265	6.3	46,269	43,646	6.0
<b>Net sales</b>	<b>46,640</b>	<b>45,394</b>	<b>36,850</b>	<b>49,935</b>	<b>2.7</b>	<b>26.6</b>	<b>(6.6)</b>	<b>138,259</b>	<b>111,492</b>	<b>24.0</b>	<b>181,278</b>	<b>151,296</b>	<b>19.8</b>
Incr/dec in stock	(301)	-	(1,419)	(224)				945	124				
Raw materials	(35,046)	(34,500)	(25,363)	(37,616)	2.5	32.0	(6.6)	(105,775)	(81,996)	29.0	(137,046)	(111,330)	23.1
Staff costs	(2,367)	(2,450)	(2,118)	(2,449)	(3.4)	11.7	(3.4)	(7,191)	(6,408)	12.2	(9,635)	(8,680)	11.0
Other expenses	(5,169)	(5,095)	(5,081)	(5,363)	1.4	1.7	(3.6)	(14,988)	(14,603)	2.6	(19,858)	(19,995)	(0.7)
Total expenses	(42,883)	(42,045)	(33,982)	(45,653)	2.0	26.2	(6.1)	(127,008)	(102,884)	23.4	(166,540)	(140,005)	19.0
<b>EBITDA</b>	<b>3,757</b>	<b>3,349</b>	<b>2,868</b>	<b>4,282</b>	<b>12.2</b>	<b>31.0</b>	<b>(12.2)</b>	<b>11,251</b>	<b>8,608</b>	<b>30.7</b>	<b>14,739</b>	<b>11,291</b>	<b>30.5</b>
Depreciation expense	(1,012)	(1,020)	(824)	(1,016)	(0.7)	22.8	(0.4)	(2,962)	(2,444)		(3,973)	(3,387)	
<b>EBIT</b>	<b>2,745</b>	<b>2,329</b>	<b>2,044</b>	<b>3,266</b>	<b>17.8</b>	<b>34.3</b>	<b>(16.0)</b>	<b>8,289</b>	<b>6,165</b>	<b>34.5</b>	<b>10,766</b>	<b>7,904</b>	<b>36.2</b>
Other income	7	30	182	7	(78.3)	(96.4)	(12.2)	40	1,085		140	1,448	
Interest expense	(167)	(210)	(122)	(212)	(20.5)	37.1	(21.1)	(559)	(384)	45.6	(742)	(566)	31.1
Profit before tax	2,585	2,149	2,104	3,062	20.3	22.9	(15.6)	7,770	6,866	13.2	10,164	8,785	15.7
Tax expense	(801)	(666)	(560)	(949)	20.2	42.9	(15.6)	(2,407)	(1,896)		(3,151)	(2,161)	
<b>Profit after tax</b>	<b>1,784</b>	<b>1,483</b>	<b>1,544</b>	<b>2,113</b>	<b>20.3</b>	<b>15.6</b>	<b>(15.6)</b>	<b>5,363</b>	<b>4,970</b>	<b>7.9</b>	<b>7,013</b>	<b>6,625</b>	<b>5.9</b>
<b>EPS</b>	<b>3.8</b>	<b>3.1</b>	<b>3.2</b>	<b>4.4</b>	<b>20.3</b>	<b>15.6</b>	<b>(15.6)</b>	<b>11.3</b>	<b>10.5</b>	<b>7.9</b>	<b>14.8</b>	<b>13.9</b>	<b>5.9</b>
<b>Ratios (%)</b>													
Raw material cost to net sales	75.8	76.0	72.7	75.8				75.8	73.4		75.6	73.6	
Staff cost to net sales	5.1	5.4	5.7	4.9				5.2	5.7		5.3	5.7	
Other expenses to net sales	11.1	11.2	13.8	10.7				10.8	13.1		11.0	13.2	
Gross margin (%)	24.2	24.0	27.3	24.2				24.2	26.6		24.4	26.4	
<b>EBITDA margin (%)</b>	<b>8.1</b>	<b>7.4</b>	<b>7.8</b>	<b>8.6</b>				<b>8.1</b>	<b>7.7</b>		<b>8.1</b>	<b>7.5</b>	
No of shares	475.1	475.1	475.1	475.1				475.1	475.1		475.1	475.1	
Tax rate (%)	31.0	31.0	26.6	31.0				31.0	27.6		31.0	24.6	
<b>Volume break up (units)</b>													
Motorcycles	257,501	257,501	210,112	277,034		22.6	(7.1)	785,550	693,131	13.3	1,026,898	916,811	12.0
Scooters	337,283	337,283	259,244	369,590		30.1	(8.7)	982,303	827,801	18.7	1,231,031	1,099,135	12.0
Mopeds	216,374	216,374	211,932	237,582		2.1	(8.9)	661,522	632,023	4.7	859,820	859,820	-
Three-wheelers	3,629	3,629	4,535	4,706		(20.0)	(22.9)	12,611	10,801	16.8	18,400	16,429	12.0
<b>Total domestic sales</b>	<b>814,787</b>	<b>814,787</b>	<b>685,823</b>	<b>888,912</b>		<b>18.8</b>	<b>(8.3)</b>	<b>2,441,986</b>	<b>2,163,756</b>	<b>12.9</b>	<b>3,136,149</b>	<b>2,892,195</b>	<b>8.4</b>
Motorcycles	120,000	120,000	103,780	142,632		15.6	(15.9)	398,857	316,088	26.2	570,395	438,765	30.0
Scooters	17,000	17,000	9,703	18,644		75.2	(8.8)	48,101	27,051	77.8	53,675	35,783	50.0
Mopeds	2,000	2,000	4,546	3,146		(56.0)	(36.4)	15,207	11,630	30.8	26,118	17,412	50.0
Three-wheelers	36,000	36,000	22,433	35,040		60.5	2.7	102,284	58,452	75.0	131,608	82,255	60.0
<b>Total export sales</b>	<b>175,000</b>	<b>175,000</b>	<b>140,462</b>	<b>199,462</b>		<b>24.6</b>	<b>(12.3)</b>	<b>564,449</b>	<b>413,221</b>	<b>36.6</b>	<b>781,795</b>	<b>574,215</b>	<b>36.2</b>
<b>Volume mix (%)</b>													
Motorcycles	26.0	26.0	25.4	25.5				26.1	26.9		26.2	26.4	
Scooters	34.1	34.1	31.4	34.0				32.7	32.1		31.4	31.7	
Mopeds	21.9	21.9	25.6	21.8				22.0	24.5		21.9	24.8	
Three-wheelers	0.4	0.4	0.5	0.4				0.4	0.4		0.5	0.5	
<b>Total domestic sales</b>	<b>82.3</b>	<b>82.3</b>	<b>83.0</b>	<b>81.7</b>				<b>81.2</b>	<b>84.0</b>		<b>80.0</b>	<b>83.4</b>	
Motorcycles	12.1	12.1	12.6	13.1				13.3	12.3		14.6	12.7	
Scooters	1.7	1.7	1.2	1.7				1.6	1.0		1.4	1.0	
Mopeds	0.2	0.2	0.6	0.3				0.5	0.5		0.7	0.5	
Three-wheelers	3.6	3.6	2.7	3.2				3.4	2.3		3.4	2.4	
<b>Total export sales</b>	<b>17.7</b>	<b>17.7</b>	<b>17.0</b>	<b>18.3</b>				<b>18.8</b>	<b>16.0</b>		<b>20.0</b>	<b>16.6</b>	

Source: Company, Kotak Institutional Equities estimates

Exhibit 2: TVS' market share in domestic two-wheeler industry has improved by 130 bps qoq in 3QFY19  
Domestic two-wheeler industry mix and TVS' market share across segments, March fiscal year-ends, 2010-19 (%)

	2010	2011	2012	2013	2014	2015	2016	2017	2018	1QFY19	2QFY19	3QFY19
<b>Domestic two-wheeler industry mix (%)</b>												
Motorcycles	78.3	76.5	75.2	73.1	70.8	67.1	65.0	63.1	62.5	64.3	63.1	63.9
Scooters	15.6	17.6	19.0	21.2	24.3	28.2	30.6	31.9	33.3	32.0	32.9	31.7
Mopeds	6.0	5.9	5.8	5.7	4.9	4.7	4.4	5.1	4.3	3.7	4.1	4.4
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>
<b>Market share of TVS (%)</b>												
Motorcycles	6.7	7.0	6.2	5.5	5.5	6.2	6.7	7.0	7.3	6.9	7.4	8.0
Scooters	20.5	21.6	19.5	14.5	12.7	15.2	15.4	14.7	16.4	15.1	19.1	21.5
Mopeds	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
<b>Overall two-wheeler industry</b>	<b>14.5</b>	<b>15.1</b>	<b>14.2</b>	<b>12.8</b>	<b>11.8</b>	<b>13.2</b>	<b>13.4</b>	<b>14.2</b>	<b>14.2</b>	<b>12.9</b>	<b>15.0</b>	<b>16.3</b>

Source: SIAM, Kotak Institutional Equities

**Exhibit 3: We have kept our EPS estimate broadly unchanged for FY2019-21E**  
Earnings revision table for standalone entity, March fiscal year-ends, 2019-21E (₹ mn)

	New estimates			Old estimates			% change		
	2019E	2020E	2021E	2019E	2020E	2021E	2019E	2020E	2021E
<b>Standalone</b>									
Volumes (units)	3,917,944	4,153,685	4,416,099	3,917,944	4,144,502	4,393,724	—	0.2	0.5
Net sales	181,278	200,060	224,675	179,686	199,897	223,085	0.9	0.1	0.7
EBITDA	14,739	17,239	18,352	14,774	16,608	18,455	(0.2)	3.8	(0.6)
EBITDA margin (%)	8.1	8.6	8.2	8.2	8.3	8.3			
<b>Adjusted net profit</b>	<b>6,937</b>	<b>8,432</b>	<b>9,085</b>	<b>7,037</b>	<b>8,107</b>	<b>9,301</b>	<b>(1.4)</b>	<b>4.0</b>	<b>(2.3)</b>
<b>EPS</b>	<b>14.6</b>	<b>17.7</b>	<b>19.1</b>	<b>14.8</b>	<b>17.1</b>	<b>19.6</b>	<b>(1.4)</b>	<b>4.0</b>	<b>(2.3)</b>

Source: Company, Kotak Institutional Equities estimates

**Exhibit 4: We value TVS Motor at ₹350/share**  
SoTP valuation, March fiscal year-end, 2020E

	EPS (Rs)	Multiple (X)	Value per share (Rs)	Comments
December 2020 standalone	18.8	16.0	300	
TVS Motor Services			51	Valued at 2X equity invested by TVS Motor (parent entity)
Total value per share			352	
<b>Target price</b>			<b>350</b>	

Source: Company, Kotak Institutional Equities estimates

Exhibit 5: We expect the company's volumes to grow at 8% CAGR over FY2018-21E  
TVS Motor, volume break-down across segments, March fiscal year-ends, 2010-21E (units)

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019E	2020E	2021E
<b>Volumes (units)</b>												
<b>Domestic volumes</b>												
Motorcycles	493,396	632,150	621,738	558,468	572,732	667,624	712,002	776,934	916,811	1,026,898	1,042,396	1,087,538
Economy (Star City)	345,395	422,733	466,745	392,931	343,960	432,620	384,545	324,877	383,065	371,573	360,426	349,613
Executive (Victor & Phoenix)	38,258	66,239	10,185	43,475	88,357	37,660	65,828	155,703	133,067	122,422	122,422	122,422
Premium (Apache)	109,743	143,178	144,808	122,062	140,415	197,344	261,629	296,354	400,679	532,903	559,548	615,503
Scooters	299,370	446,776	496,584	424,183	456,975	684,569	773,597	826,291	1,099,135	1,231,031	1,378,755	1,516,630
Mopeds	564,584	697,778	776,916	788,761	722,920	755,503	723,767	890,367	859,820	859,820	859,820	859,820
<b>Total domestic 2W</b>	<b>1,357,350</b>	<b>1,776,704</b>	<b>1,895,238</b>	<b>1,771,412</b>	<b>1,752,627</b>	<b>2,107,696</b>	<b>2,209,366</b>	<b>2,493,592</b>	<b>2,875,766</b>	<b>3,117,749</b>	<b>3,280,971</b>	<b>3,463,988</b>
3 Wheelers	13,400	22,357	14,172	15,616	12,515	17,606	15,536	12,277	16,429	18,400	19,321	20,287
<b>Total domestic</b>	<b>1,370,750</b>	<b>1,799,061</b>	<b>1,909,410</b>	<b>1,787,028</b>	<b>1,765,142</b>	<b>2,125,302</b>	<b>2,224,902</b>	<b>2,505,869</b>	<b>2,892,195</b>	<b>3,136,149</b>	<b>3,300,291</b>	<b>3,484,275</b>
<b>Export volumes</b>												
Motorcycles	148,443	205,103	219,624	191,338	220,747	292,935	304,805	299,388	438,765	570,395	627,434	690,177
Scooters	9,192	18,156	32,199	17,369	18,693	22,457	38,930	44,572	35,783	53,675	59,042	64,946
Mopeds	6,905	6,295	9,076	3,308	7,252	9,679	14,780	20,152	17,412	26,118	28,730	31,603
<b>Total exports 2W</b>	<b>164,540</b>	<b>229,554</b>	<b>260,899</b>	<b>212,015</b>	<b>246,692</b>	<b>325,071</b>	<b>358,515</b>	<b>364,112</b>	<b>491,960</b>	<b>650,187</b>	<b>715,206</b>	<b>786,726</b>
3 Wheelers	1,716	17,503	25,567	33,574	68,327	90,773	95,285	56,977	82,255	131,608	138,188	145,098
<b>Total exports</b>	<b>166,256</b>	<b>247,057</b>	<b>286,466</b>	<b>245,589</b>	<b>315,019</b>	<b>415,844</b>	<b>453,800</b>	<b>421,089</b>	<b>574,215</b>	<b>781,795</b>	<b>853,394</b>	<b>931,824</b>
<b>Total volumes</b>	<b>1,537,006</b>	<b>2,046,118</b>	<b>2,195,876</b>	<b>2,032,617</b>	<b>2,080,161</b>	<b>2,541,146</b>	<b>2,678,702</b>	<b>2,926,958</b>	<b>3,466,410</b>	<b>3,917,944</b>	<b>4,153,685</b>	<b>4,416,099</b>
<b>YoY growth (%)</b>												
<b>Domestic volumes</b>												
Motorcycles	7.8	28.1	(1.6)	(10.2)	2.6	16.6	6.6	9.1	18.0	12.0	1.5	4.3
Economy (Star City)	—	22.4	10.4	(15.8)	(12.5)	25.8	(11.1)	(15.5)	17.9	(3.0)	(3.0)	(3.0)
Executive (Victor & Phoenix)	—	73.1	(84.6)	326.9	103.2	(57.4)	74.8	136.5	(14.5)	(8.0)	0.0	0.0
Premium (Apache)	—	30.5	1.1	(15.7)	15.0	40.5	32.6	13.3	35.2	33.0	5.0	10.0
Scooters	23.8	49.2	11.1	(14.6)	7.7	49.8	13.0	6.8	33.0	12.0	12.0	10.0
Mopeds	30.9	23.6	11.3	1.5	(8.3)	4.5	(4.2)	23.0	(3.4)	0.0	0.0	0.0
<b>Total domestic 2W</b>	<b>20.0</b>	<b>30.9</b>	<b>6.7</b>	<b>(6.5)</b>	<b>(1.1)</b>	<b>20.3</b>	<b>4.8</b>	<b>12.9</b>	<b>15.3</b>	<b>8.4</b>	<b>5.2</b>	<b>5.6</b>
3 Wheelers	—	66.8	(36.6)	10.2	(19.9)	40.7	(11.8)	(21.0)	33.8	12.0	5.0	5.0
<b>Total domestic</b>	<b>20.8</b>	<b>31.2</b>	<b>6.1</b>	<b>(6.4)</b>	<b>(1.2)</b>	<b>20.4</b>	<b>4.7</b>	<b>12.6</b>	<b>15.4</b>	<b>8.4</b>	<b>5.2</b>	<b>5.6</b>
<b>Export volumes</b>												
Motorcycles	(16.6)	38.2	7.1	(12.9)	15.4	32.7	4.1	(1.8)	46.6	30.0	10.0	10.0
Scooters	10.6	97.5	77.3	(46.1)	7.6	20.1	73.4	14.5	(19.7)	50.0	10.0	10.0
Mopeds	(1.9)	(8.8)	44.2	(63.6)	119.2	33.5	52.7	36.3	(13.6)	50.0	10.0	10.0
<b>Total exports 2W</b>	<b>(14.9)</b>	<b>39.5</b>	<b>13.7</b>	<b>(18.7)</b>	<b>16.4</b>	<b>31.8</b>	<b>10.3</b>	<b>1.6</b>	<b>35.1</b>	<b>32.2</b>	<b>10.0</b>	<b>10.0</b>
3 Wheelers	—	—	46.1	31.3	103.5	32.9	5.0	(40.2)	44.4	60.0	5.0	5.0
<b>Total exports</b>	<b>(14.0)</b>	<b>48.6</b>	<b>16.0</b>	<b>(14.3)</b>	<b>28.3</b>	<b>32.0</b>	<b>9.1</b>	<b>(7.2)</b>	<b>36.4</b>	<b>36.2</b>	<b>9.2</b>	<b>9.2</b>
<b>Total volumes</b>	<b>15.7</b>	<b>33.1</b>	<b>7.3</b>	<b>(7.4)</b>	<b>2.3</b>	<b>22.2</b>	<b>5.4</b>	<b>9.3</b>	<b>18.4</b>	<b>13.0</b>	<b>6.0</b>	<b>6.3</b>

Source: Company, Kotak Institutional Equities estimates

Exhibit 6: We expect overall revenues to grow at 14% CAGR over FY2018-21E  
TVS Motor, revenue break-down across segments, March fiscal year-ends, 2010-21E (₹ mn, %)

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019E	2020E	2021E
<b>Revenues (Rs mn)</b>												
<b>Domestic revenues</b>												
Motorcycles	15,854	22,215	21,477	20,410	21,564	24,676	28,018	32,215	37,716	44,696	49,430	55,674
Economy	9,412	12,682	13,539	11,871	10,307	11,329	11,387	9,584	10,917	10,590	10,452	10,663
Executive	1,339	2,517	407	1,826	3,534	1,506	2,765	6,540	5,477	5,039	5,100	5,284
Premium	5,103	7,016	7,530	6,713	7,723	11,841	13,866	16,092	21,322	29,067	33,877	39,727
Scooters	7,945	12,880	16,164	14,062	15,080	23,618	28,932	31,399	40,932	45,844	51,345	58,754
Mopeds	9,389	12,281	14,412	16,564	15,181	16,621	15,138	19,143	18,116	18,116	18,116	19,406
<b>Total domestic 2W</b>	<b>33,188</b>	<b>47,375</b>	<b>52,052</b>	<b>51,036</b>	<b>51,826</b>	<b>64,915</b>	<b>72,088</b>	<b>82,757</b>	<b>96,764</b>	<b>108,656</b>	<b>118,891</b>	<b>133,835</b>
3 Wheelers	1,051	1,568	941	1,379	1,198	1,581	1,395	1,105	1,449	1,639	1,721	1,868
<b>Total domestic</b>	<b>34,239</b>	<b>48,944</b>	<b>52,994</b>	<b>52,415</b>	<b>53,024</b>	<b>66,496</b>	<b>73,484</b>	<b>83,862</b>	<b>98,213</b>	<b>110,295</b>	<b>120,612</b>	<b>135,703</b>
<b>Export revenues</b>												
Motorcycles	4,608	6,312	7,753	8,071	9,751	13,475	14,344	13,922	26,326	34,566	38,783	43,514
Scooters	275	527	1,055	680	761	915	1,617	1,872	1,473	2,231	2,504	2,809
Mopeds	136	120	194	85	193	253	410	574	486	737	827	928
<b>Total exports 2W</b>	<b>5,019</b>	<b>6,959</b>	<b>9,002</b>	<b>8,836</b>	<b>10,706</b>	<b>14,643</b>	<b>16,371</b>	<b>16,368</b>	<b>28,285</b>	<b>37,534</b>	<b>42,113</b>	<b>47,251</b>
3 Wheelers	154	1,575	2,301	3,022	6,491	8,179	8,844	6,272	8,873	14,338	15,356	16,447
<b>Total exports</b>	<b>5,173</b>	<b>8,534</b>	<b>11,303</b>	<b>11,858</b>	<b>17,197</b>	<b>22,821</b>	<b>25,214</b>	<b>22,639</b>	<b>37,158</b>	<b>51,872</b>	<b>57,470</b>	<b>63,698</b>
<b>Total vehicle revenues</b>	<b>39,412</b>	<b>57,478</b>	<b>64,297</b>	<b>64,273</b>	<b>70,221</b>	<b>89,317</b>	<b>98,698</b>	<b>106,502</b>	<b>135,371</b>	<b>162,167</b>	<b>178,082</b>	<b>199,400</b>
Accessories and spare pa	4,218	5,402	6,966	7,417	9,473	10,931	12,384	14,861	15,926	19,111	21,978	25,274
<b>Total revenues</b>	<b>43,631</b>	<b>62,880</b>	<b>71,264</b>	<b>71,690</b>	<b>79,694</b>	<b>100,248</b>	<b>111,082</b>	<b>121,362</b>	<b>151,297</b>	<b>181,278</b>	<b>200,060</b>	<b>224,675</b>
YoY growth (%)		44.1	13.3	0.6	11.2	25.8	10.8	9.3	24.7	19.8	10.4	12.3
<b>Revenue mix (%)</b>												
Motorcycles	36.3	35.3	30.1	28.5	27.1	24.6	25.2	26.5	24.9	24.7	24.7	24.8
Economy	21.6	20.2	19.0	16.6	12.9	11.3	10.3	7.9	7.2	5.8	5.2	4.7
Executive	3.1	4.0	0.6	2.5	4.4	1.5	2.5	5.4	3.6	2.8	2.5	2.4
Premium	11.7	11.2	10.6	9.4	9.7	11.8	12.5	13.3	14.1	16.0	16.9	17.7
Scooters	18.2	20.5	22.7	19.6	18.9	23.6	26.0	25.9	27.1	25.3	25.7	26.2
Mopeds	21.5	19.5	20.2	23.1	19.0	16.6	13.6	15.8	12.0	10.0	9.1	8.6
<b>Total domestic 2W</b>	<b>76.1</b>	<b>75.3</b>	<b>73.0</b>	<b>71.2</b>	<b>65.0</b>	<b>64.8</b>	<b>64.9</b>	<b>68.2</b>	<b>64.0</b>	<b>59.9</b>	<b>59.4</b>	<b>59.6</b>
3 Wheelers	2.4	2.5	1.3	1.9	1.5	1.6	1.3	0.9	1.0	0.9	0.9	0.8
<b>Total domestic</b>	<b>78.5</b>	<b>77.8</b>	<b>74.4</b>	<b>73.1</b>	<b>66.5</b>	<b>66.3</b>	<b>66.2</b>	<b>69.1</b>	<b>64.9</b>	<b>60.8</b>	<b>60.3</b>	<b>60.4</b>
<b>Export revenues</b>												
Motorcycles	10.6	10.0	10.9	11.3	12.2	13.4	12.9	11.5	17.4	19.1	19.4	19.4
Scooters	0.6	0.8	1.5	0.9	1.0	0.9	1.5	1.5	1.0	1.2	1.3	1.3
Mopeds	0.3	0.2	0.3	0.1	0.2	0.3	0.4	0.5	0.3	0.4	0.4	0.4
<b>Total exports 2W</b>	<b>11.5</b>	<b>11.1</b>	<b>12.6</b>	<b>12.3</b>	<b>13.4</b>	<b>14.6</b>	<b>14.7</b>	<b>13.5</b>	<b>18.7</b>	<b>20.7</b>	<b>21.1</b>	<b>21.0</b>
3 Wheelers	0.4	2.5	3.2	4.2	8.1	8.2	8.0	5.2	5.9	7.9	7.7	7.3
<b>Total exports</b>	<b>11.9</b>	<b>13.6</b>	<b>15.9</b>	<b>16.5</b>	<b>21.6</b>	<b>22.8</b>	<b>22.7</b>	<b>18.7</b>	<b>24.6</b>	<b>28.6</b>	<b>28.7</b>	<b>28.4</b>
<b>Total vehicle revenues</b>	<b>90.3</b>	<b>91.4</b>	<b>90.2</b>	<b>89.7</b>	<b>88.1</b>	<b>89.1</b>	<b>88.9</b>	<b>87.8</b>	<b>89.5</b>	<b>89.5</b>	<b>89.0</b>	<b>88.8</b>
Accessories and spare pa	9.7	8.6	9.8	10.3	11.9	10.9	11.1	12.2	10.5	10.5	11.0	11.2
<b>Total revenues</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

Source: Company, Kotak Institutional Equities estimates

Exhibit 7: We expect standalone net profit to grow at 11% CAGR over FY2018-21E  
TVS Motor, standalone financial summary, March fiscal year-ends, 2012-21E (₹ mn)

	2012	2013	2014	2015	2016	2017	2018	2019E	2020E	2021E
<b>Profit model (Rs mn)</b>										
Net sales	71,262	71,693	79,659	100,423	111,047	121,353	151,296	181,278	200,060	224,675
<b>EBITDA</b>	<b>4,694</b>	<b>4,090</b>	<b>4,822</b>	<b>6,066</b>	<b>8,099</b>	<b>8,571</b>	<b>11,291</b>	<b>14,739</b>	<b>17,239</b>	<b>18,352</b>
Other income	217	238	302	303	1,039	1,734	1,448	60	120	130
Interest	(571)	(480)	(254)	(274)	(487)	(440)	(566)	(772)	(847)	(662)
Depreciation	(1,175)	(1,304)	(1,317)	(1,533)	(2,361)	(2,878)	(3,387)	(3,973)	(4,291)	(4,653)
Exceptional income	—	(908)	(28)	—	—	—	—	—	—	—
<b>Profit before tax</b>	<b>3,165</b>	<b>1,636</b>	<b>3,525</b>	<b>4,562</b>	<b>6,289</b>	<b>6,987</b>	<b>8,785</b>	<b>10,054</b>	<b>12,221</b>	<b>13,167</b>
Tax expense	(674)	(476)	(909)	(1,083)	(1,397)	(1,406)	(2,161)	(3,117)	(3,788)	(4,082)
Reported PAT	2,491	1,160	2,616	3,478	4,893	5,581	6,625	6,937	8,432	9,085
<b>Adjusted net profit</b>	<b>2,491</b>	<b>1,804</b>	<b>2,637</b>	<b>3,478</b>	<b>4,893</b>	<b>5,581</b>	<b>6,625</b>	<b>6,937</b>	<b>8,432</b>	<b>9,085</b>
<b>Earnings per share (Rs)</b>	<b>5.2</b>	<b>3.8</b>	<b>5.6</b>	<b>7.3</b>	<b>10.3</b>	<b>11.7</b>	<b>13.9</b>	<b>14.6</b>	<b>17.7</b>	<b>19.1</b>
<b>Balance sheet (Rs mn)</b>										
Equity	11,693	12,247	14,153	16,454	19,583	24,083	28,804	33,244	38,641	44,455
Deferred tax liability	976	931	1,247	1,528	1,437	1,257	1,482	1,482	1,482	1,482
Total Borrowings	8,311	6,345	5,276	9,705	7,585	10,851	10,370	15,370	12,870	9,194
Current liabilities	9,363	10,767	13,760	16,869	19,932	21,719	29,981	32,117	34,947	38,656
Other liabilities	1,063	1,066	1,211	1,488	985	1,137	1,158	1,158	1,158	1,158
<b>Total liabilities</b>	<b>31,405</b>	<b>31,356</b>	<b>35,647</b>	<b>46,042</b>	<b>49,522</b>	<b>59,047</b>	<b>71,795</b>	<b>83,370</b>	<b>89,097</b>	<b>94,944</b>
Net fixed assets	10,781	10,476	11,738	14,190	17,506	20,462	25,030	29,057	29,766	30,113
Investments	9,309	8,688	8,959	10,125	12,149	15,879	20,354	22,654	24,854	26,854
Cash	130	175	826	54	327	85	109	169	448	619
Other current assets	11,185	12,017	14,124	21,674	19,540	22,622	26,302	31,490	34,030	37,359
<b>Total assets</b>	<b>31,405</b>	<b>31,356</b>	<b>35,647</b>	<b>46,042</b>	<b>49,522</b>	<b>59,047</b>	<b>71,795</b>	<b>83,370</b>	<b>89,097</b>	<b>94,944</b>
<b>Free cash flow (Rs mn)</b>										
Operating cash flow excl. working capital	3,783	3,685	3,625	4,699	6,658	7,754	8,848	11,622	13,451	14,270
Working capital changes	626	643	1,613	(3,851)	2,753	(514)	3,668	(3,052)	290	380
Capital expenditure	(1,768)	(995)	(2,580)	(4,052)	(4,872)	(6,122)	(7,698)	(8,000)	(5,000)	(5,000)
<b>Free cash flow</b>	<b>2,640</b>	<b>3,333</b>	<b>2,658</b>	<b>(3,203)</b>	<b>4,539</b>	<b>1,118</b>	<b>4,818</b>	<b>570</b>	<b>8,741</b>	<b>9,650</b>
<b>Ratios</b>										
Gross margin (%)	26.2	27.5	28.8	27.3	28.1	27.0	26.4	24.4	24.5	23.5
EBITDA margin (%)	6.6	5.7	6.1	6.0	7.3	7.1	7.5	8.1	8.6	8.2
PAT margin (%)	3.5	2.5	3.3	3.5	4.4	4.6	4.4	3.8	4.2	4.0
Net debt/equity (X)	0.7	0.5	0.3	0.6	0.4	0.4	0.4	0.5	0.3	0.2
Book Value (Rs/share)	24.6	25.8	29.8	34.6	41.2	50.7	60.6	70.0	81.3	93.6
RoAE (%)	23.0	15.1	20.0	22.7	27.2	25.6	25.1	22.4	23.5	21.9
<b>RoACE (%)</b>	<b>14.8</b>	<b>10.3</b>	<b>14.1</b>	<b>15.5</b>	<b>16.9</b>	<b>14.7</b>	<b>16.1</b>	<b>17.0</b>	<b>18.0</b>	<b>18.2</b>

Source: Company, Kotak Institutional Equities estimates

**JANUARY 22, 2019**
**RESULT**

Coverage view: **Attractive**

Price (₹): **481**

Fair Value (₹): **545**

BSE-30: **36,445**

**3QFY19: improved revenue momentum.** JUST's revenue growth improved further to 15% yoy, driven by healthy 10% growth in paid campaigns and 5% growth in pricing. Cost controls and improved employee productivity drove a 6% outperformance in EBITDA. Healthy growth in unique visitors is a positive and is possibly driving adoption of the platform in Tier II/III cities. Stagnant deferred revenue base drives some caution on future revenue growth, reflected in lower target P/E multiple of 15X. ADD with a revised fair value of ₹545.

**Company data and valuation summary**

Just Dial

**Stock data**

52-week range (Rs) (high,low) 638-358

Market Cap. (Rs bn) 32.5

**Shareholding pattern (%)**

Promoters 33.9

FIs 36.3

MFs 9.0

**Price performance (%)**

Absolute (0.2) (1.8) (20.3)

Rel. to BSE-30 (2.2) (8.0) (21.7)

**Forecasts/Valuations**

2019E 2020E 2021E

EPS (Rs) 29.6 31.1 33.2

EPS growth (%) 39.3 5.1 6.8

P/E (X) 16.3 15.5 14.5

Sales (Rs bn) 8.9 9.7 10.5

Net profits (Rs bn) 1.9 2.0 2.1

EBITDA (Rs bn) 2.3 2.3 2.4

EV/EBITDA (X) 9.0 7.9 6.8

ROE (%) 20.1 19.8 17.9

Div. Yield (%) 0.6 0.6 0.7

**3QFY19: revenue growth trajectory improves further to 15% yoy**

Just Dial's revenue growth accelerated to 15.2% yoy in 3QFY19 from 11.3% yoy in 1QFY19 and 13.7% yoy in 2QFY19. The acceleration was driven by a healthy 10% yoy growth in paid campaigns and 5% growth in pricing. Paid campaign addition has picked up in the past two quarters due to improved momentum in Tier II/III cities, which accounted for 46% of overall campaigns in 3QFY19. Despite higher contribution from Tier II/III cities, JUST still managed to post healthy 5% yoy pricing increase driven by increase in pricing of its packages as well as higher sales of bundled products.

**Cost optimizations drive better-than-expected margins**

JUST posted EBITDA of ₹552 mn, 6% higher than estimates on account of lower-than-expected other expenses. Ad-spends increased 73% qoq to ₹190 mn in 3QFY19 as JUST commenced TV advertising. We expect JUST's ad-spends to average at 6.5% of revenues in FY2019, though quarterly trends may remain volatile. JUST further pruned its non-core employee count in 3QFY19, thereby driving up employee productivity metrics.

**Pace of user addition healthy, driven by visitors on mobile website**

JUST's unique visitor count increased 25% yoy to 134 mn. Interestingly, both the desktop and voice-based visitor count declined, and only mobile contributed to the growth. We believe the healthy pace of user addition is driving improved lead generation and hence better response from JUST's SME customers.

**Sustained revenue growth momentum is key; retain ADD**

JUST's focus on specific verticals as well as relatively underpenetrated Tier II/III cities is resulting in improved revenue trajectory. We acknowledge that threat from better funded rivals remains, and hence sustained improvement in deferred revenues is critical. Deferred revenues have remained relatively static over the past three quarters, and need to move up to sustain the current revenue growth trajectory. We factor in these risks in our valuations by reducing our target P/E multiple to 15X (20X earlier), resulting in a revised fair value of ₹545 (₹610 earlier). ADD stays.

Kawaljeet Saluja

Garima Mishra

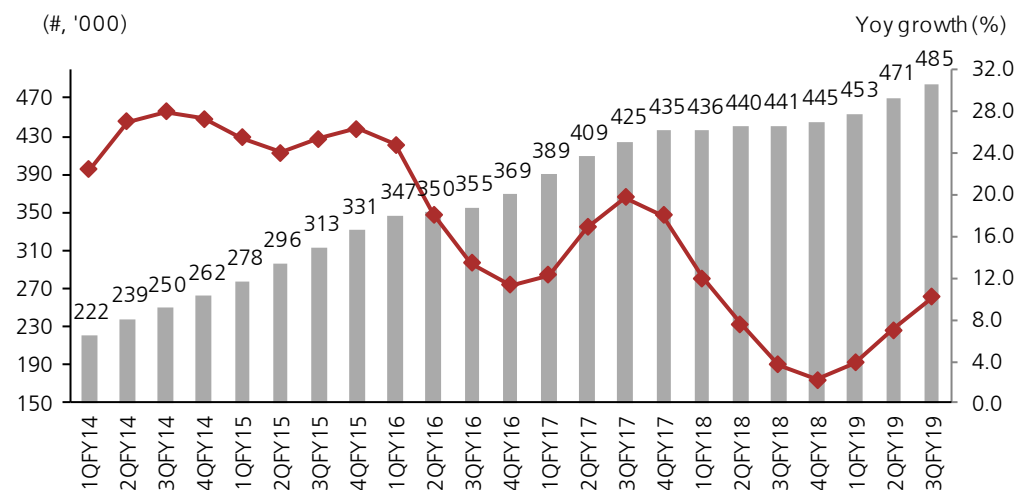
**Exhibit 1: Revenue growth momentum improved further in 3QFY19**  
3QFY19 results of Just Dial, March fiscal year-ends (Rs mn)

	3QFY19	3QFY19E	3QFY18	2QFY19	Change (%)			9MFY19	9MFY18	FY2019E
					KIE Est	yoy	qoq			
Sales	2,268	2,253	1,968	2,210	0.6	15.2	2.6	6,592	5,813	8,903
Expenses	(1,716)	(1,733)	(1,502)	(1,636)	(1.0)	14.2	4.9	(4,891)	(3,124)	(6,651)
Employee	(1,258)	(1,248)	(1,076)	(1,241)	0.8	16.9	1.4	(3,675)	(3,227)	(4,940)
Other expenses	(458)	(485)	(427)	(395)	(5.6)	7.3	16.0	(1,216)	(1,400)	(1,710)
<b>Operating profit</b>	<b>552</b>	<b>521</b>	<b>466</b>	<b>575</b>	<b>6.0</b>	<b>18.6</b>	<b>(3.9)</b>	<b>1,701</b>	<b>2,689</b>	<b>2,252</b>
Other income	341	200	26	184	70.4	1,220.9	85.1	607	492	787
Interest	(0)	—	—	—	—	—	—	(0)	—	—
Depreciation	(86)	(87)	(90)	(84)	(1.7)	(5.2)	1.3	(254)	(280)	(355)
<b>PBT</b>	<b>807</b>	<b>634</b>	<b>401</b>	<b>674</b>	<b>27.3</b>	<b>101.2</b>	<b>19.7</b>	<b>2,054</b>	<b>1,399</b>	<b>2,685</b>
Tax	(234)	(183)	(115)	(191)	28.0	103.0	22.6	(612)	(357)	(771)
<b>Net profit</b>	<b>573</b>	<b>451</b>	<b>286</b>	<b>484</b>	<b>27.1</b>	<b>100.5</b>	<b>18.5</b>	<b>1,443</b>	<b>1,042</b>	<b>1,914</b>
Extraordinary items	—	—	—	—	—	—	—	—	—	—
Reported PAT	573	451	286	484	27.1	100.5	18.5	1,443	1,042	1,914
<b>Key ratios (%)</b>										
Employee cost/sales	55.5	55.4	54.7	56.2				55.8	55.5	55.5
Other operating expenses/sales	20.2	21.5	21.7	17.8				18.4	24.1	19.2
<b>EBITDA margin</b>	<b>24.3</b>	<b>23.1</b>	<b>23.7</b>	<b>26.0</b>				<b>25.8</b>	<b>46.3</b>	<b>25.3</b>
PBT margin	35.6	28.1	20.4	30.5				31.2	24.1	30.2
Tax rate	28.9	28.8	28.7	28.3				29.8	25.5	28.7
PAT margin	25.3	20.0	14.5	21.9				21.9	17.9	21.5
<b>Other operating metrics</b>										
Total campaigns (#)	485,410	—	440,600	470,620		10.2	3.1	485,410	440,600	490,956
Price per campaign (Rs)	18,688	—	17,866	18,786		4.6	(0.5)	18,108	17,591	18,134
Headcount (#)	12,476	—	10,948	12,417		14.0	0.5			
Advertising spend (Rs mn)	190	—	155	110		NA	72.7			
Unearned revenue (Rs mn)	3,786	—	2,852	3,749		32.7	1.0			

Source: Company, Kotak Institutional Equities estimates

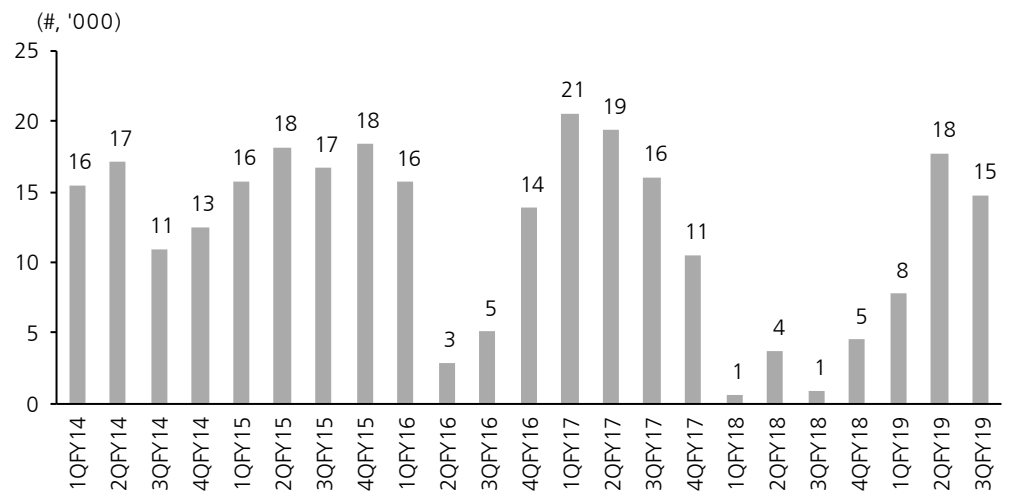
**Exhibit 2: Pace of campaigns addition on a recovery path**

End of the period paid campaigns (#, LHS) and yoy growth (%), March fiscal year-ends



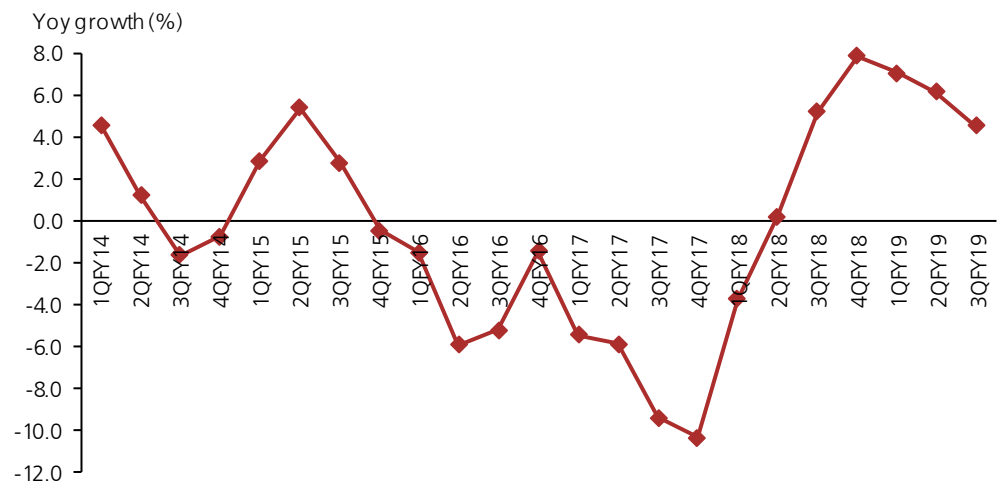
Source: Company, Kotak Institutional Equities

**Exhibit 3: Campaign addition pace has recovered materially**  
Sequential campaign addition, March fiscal year-ends (#, '000)



Source: Company, Kotak Institutional Equities

**Exhibit 4: Pricing trend is still reasonably healthy**  
Yoy change in per campaign realization, March fiscal year-ends (%)



Source: Company, Kotak Institutional Equities

JUST's unearned revenue base has been static for the past three quarters. While contracts may have different durations and hence this figure could be volatile on a quarterly basis, we remain circumspect on this figure.

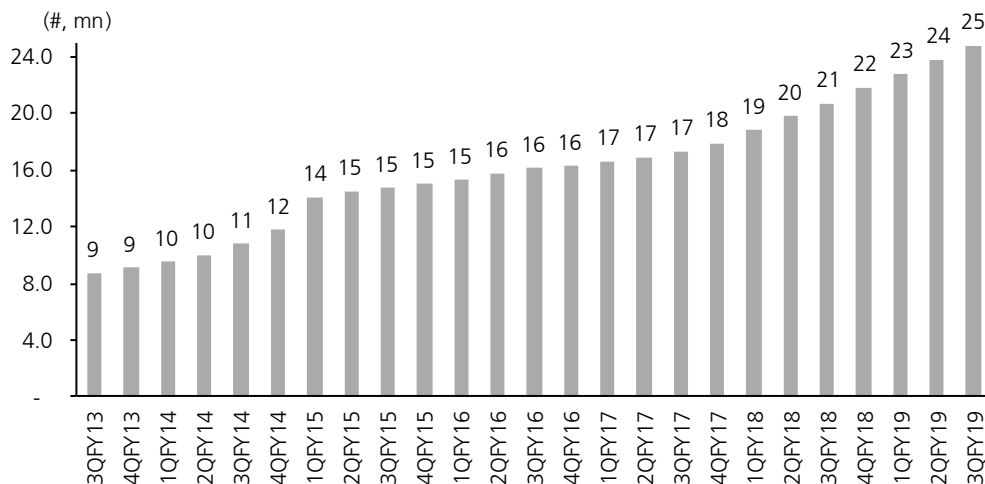
**Exhibit 5: Unearned revenue base has been stagnant for past three quarters**  
Unearned revenue growth, March fiscal year-ends

	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19
Unearned revenue (Rs mn)	2,419	2,451	2,559	2,743	2,904	2,774	2,852	3,330	3,713	3,749	3,786
Yoy growth (%)					20	13	11	21	28	35	33
Revenue (Rs mn)	1,763	1,803	1,803	1,817	1,900	1,945	1,968	2,005	2,114	2,210	2,268
Yoy growth (%)					8	8	9	10	11	14	15

Source: Company, Kotak Institutional Equities

**Exhibit 6: Steady growth in listings database**

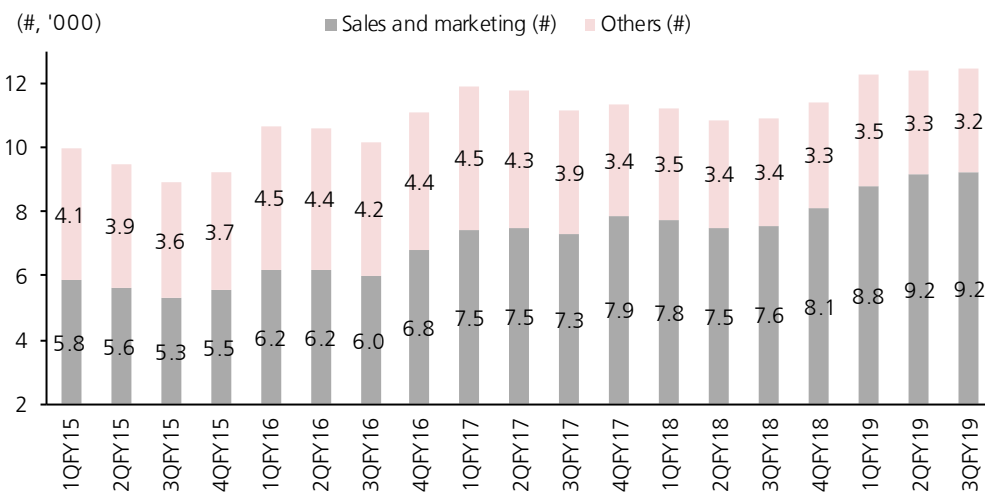
Total listings database of Just Dial, March fiscal year-ends (mn)



Source: Company, Kotak Institutional Equities

**Exhibit 7: Sales force headcount increases, non-core employee headcount pruned further**

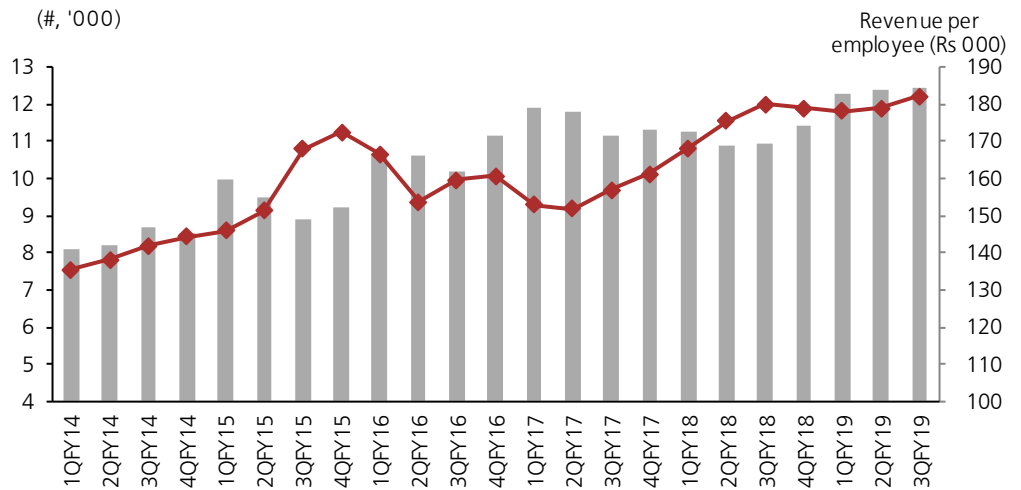
End of the period employee count in sales and other functions, March fiscal year-ends (#, '000)



Source: Company, Kotak Institutional Equities

**Exhibit 8: Revenue per employee steady in 3Q**

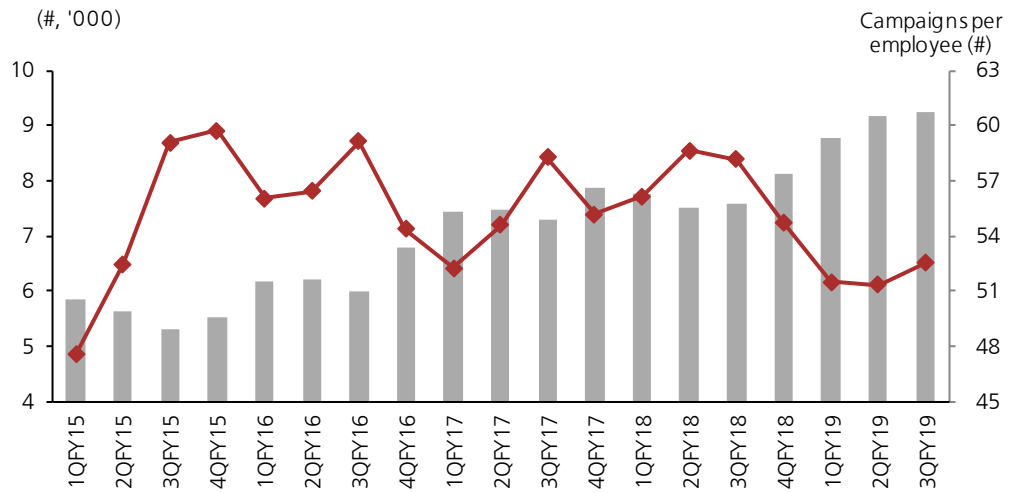
End of the period employee count (#, LHS) and revenue per employee (Rs 000, RHS), March fiscal year-ends



Source: Company, Kotak Institutional Equities

**Exhibit 9: Campaigns per sales employee metric improved in 3Q**

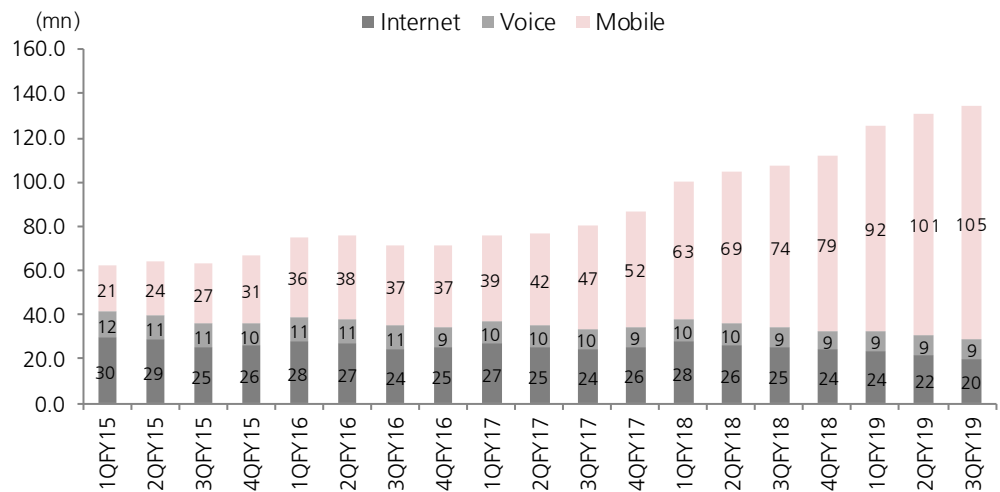
End of the period sales and marketing employee count (#, LHS) and campaigns per employee (#, RHS), March fiscal year-ends



Source: Company, Kotak Institutional Equities

**Exhibit 10: Mobile continues to drive user addition**

Unique visitors of Just Dial across various platforms, March fiscal year-ends (mn)



Source: Company, Kotak Institutional Equities

**Exhibit 11: App downloads per day remain static**

Key operating metrics of JUST's platform, March fiscal year-ends

	3QFY16	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	Yoy growth (%)
Unique visitors (mn)	71.5	71.3	75.9	76.6	80.5	86.8	100.5	105.0	107.6	111.6	125.2	131.3	134.2	24.7
Total listings (mn)	16.1	16.3	16.6	16.9	17.3	17.9	18.8	19.8	20.7	21.8	22.7	23.8	24.8	19.8
Total images in listings (mn)	17.0	19.7	22.5	25.4	27.9	31.7	35.6	38.5	41.4	44.8	47.9	51.4	55.3	33.6
Listings with geocodes (mn)	5.6	5.9	6.1	6.2	6.3	6.8	7.8	9.2	10.1	10.9	11.8	12.3	13.4	32.7
Ratings and reviews (mn)	58.3	60.6	62.6	64.8	67.9	70.5	73.1	76.1	79.0	81.9	85.1	88.0	91.3	15.6
Cumulative app downloads (mn)	9.1	9.6	10.1	10.7	11.6	13.3	15.4	17.3	18.7	19.8	20.8	21.8	22.8	21.9
Android			8.1	8.6	9.4	10.9	12.9	14.7	16.0	17.0	17.9	18.9	19.8	23.8
iOS			1.4	1.4	1.5	1.6	1.7	1.8	1.9	2.0	2.1	2.1	2.2	15.8
Others			0.7	0.7	0.7	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	—
Add downloads per day (#)			7,721	8,704	12,416	19,687	26,533	23,871	19,103	15,501	14,351	13,555	14,437	(24.4)

Source: Company, Kotak Institutional Equities

**Other takeaways from the earnings call**

- ▶ **Campaign addition.** Contribution from tier II/III cities continues to increase. These cities contributed 26% to topline and 46% to campaigns, in 3QFY19, and their contribution is increasing every quarter. JUST is present in more than 200 Tier II/III cities, while top-11 is defined as Tier I. The 200 tier II/III cities are still underpenetrated and there is sufficient opportunity for JUST to penetrate these cities better by adding requisite FOS and area manager.
- ▶ **Realizations.** On a blended basis, there will be downward pressure on realizations as Tier II/III contribution increases. However, JUST has managed to drive up pricing in FY2019 by selling bundled products to existing customers and also taking regular price hikes.
- ▶ **Employee addition.** JUST has added ~1,100 sales employees in 9MFY19, and expects the recently added employees to contribute in the next 6-9 months. Revenue per sales employee and revenue per SME are the two metrics evaluated internally. There is room to increase sales force and drive revenue growth.
- ▶ **Mobile traffic.** 90%+ of mobile traffic is accounted for by the mobile website. JUST attempts to remain platform agnostic, and thus the app and mobile site are replica of

each other. Last year's app installs were boosted by promotions of the JD Lite app; the app was however founding wanting in user experience and hence JUST isn't actively promoting the app now. Ideally, the attempt would be to have more apps installed, but JUST will not pay large costs for downloads.

- ▶ Ad-spends will trend at 7-8% of topline normally, but spends can go up if there is any specific opportunity of targeted advertising. As before, JUST keeps evaluating RoI from various advertising platforms very closely.
- ▶ **Deferred revenue.** Deferred revenue should be best evaluated on a yoy basis. Sequential declines in the past have also happened as this is a volatile number. Quarterly targets can sometime focus on contracts, sometime on pricing, and hence deferred revenue trends may differ from quarter to quarter.
- ▶ **Cash.** ₹2.2 bn of buyback was completed earlier in January 2019. The next buyback can thus happen after one year. This is the most tax efficient route of returning cash to shareholders and there are no near-term plans of any special dividend/other payouts.
- ▶ **Vision.** JUST's key responsibility is to get customers for SMEs. Thus, key revenue driver will remain the SMEs. Currently, SMEs pay JUST for getting leads, and also buy products such as customized websites and apps. JUST envisages sales of related products, tools to SMEs to boost its revenue stream in the future, though the core revenue driver will remain the advertising product.
- ▶ **Service versus search.** JD does not want to become a service provider. JD is driving traffic to a lot of start-up platforms such as Urban Clap which fulfill services, and will continue to target higher revenue from such service providers.

### Estimate change for Just Dial

We revise upwards our FY2019 EBITDA estimate to factor in superior margin performance in 9MFY19. We also raise our FY2020-21 EPS estimates by 3-4% as we expect productivity measures to drive better margin performance.

We have, however, revised revenue expectations down as we remain cautious on the static deferred revenue base.

Exhibit 12: Change in estimates for Just Dial, March fiscal year-ends, 2019-21E (Rs mn)

	New estimates			Old estimates			% revision		
	2019E	2020E	2021E	2019E	2020E	2021E	2019E	2020E	2021E
Total revenues	8,903	9,717	10,506	8,874	9,875	10,731	0.3	(1.6)	(2.1)
EBITDA	2,252	2,311	2,354	2,129	2,184	2,254	5.8	5.8	4.5
EBITDA margin (%)	25.3	23.8	22.4	24.0	22.1	21.0			
PAT	1,914	2,011	2,149	1,829	1,924	2,081	4.6	4.5	3.3
EPS (Rs)	29.0	31.1	33.2	27.7	29.8	32.2	4.6	4.5	3.3
Tax rate (%)	28.7	28.5	28.0	28.5	28.3	27.8			
<b>Yoy growth metrics (%)</b>									
Sales	13.9	9.1	8.1	13.5	11.3	8.7			
EBITDA	37.0	2.6	1.9	29.5	2.6	3.2			
PAT	33.6	5.1	6.8	27.8	5.1	8.2			

Source: Kotak Institutional Equities estimates

Exhibit 13: Details of the estimates for Just Dial, March fiscal year-ends, 2015-21E (Rs mn)

	2015	2016	2017	2018	2019E	2020E	2021E
<b>Search</b>							
Campaigns (#)	331,200	367,000	429,840	445,110	490,956	525,323	556,843
Revenues from core business (Rs mn)	5,898	6,640	7,062	7,818	8,903	9,717	10,506
Yoy growth (%)	27.9	12.6	6.4	10.7	13.9	9.1	8.1
Other revenues	—	37	132	—	—	—	—
<b>Total revenues</b>	<b>5,898</b>	<b>6,677</b>	<b>7,186</b>	<b>7,818</b>	<b>8,903</b>	<b>9,717</b>	<b>10,506</b>
<b>Yoy growth (%)</b>	<b>27.9</b>	<b>13.2</b>	<b>7.6</b>	<b>8.8</b>	<b>13.9</b>	<b>9.1</b>	<b>8.1</b>
Number of employees (#)	9,533	11,142	11,334	11,452	12,352	12,852	13,652
Employee cost/ sales (%)	52.4	56.9	61.4	56.5	55.5	56.8	58.1
Other expenses/sales (%)	19.5	21.5	23.4	22.5	19.2	19.4	19.5
<b>EBITDA margin (%)</b>	<b>28.1</b>	<b>21.6</b>	<b>15.3</b>	<b>21.0</b>	<b>25.3</b>	<b>23.8</b>	<b>22.4</b>
<b>PAT</b>	<b>1,389</b>	<b>1,427</b>	<b>1,214</b>	<b>1,432</b>	<b>1,914</b>	<b>2,011</b>	<b>2,149</b>
<b>EPS (Rs)</b>	<b>19.7</b>	<b>20.5</b>	<b>17.5</b>	<b>21.2</b>	<b>29.0</b>	<b>31.1</b>	<b>33.2</b>

Source: Company, Kotak Institutional Equities estimates

Exhibit 14: Financial snapshot of Just Dial, March fiscal year-ends, 2011-21E (Rs mn)

	2011	2012	2013	2014	2015	2016	2017	2018	2019E	2020E	2021E
<b>Profit model</b>											
Total operating income	1,839	2,621	3,628	4,613	5,898	6,677	7,186	7,818	8,903	9,717	10,506
Operating expenses	(1,385)	(1,948)	(2,619)	(3,191)	(4,240)	(5,235)	(6,090)	(6,174)	(6,651)	(7,406)	(8,152)
Employee expenses	(947)	(1,308)	(1,779)	(2,286)	(3,088)	(3,799)	(4,409)	(4,416)	(4,940)	(5,520)	(6,102)
Operating and other expenses	(438)	(640)	(841)	(905)	(1,152)	(1,435)	(1,681)	(1,758)	(1,710)	(1,885)	(2,049)
<b>EBITDA</b>	<b>454</b>	<b>672</b>	<b>1,008</b>	<b>1,422</b>	<b>1,658</b>	<b>1,442</b>	<b>1,096</b>	<b>1,644</b>	<b>2,252</b>	<b>2,311</b>	<b>2,354</b>
Pre-tax profit	423	713	1,000	1,649	1,905	1,931	1,565	1,939	2,685	2,814	2,985
<b>PAT</b>	<b>288</b>	<b>504</b>	<b>685</b>	<b>1,206</b>	<b>1,389</b>	<b>1,427</b>	<b>1,214</b>	<b>1,432</b>	<b>1,914</b>	<b>2,011</b>	<b>2,149</b>
Weighted diluted number of shares (mn)	53	60	69	70	70	69	70	67	66	65	65
<b>EPS (Rs)</b>	<b>5</b>	<b>8</b>	<b>10</b>	<b>17</b>	<b>20</b>	<b>21</b>	<b>17</b>	<b>21</b>	<b>29</b>	<b>31</b>	<b>33</b>
<b>Balance sheet</b>											
Equity share capital	519	519	695	702	705	695	695	674	646	646	646
Reserves & surplus	433	542	3,556	4,643	6,029	6,699	8,356	9,118	8,629	10,398	12,288
<b>Shareholders funds</b>	<b>954</b>	<b>1,033</b>	<b>4,259</b>	<b>5,345</b>	<b>6,734</b>	<b>7,394</b>	<b>9,052</b>	<b>9,792</b>	<b>9,275</b>	<b>11,044</b>	<b>12,934</b>
Loan funds	1	—	—	—	—	—	—	—	—	—	—
<b>Total source of funds</b>	<b>956</b>	<b>1,033</b>	<b>4,269</b>	<b>5,363</b>	<b>6,734</b>	<b>7,396</b>	<b>9,052</b>	<b>9,792</b>	<b>9,275</b>	<b>11,044</b>	<b>12,934</b>
<b>Net fixed assets</b>	<b>272</b>	<b>360</b>	<b>623</b>	<b>539</b>	<b>921</b>	<b>1,474</b>	<b>1,647</b>	<b>1,489</b>	<b>1,535</b>	<b>1,621</b>	<b>1,732</b>
Investments	1,182	1,568	4,858	6,257	7,722	8,077	9,768	11,549	11,749	13,749	16,249
Cash balances	196	237	239	369	422	336	525	575	340	432	108
<b>Net current assets excluding cash</b>	<b>(707)</b>	<b>(1,102)</b>	<b>(1,452)</b>	<b>(1,803)</b>	<b>(2,355)</b>	<b>(2,492)</b>	<b>(3,128)</b>	<b>(3,946)</b>	<b>(4,474)</b>	<b>(4,883)</b>	<b>(5,279)</b>
<b>Total application of funds</b>	<b>956</b>	<b>1,033</b>	<b>4,269</b>	<b>5,363</b>	<b>6,734</b>	<b>7,396</b>	<b>9,052</b>	<b>9,792</b>	<b>9,275</b>	<b>11,044</b>	<b>12,934</b>
<b>Cash flow statement</b>											
Operating profit before working capital change	357	595	846	1,379	1,630	1,738	1,615	1,796	2,268	2,362	2,511
Change in working capital/other adjustment	230	395	350	351	552	137	636	818	528	409	396
<b>Cashflow from operating activities</b>	<b>586</b>	<b>990</b>	<b>1,196</b>	<b>1,730</b>	<b>2,182</b>	<b>1,875</b>	<b>2,251</b>	<b>2,614</b>	<b>2,796</b>	<b>2,771</b>	<b>2,907</b>
Fixed assets	(152)	(179)	(407)	(89)	(623)	(864)	(574)	(207)	(401)	(437)	(473)
<b>Free cash flow</b>	<b>435</b>	<b>811</b>	<b>789</b>	<b>1,641</b>	<b>1,559</b>	<b>1,012</b>	<b>1,677</b>	<b>2,407</b>	<b>2,396</b>	<b>2,333</b>	<b>2,434</b>
Issue of share capital	8	(425)	2,541	43	170	(767)	444	(692)	(2,200)	—	—
<b>Cash (used)/realised in financing activities</b>	<b>6</b>	<b>(427)</b>	<b>2,541</b>	<b>(121)</b>	<b>0</b>	<b>(767)</b>	<b>444</b>	<b>(692)</b>	<b>(2,430)</b>	<b>(242)</b>	<b>(259)</b>
Cash generated/utilised	457	427	3,292	1,529	1,517	270	1,880	1,831	(35)	2,091	2,176
Cash+investments at beginning of year	922	1,378	1,805	5,097	6,626	8,143	8,414	10,294	12,124	12,090	14,181
<b>Cash+investments at end of year</b>	<b>1,378</b>	<b>1,805</b>	<b>5,097</b>	<b>6,626</b>	<b>8,143</b>	<b>8,414</b>	<b>10,294</b>	<b>12,124</b>	<b>12,090</b>	<b>14,181</b>	<b>16,357</b>

Source: Company, Kotak Institutional Equities estimates

JANUARY 22, 2019

RESULT, CHANGE IN RECO.

Coverage view: **Neutral**

Price (₹): **137**

Fair Value (₹): **145**

BSE-30: **36,445**

**Wholesale business flat, high-yield segments monitorable.** LTFH continues to report high growth in rural and developer lending segments even as its wholesale business segment was sluggish. While operating trends in 3QFY19 were in line with expectations, rapid growth in high-yield segments raises concerns. Large exposure to IL&FS, though seems well-covered, is another development to monitor. We are tweaking our estimates; downgrade the stock to REDUCE from ADD; fair value of ₹145 (unchanged).

#### Company data and valuation summary

L&T Finance Holdings

Stock data				Forecasts/Valuations			
				2019E	2020E	2021E	
52-week range (Rs) (high,low)				11.7	13.0	15.0	
Market Cap. (Rs bn)				58.9	11.2	15.6	
Shareholding pattern (%)				11.7	10.6	9.1	
Promoters				47.8	55.3	65.5	
FII				23.3	25.9	29.9	
MFs				68.4	78.5	90.7	
Price performance (%)				1M	3M	12M	
Absolute				(9.4)	12.2	(23.2)	
Rel. to BSE-30				(11.1)	5.1	(24.5)	
				2.0	1.7	1.5	
				17.7	17.7	17.7	
				1.5	1.8	1.7	

#### Growth in high-yield retail loans to continue; wholesale business sluggish

LTFH has reported flat loan book in the wholesale segment; it sold its supply chain business during 3QFY19. We believe that debt markets and banks will prefer NBFCs with a higher retail book, prompting NBFCs to reduce/run down their wholesale books and accelerate on the retail front. We accordingly expect LTFH to go slow in the wholesale segment; the company has followed a model of originate and sell (and earn fees) wholesale loans—a business that will anyway see low growth in the current environment. This further necessitates growth in the retail book, which so far has been an RoE expansion strategy. The company nevertheless continues to focus on developer loans as well.

LTFH has focused on high-yield segments of retail finance such as microfinance (up 86% yoy), two-wheelers (up 75% yoy), etc.—segments in which credit costs tends to be episodic/lumpy and LGD are high. LTFH follows a system-driven lending model (loan appraisal is fully centralized) and have highlighted that early warning signals are currently under control. We, however, believe consistent high growth in these high-yield segments is worrying and asset quality trends in these segments are an important monitorable.

#### Revise estimates; downgrade to REDUCE; fair value at ₹145 (unchanged)

We are tweaking our PBT estimates for the lending business up by 4% in FY2019E and down by 1% in FY2020-21E to reflect the faster growth in high-yield segments even as we raise our provision estimates as well. On the base of high loan growth in the rural business and developer loans, we are building moderation from here. Post the revision, we expect the company to deliver 18% consolidated RoE (~19-20% in core lending business). Our valuation of lending business works out to 1.8X book (down from 2X) to reflect higher risk in the business. With rollover to December 2020E, we retain fair value of ₹145. We are downgrading our rating to REDUCE from ADD after 18% rally in the stock over the past three months. Strong growth in high-yield retail and developer loans remains a concern even as erstwhile stress in wholesale book may be provided for. Development with respect to its exposure to IL&FS' SPV of ₹18 bn remains crucial.

#### QUICK NUMBERS

- PAT up 81% yoy
- Loan book up 22% yoy
- GNPLs/stage 3 loan ratio down 40 bps qoq to 6.7%

Nischint Chawathe

M B Mahesh CFA

Dipanjan Ghosh

Shrey Singh

**IL&FS exposure—backed by escrows but remains a monitorable**

LTFH has exposure of ₹18 bn across six SPVS of IL&FS; four of the SPVs earn annuity from NHAI while the other two are backed by self-sustaining/operating tolls, according to the management. Three of the SPVs have issued letters to lenders that normal servicing of loans is stayed by NCLT. LTFH believes that the NCLT Order does not affect regular servicing of loans and the next date of hearing is on January 28. Based on ECL methodology, the company, at this stage, does not foresee any extra provisions/write-offs on these loans.

**Earnings growth strong in 2QFY19**

L&TFH reported 81% yoy growth in PAT to ₹5.8 bn. Pre-provisioning profit (up 43% yoy) was driven by strong NII growth (up 54% yoy) and reduction in credit cost (down 10% yoy), though partially offset by elevated operating expenses (up 68% yoy). Loan growth was strong at 22% yoy on the back of 64% yoy growth in rural finance (25% of total) and 34% in housing finance (24% of total). Wholesale loans were muted, up 5% yoy. Stage 3 loans declined to 6.7% from 7.1% qoq driven by improvement in asset quality of the rural business. The company made extra provisions of ₹850 mn in 3QFY19 towards rural and housing businesses (aggregate extra provisions of ₹2.69 bn on balance sheet). Reported NIM was flat qoq at 5% on the back of 60 bps qoq improvement in yields even as borrowing cost inched upwards by 17 bps qoq to 8.5%. Yield expansion is a result of change in asset mix towards high-yielding rural and real estate loans.

**Exhibit 1: L&T Finance Holdings (lending business) - quarterly summary**  
 March fiscal year-ends, 3QFY18-3QFY19 (₹ mn)

	Ind-AS	Ind-AS	Ind-AS	Ind-AS	(% chg.)			9MFY19	9MFY18	(% chg.)	Ind-AS	IGAAP	(% chg.)	Ind-AS
	3QFY19	3QFY19E	3QFY18	2QFY19	3QFY19E	3QFY18	2QFY19				2019E	2018		2020E
<b>Income statement (Rs mn)</b>														
Total income	32,720		23,530	30,760	39.1	6.4		91,730	67,000	36.9	74,940	71,680	4.5	77,470
Interest income	30,150		21,210	27,480	42.1	9.7		82,940	60,250	37.7	114,418	84,770	35.0	137,443
Fee and other income	2,570	3,500	2,320	3,280	(26.6)	10.8	(21.6)	8,790	6,750	30.2	10,748	9,340	15.1	11,879
Interest expenses	17,310		13,390	16,030	29.3	8.0		48,150	37,850	27.2	66,268	51,680	28.2	81,717
NII	12,840	11,502	7,820	11,450	11.6	64.2	12.1	34,790	22,400	55.3	48,151	33,090	45.5	55,726
Credit losses/ provisions	4,110	3,600	4,090	3,400	14.2	0.5	20.9	10,950	12,090	(9.4)	15,019	16,430	(8.6)	20,365
NII post provision	11,300	11,402	6,050	11,300	(0.9)	86.8	(0.3)	32,630	17,060	91.3	43,879	26,000	68.8	47,239
Operating expenses	3,310	2,600	1,410	2,730	27.3	134.8	21.2	8,470	4,300	97.0	11,774	6,670	76.5	13,635
PBT	7,990	8,802	4,640	8,600	(9.2)	72.2	(7.1)	24,160	12,760	89.3	32,106	19,330	66.1	33,604
Taxes	1,980	2,376	840	2,430	(16.7)	135.7	(18.5)	6,310	1,430	341.3	8,335	3,540	135.4	9,104
PAT	6,010	6,425	3,800	6,170	(6.5)	58.2	(2.6)	17,850	11,330	57.5	23,771	15,790	50.5	24,500
PBT+provisions	12,100	12,402	8,730	12,000	(2.4)	38.6	0.8	35,110	24,850	41.3	47,125	35,760	31.8	53,969
PAT (de-focused business)	(210)	(300)	(590)	(570)	(30.0)	(64.4)	(63.2)	(1,070)	(1,600)	NM	(1,313)	(1,900)	(30.9)	—
PAT for lending business	5,800	6,125	3,210	5,600	(5.3)	80.7	3.6	16,780	9,730	72.5	22,458	13,890	61.7	24,500
Tax rate (%)	25	27	18	28	-222 bps	668 bps	-347 bps	26	11		26	18		27
<b>Key balance sheet items (Rs bn)</b>														
Gross loans	937	904	759	900	3.7	23.4	4.1	937	759	23.4	948	821	15.5	1,094
Rural	241		147	214	64.3	12.5		241	147	64.3	257	165	55.9	314
Microfinance	116		62	104	86.4	11.2		116	62	86.4	125	75	65.0	153
2-W	52		30	43	75.3	22.3		52	30	75.3	57	33	72.0	71
Farm equipment	73		55	67	33.3	8.5		73	55	33.3	75	56	34.0	90
Housing	233		174	217	34.0	7.4		233	174	34.0	238	189	25.8	286
Home loans/ LAP	101		83	96	20.5	5.1		101	83	20.5	107	88	21.0	135
Real estate finance	133		91	122	46.5	9.1		133	91	46.5	131	101	30.0	151
Wholesale	463		439	469	5.5	(1.3)		463	439	5.5	454	468	(2.9)	493
Infrastructure finance	388		347	385	11.9	0.6		388	347	11.9	381	373	2.0	411
Structured finance	75		73	76	1.9	(1.4)		75	73	1.9	73	77	(5.0)	82
Supply chain finance	-		19	7	(100.0)	(100.0)		-	19	(100.0)	-	17	(100.0)	-
Net worth	130		80	123	61.7	5.3		130	80	61.7	117	117	(0.1)	130
<b>Asset quality</b>														
GNPL (Rs mn)	60,330		75,130	61,190				60,330	75,130	(19.7)	24,300	20,830	16.7	24,900
GNPL (%)	6.7		10.4	7.1				7	10	-366 bps	4.1	3.6	48 bps	3.9
NNPL (Rs mn)	22,630		32,220	22,960				22,630	32,220	(29.8)	16,020	13,720	16.8	14,610
NNPL (%)	2.6		4.7	2.8				3	5	-210 bps	2.7	2.4	32 bps	2.3
PCR (%)	62		57	62				62	57	500 bps	34	34	-6 bps	41
<b>Key calculated ratios (%)</b>														
Yield on AUM	13.1		11.5	12.6		161 bps	58 bps	12.6	11.5	110 bps	12.9	11.6	133 bps	13.5
NIM (NII/AUM)	5.6	5.1	4.2	5.2	49 bps	134 bps	36 bps	5.3	4.3	101 bps	5.4	4.5	91 bps	5.5
Cost to income	21.5	-	13.9	18.5	2148 bps	757 bps	295 bps	19.4	14.8	468 bps	20.0	15.7	427 bps	20.2
Cost to average AUM	1.4		0.8	1.2		68 bps	19 bps	1.3	0.8	47 bps	1.3	0.9	42 bps	1.3
Credit cost	1.8	1.6	2.2	1.6	19 bps	-43 bps	24 bps	1.7	2.3	-64 bps	1.7	2.2	-55 bps	2.0
<b>Disbursement mix (Rs bn)</b>														
Net disbursements	137		172	167	(20.3)	(18.2)		454	479	(5.2)		706		
Rural	57		41	47	39.5	21.8		149	98	51.5		142		
Microfinance	28		22	28	28.3	0.2		82	46	77.7		72		
2-W	16		9	11	92.6	48.8		37	24	54.1		33		
Farm equipment	13		11	8	20.1	59.0		30	28	6.7		37		
Housing	24		31	26	(23.0)	(9.0)		74	79	(6.8)		108		
Home loans/ LAP	9		10	10	(4.3)	(1.8)		28	26	7.2		37		
Real estate finance	14		21	16	(31.8)	(13.2)		46	53	(13.5)		71		
Wholesale	56		100	94	(44.1)	(40.7)		231	302	(23.3)		456		
Infrastructure finance	41		68	75	(40.2)	(45.8)		176	200	(12.1)		309		
Structured finance	5		6	6	(12.8)	(7.7)		15	25	(41.6)		46		
Supply chain finance	10		26	14	(61.2)	(26.7)		41	77	(46.4)		102		

Source: Company, Kotak Institutional Equities estimates

**Exhibit 2: Strong performance of focused business**

PAT, net worth and RoE across business segments, March fiscal year-ends, 3QFY18-3QFY19

	PAT (Rs mn)				Networth (Rs bn)				RoE (%)		
	3QFY18	2QFY19	3QFY19	YoY (%)	3QFY18	2QFY19	3QFY19	YoY (%)	3QFY18	2QFY19	3QFY19
Rural	1,450	2,180	2,330	61	17	31	37	113	36.4	28.6	27.5
Housing	1,290	1,970	2,090	62	17	29	32	88	32.8	28.2	27.8
Wholesale	1,060	2,020	1,590	50	46	63	61	33	9.1	15.1	10.2
<b>Focus lending business</b>	<b>3,800</b>	<b>6,170</b>	<b>6,010</b>	<b>58</b>	<b>80</b>	<b>123</b>	<b>130</b>	<b>62</b>	<b>19.5</b>	<b>22.0</b>	<b>19.1</b>
De-focussed business	(640)	(420)	(290)	(55)	2	1	1	(32)			
<b>Lending businesses</b>	<b>3,160</b>	<b>5,750</b>	<b>5,720</b>	<b>81</b>	<b>82</b>	<b>124</b>	<b>131</b>	<b>60</b>			
Other businesses	300	250	510	70	9	9	10	12			
LTFH consolidated	3,460	6,000	6,230	80	91	133	140	55	15.6	19.5	18.2
Others	(250)	(390)	(430)	72	(9)	(11)	(11)	22			
<b>LTFH consol. (to shareholders)</b>	<b>3,210</b>	<b>5,610</b>	<b>5,800</b>	<b>81</b>	<b>81.8</b>	<b>123</b>	<b>130</b>	<b>59</b>	<b>16.0</b>	<b>18.5</b>	<b>18.3</b>

Source: Company, Kotak Institutional Equities

**Exhibit 3: We value LTFH at ₹145 per share**

SoTP-based valuation, March fiscal year-ends, 2020-2021E (₹ mn)

	2020E	2021E	Dec-20
Net worth of lending business	129,550	147,466	142,987
Valuation multiple (X)	1.8	1.8	1.8
<b>Valuation (Rs mn)</b>	<b>233,190</b>	<b>265,439</b>	<b>257,377</b>
Others	30,656	36,000	36,000
Value of MF	36,000	36,000	36,000
Preference shares	(5,344)	—	—
<b>Fair value of LTFH</b>	<b>263,846</b>	<b>301,439</b>	<b>293,377</b>
<b>Per share (Rs)</b>	<b>132</b>	<b>151</b>	<b>147</b>

Note:

(a) We value the MF at Rs36 bn.

Source: Company, Kotak Institutional Equities estimates

**Exhibit 4: Our fair value implies 1.8X PBR for rural business, 1.4X for housing and 1X for wholesale**

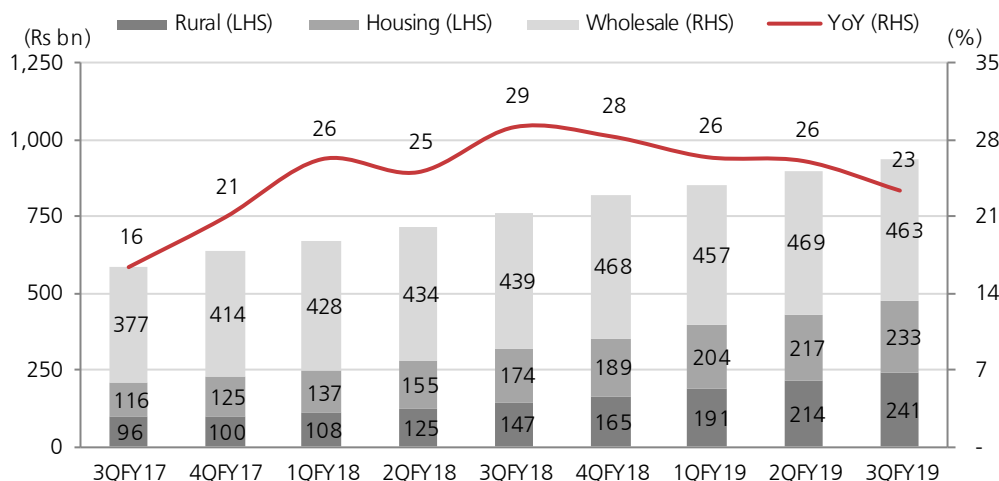
Implied segmental valuation for our SoTP, March fiscal year-end, 2021E (₹ mn)

	Net worth (Rs mn)	Multiple (X)	Valuation (Rs mn)	Value/share (Rs)
Rural	46,009	1.8	82,817	41
Housing	37,435	1.4	52,410	26
Wholesale	64,021	1.0	64,021	32
<b>Total</b>			<b>199,248</b>	<b>100</b>
After assuming 25% diversification benefit			249,060	130
MF and others			36,000	18
<b>Total</b>				<b>148</b>

Source: Company, Kotak Institutional Equities estimates

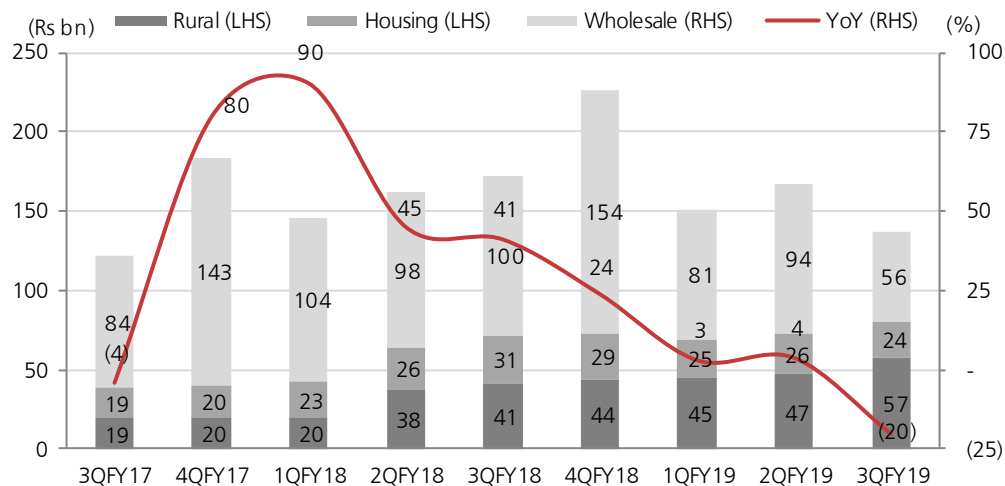
**Exhibit 5: Strong loan growth at 23% yoy**

Loan book break-up (lending business), March fiscal year-ends, 3QFY17-3QFY19 (₹ bn)



Source: Company, Kotak Institutional Equities

**Exhibit 6: Disbursement declined by 20% yoy largely in wholesale business**  
Disbursements break-up (lending business), March fiscal year-ends, 3QFY17-3QFY19 (₹ bn)



Source: Company, Kotak Institutional Equities

**Exhibit 7: RoE of lending business will move to ~20% by FY2021E**  
DU Pont analysis of lending business, March fiscal year-ends, 2017-2021E (%)

	IGAAP 2017	IGAAP 2018	Ind-AS 2019E	Ind-AS 2020E	Ind-AS 2021E
<b>Du Pont analysis</b>					
(% of average assets)					
Net interest income	4.9	4.3	5.2	5.2	5.3
Other income	0.8	1.2	1.2	1.1	1.1
Total income	5.6	5.5	6.3	6.3	6.4
Credit costs	1.9	2.1	1.6	1.9	2.0
Operating expenses	1.1	0.9	1.3	1.3	1.3
PBT post extraordinary	2.6	2.5	3.5	3.1	3.1
1-tax rate	69	82	74	73	73
<b>RoA</b>	<b>1.8</b>	<b>2.0</b>	<b>2.6</b>	<b>2.3</b>	<b>2.3</b>
Average assets / average equity (X)	8.5	7.8	8.0	8.7	8.9
<b>RoE</b>	<b>15.3</b>	<b>16.1</b>	<b>20.4</b>	<b>19.9</b>	<b>20.2</b>
<b>RoE (including discontinued businesses)</b>	<b>13.5</b>	<b>14.1</b>	<b>19.5</b>	<b>20.0</b>	<b>20.2</b>

Source: Company, Kotak Institutional Equities estimates

**Exhibit 8: Retail book to increase in overall portfolio mix going ahead**

Loan book composition, March fiscal year-ends, 2017-2021E (₹ mn)

	IGAAP 2017	IGAAP 2018	Ind-AS 2019E	Ind-AS 2020E	Ind-AS 2021E
<b>Loan book composition</b>					
Wholesale	414,030	467,590	453,862	493,098	535,825
Housing loans	125,340	188,980	237,749	286,197	345,365
Rural	100,410	164,570	256,527	314,420	381,901
<b>Total</b>	<b>639,780</b>	<b>821,140</b>	<b>948,137</b>	<b>1,093,716</b>	<b>1,263,091</b>
<b>(% of total)</b>					
Wholesale	65	57	48	45	42
Housing loans	20	23	25	26	27
Rural	16	20	27	29	30
<b>Total</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>
<b>YoY (%)</b>					
Wholesale	20	13	(3)	9	9
Housing loans	NA	51	26	20	21
Rural	16	64	56	23	21
<b>Total</b>	<b>21</b>	<b>28</b>	<b>15</b>	<b>15</b>	<b>15</b>

Source: Company, Kotak Institutional Equities estimates

**Exhibit 9: Higher earnings post Ind-AS migration**

Key financial statements of LTFH, March fiscal year-ends, 2016-2021E (₹ mn)

	IGAAP 2016	IGAAP 2017	IGAAP 2018	Ind-AS 2019E	Ind-AS 2020E	Ind-AS 2021E
<b>Income statement (Rs mn)</b>						
Interest income	62,480	72,730	84,770	114,418	137,443	160,597
Interest costs	36,440	42,500	51,680	66,268	81,717	94,524
Net interest income	26,040	30,230	33,090	48,151	55,726	66,073
Other income	2,600	4,750	9,340	10,748	11,879	13,489
Net total income	28,640	34,980	42,430	58,899	67,605	79,562
Provisioning expenses	8,760	12,050	16,430	15,019	20,365	25,051
Net income (post provisions)	19,880	22,930	26,000	43,879	47,239	54,511
Operating expenses	7,210	6,750	6,670	11,774	13,635	16,038
PBT before extraordinaries	12,670	16,180	19,330	32,106	33,604	38,474
Extraordinary income	—	—	—	—	—	—
PBT post extraordinaries	12,670	16,180	19,330	32,106	33,604	38,474
Tax	3,830	4,950	3,540	8,335	9,104	10,435
<b>PAT (continuing operations)</b>	<b>8,840</b>	<b>11,230</b>	<b>15,790</b>	<b>23,771</b>	<b>24,500</b>	<b>28,038</b>
PAT of defocus business	(700)	(1,450)	(1,900)	(1,313)	—	—
<b>PAT for all lending business</b>	<b>8,140</b>	<b>9,780</b>	<b>13,890</b>	<b>22,458</b>	<b>24,500</b>	<b>28,038</b>
Dividend	—	2,934	4,167	9,508	9,800	8,652
Dividend tax	—	496	704	1,616	1,666	1,471
<b>Balance sheet (Rs mn) - continuing ops</b>						
<b>Assets</b>						
Gross loans	529,000	639,780	821,140	948,137	1,093,716	1,263,091
Net other assets	38,930	37,650	42,560	46,654	53,153	60,721
<b>Total assets</b>	<b>567,930</b>	<b>677,430</b>	<b>863,700</b>	<b>994,791</b>	<b>1,146,869</b>	<b>1,323,812</b>
<b>Liabilities</b>						
Borrowings	467,510	569,640	707,860	878,274	1,017,319	1,176,346
Other liabilities	33,680	27,690	39,260	—	—	—
<b>Total liabilities</b>	<b>501,190</b>	<b>597,330</b>	<b>747,120</b>	<b>878,274</b>	<b>1,017,319</b>	<b>1,176,346</b>
Shareholders funds	66,740	80,100	116,580	116,516	129,550	147,466

Source: Company, Kotak Institutional Equities estimates

**ALM position comfortable**

As of December 2018, LTFH reported a positive cumulative ALM gap for the first year. The cumulative positive ALM gap for 6 months to 1 year bucket was high at 69%. The company raised ₹170 bn of borrowings through NCDs/CPs in 3QFY19 and ₹130 bn from bank loans. Going ahead, it plans to mobilize retail deposits and foreign borrowings as well. A stress test (collections shortfall of 15% and 40% hair-cut on back-up lines of credit) suggests a surplus of ₹63 bn for the first month as compared to reported surplus of ₹197 bn in base case.

**Exhibit 10: Comfortable liquidity position**

ALM statement, March fiscal year end, 3QFY19 (₹ bn)

Maturity	0-1 month	1-2 months	2-3 months	3-6 months	6-12 months
Cumulative outflows	104	109	174	229	309
Cumulative inflows	308	219	250	316	523
Cumulative mismatch	204	110	76	88	214
Gap (% of outflows)	197	101	44	38	69

Source: Company, Kotak Institutional Equities

### Rural disbursements remain strong; cost ratios remain elevated

- ▶ **AUM growth maintains momentum.** Rural segment witnessed 64% yoy growth driven by sharp rise in microfinance loans and 2W loans at 86% and 75% yoy, respectively. The share of microfinance loans to overall AUM is high at 48%. Microfinance disbursements (up 28% yoy) have moderated a bit post recording steep growth from 2QFY18-1QFY19 (up ~1.1X during this period). Overall rural disbursements were robust at 40% yoy driven by pick up in 2W financing (up 93% yoy). Growth in tractor loans was relatively lower, up 34% yoy (similar to last two quarters). The share of rural loans to overall AUM increased to 26% in 3QFY19 (up 640 bps yoy and 190 bps qoq). As the company focuses on retalization of the book and increase on the ground footprint, this book is expected to maintain growth at a high pace. Management guided a gradual slowdown in tractor and microfinance disbursements while that of 2W will remain strong. On a high base, we forecast 22% CAGR in rural AUM over FY2019-21E.
- ▶ **Asset quality continues to improve.** Strong focus on collections led to ~440 bps yoy decline in GNPL (gross stage 3 loans) to 3.8% in 3QFY19 (down 45 bps qoq). Net NPL dropped to 1.3% (down 250 bps yoy and 17 bps qoq). Calculated credit cost increased ~10 bps qoq to 4.4% owing to macro-prudential provisions in this book (₹500 mn in 3QFY19 on the back of ₹1.5 bn in 1HFY19). Adjusting for the same, credit cost was low at 3.5%. The company maintains a high coverage of 66% in this segment. LTFH witnessed some stress in the microfinance business originated from Odisha. It has provided 100% for loans which are overdue by 60 days or more (₹810 mn; ~0.7% of the MFI book) and 70% for loans in 30-60 dpd buckets (₹720 mn, ~0.6% of the MFI book). We model credit cost to moderate to 4.1% in FY2019E and inch up to 4.3% over FY2020-21E from 5.2% in FY2018.
- ▶ **Microfinance business remains strong.** LTFH reported 28% growth in microfinance disbursement growth in 3QFY19. The average ticket size at ₹31,000 is higher than industry average for average ticket size at disbursement for NBFC-MFIs at ₹25,000 as per MFIN (2QFY19). We project loan growth of about 23% CAGR over FY2019-21E for LTFH's microfinance business on a high base of 65% in FY2019E and 113% in FY2018. L&TFH will continue to expand into newer geographies with a push towards higher customer acquisition from new branches in these locations over the medium term. The number of micro lending meeting units has increased by 291 in 9MFY19 (up qoq by 67 in 3QFY19).
- ▶ **Two-wheeler lending picks pace.** Loan growth was robust at 75% yoy, highest since 1QFY17. Disbursement growth was strong at 93% in 3QFY19 after recording muted increase in 2QFY19. The surge in disbursements in 3QFY19 was led by strong demand during the festive season. L&TFH's investments in technology have seen a reduction in turnaround time to less than 5 minutes from a few hours earlier; the entire loans approval process is system-driven (based on maxtrix/algos) with no human intervention. Average ticket size is ₹53,000 (flat qoq) with 25 months of tenor. We project loan growth of about 23% CAGR over FY2019-21E for LTFH's 2W business on the back of 72% in FY2019E and 57% in FY2018. Increase in per branch productivity will drive business for this segment.
- ▶ **Stable growth in tractor business.** Farm equipment (tractor) AUM witnessed 34% yoy growth in 3QFY19; similar to past two quarters. Disbursements saw a reversal in 3QFY19 to 20% yoy post 2% decline in 1HFY19. Majority of growth in this segment comes from the back of higher penetration across large OEMs (M&M, Tafe and John Deer accounts for ~80% of the business) and geographies. L&TFH is currently ranked second in terms of market share in tractor financing within India. The company went to an aggressive expansion mode last year and will now go slow; it expects industry growth in the range of 10-15% in FY2019E. We expect 20% AUM CAGR during FY2019-21E in farm

equipment segment (on the back of 34% growth in FY2019E) driven by rural recovery and market share gains across the geography.

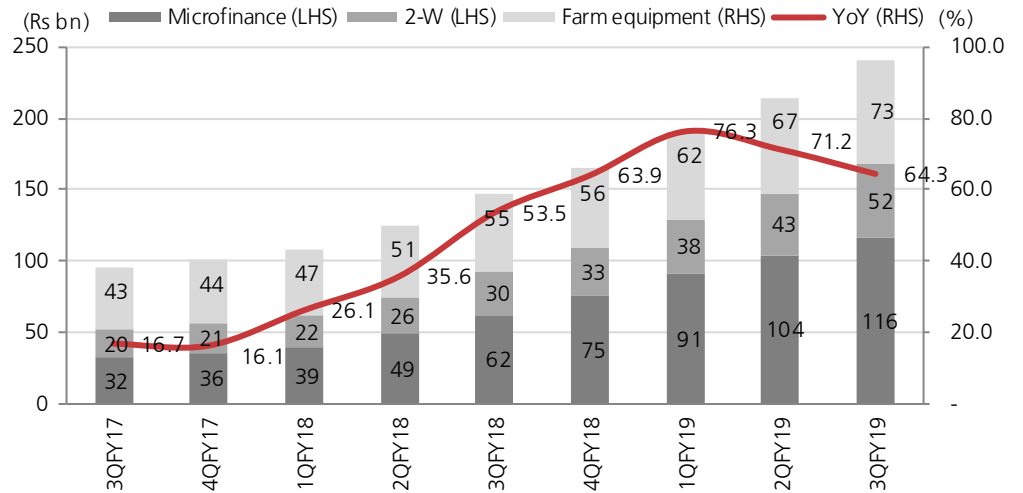
- ▶ **Margin compression in medium term.** Yields (reported) expanded 20 bps qoq to 18.8% in 3QFY19 driven by improvement in pricing in certain products. This was offset by a sharp rise in borrowing cost during 3QFY19 leading to 20 bps drop in reported margins (NIM) to 11.6%. We forecast margins (calculated) to show gradual decline over the medium term from 11.8% in FY2018 to 11.7% in FY2019E and further to 11.3% by FY2021E. Borrowing cost is expected to rise as higher cost of borrowing post September 2018 will get reflected over the next few quarters. Additionally, in the past (till FY2018), fees on borrowings were adjusted with share premium account but will now need to be added to interest expenses and deferred over the tenure the borrowing—this will raise borrowing costs as well. We forecast 40 bps rise in cost of funds over FY2019-21E to 8.7%. Yields will show marginal improvement (up 30 bps to 19.2%) during the same period driven by improvement in product pricing across various product classes.
- ▶ **Cost pressure to sustain as investment in business expansion maintains steady pace.** The company has been investing rapidly on technology and analytics to improve origination, penetration and collection statistics in its rural business. There has been additional investment on infrastructure and human capital to increase presence in newer locations. The number of micro-loan meeting centres has increased by 67 qoq to 1,181 in 3QFY19. Operating expenses increased 2.8X yoy in 3QFY19; similar to 2QFY19 (cost-income ratio up 190 bps qoq to 27%)—the company has guided for further investments in growth and technology. We expect cost-income ratio to remain high at 26% in FY2019E and moderate marginally to 25% by FY2021E as operating leverage gradually sets in.

**Exhibit 11: Rural segment delivered ~28% RoE as of 3QFY19**  
Quarterly summary, March fiscal year-ends, 3QFY17-3QFY19 (₹ mn)

	IGAAP 3QFY17	IGAAP 4QFY17	Ind-AS 1QFY18	Ind-AS 2QFY18	Ind-AS 3QFY18	IGAAP 4QFY18	Ind-AS 1QFY19	Ind-AS 2QFY19	Ind-AS 3QFY19	YoY (%)	QoQ (%)
<b>Financials summary (Rs mn)</b>											
Net interest income	3,040	2,870	2,870	2,930	3,660	4,820	5,070	6,050	6,690	83	11
Fee and othe income	170	340	420	170	300	610	740	980	1,130	277	15
Credit losses/provisions	1,210	1,240	1,230	910	1,170	1,790	1,860	2,160	2,480	112	15
Operating expenses	900	820	820	450	560	1,550	1,370	1,760	2,100	275	19
PBT	1,100	1,150	1,240	1,740	2,230	2,090	2,580	3,110	3,240	45	4
PAT	740	730	1,040	1,160	1,450	1,480	1,930	2,180	2,330	61	7
Gross loans	95,650	100,410	108,240	125,180	146,780	164,570	190,790	214,330	241,220	64	13
Networth	13,500	13,310	13,590	14,650	17,190	26,000	29,860	31,080	36,640	113	18
<b>Reported ratios (%)</b>											
Yield	20.4	19.0	18.0	16.4	17.5	19.4	18.3	18.6	18.8	129 bps	21 bps
Net Interest Margin	13.0	11.7	11.0	10.0	10.7	12.6	11.3	11.8	11.6	97 bps	-20 bps
Fee Income	0.7	1.4	1.6	0.6	0.9	1.6	1.6	1.9	2.0	107 bps	5 bps
Operating Expenses	3.8	3.3	3.1	1.5	1.6	4.1	3.1	3.5	3.7	202 bps	20 bps
Credit Cost	5.2	5.1	4.7	3.1	3.4	4.7	4.1	4.2	4.3	92 bps	10 bps
Return on Assets	3.0	2.8	4.0	4.0	4.3	3.8	4.3	4.2	3.9	-36 bps	-26 bps
Return on Equity	22.1	21.0	31.3	32.9	36.4	26.9	28.0	28.6	27.5	-884 bps	-108 bps
GNPL (%)	9.7	7.7	11.3	10.9	8.2	6.4	4.9	4.3	3.8	-435 bps	-46 bps
NNPL (%)	7.4	5.5	6.8	6.1	3.8	2.6	1.7	1.5	1.3	-246 bps	-17 bps

Source: Company, Kotak Institutional Equities estimates

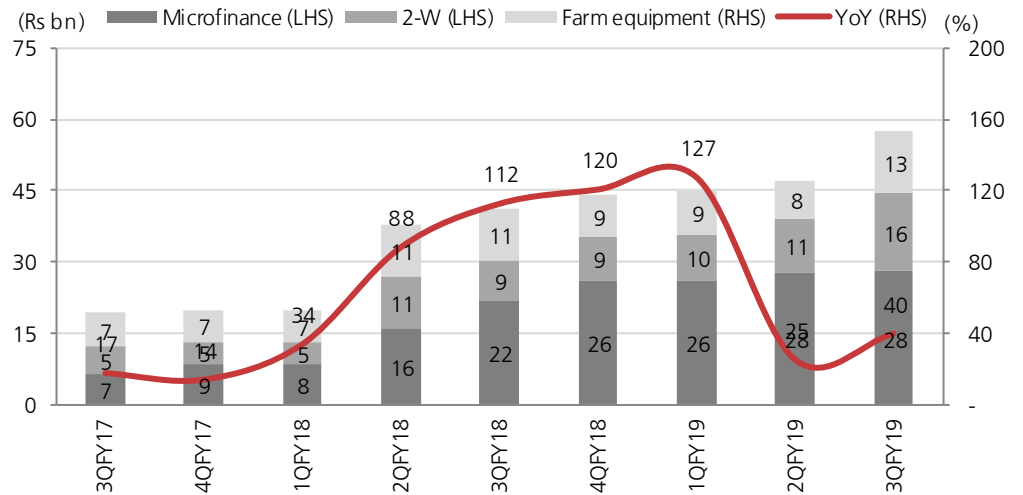
**Exhibit 12: Microfinance portfolio has witnessed sharp increase in the past few quarters**  
 Loan book break-up (rural business), March fiscal year-ends, 3QFY17-3QFY19 (₹ bn)



Source: Company, Kotak Institutional Equities

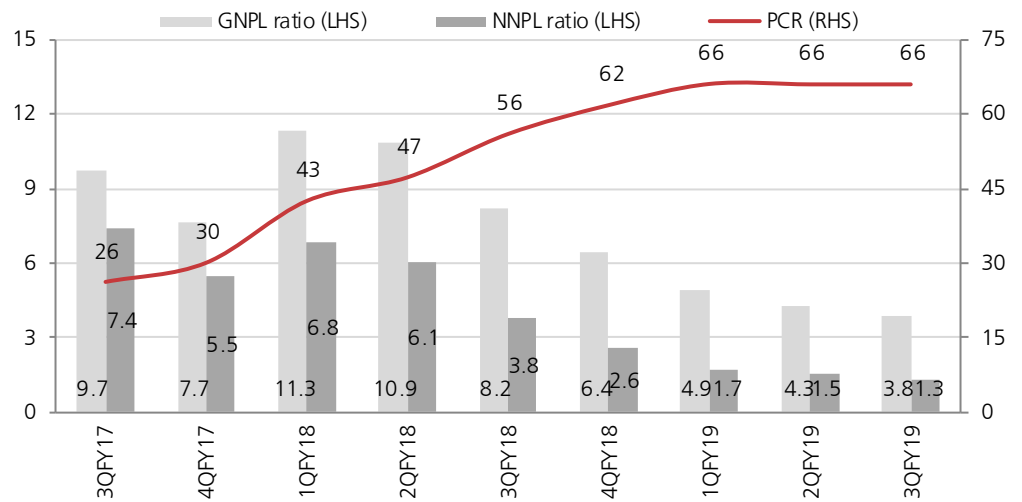
**Exhibit 13: Disbursement growth of 40% yoy**

Disbursements break-up (rural business), March fiscal year-ends, 3QFY17-3QFY19 (₹ bn)



Source: Company, Kotak Institutional Equities

**Exhibit 14: Continuous improvement in asset quality driven by improvement in collections**  
 Asset quality (rural business), March fiscal year-ends, 3QFY17-3QFY19 (%)



Notes:

(a) 1Q-3Q numbers for FY2019 and FY2018 are based on Ind-AS.

Source: Company, Kotak Institutional Equities

Exhibit 15: RoA of rural business at ~3%  
Key ratios, March fiscal year-end, 2017-2021E (5)

	IGAAP 2017	IGAAP 2018	Ind-AS 2019E	Ind-AS 2020E	Ind-AS 2021E
<b>Growth in key parameters (%)</b>					
<b>Profit and loss statement - yoy (%)</b>					
Interest income	15	32	65	37	22
Interest costs	12	25	78	46	22
Net interest income	17	37	58	32	22
Other income	23	160	65	25	24
Net total income	17	45	59	31	22
Provisioning expenses	9	63	25	42	22
Net income (post provisions)	22	36	81	26	22
Operating expenses	(8)	28	60	23	23
PAT	38	48	108	28	21
<b>Balance sheet - yoy (%)</b>					
Loans	16	64	56	23	21
Total assets	14	61	56	23	21
Borrowings	19	57	68	23	22
Total liabilities	14	56	65	23	21
Shareholders funds	12	95	26	18	19
<b>Key ratios (%)</b>					
Interest yield	19.8	18.2	18.9	19.2	19.2
Interest cost	8.5	7.6	8.3	8.7	8.7
<b>Spreads</b>	<b>11.3</b>	<b>10.6</b>	<b>10.6</b>	<b>10.5</b>	<b>10.5</b>
NIMs	12.2	11.8	11.7	11.4	11.3
Cost-income ratio	29.3	25.8	25.9	24.4	24.6
Cost to assets (%)	3.7	3.4	3.4	3.1	3.1
Tax rate	34.8	32.2	28.0	28.0	28.0
Debt/ equity (X)	6.5	5.3	7.0	7.3	7.5
Credit costs(%)	4.5	5.2	4.1	4.3	4.3
<b>Du Pont analysis</b>					
(% of average assets)					
Net interest income	11.7	11.5	11.5	11.1	11.1
Other income	0.9	1.6	1.7	1.6	1.6
Total income	12.5	13.1	13.2	12.7	12.7
Credit costs	4.3	5.1	4.0	4.2	4.2
Operating expenses	3.7	3.4	3.4	3.1	3.1
PBT post extraordinary	4.5	4.6	5.7	5.4	5.4
1-tax rate	65.2	67.8	72.0	72.0	72.0
<b>RoA</b>	<b>3.0</b>	<b>3.1</b>	<b>4.1</b>	<b>3.9</b>	<b>3.9</b>
Average assets / average equity (X)	7.8	6.9	7.3	8.2	8.4
<b>RoE</b>	<b>22.9</b>	<b>21.8</b>	<b>30.3</b>	<b>31.8</b>	<b>32.5</b>

Source: Company, Kotak Institutional Equities estimates

**Exhibit 16: High growth in the rural finance to moderate going forward**  
Loan book break-up, March fiscal year-end, 2017-2021E (₹ mn)

	IGAAP 2017	IGAAP 2018	Ind-AS 2019E	Ind-AS 2020E	Ind-AS 2021E
<b>Loan book (Rs mn)</b>					
Microfinance	35,510	75,490	124,559	153,207	188,445
2W finance	21,100	33,160	57,035	71,294	85,553
Farm equipment	43,790	55,920	74,933	89,919	107,903
Total	100,400	164,570	256,527	314,420	381,901
<b>YoY growth (%)</b>					
Microfinance	59	113	65	23	23
2W finance	20	57	72	25	20
Farm equipment	(6)	28	34	20	20
Total	16	64	56	23	21

Source: Company, Kotak Institutional Equities estimates

**Exhibit 17: Key financials of LTFH's rural finance business**  
March fiscal year-end, 2017-2021E (₹ mn)

	IGAAP 2017	IGAAP 2018	Ind-AS 2019E	Ind-AS 2020E	Ind-AS 2021E
<b>Income statement (Rs mn)</b>					
Interest income	18,230	24,100	39,794	54,668	66,673
Interest costs	6,820	8,520	15,176	22,228	27,209
Net interest income	11,410	15,580	24,618	32,440	39,463
Other income	860	2,240	3,696	4,620	5,729
Net total income	12,270	17,820	28,314	37,060	45,192
Provisioning expenses	4,250	6,920	8,632	12,275	14,971
Net income (post provisions)	8,020	10,900	19,681	24,785	30,221
Operating expenses	3,590	4,590	7,344	9,033	11,111
PBT before extraordinaries	4,430	6,310	12,337	15,752	19,111
PBT post extraordinaries	4,430	6,310	12,337	15,752	19,111
Tax	1,540	2,030	3,454	4,411	5,351
<b>PAT</b>	<b>2,890</b>	<b>4,280</b>	<b>8,883</b>	<b>11,341</b>	<b>13,760</b>
<b>Balance sheet (Rs mn)</b>					
<b>Assets</b>					
Gross loans	100,410	164,570	256,527	314,420	381,901
<b>Total assets</b>	<b>104,120</b>	<b>167,850</b>	<b>261,639</b>	<b>320,687</b>	<b>389,512</b>
<b>Liabilities</b>					
<b>Borrowings</b>	<b>86,860</b>	<b>136,700</b>	<b>228,984</b>	<b>281,998</b>	<b>343,503</b>
<b>Total liabilities</b>	<b>90,810</b>	<b>141,850</b>	<b>234,134</b>	<b>287,148</b>	<b>348,653</b>
<b>Shareholders funds</b>	<b>13,310</b>	<b>26,000</b>	<b>32,656</b>	<b>38,689</b>	<b>46,009</b>

Source: Company, Kotak Institutional Equities estimates

### Housing finance: strong growth in 3Q; real estate financing remains strong

- ▶ **34% yoy AUM growth in 3QFY19.** Housing segment AUMs grew 34% yoy driven by 46% yoy growths in real estate finance and 21% yoy growth in home loan/LAP. The share of home loans/LAP in overall housing portfolio has declined to 43% in 3QFY19 from 48% in 3QFY18.
- ▶ **Loan growth to moderate in real estate finance segment.** Real estate finance segment has seen rapid growth over the past four quarters. We expect LTFH to eventually slow down in this segment and realign its product mix towards higher share of retail home loans. We forecast 26% AUM growth in FY2019E driven by pick-up in growth

across home loans/LAP segment. This will likely moderate to 21% CAGR on a high base in FY2019-21E.

- ▶ **Disbursements decline in real estate loans but remain high.** LTFH has increased the exposure to wholesale real-estate loans in the housing segment to 57% in 3QFY19 from 53% in FY2018 and 39% in FY2017. Disbursements remained high at ₹14 bn in 3QFY19, though somewhat lower than ₹16-20 bn over the past four quarters. Market sources suggest that most NBFCs have gone extremely slow on real estate developer loans in 3QFY19 due to their liquidity constrain, which in turn led to challenges for developers as well. Against this backdrop, disbursements of LTFH in real estate lending appear high. Management highlighted that about 50% of these disbursements were to existing projects. Disbursements in home loans have been picking pace since 3QFY18 and increased 56% yoy in 3QFY19 (up 7% qoq).
- ▶ **Medium-term margin compression.** Reported margins increased 20 bps qoq to 5.7%. The rise in yields has mostly been driven by the rising share of high-yielding real estate financing in overall housing finance portfolio. Market sources suggest that most lenders increased lending rates on real estate loans in 3QFY19. Going ahead, yields will witness marginal compression led by change in AUM mix towards higher share of low-yielding home loans even as the company may raise lending rates in both retail business and real estate finance. There will be additional pressure from the cost of funds side as high-cost borrowings post September 2018 get reflected in its overall funding cost. We expect NIM in housing finance business to moderate to 4.8% in FY2021E from 5.6-5.7% in FY2018-19E.
- ▶ **NPLs remain flat, provisions increase qoq.** GNPL increased 5.3% qoq to ₹2.2 bn (1% of loans; flat qoq). Provision coverage ratio has inched up to 27% in 3QFY19 (up ~100 bps qoq). With risk of defaults in the real estate increasing in the current environment, credit quality of the construction finance segment needs to be monitored closely.

#### Exhibit 18: Strong overall performance in the housing finance segment

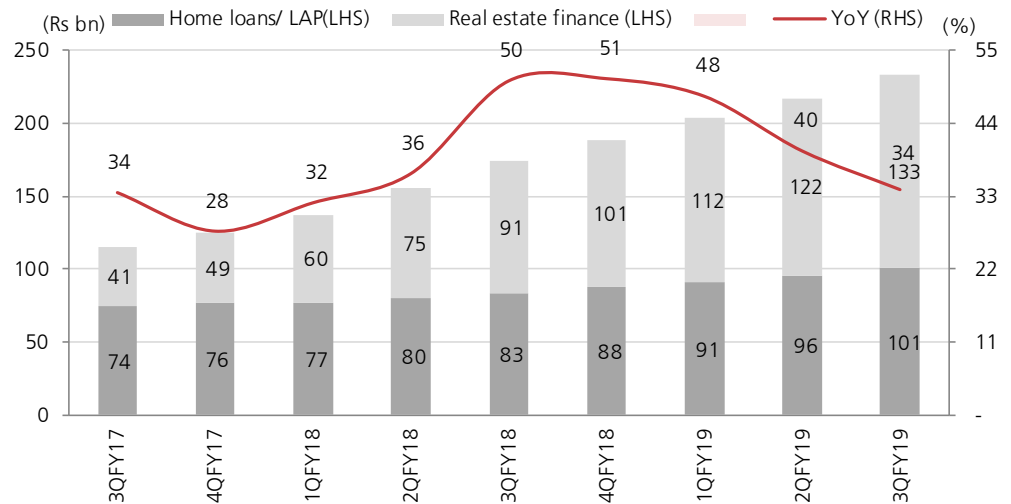
Quarterly summary, March fiscal year-ends, 3QFY17-3QFY19 (₹ mn)

	IGAAP	IGAAP	Ind-AS	Ind-AS	Ind-AS	IGAAP	Ind-AS	Ind-AS	Ind-AS	YoY (%)	QoQ (%)
	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19		
<b>Financials summary (Rs mn)</b>											
Net interest income	1,480	1,700	1,490	1,930	2,060	2,640	2,540	2,890	3,190	55	10
Fee and othe income	360	260	520	450	730	430	770	640	590	(19)	(8)
Credit losses/provisions	180	240	300	390	510	190	660	340	510	-	50
Operating expenses	350	380	280	360	330	380	380	400	470	42	18
PBT	1,310	1,340	1,430	1,630	1,950	2,500	2,270	2,790	2,800	44	0
PAT	880	870	1,190	1,070	1,290	1,600	1,660	1,970	2,090	62	6
Gross loans	115,650	125,340	137,430	155,280	173,980	188,980	203,560	217,180	233,190	34	7
Networth	12,030	13,620	14,740	14,740	16,740	25,610	27,000	28,840	31,500	88	9
<b>Reported ratios (%)</b>											
Yield	12.6	12.8	11.4	11.9	12.0	12.7	12.1	12.5	12.8	78 bps	34 bps
Net Interest Margin	5.2	5.7	4.6	5.2	5.0	5.8	5.2	5.5	5.6	65 bps	16 bps
Fee Income	1.3	0.9	1.6	1.2	1.8	1.0	1.6	1.2	1.1	-71 bps	-16 bps
Operating Expenses	1.2	1.3	0.9	1.0	0.8	0.9	0.8	0.8	0.8	3 bps	6 bps
Credit Cost	0.6	0.8	0.9	1.1	1.2	0.4	1.3	0.6	0.9	-31 bps	27 bps
Return on Assets	2.9	2.8	3.5	2.8	3.0	3.4	3.2	3.4	3.4	33 bps	-5 bps
Return on Equity	29.9	27.1	34.4	29.0	32.8	29.8	25.7	28.2	27.8	-506 bps	-44 bps
GNPL (%)	0.8	0.6	0.9	0.9	0.8	0.9	1.0	1.0	1.0	16 bps	-2 bps
NNPL (%)	0.4	0.3	0.7	0.6	0.6	0.5	0.8	0.7	0.7	14 bps	-3 bps

Source: Company, Kotak Institutional Equities

**Exhibit 19: Loan growth at 34% yoy**

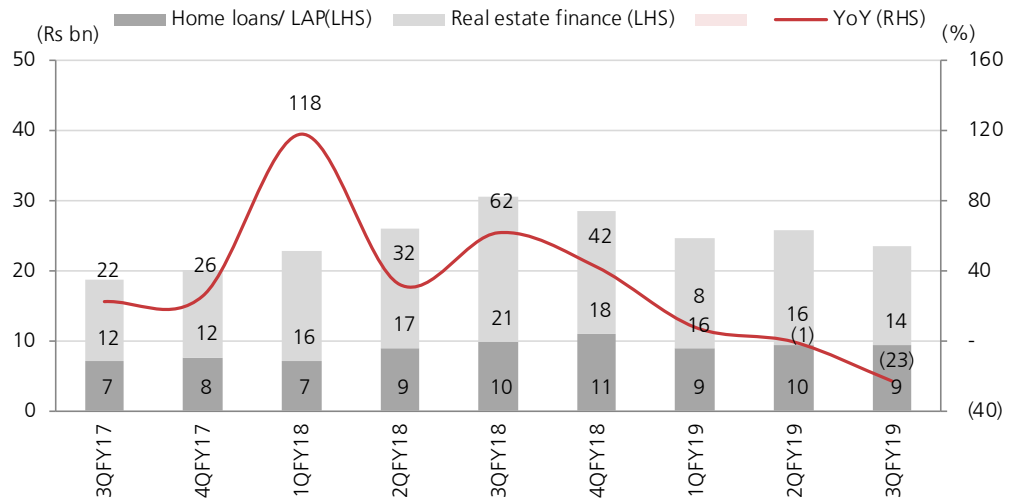
Loan book break-up (housing business), March fiscal year-ends, 3QFY17-3QFY19 (₹ bn)



Source: Company, Kotak Institutional Equities

**Exhibit 20: Disbursement declined 23% yoy in 3QFY19**

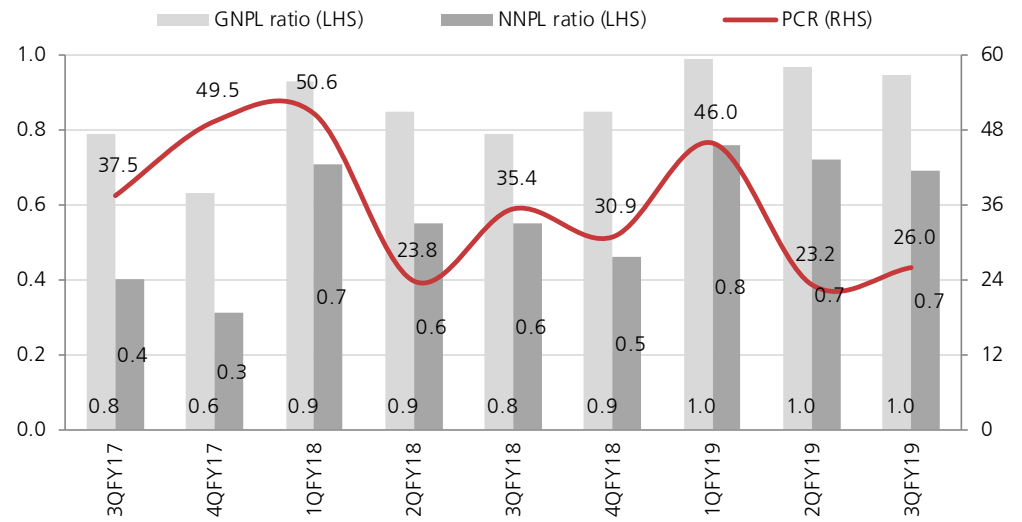
Disbursements break-up (housing business), March fiscal year-ends, 3QFY17-3QFY19 (₹ bn)



Source: Company, Kotak Institutional Equities

**Exhibit 21: Stable GNPLs in housing finance**

Asset quality (housing business), March fiscal year-ends, 3QFY17-3QFY19 (%)



Notes:

(a) 1Q-3Q numbers for FY2019 and FY2018 are based on Ind-AS.

Source: Company, Kotak Institutional Equities

## Exhibit 22: Housing finance – key ratios and growth rates

Key ratios, March fiscal year-end, 2017-2021E (%)

	IGAAP 2017	IGAAP 2018	Ind-AS 2019E	Ind-AS 2020E	Ind-AS 2021E
<b>Growth in key parameters (%)</b>					
<b>Profit and loss statement - yoy (%)</b>					
Interest income	47	42	41	21	21
Interest costs	38	28	48	32	21
Net interest income	64	62	32	7	19
Other income	96	98	40	(10)	-
Net total income	68	67	33	4	16
Provisioning expenses	172	209	7	29	53
Net income (post provisions)	60	51	40	(0)	7
Operating expenses	1	(8)	19	10	10
PAT	116	86	47	(2)	7
<b>Balance sheet - yoy (%)</b>					
Loans	28	51	26	20	21
Total assets	25	52	26	20	21
Borrowings	26	49	35	21	22
Total liabilities	26	49	35	21	22
Shareholders funds	37	88	15	13	13
<b>Key ratios (%)</b>					
Interest yield	12.4	12.5	13.0	12.8	12.8
Interest cost	8.3	7.7	8.1	8.4	8.4
<b>Spreads</b>	<b>4.1</b>	<b>4.8</b>	<b>4.9</b>	<b>4.4</b>	<b>4.4</b>
NIMs	5.0	5.7	5.6	4.9	4.8
Cost-income ratio	24	13	12	13	12
Cost to assets (%)	1.3	0.9	0.8	0.7	0.6
Tax rate	35	29	28	28	28
Debt/ equity (X)	8.2	6.5	7.6	8.1	8.8
Credit costs(%)	0.6	1.3	1.1	1.1	1.4
<b>Du Pont analysis</b>					
(% of average assets)					
Net interest income	4.6	5.4	5.2	4.6	4.5
Other income	0.8	1.1	1.1	0.8	0.7
Total income	5.4	6.5	6.3	5.4	5.2
Credit costs	0.6	1.3	1.0	1.0	1.3
Operating expenses	1.3	0.9	0.8	0.7	0.6
PBT post extraordinary	3.5	4.3	4.6	3.7	3.3
1-tax rate	65.4	70.7	72.0	72.0	72.0
<b>RoA</b>	<b>2.3</b>	<b>3.1</b>	<b>3.3</b>	<b>2.6</b>	<b>2.3</b>
Average assets / average equity (X)	10.1	8.5	8.3	8.9	9.5
<b>RoE</b>	<b>23.3</b>	<b>26.1</b>	<b>27.3</b>	<b>23.6</b>	<b>22.3</b>

Source: Company, Kotak Institutional Equities estimates

**Exhibit 23: Construction finance growth to lower by FY2020E**

Loan book break-up, March fiscal year-end, 2017-2021E (₹ mn)

	IGAAP 2017	IGAAP 2018	Ind-AS 2019E	Ind-AS 2020E	Ind-AS 2021E
<b>Loan book (Rs mn)</b>					
Home loans / LAP	76,430	88,060	106,553	135,322	171,859
Real estate finance	48,910	100,920	131,196	150,875	173,507
<b>Total</b>	<b>125,340</b>	<b>188,980</b>	<b>237,749</b>	<b>286,197</b>	<b>345,365</b>
<b>YoY growth (%)</b>					
Home loans / LAP	21	15	21	27	27
Real estate finance	40	106	30	15	15
<b>Total</b>	<b>28</b>	<b>51</b>	<b>26</b>	<b>20</b>	<b>21</b>

Source: Company, Kotak Institutional Equities estimates

**Exhibit 24: Key financials of LTFH's housing finance business**

March fiscal year-end, 2017-2021E (₹ mn)

	IGAAP 2017	IGAAP 2018	Ind-AS 2019E	Ind-AS 2020E	Ind-AS 2021E
<b>Income statement (Rs mn)</b>					
Interest income	13,860	19,630	27,631	33,533	40,420
Interest costs	8,320	10,630	15,744	20,761	25,224
Net interest income	5,540	9,000	11,887	12,772	15,196
Other income	900	1,780	2,492	2,243	2,243
Net total income	6,440	10,780	14,379	15,015	17,438
Provisioning expenses	680	2,100	2,240	2,882	4,421
Net income (post provisions)	5,760	8,680	12,139	12,133	13,017
Operating expenses	1,570	1,450	1,726	1,898	2,088
PBT before extraordinaries	4,190	7,230	10,413	10,235	10,930
PBT post extraordinaries	4,190	7,230	10,413	10,235	10,930
Tax	1,450	2,120	2,916	2,866	3,060
<b>PAT</b>	<b>2,740</b>	<b>5,110</b>	<b>7,497</b>	<b>7,369</b>	<b>7,869</b>
<b>Balance sheet (Rs mn)</b>					
<b>Assets</b>					
Loans	125,340	188,980	237,749	286,197	345,365
<b>Total assets</b>	<b>132,200</b>	<b>200,860</b>	<b>252,694</b>	<b>304,189</b>	<b>367,076</b>
<b>Liabilities</b>					
Borrowings	111,140	165,370	223,366	270,940	329,641
<b>Total liabilities</b>	<b>111,140</b>	<b>165,370</b>	<b>223,366</b>	<b>270,940</b>	<b>329,641</b>
Shareholders funds	13,620	25,610	29,329	33,249	37,435

Source: Company, Kotak Institutional Equities estimates

### Wholesale business growth slows down

- ▶ **Drop in credit cost improves earnings.** Wholesale segment reported PAT of ₹1.6 bn, up 50% yoy. NII increased 41% yoy led by expansion in margins by 60 bps yoy (up 40 bps qoq). Earnings growth was driven by 54% reduction in provisions. Growth in operating expenses was high at 42% yoy.
- ▶ **Muted loan book growth.** Wholesale segment loan disbursements dropped 44% yoy (adjusting for IPO funding book), driven by drop in infrastructure finance book by 40% yoy. Disbursements in structured finance book saw a decline of 13% yoy (down 7% qoq). The disbursements to the renewables space were up 13% yoy while disbursements to road projects increased by 44% yoy. We expect the company to slow down in wholesale segment and focus on retail businesses (as discussed earlier); we forecast 3% loan book decline in FY2019E and 9% CAGR over FY2020-21E.
- ▶ **NIM to remain stable over FY2019-21E.** NIM will be flat at around 1.7% as the rise in borrowing cost by 30-50 bps over FY2019-2021E to 8.7% will be offset by rise in yields as the company cherry picks up business. Lower volumes in this business poses risk to fee income of the company.

### Asset/wealth management business maintains robust performance

Average AUM of the AMC business increased 15% yoy to ₹691 bn. Equity (including ELSS) comprises 48% of the total average AUM, down from 57% yoy. Wealth management AUS has also grown 34% yoy to ₹229 bn.

#### Exhibit 25: Margin expansion drives profitability for the wholesale business

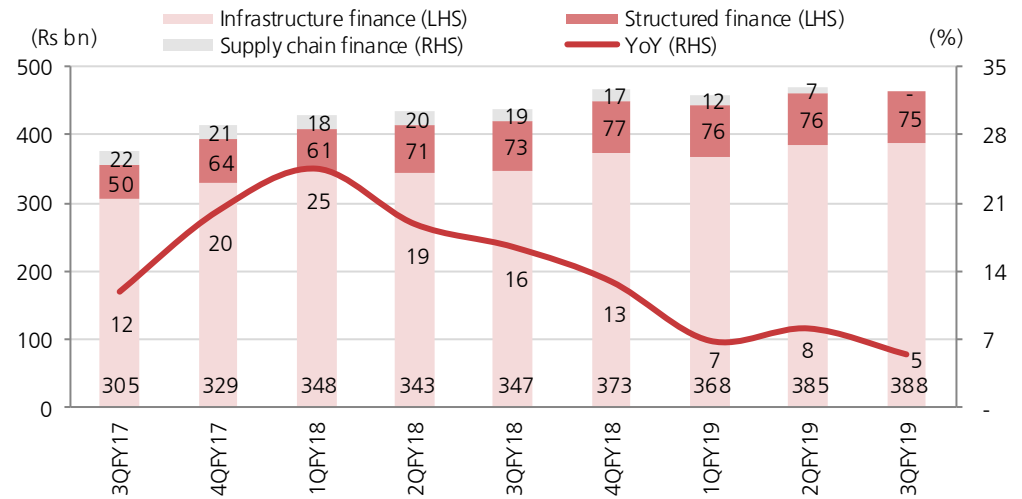
Quarterly summary of wholesale business, March fiscal year-ends, 3QFY17-3QFY19 (₹ mn)

	IGAAP 3QFY17	IGAAP 4QFY17	Ind-AS 1QFY18	Ind-AS 2QFY18	Ind-AS 3QFY18	IGAAP 4QFY18	Ind-AS 1QFY19	Ind-AS 2QFY19	Ind-AS 3QFY19	YoY (%)	QoQ (%)
<b>Financials summary (Rs mn)</b>											
Net interest income	3,250	3,160	2,790	2,570	2,100	3,230	2,890	2,510	2,960	41	18
Fee and othe income	730	1,480	1,230	1,640	1,290	1,550	1,430	1,660	850	(34)	(49)
Credit losses/provisions	1,710	2,150	1,910	3,260	2,410	2,360	920	900	1,120	(54)	24
Operating expenses	430	290	450	530	520	440	680	570	740	42	30
PBT	1,840	2,200	1,660	420	460	1,980	2,720	2,700	1,950	324	(28)
PAT	1,280	1,790	1,600	1,470	1,060	1,380	2,080	2,020	1,590	50	(21)
Gross loans	376,600	414,030	427,600	433,530	438,710	467,590	456,940	468,740	462,670	5	(1)
Networth	50,770	53,170	44,830	46,940	46,150	64,970	52,680	63,050	61,370	33	(3)
<b>Reported ratios (%)</b>											
Yield	10.9	10.2	10.1	9.9	9.3	10.2	9.5	9.8	10.3	100 bps	54 bps
Net Interest Margin	3.5	3.2	2.6	2.4	1.9	2.9	2.5	2.2	2.5	61 bps	37 bps
Fee Income	0.8	1.5	1.2	1.5	1.2	1.4	1.2	1.4	0.7	-44 bps	-69 bps
Operating Expenses	0.5	0.3	0.4	0.5	0.5	0.4	0.6	0.5	0.6	16 bps	14 bps
Credit Cost	2.0	2.2	1.8	3.0	2.2	2.1	0.8	0.8	1.0	-125 bps	18 bps
Return on Assets	1.3	1.3	1.5	1.3	0.9	1.1	1.8	1.7	1.3	33 bps	-39 bps
Return on Equity	10.3	13.7	14.5	12.8	9.1	9.0	15.6	15.1	10.2	108 bps	-485 bps
Gross impaired assets (%)	9.2	9.8	9.6	—	—	9.5	—	—	—	0 bps	0 bps
Net impaired assets (%)	7.1	7.2	6.9	—	—	6.5	—	—	—	0 bps	0 bps

Source: Company, Kotak Institutional Equities

**Exhibit 26: Loan growth was muted at 5% yoy**

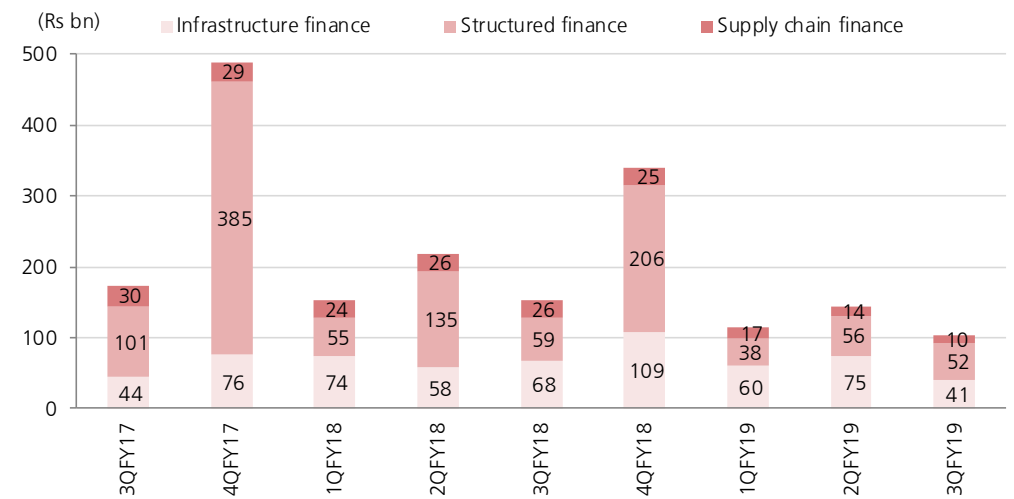
Loan book break-up (wholesale business), March fiscal year-ends, 3QFY17-3QFY19 (₹ bn)



Source: Company, Kotak Institutional Equities

**Exhibit 27: Infrastructure finance disbursements slowed in 3QFY19**

Disbursements break-up (wholesale business), March fiscal year-ends, 3QFY17-3QFY19 (₹ bn)



Source: Company, Kotak Institutional Equities

Exhibit 28: Key growth rates and ratios - wholesale finance business  
Key ratios, March fiscal year-ends, 2017-2021E (%)

	IGAAP 2017	IGAAP 2018	Ind-AS 2019E	Ind-AS 2020E	Ind-AS 2021E
<b>Growth in key parameters (%)</b>					
<b>Profit and loss statement - yoy (%)</b>					
Interest income	9	9	7	5	9
Interest costs	13	16	11	10	9
Net interest income	3	(7)	(5)	(10)	9
Other income	108	86	—	10	10
Net total income	14	10	(9)	(4)	9
Provisioning expenses	54	16	(50)	26	9
Net income (post provisions)	(6)	5	25	(14)	9
Operating expenses	(10)	6	60	—	5
PBT before extraordinaries	(5)	5	18	(19)	11
Tax	(21)	17	(14)	(7)	11
PAT	2	1	31	(22)	11
<b>Balance sheet - yoy (%)</b>					
Loans	20	13	(3)	9	9
Total assets	19	12	(3)	9	9
Borrowings	21	9	5	9	8
Total liabilities	21	9	5	9	8
<b>Key ratios (%)</b>					
Interest yield	11.2	10.2	10.2	10.4	10.4
Interest cost	8.2	8.2	8.5	8.7	8.7
<b>Spreads</b>	<b>3.0</b>	<b>2.0</b>	<b>1.7</b>	<b>1.7</b>	<b>1.7</b>
NIMs	3.5	2.8	2.5	2.2	2.2
Cost-income ratio	9.8	9.5	16.7	17.4	16.8
Cost to assets (%)	0.4	0.4	0.6	0.5	0.5
Tax rate	25.9	28.9	21.0	24.0	24.0
Debt/ equity (X)	7.0	6.2	7.8	8.1	7.9
Credit costs(%)	1.9	1.9	0.9	1.1	1.1
<b>Du Pont analysis</b>					
<b>(% of average assets)</b>					
Net interest income	3.3	2.6	2.4	2.1	2.1
Other income	0.7	1.2	0.9	1.0	1.0
Total income	4.0	3.8	3.3	3.1	3.1
Credit costs	1.8	1.8	0.9	1.0	1.0
Operating expenses	0.4	0.4	0.6	0.5	0.5
PBT post extraordinaries	1.9	1.7	1.9	1.5	1.5
1-tax rate	74.1	71.1	79.0	76.0	76.0
<b>RoA</b>	<b>1.4</b>	<b>1.2</b>	<b>1.5</b>	<b>1.2</b>	<b>1.2</b>
Average assets / average equity (X)	8.3	7.9	8.2	8.9	9.0
<b>RoE</b>	<b>11.4</b>	<b>9.5</b>	<b>12.4</b>	<b>10.3</b>	<b>10.5</b>

Source: Company, Kotak Institutional Equities estimates

**Exhibit 29: Share of IDF will increase in the wholesale business**

Loan book break-up, March fiscal year-ends, 2017-2021E (₹ mn)

	IGAAP 2017	IGAAP 2018E	Ind-AS 2019E	Ind-AS 2020E	Ind-AS 2021E
Infrastructure finance	328,840	373,200	380,664	411,117	444,006
IDF	60,000	100,000	115,000	130,000	145,000
Others	268,840	273,200	265,664	281,117	299,006
Structured finance	63,970	77,050	73,198	81,981	91,819
Supply chain finance	21,230	17,340	—	—	—
<b>Total</b>	<b>414,040</b>	<b>467,590</b>	<b>453,862</b>	<b>493,098</b>	<b>535,825</b>
YoY growth (%)					
Infrastructure finance	21	13	2	8	8
Structured finance	28	20	(5)	12	12
Supply chain finance	(7)	(18)	(100)	(10)	(10)
<b>Total</b>	<b>20</b>	<b>13</b>	<b>(3)</b>	<b>9</b>	<b>9</b>

Source: Company, Kotak Institutional Equities estimates

**Exhibit 30: Key financials of LTFH's wholesale finance business**

March fiscal year-ends, 2017-2021E (₹ mn)

	IGAAP 2017	IGAAP 2018	Ind-AS 2019E	Ind-AS 2020E	Ind-AS 2021E
<b>Income statement (Rs mn)</b>					
Interest income	40,640	44,110	46,994	49,242	53,504
Interest costs	27,360	31,790	35,348	38,728	42,090
Net interest income	13,280	12,320	11,646	10,514	11,414
Other income	2,990	5,560	4,560	5,016	5,518
Net total income	16,270	17,880	16,206	15,530	16,932
Provisioning expenses	7,120	8,270	4,147	5,208	5,659
Net income (post provisions)	9,150	9,610	12,060	10,321	11,273
Operating expenses	1,590	1,690	2,704	2,704	2,839
PBT before extraordinaries	7,560	7,920	9,356	7,617	8,433
PBT post extraordinaries	7,560	7,920	9,356	7,617	8,433
Tax	1,960	2,290	1,965	1,828	2,024
<b>PAT</b>	<b>5,600</b>	<b>5,630</b>	<b>7,391</b>	<b>5,789</b>	<b>6,409</b>
<b>Balance sheet (Rs mn)</b>					
<b>Assets</b>					
Loans	414,030	467,590	453,862	493,098	535,825
<b>Total assets</b>	<b>441,110</b>	<b>494,990</b>	<b>480,457</b>	<b>521,993</b>	<b>567,224</b>
<b>Liabilities</b>					
Borrowings	371,640	405,790	425,925	464,381	503,203
<b>Total liabilities</b>	<b>371,640</b>	<b>405,790</b>	<b>425,925</b>	<b>464,381</b>	<b>503,203</b>
<b>Shareholders funds</b>	<b>53,170</b>	<b>64,970</b>	<b>54,532</b>	<b>57,612</b>	<b>64,021</b>

Source: Company, Kotak Institutional Equities estimates

**Exhibit 31: Change in estimates**

March fiscal year-ends, 2019E-2021E (₹ mn)

	New estimates			Old estimates			% Change		
	2019E	2020E	2021E	2019E	2020E	2021E	2019E	2020E	2021E
Net interest income	48,151	55,726	66,073	44,404	50,366	59,555	8	11	11
Loan book	948,137	1,093,716	1,263,091	951,486	1,102,078	1,280,166	(0)	(1)	(1)
NPL provisions	15,019	20,365	25,051	17,402	19,979	23,741	(14)	2	6
Operating expenses	11,774	13,635	16,038	9,590	10,887	12,311	23	25	30
PBT	32,106	33,604	38,474	30,885	33,788	38,839	4	(1)	(1)
Tax	8,335	9,104	10,435	9,213	9,970	11,491	(10)	(9)	(9)
PAT	22,458	24,500	28,038	21,170	23,818	27,348	6	3	3

Source: Company, Kotak Institutional Equities estimates

Exhibit 32: L&T Finance Holdings - key ratios and growth rates  
March fiscal year-ends, 2016-2021E (%)

	IGAAP 2016	IGAAP 2017	IGAAP 2018	Ind-AS 2019E	Ind-AS 2020E	Ind-AS 2021E
<b>Growth in key parameters (%)</b>						
<b>Profit and loss statement - yoy (%)</b>						
Interest income	17.6	14.4	20.1	14.9	19.4	16.8
Interest costs	15.6	12.2	15.1	26.4	21.9	15.8
Net interest income	20.4	17.3	26.4	1.8	15.7	18.4
Other income	28.8	27.4	106.7	237.7	13.8	16.0
Net total income	20.8	17.9	31.1	23.7	15.2	17.8
Provisioning expenses	18.0	103.6	19.3	(10.7)	26.1	21.9
Net income (post provisions)	21.7	(8.2)	39.1	43.6	11.3	16.1
PBT post extraordinary	6.6	(13.9)	61.3	78.3	12.6	15.2
Tax	23.1	(90.9)	654.2	181.8	16.7	14.1
PAT	0.4	22.1	40.5	58.9	11.2	15.6
<b>Balance sheet - yoy (%)</b>						
Loans	22.5	11.1	27.3	19.5	15.4	15.5
Investments	34.5	68.7	(19.4)	58.6	17.7	10.3
Fixed assets	(3.1)	(11.1)	15.0	15.0	15.0	15.0
Other current assets	(6.4)	(21.4)	32.6	5.0	5.0	5.0
Total assets	20.9	12.6	23.0	20.9	15.1	14.7
Borrowings	22.6	15.9	19.7	22.7	15.8	15.6
Total liabilities	23.0	13.2	19.0	23.8	15.5	15.1
Shareholders funds	12.9	9.7	60.5	7.7	14.7	15.6
<b>Key ratios (%)</b>						
Interest yield	14.3	14.1	14.1	13.2	13.5	13.6
Interest cost	8.8	8.3	8.1	8.4	8.7	8.7
Spreads	5.5	5.8	6.0	4.8	4.8	5.0
NIMs	6.2	6.3	6.6	5.5	5.4	5.6
Operating costs/ net income (pre provisions)	39.2	32.4	29.7	25.0	23.7	23.7
Tax rate	31.8	3.4	15.8	25.0	25.9	25.6
Debt/ equity (X)	7.2	7.6	5.6	6.4	6.5	6.5
Credit costs(%)	1.5	2.7	2.7	1.9	2.1	2.2
<b>Du Pont analysis</b>						
<b>(% of average assets)</b>						
Net interest income	5.4	5.5	5.9	4.9	4.8	5.0
Other income	0.3	0.3	0.6	1.7	1.6	1.6
Credit costs	1.3	2.3	2.4	1.7	1.9	2.0
Operating expenses	2.3	1.9	1.9	1.6	1.5	1.6
PBT post extraordinary	2.2	1.6	2.2	3.2	3.0	3.1
1-tax rate	0.7	1.0	0.8	0.8	0.7	0.7
RoA	1.5	1.5	1.8	2.4	2.3	2.3
Average assets / average equity (X)	8.6	9.0	7.8	7.4	7.8	7.8
RoE	12.6	13.8	14.2	17.7	17.7	17.7

Source: Company, Kotak Institutional Equities estimates

**Exhibit 33: L&T Finance Holdings - key financials**

March fiscal year-ends, 2016-2021E (₹ mn)

	IGAAP 2016	IGAAP 2017	IGAAP 2018	Ind-AS 2019E	Ind-AS 2020E	Ind-AS 2021E
<b>Income statement (Rs mn)</b>						
Interest income	72,888	83,406	100,210	115,150	137,443	160,597
Interest costs	41,241	46,270	53,261	67,336	82,112	95,093
Net interest income	31,647	37,136	46,949	47,813	55,331	65,504
Other income	1,819	2,317	4,789	16,175	18,408	21,359
Net total income	33,466	39,453	51,738	63,988	73,739	86,862
Provisioning expenses	7,810	15,899	18,968	16,939	21,365	26,051
Net income (post provisions)	25,655	23,554	32,771	47,049	52,374	60,811
Operating expenses	13,129	12,765	15,373	16,020	17,449	20,583
PBT before extraordinary	12,527	10,789	17,398	31,029	34,925	40,229
PBT post extraordinary	12,527	10,789	17,398	31,029	34,925	40,229
Tax	3,990	364	2,748	7,745	9,037	10,311
PAT	8,537	10,425	14,650	23,284	25,887	29,918
PAT for appropriation	8,537	10,422	14,587	23,284	25,887	29,918
Dividend	1,403	1,500	3,500	4,000	5,000	4,750
Dividend tax	237	254	592	676	845	803
Payout ratio (%)	16	14	24	17	19	16
No of shares (mn)	1,754	1,756	1,996	1,996	1,996	1,996
EPS (Rs)	5	6	7	12	13	15
BVPS (Rs)	41	45	64	68	78	91
<b>Balance sheet (Rs mn)</b>						
Loans	560,654	623,145	793,300	948,137	1,093,716	1,263,091
Investments	35,633	60,115	48,433	76,833	90,429	99,730
Fixed assets	6,962	6,189	5,311	5,577	5,856	6,148
Current assets	27,826	21,872	29,008	30,459	31,982	33,581
Total assets	637,463	717,710	882,442	1,067,074	1,227,748	1,408,028
<b>Liabilities</b>						
Borrowings	516,156	598,111	715,771	878,274	1,017,319	1,176,346
Deferred tax liability	(3,993)	(7,426)	(9,837)	(9,837)	(9,837)	(9,837)
Current liabilities and provisions	40,211	34,767	38,186	43,914	50,501	58,076
Total liabilities	552,375	625,451	744,120	921,444	1,064,575	1,225,834
Share capital	17,538	17,561	19,957	19,957	19,957	19,957
Reserves and surplus	54,418	61,382	106,773	116,582	136,624	160,989
Minority interest	1,003	1,186	1,248	1,248	1,248	1,248
Shareholders funds	71,956	78,943	126,730	136,538	156,581	180,946
Preference shares	71,956	78,943	126,730	136,538	156,581	180,946

## Notes:

(a) We have not netted-off preference shares with net worth.

Source: Company, Kotak Institutional Equities estimates

JANUARY 22, 2019

UPDATE

Coverage view: **Neutral**

Price (₹): 419

Fair Value (₹): 475

BSE-30: 36,445

**Assuaging investor concerns.** SUNP announced (1) shift in distribution from Aditya Medisales to wholly owned subsidiary, and (2) unwinding of the US\$300 mn third party loan. These are welcome moves towards simplifying SUNP's balance sheet and business operations, and we believe this is an excellent time for SUNP to improve disclosure levels on an ongoing basis. While concerns over the specialty ramp-up persist, these are adequately captured in valuations. ADD with an unchanged fair value of ₹475/share.

#### Company data and valuation summary

Sun Pharmaceuticals

Stock data				Forecasts/Valuations						
				2019E	2020E	2021E				
52-week range (Rs) (high,low)				679-370	16.0	21.7	26.4			
Market Cap. (Rs bn)				1,005.2	5.8	35.3	21.7			
Shareholding pattern (%)				P/E (X)	26.1	19.3	15.9			
Promoters				54.4	Sales (Rs bn)	293.8	333.3	368.3		
FIs				16.8	Net profits (Rs bn)	38.6	52.2	63.6		
MFs				8.5	EBITDA (Rs bn)	63.2	82.3	94.6		
Price performance (%)				1M	3M	12M	EV/EBITDA (X)	13.5	9.9	8.1
Absolute				(1.5)	(31.0)	(27.3)	ROE (%)	9.8	12.1	12.5
Rel. to BSE-30				(3.4)	(35.3)	(28.6)	Div. Yield (%)	0.5	1.0	1.3

#### Assuaging governance concerns – AML and US\$300 mn third-party loans reversed

SUNP announced (1) phasing out of the distribution arrangement with Aditya Medisales by transitioning the distribution to a wholly owned subsidiary, and (2) unwinding of the US\$300 mn loan to a third party. The shift in distribution to wholly owned subsidiary should eliminate any concerns over SUNP's indirect exposure to any receivables mark-down in case of aggressive lending by Aditya Medisales to any third party, while also adding ~50bps to its consolidated EBITDA margin, and freeing up working capital. On the third party loan, we are not really surprised with the disclosure that the beneficiary is Atlas Global Trading. However, we believe that the transaction chain, starting from the US\$400 mn Protonix financing deal with Atlas, yearly supplies (or lack of) and subsequent tranches of loans to Atlas in FY2015 (as per our analysis), and in FY2018 (as per the disclosure) could have been better disclosed at relevant time points, and are still not completely convinced on the rationale for such a deal in the first place.

#### Material outperformance hinges on success of specialty roll-out

While we believe valuations are now materially reasonable, we believe significant upside is contingent on the success of the specialty pipeline roll-out, where SUNP has spent cumulatively >US\$800 mn from its balance sheet, not accounting for the implied valuation for Absorica within Ranbaxy or the P&L spend on R&D and promotion (>US\$400 mn). We believe there are still significant risks for all key products, particularly, Ilumya, which is now launched in a significantly competitive (with increasing intensity) market, as well as Cequa, where market dynamics remain uncertain given the upcoming Restasis generic threat, and potentially increasing therapeutic competition (see "[Better to travel than arrive](#)" for analysis of specialty pipeline). We also continue to expect a challenges for Odomzo given Roche's head-start in a therapy that has a >26-month median DOR. We expect the specialty franchise to peak in FY2021 at ~US\$600 mn sales (incl. DUSA and Absorica), with FY2022 likely to fall to US\$585.

#### An excellent opportunity to increase disclosure levels - ADD

We believe that the current situation presents SUNP with an excellent opportunity to increase disclosure levels, both on the balance sheet (addressed to a large extent, though questions over tax liabilities remain), but more importantly, on the progress in business areas, including details pertaining to the US specialty (revenues, costs as well as capital spend), areas such as synergy accretion from Ranbaxy or even more details on the RoW/EM segment. At our unchanged fair value of ₹475, SUNP will trade at 18X FY2021 EPS. ADD.

Chirag Talati, CFA

Kumar Gaurav

**Exhibit 1: Sun Pharma – we expect US to drive revenue growth**  
 March fiscal year-ends, 2013-21E (Rs mn)

	2013	2014	2015	2016	2017	2018	2019E	2020E	2021E
Domestic formulations	29,660	36,918	67,166	75,537	77,490	80,293	85,316	94,309	104,308
US (excluding Taro)	25,633	53,027	44,585	48,112	52,306	51,845	65,478	83,296	97,590
Taro (US)	31,956	40,468	47,506	56,634	52,487	36,946	38,097	40,408	39,087
RoWEM	18,240	19,084	60,646	57,461	77,399	78,132	84,877	94,963	105,903
<b>Total formulations</b>	<b>105,489</b>	<b>149,498</b>	<b>219,903</b>	<b>237,744</b>	<b>259,682</b>	<b>247,216</b>	<b>273,768</b>	<b>312,976</b>	<b>346,888</b>
API	7,550	8,010	9,910	14,025	15,980	13,993	16,372	17,191	18,050
Others	73	138	792	752	715	679	800	760	722
Other income	610	740	1,469	5,256	13,142	4,235	2,850	2,359	2,686
<b>Total</b>	<b>113,721</b>	<b>158,386</b>	<b>232,074</b>	<b>257,777</b>	<b>289,518</b>	<b>266,123</b>	<b>293,790</b>	<b>333,286</b>	<b>368,346</b>
<b>yoy growth, %</b>									
Domestic formulations	2	24	82	12	3	4	6	11	11
US (excluding Taro)	104	107	(16)	8	9	(1)	26	27	17
Taro	44	27	17	19	(7)	(30)	3	6	(3)
RoW	64	5	218	(5)	35	1	9	12	12
<b>Total formulations</b>	<b>41</b>	<b>42</b>	<b>47</b>	<b>8</b>	<b>9</b>	<b>(5)</b>	<b>11</b>	<b>14</b>	<b>11</b>
API	23	6	24	42	14	(12)	17	5	5
<b>Total</b>	<b>40</b>	<b>39</b>	<b>47</b>	<b>11</b>	<b>12</b>	<b>(8)</b>	<b>10</b>	<b>13</b>	<b>11</b>
<b>% of sales</b>									
Domestic formulations	26	23	29	29	27	30	29	28	28
US (excluding Taro)	23	33	19	19	18	19	22	25	26
Taro	28	26	20	22	18	14	13	12	11
RoW	16	12	26	22	27	29	29	28	29
<b>Total formulations</b>	<b>93</b>	<b>94</b>	<b>95</b>	<b>92</b>	<b>90</b>	<b>93</b>	<b>93</b>	<b>94</b>	<b>94</b>
API	7	5	4	5	6	5	6	5	5

Source: Company, Kotak Institutional Equities estimates

**Exhibit 2: New product launches and specialty to drive US revenue growth**  
 March fiscal year-ends, 2013-21E (Rs mn)

	2013	2014	2015	2016	2017	2018	2019E	2020E	2021E
Branded sales	11	70	312	317	375	356	359	472	619
Taro price-increase led products	454	469	526	577	508	291	224	197	185
Taro base business	134	195	240	265	214	154	131	124	127
Taro new products	0	0	0	10	44	85	155	194	179
SUNP key opportunities	345	700	565	526	622	275	378	445	441
SUNP base business + Halol recovery	127	179	631	375	284	193	215	249	298
<b>Total US sales</b>	<b>1,070</b>	<b>1,613</b>	<b>2,274</b>	<b>2,070</b>	<b>2,048</b>	<b>1,355</b>	<b>1,462</b>	<b>1,682</b>	<b>1,849</b>
<b>yoy growth (%)</b>	<b>57.7</b>	<b>50.7</b>	<b>40.9</b>	<b>(9.0)</b>	<b>(1.1)</b>	<b>(33.8)</b>	<b>7.9</b>	<b>15.0</b>	<b>46.7</b>
Branded sales	1	4	14	15	18	26	25	28	31.9
Taro price-increase led products	42	29	23	28	25	21	15	12	14.9
Taro base business	13	12	11	13	10	11	9	7	22.0
Taro new products	0	0	0	0	2	6	11	12	3.4
SUNP key opportunities	32	43	25	25	30	20	26	26	28

Source: Company, Kotak Institutional Equities estimates

**Exhibit 3: FY2021 to be a peak year for SUNP – further in-licensing deals critical to drive incremental growth beyond FY2022**  
March fiscal year-ends, 2013-22E (US\$ mn)

	2013	2014	2015	2016	2017	2018	2019E	2020E	2021E	2022E
DUSA	55	72	111	105	130	93	94	93	93	92
Absorica		131	165	151	193	186	129	116	106	30
BromSite					4	25	32	38	46	23
Odomzo					4	14	22	34	50	66
Ilumya							17	79	156	197
Cequa							10	47	93	119
Yonsa							25	25	30	23
Xelpros							5	15	25	35
<b>Key US brands</b>	<b>55</b>	<b>203</b>	<b>276</b>	<b>257</b>	<b>331</b>	<b>318</b>	<b>333</b>	<b>448</b>	<b>599</b>	<b>585</b>
- as a % of US sales	4.9	12.5	12.3	12.4	16.1	23.5	22.4	26.1	31.6	30.3
- % growth		270	36	(7)	29	(4)	5	34	34	(2)

Source: Kotak Institutional Equities estimates

**Exhibit 4: Sun Pharma – Decline in generics R&D offset by increase in specialty R&D spend**  
March fiscal year-ends, 2013-21E (Rs mn)

	2013	2014	2015	2016	2017	2018	2019E	2020E	2021E
<b>US Sales (Rs mn)</b>	<b>60,568</b>	<b>97,844</b>	<b>137,198</b>	<b>135,170</b>	<b>137,588</b>	<b>87,466</b>	<b>103,575</b>	<b>124,424</b>	<b>138,117</b>
- Generics	21,397	39,744	67,594	56,701	56,628	24,218	36,497	45,774	49,972
- Specialty	2,972	12,240	16,844	16,765	22,102	20,488	22,726	31,762	42,578
- Taro	36,199	45,861	52,760	61,704	58,858	42,760	44,352	46,888	45,567
<b>Sales</b>	<b>112,999</b>	<b>160,784</b>	<b>275,390</b>	<b>287,953</b>	<b>315,784</b>	<b>264,895</b>	<b>293,790</b>	<b>334,015</b>	<b>369,804</b>
<b>R&amp;D expenses (Rs mn)</b>	<b>(7,042)</b>	<b>(10,169)</b>	<b>(18,373)</b>	<b>(23,025)</b>	<b>(21,459)</b>	<b>(20,669)</b>	<b>(20,850)</b>	<b>(22,842)</b>	<b>(23,662)</b>
- Generics	(4,532)	(6,821)	(11,455)	(12,168)	(10,934)	(9,816)	(9,730)	(10,080)	(10,800)
- Specialty	—	—	(2,913)	(6,238)	(5,641)	(6,304)	(7,298)	(9,000)	(9,288)
- Taro	(2,510)	(3,348)	(4,005)	(4,618)	(4,884)	(4,549)	(3,823)	(3,762)	(3,574)
<b>R&amp;D as a % of sales</b>	<b>(6.2)</b>	<b>(6.3)</b>	<b>(6.7)</b>	<b>(8.0)</b>	<b>(6.8)</b>	<b>(7.8)</b>	<b>(7.1)</b>	<b>(6.8)</b>	<b>(6.4)</b>
- of which generics	64	67	62	53	51	47	47	44	46
- of which Specialty	—	—	16	27	26	31	35	39	39
- of which Taro	36	33	22	20	23	22	18	16	15
<b>R&amp;D as a % of US sales</b>	<b>(11.6)</b>	<b>(10.4)</b>	<b>(13.4)</b>	<b>(17.0)</b>	<b>(15.6)</b>	<b>(23.6)</b>	<b>(20.1)</b>	<b>(18.4)</b>	<b>(17.1)</b>
Generics R&D as a % of US generics sales	(21)	(17)	(17)	(21)	(19)	(41)	(27)	(22)	(22)
Specialty R&D as a % of US specialty sales	—	—	(17)	(37)	(26)	(31)	(32)	(28)	(22)
Taro R&D as a % of Taro sales	(7)	(7)	(8)	(7)	(8)	(11)	(9)	(8)	(8)
<b>R&amp;D expenses (US\$ mn)</b>	<b>(130)</b>	<b>(168)</b>	<b>(301)</b>	<b>(352)</b>	<b>(321)</b>	<b>(320)</b>	<b>(300)</b>	<b>(317)</b>	<b>(329)</b>
- of which generics	(83)	(113)	(187)	(186)	(163)	(152)	(140)	(140)	(150)
- of which Specialty	—	—	(48)	(95)	(84)	(98)	(105)	(125)	(129)
- of which Taro	(46)	(55)	(66)	(71)	(73)	(70)	(55)	(52)	(50)

Source: Company, Kotak Institutional Equities estimates

Exhibit 5: Sun Pharma - consolidated profit and loss, balance sheet, cash model  
March fiscal year-ends, 2013-21E (Rs mn)

	2013	2014	2015	2016	2017	2018	2019E	2020E	2021E
<b>Net revenues</b>	<b>112,999</b>	<b>160,784</b>	<b>275,390</b>	<b>287,953</b>	<b>315,784</b>	<b>264,895</b>	<b>293,790</b>	<b>334,015</b>	<b>369,804</b>
<b>Gross Profit</b>	<b>92,265</b>	<b>132,990</b>	<b>207,998</b>	<b>223,121</b>	<b>234,477</b>	<b>190,648</b>	<b>212,627</b>	<b>239,297</b>	<b>264,359</b>
Staff costs	(15,345)	(20,744)	(45,026)	(47,971)	(49,023)	(53,671)	(59,306)	(63,457)	(68,534)
R&D expenses	(7,042)	(10,169)	(18,373)	(23,025)	(21,459)	(20,669)	(21,850)	(22,842)	(23,662)
Other expenses	(20,916)	(30,142)	(64,462)	(63,630)	(63,103)	(60,227)	(68,277)	(70,358)	(76,833)
<b>EBITDA</b>	<b>48,963</b>	<b>71,936</b>	<b>80,136</b>	<b>88,494</b>	<b>100,893</b>	<b>56,081</b>	<b>63,195</b>	<b>82,640</b>	<b>95,331</b>
Depreciation & amortisation	(3,362)	(4,094)	(11,947)	(10,135)	(12,648)	(14,998)	(16,464)	(17,084)	(17,704)
<b>EBIT</b>	<b>49,482</b>	<b>72,923</b>	<b>68,189</b>	<b>78,359</b>	<b>88,245</b>	<b>41,083</b>	<b>46,731</b>	<b>65,556</b>	<b>77,627</b>
Net Interest	(432)	(442)	(5,790)	(4,769)	(3,998)	(5,176)	(5,071)	(5,281)	(5,198)
Other income	3,881	5,081	4,008	914	6,232	8,388	9,912	10,156	12,509
Exceptional items	—	(25,174)	(2,378)	(6,852)	—	(9,505)	(12,144)	—	—
<b>Profit before tax</b>	<b>49,050</b>	<b>72,481</b>	<b>63,904</b>	<b>74,486</b>	<b>90,578</b>	<b>44,062</b>	<b>51,572</b>	<b>70,431</b>	<b>84,937</b>
Tax & Deferred Tax	(8,456)	(7,908)	(9,147)	(9,349)	(12,116)	(8,452)	(8,292)	(13,079)	(16,321)
Less: minority interest	(4,863)	(7,375)	(9,363)	(11,126)	(8,819)	(4,468)	(4,676)	(4,831)	(4,463)
<b>Net Income (adjusted)</b>	<b>35,732</b>	<b>57,198</b>	<b>45,394</b>	<b>54,011</b>	<b>69,644</b>	<b>33,665</b>	<b>38,605</b>	<b>52,521</b>	<b>64,153</b>
<b>EPS adjusted (Rs)</b>	<b>17.2</b>	<b>27.6</b>	<b>18.9</b>	<b>22.4</b>	<b>28.9</b>	<b>14.0</b>	<b>16.0</b>	<b>21.8</b>	<b>26.7</b>
<b>Balance sheet</b>									
Equity	166,248	204,461	293,582	354,901	404,305	419,847	430,878	482,557	542,806
Total borrowings	1,982	24,890	75,963	83,381	80,910	97,518	96,018	94,518	93,018
Deferred tax liability	2,054	2,757	985	616	3,148	2,190	2,190	2,190	2,190
Other liabilities	30,568	35,493	92,561	80,263	112,321	118,846	122,263	127,608	133,488
<b>Total liabilities</b>	<b>208,812</b>	<b>293,708</b>	<b>490,279</b>	<b>542,196</b>	<b>614,102</b>	<b>643,028</b>	<b>675,466</b>	<b>730,990</b>	<b>795,618</b>
Net fixed assets	50,771	58,242	110,201	133,606	149,403	157,111	153,147	146,063	138,359
Investments	11,064	7,876	5,989	5,933	16,062	31,572	31,572	31,572	31,572
Cash	53,639	95,886	131,155	147,045	153,717	140,200	169,264	208,482	261,240
Other current assets	84,882	121,192	215,576	225,287	287,360	286,061	293,399	316,788	336,363
<b>Total assets</b>	<b>208,812</b>	<b>293,708</b>	<b>490,279</b>	<b>542,196</b>	<b>614,102</b>	<b>643,028</b>	<b>675,466</b>	<b>730,990</b>	<b>795,618</b>
<b>Cashflow statement</b>									
<b>Operating profit before working capital</b>	<b>44,812</b>	<b>45,410</b>	<b>71,765</b>	<b>84,923</b>	<b>95,485</b>	<b>48,621</b>	<b>55,892</b>	<b>87,515</b>	<b>102,641</b>
Tax paid	(10,735)	(7,889)	(17,404)	(19,885)	(20,571)	(7,417)	(8,292)	(13,079)	(16,321)
Change in working capital	(448)	2,071	1,796	2,656	(4,092)	(2,123)	(3,921)	(18,045)	(13,695)
Capital expenditure	(8,455)	(9,060)	(23,419)	(33,825)	(36,929)	(19,608)	(12,500)	(10,000)	(10,000)
<b>Free cash flow</b>	<b>25,174</b>	<b>30,532</b>	<b>32,739</b>	<b>33,869</b>	<b>33,894</b>	<b>19,473</b>	<b>31,180</b>	<b>46,391</b>	<b>62,625</b>
<b>Margins and ratios</b>									
Gross profit margin (%)	81.7	82.7	75.5	77.5	74.3	72.0	72.4	71.6	71.5
EBITDA margin (%)	43.3	44.7	29.1	30.7	31.9	21.2	21.5	24.7	25.8
Tax rate (%)	17.2	10.9	14.3	12.6	13.4	19.2	16.1	18.6	19.2
RoAE (%)	26.3	19.1	20.2	16.3	20.5	5.8	6.7	12.2	13.3
RoACE (%)	40.0	52.9	33.4	29.8	31.3	16.3	18.0	24.7	28.9

Source: Company, Kotak Institutional Equities estimates

## December 2018: Results calendar

Mon	Tue	Wed	Thu	Fri	Sat	Sun
<b>21-Jan</b>	<b>22-Jan</b>	<b>23-Jan</b>	<b>24-Jan</b>	<b>25-Jan</b>	<b>26-Jan</b>	<b>27-Jan</b>
		Bharti Infratel	Biocon	Dewan Housing Finance		
		DB Corp.	Colgate-Palmolive (India)	GRUH Finance		
		Interglobe Aviation	Edelweiss Financial Services	Indian Bank		
		ITC	Jyothy Laboratories	L&T		
		Pdillite Industries	Mphasis	Mahindra & Mahindra Financial		
		Ujjivan Financial Services	PNB Housing Finance	Maruti Suzuki		
		United Spirits	PVR	Shriram City Union Finance		
			Reliance Power	Vakrangee		
			Sunteck Realty			
			Supreme Industries			
			UltraTech Cement			
			Yes Bank			
<b>28-Jan</b>	<b>29-Jan</b>	<b>30-Jan</b>	<b>31-Jan</b>	<b>1-Feb</b>	<b>2-Feb</b>	<b>3-Feb</b>
Bank of India	Axis Bank	Ajanta Pharma	Bharti Airtel	Berger Paints	J K Cement	
Canara Bank	Bajaj Finance	Ashoka Buildcon	Dabur India	Carborundum Universal		
CEAT	Bajaj Finserv	Bajaj Auto	Emami	Dr Reddy's Laboratories		
Century Textile	Bank of Baroda	Bajaj Holding & Investment	Hero Motocorp	Jagran Prakashan		
City Union Bank	Bharat Financial Inclusion	Bharat Electronics	Magma Fincorp	Kalpitaru Power Transmission		
Escorts	Crompton Greaves Consumer	Castrol India	Petronet LNG	Rajesh Exports		
Godrej Properties	Godrej Consumer Products	Cholamandalam	Power Grid	State Bank of India		
Pramal Enterprises	HCL Technologies	Gujarat Pipavav Port	UPL	Titan Company		
RBL Bank	HDFC	Hexaware Technologies	Vedanta			
Shriram Transport	Info Edge	ICICI Bank				
Tata Power	Kansai Nerolac	IIFL Holdings				
	KEC International	IOCL				
	Mahanagar Gas	JSW Energy				
	TeamLease Services	Jubilant Foodworks				
	The Ramco Cement	LIC Housing Finance				
	WABCO India	Mahindra Logistics				
		NTPC				
		SIS				
		Tata Communications				
		Torrent Pharmaceuticals				
<b>4-Feb</b>	<b>5-Feb</b>	<b>6-Feb</b>	<b>7-Feb</b>	<b>8-Feb</b>	<b>9-Feb</b>	<b>10-Feb</b>
Aditya Birla Fashion	ACC	CG Power and Industrial	Britannia Industries	Dr Lal Pathlabs	Apollo Hospitals	
Exide Industries	GAIL (India)	Cipla	Coffee Day Enterprises	GSPL		
GlaxoSmithkline Pharmaceuticals	HPCL	Cummins India	Endurance Technologies	Mahindra & Mahindra		
Godrej Agrovet	Marico	JSW Steel	Gillette India	NHPC		
	MRPL		Grasim Industries	Orient Cement		
	Tata Chemicals		HCG	Rural Electrification Corp.		
	Tata Global Beverages		P&G Hygiene	Thermax		
	Tech Mahindra		Tata Motors			
	Timken					
	Torrent Power					
<b>11-Feb</b>	<b>12-Feb</b>	<b>13-Feb</b>	<b>14-Feb</b>	<b>15-Feb</b>	<b>16-Feb</b>	<b>17-Feb</b>
Amara Raja Batteries	Prestige Estates Projects	Bosch				
Motherhood Sumi Systems						
PFC						
PI Industries						
<b>18-Feb</b>	<b>19-Feb</b>	<b>20-Feb</b>	<b>21-Feb</b>	<b>22-Feb</b>	<b>23-Feb</b>	<b>24-Feb</b>
		Mahindra CIE Automotive				

Source: NSE, Kotak Institutional Equities

## Kotak Institutional Equities: Valuation summary of KIE Universe stocks

Company	Rating	Price (Rs)		Upside (%)	Mkt cap.		O/S shares (mn)	EPS (Rs)			EPS growth (%)			P/E (X)			EV/EBITDA (X)			P/B (X)			RoE (%)			Dividend yield (%)			ADVT 3mo (US\$ mn)
		22-Jan-19	Fair Value (Rs)		(Rs bn)	(US\$ bn)		2019E	2020E	2021E	2019E	2020E	2021E	2019E	2020E	2021E	2019E	2020E	2021E	2019E	2020E	2021E	2019E	2020E	2021E	2019E	2020E	2021E	
<b>Automobiles &amp; Components</b>																													
Amara Raja Batteries	REDUCE	780	740	(5)	133	1.9	171	31	36	42	11.2	19	15	25	21	18.6	13	11.2	9.6	4.0	3.4	3.0	16.6	17.2	17.2	0.6	0.7	0.8	5.2
Apollo Tyres	BUY	219	315	44	125	1.8	541	17	22	26	25	33	18	13.1	9.9	8.4	7.7	6.4	5.3	1.2	1.1	1.0	9.4	11.5	12.3	1.4	1.4	1.4	9.5
Ashok Leyland	BUY	88	150	71	258	3.6	2,926	5.9	8.0	8.6	10.1	36	6.5	14.8	10.9	10.3	8.3	6.6	6.4	3.1	2.6	2.3	23	26	24	2.0	2.7	2.9	33
Bajaj Auto	REDUCE	2,684	2,500	(7)	777	10.9	289	149	169	178	6.0	13.8	5.0	18.0	15.9	15.1	12	10.4	9.6	3.6	3.3	2.9	21	22	20	2.2	2.5	2.6	15.9
Balkrishna Industries	BUY	859	1,030	20	166	2.3	193	44	54	60	18	22	12.0	19.5	16.0	14.3	10.3	8.8	7.5	3.4	2.9	2.5	19.1	19.6	18.6	0.6	0.7	0.7	11.9
Bharat Forge	SELL	486	445	(8)	226	3.2	466	21	23	25	31	7.5	9.0	23	21	19.5	13	12	11.0	4.2	3.7	3.3	19.8	18.5	17.8	1.0	1.1	1.2	12.2
CEAT	ADD	1,219	1,280	5	49	0.7	40	79	97	101	23	22	4.3	15.3	12.6	12.1	9.0	8.0	7.2	1.7	1.5	1.4	11.7	12.8	12.0	0.7	0.8	0.8	11.3
Eicher Motors	SELL	20,024	18,500	(8)	546	7.6	27	841	966	1,043	6.1	14.8	8.0	24	21	19.2	16	14	13	7.7	6.0	4.9	37	33	28	0.1	0.1	0.0	35
Escorts	BUY	721	1,050	46	61	1.2	89	57	67	75	47	17	11.9	12.7	10.8	9.7	7.4	6.3	5.1	2.2	1.9	1.6	17.1	17.2	16.6	1.2	1.4	1.6	18.7
Exide Industries	SELL	245	235	(4)	208	2.9	850	9.3	10.8	12.0	13.6	15	11.8	26	23	20	14	13	11.3	3.5	3.2	2.9	13.9	14.6	14.9	1.2	1.4	1.6	5.8
Hero Motocorp	SELL	2,825	2,600	(8)	564	7.9	200	173	181	195	(6.4)	4.7	7.5	16.3	15.6	14.5	9.5	8.9	8.0	4.3	3.9	3.5	28	26	25	3.1	3.2	3.5	22
Mahindra CIE Automotive	ADD	230	280	22	87	1.2	378	13.9	16	17	44	12.1	9.0	16.6	14.8	13.6	8.5	7.5	6.7	2.1	1.8	1.6	13.2	13.0	12.4	—	—	—	0.6
Mahindra & Mahindra	BUY	708	1,000	41	880	12.3	1,138	42	50	53	11.3	18	7.3	16.8	14.3	13.3	11.1	9.3	8.5	2.4	2.1	1.9	14.9	15.5	14.8	1.2	1.4	1.5	37
Maruti Suzuki	BUY	7,069	8,300	17	2,135	29.9	302	268	346	387	4.9	29	11.8	26	20	18.3	14	10.6	9.1	4.5	3.9	3.4	18.2	20	19.9	0.9	1.2	1.4	85
Motherson Sumi Systems	SELL	163	140	(14)	513	7.2	3,158	6.0	7.2	8.3	10.3	20	15	27	23	19.6	10.8	8.7	7.5	4.6	4.0	3.5	18.1	19.1	19.2	1.0	1.1	1.2	17.1
MRF	REDUCE	65,260	62,000	(5)	277	3.9	4	3,048	3,702	4,089	14.2	21	10.4	21	17.6	16.0	9.5	8.0	6.9	2.5	2.2	1.9	12.5	13.3	13.0	0.1	0.1	0.1	5.7
Schaeffler India	BUY	5,458	5,700	4	91	1.3	17	148	192	237	3.6	30	23	37	28	23	10.5	7.9	6.2	6.2	5.2	4.3	21	19.9	20	0.2	0.2	0.2	0.6
SKF	ADD	1,935	1,900	(2)	99	1.4	51	68	82	97	18	20	18	28	24	20	18	15	12	4.7	4.1	3.5	16.5	17.2	17.5	0.6	0.7	0.9	1.1
Tata Motors	BUY	181	300	66	614	8.0	3,396	1.0	21	31	(95)	1,935	47	175	8.6	5.9	4.0	3.0	2.5	0.6	0.6	0.5	0.4	7.2	9.7	—	—	—	42
Timken	SELL	558	550	(1)	42	0.6	68	19	22	25	39	16	15.0	30	26	22	18	15	13	4.5	3.8	3.2	16.6	16.2	15.7	0.2	0.2	0.2	0.2
TVS Motor	SELL	554	350	(37)	263	3.7	475	14.6	18	19	4.7	22	7.7	38	31	29	19	16	15	7.9	6.8	5.9	22	23	22	0.8	1.0	1.0	11.3
Varrco Engineering	BUY	692	1,050	52	93	1.3	135	37	46	69	9.5	26	51	18.9	15.0	10.0	9.7	7.7	5.5	2.8	2.4	1.9	14.8	15.7	19.1	—	—	—	0.4
WABCO India	SELL	6,381	6,100	(4)	121	1.7	19	183	222	230	27	22	3.6	35	29	28	24	19	18	6.6	5.4	4.6	21	21	17.9	0.2	0.2	0.2	0.4
<b>Automobiles &amp; Components</b>	<b>Neutral</b>				<b>8,331</b>	<b>116.5</b>					<b>(8.4)</b>	<b>39</b>	<b>16</b>	<b>23</b>	<b>16.6</b>	<b>14.4</b>	<b>9.3</b>	<b>7.4</b>	<b>6.4</b>	<b>2.7</b>	<b>2.4</b>	<b>2.2</b>	<b>11.9</b>	<b>14.7</b>	<b>15.1</b>	<b>1.1</b>	<b>1.2</b>	<b>1.3</b>	<b>382</b>
<b>Banks</b>																													
Axis Bank	REDUCE	662	635	(4)	1,700	23.8	2,567	18	42	47	1,579	130	12.5	37	15.9	14.2	—	—	—	2.8	2.3	2.0	7.1	14.6	14.5	0.4	0.9	1.1	96
Bank of Baroda	ADD	114	130	14	301	4.2	2,652	17	25	28	286	46	13.3	6.7	4.6	4.0	—	—	—	0.9	0.8	0.6	10.6	15.2	13.3	—	—	—	29
Canara Bank	ADD	263	280	6	193	2.7	733	1.3	54	68	102	3,946	26	197	4.9	3.9	—	—	—	1.3	0.9	0.7	0.3	10.6	11.9	—	—	—	24
City Union Bank	ADD	190	185	(3)	139	1.9	732	9.4	10.5	12.2	5.5	11.9	16	20	18.1	15.6	—	—	—	3.1	2.8	2.4	15.5	15.3	15.7	0.9	1.0	1.1	2.3
DCB Bank	BUY	180	210	17	56	0.8	308	10.3	12.7	17	29	24	33	17.5	14.1	10.6	—	—	—	2.1	1.8	1.6	11.7	13.0	15.3	0.5	0.7	0.9	4.4
Equitas Holdings	BUY	121	160	32	41	0.6	340	4.6	8.4	11.4	398	83	36	26	14.4	10.6	—	—	—	1.8	1.6	1.4	6.7	11.1	13.4	—	—	—	7.8
Federal Bank	BUY	90	110	23	178	2.5	1,972	6.1	8.3	10.1	36	37	22	14.8	10.8	8.8	—	—	—	1.5	1.4	1.2	9.4	11.9	13.3	1.5	2.1	2.5	16.3
HDFC Bank	ADD	2,136	2,200	3	5,808	81.4	2,595	78	93	110	15	20	18	28	23	19.3	—	—	—	4.0	3.5	3.1	16.6	16.2	16.8	0.7	0.8	1.0	91
ICICI Bank	BUY	369	410	11	2,377	33.3	7,072	8.2	27	32	(14.1)	223	20	45	13.9	11.6	—	—	—	2.5	2.1	1.8	4.9	14.8	15.8	0.4	1.4	1.7	104
IDFC Bank	NR	-	-	-	-	0.0	3,404	0.9	2.9	4.2	(6.4)	215	45	NM	NM	NM	—	—	—	0.0	0.0	0.0	2.0	6.2	8.5	-	-	-	0.0
IndusInd Bank	BUY	1,501	1,700	13	904	12.7	600	56	75	94	(7)	35	25	27	19.9	16.0	—	—	—	3.3	2.9	2.5	14.2	15.0	16.4	0.4	0.6	0.7	53
J&K Bank	BUY	39	90	132	22	0.3	557	7.1	9.6	18	95	35	84	5.5	4.1	2.2	—	—	—	0.5	0.4	0.3	6.2	8.0	13.5	3.7	4.9	9.1	0.5
Karur Vysya Bank	ADD	92	110	19	74	1.0	799	3.2	13.4	14.3	(33)	318	7.0	29	6.9	6.4	—	—	—	1.4	1.2	1.0	3.7	14.4	13.9	0.9	3.6	4.0	1.3
Punjab National Bank	ADD	79	85	8	292	4.1	2,761	(18)	12.9	14.0	59	170	8.8	NM	6.1	5.6	—	—	—	1.8	1.0	0.8	NM	11.4	11.0	—	—	—	25
RBL Bank	SELL	575	500	(13)	245	3.4	420	21	29	34	40	34	20	27	20	16.8	—	—	—	3.4	3.0	2.7	12.7	15.1	16.0	0.6	0.7	0.9	12.3
State Bank of India	BUY	290	370	27	2,591	36.3	8,925	7.5	39	52	202	424	33	39	7.4	5.6	—	—	—	1.9	1.4	1.1	3.0	14.5	16.5	0.1	0.1	0.2	84
Ujivan Financial Services	BUY	291	350	20	35	0.5	121	16	25	31	2,648	54	24	17.7	11.5	9.3	—	—	—	1.8	1.6	1.4	10.7	14.7	16.0	0.5	0.9	1.2	9.8
Union Bank	ADD	84	90	7	98	1.4	1,169	0.3	11.2	29	101	3,653	160	280	7.5	2.9	—	—	—	1.1	0.8	0.5	0.1	5.6	13.3	0.1	2.0	5.2	13.4
YES Bank	SELL	192	190	(1)	444	6.2	2,303	18	19	24	(2.8)	6.5	25	10.8	10.1	8.1	—	—	—	1.6	1.4	1.2	15.0	14.2	15.7	1.5	1.6	2.0	161
<b>Banks</b>	<b>Attractive</b>				<b>1</b>																								

## Kotak Institutional Equities: Valuation summary of KIE Universe stocks

Company	Rating	Price (Rs)	Fair Value	Upside	Mkt cap.		O/S shares	EPS (Rs)			EPS growth (%)			P/E (X)			EV/EBITDA (X)			P/B (X)			RoE (%)			Dividend yield (%)			ADVT 3mo
		22-Jan-19	(Rs)	(%)	(Rs bn)	(US\$ bn)	(mn)	2019E	2020E	2021E	2019E	2020E	2021E	2019E	2020E	2021E	2019E	2020E	2021E	2019E	2020E	2021E	2019E	2020E	2021E	2019E	2020E	2021E	(US\$ mn)
<b>Building Products</b>																													
Astral Poly Technik	SELL	1,045	640	(39)	125	1.8	120	18	22	26	20	25	17	60	48	41	31	26	22	9.8	8.2	6.9	18.3	18.7	18.3	0.1	0.1	0.1	1.1
<b>Building Products</b>	<b>Cautious</b>				<b>125</b>	<b>1.8</b>					<b>20</b>	<b>25</b>	<b>17</b>	<b>59</b>	<b>47</b>	<b>40</b>	<b>31</b>	<b>26</b>	<b>22</b>	<b>9.7</b>	<b>8.1</b>	<b>6.8</b>	<b>16.4</b>	<b>17.2</b>	<b>16.9</b>	<b>0.1</b>	<b>0.1</b>	<b>0.1</b>	<b>1.1</b>
<b>Capital goods</b>																													
ABB	SELL	1,309	1,040	(21)	277	3.9	212	28	31	38	39	12.5	22	48	42	35	28	26	22	6.8	6.1	5.3	15.2	15.2	16.3	0.4	0.5	0.5	6.2
Ashoka Buildcon	BUY	125	200	60	35	0.5	282	9.6	10.4	10.5	13.6	8.3	1.1	13.0	12.0	11.9	8.7	7.9	7.2	1.6	1.4	1.3	12.9	12.2	11.2	1.4	1.0	1.1	0.5
BHEL	REDUCE	71	—	7	261	3.7	3,482	3.0	5.0	6.7	28	70	34	24	14.2	10.6	12.0	7.2	5.2	0.8	0.8	0.8	3.2	5.6	7.3	2.6	4.4	5.9	14.3
Carborundum Universal	SELL	358	315	(12)	68	0.9	189	14.3	17	20	26	21	14.5	25	21	18.1	14	11.3	9.7	3.9	3.5	3.1	16.4	17.8	18.2	1.2	1.5	1.7	0.5
CG Power and Industrial	BUY	42	67	60	26	0.4	627	3.0	4.8	7.0	273	59	45	13.7	8.6	5.9	6.1	4.3	3.2	1.0	0.9	0.8	7.1	11.1	14.8	—	—	—	4.0
Cummins India	REDUCE	829	700	(16)	230	3.2	277	27	33	37	12.3	21	14.2	31	25	22	25	21	18	5.4	5.1	4.7	18.3	21	22	1.8	2.1	2.5	7.7
Dilip Buildcon	BUY	367	855	133	50	0.7	137	52	57	69	11.5	9.2	23	7.1	6.5	5.3	4.4	3.9	3.2	1.6	1.3	1.0	25	22	21	0.3	0.3	0.4	2.4
IRB Infrastructure	BUY	150	260	74	53	0.7	351	30	32	20	32	6.8	(36.3)	5.0	4.7	7.4	6.3	6.9	8.4	0.8	0.7	0.6	17.0	15.7	9.1	2.1	2.6	2.7	4.2
Kalpataru Power Transmission	BUY	374	540	44	57	0.8	153	30	36	42	55	18	19	12.5	10.5	8.8	6.7	5.5	4.7	1.9	1.6	1.4	16.0	16.3	16.7	0.4	0.4	0.4	0.4
KEC International	BUY	266	380	43	68	1.0	257	20	26	32	13.7	28	23	13.1	10.2	8.3	7.8	6.4	5.3	2.8	2.2	1.8	24	24	24	0.8	1.1	1.3	1.3
L&T	BUY	1,301	1,530	18	1,824	25.6	1,401	68	67	75	32	(1.8)	12.3	19.0	19.4	17.3	17	17	15	3.1	2.8	2.6	17.6	15.3	15.6	1.8	1.7	1.9	44
Sadbhav Engineering	BUY	200	340	70	34	0.5	172	14.7	18	19	13.9	26	3.1	13.6	10.8	10.5	10.3	8.0	6.9	1.6	1.4	1.3	12.7	14.1	12.8	—	—	—	0.7
Siemens	SELL	1,050	920	(12)	374	5.2	356	28	33	39	13.1	17	18	37	32	27	22	19	16	4.2	3.8	3.5	11.7	12.6	13.7	0.8	0.9	1.0	11.4
Thermax	REDUCE	1,100	970	(12)	131	1.8	113	28	38	43	38	33	13.6	39	29	26	27	21	18	27	21	18	11.3	13.9	14.3	0.7	0.9	1.1	0.9
<b>Capital goods</b>	<b>Neutral</b>				<b>3,489</b>	<b>48.9</b>					<b>29</b>	<b>9.9</b>	<b>13.5</b>	<b>21</b>	<b>18.7</b>	<b>16.5</b>				<b>2.6</b>	<b>2.4</b>	<b>2.2</b>	<b>12.7</b>	<b>12.8</b>	<b>13.3</b>	<b>1.4</b>	<b>1.6</b>	<b>1.9</b>	<b>734</b>
<b>Commercial &amp; Professional Services</b>																													
SIS	REDUCE	785	855	9	58	0.8	73	28	34	41	26	21	19	28	23	19.2	17	14	11.4	4.8	4.0	3.4	18.8	19.2	19.3	0.3	0.4	0.5	0.5
TeamLease Services	SELL	2,622	1,925	(27)	45	0.6	17	59	76	99	37	29	30	45	35	27	45	34	26	8.3	6.7	5.3	20	21	22	—	—	—	0.5
<b>Commercial &amp; Professional Services</b>	<b>Cautious</b>				<b>102</b>	<b>1.4</b>					<b>32</b>	<b>24</b>	<b>23</b>	<b>33</b>	<b>27</b>	<b>22</b>	<b>23</b>	<b>18</b>	<b>15</b>	<b>5.8</b>	<b>4.8</b>	<b>4.0</b>	<b>17.7</b>	<b>18.2</b>	<b>18.5</b>	<b>0.2</b>	<b>0.2</b>	<b>0.3</b>	<b>0.9</b>
<b>Commodity Chemicals</b>																													
Asian Paints	REDUCE	1,407	1,225	(13)	1,349	18.9	959	24	30	36	19	25	19	58	46	39	36	28	24	14	12	11	26	29	30	0.8	1.0	1.2	30
Tata Chemicals	ADD	688	760	10	175	2.5	256	42	50	57	(19)	19	12.9	16.3	13.7	12.1	7.1	5.8	5.0	1.5	1.4	1.3	9.3	10.3	10.9	2.2	2.5	2.5	5.4
<b>Commodity Chemicals</b>	<b>Neutral</b>				<b>1,524</b>	<b>21.4</b>					<b>(4.3)</b>	<b>23</b>	<b>17</b>	<b>45</b>	<b>36</b>	<b>31</b>	<b>25</b>	<b>20</b>	<b>18</b>	<b>7.1</b>	<b>6.4</b>	<b>5.9</b>	<b>15.8</b>	<b>17.8</b>	<b>18.9</b>	<b>0.9</b>	<b>1.2</b>	<b>1.4</b>	<b>35</b>
<b>Conglomerate</b>																													
Godrej Industries	RS	525	—	—	177	2.5	336	16	20	0.0	8.9	24		33	27		28	31		4.3	3.8		13.9	15.1		0.3	0.3		3.7
<b>Conglomerate</b>	<b>Neutral</b>				<b>177</b>	<b>2.5</b>					<b>8.9</b>	<b>24</b>		<b>33</b>	<b>27</b>		<b>28</b>	<b>31</b>		<b>4.3</b>	<b>3.8</b>		<b>13.1</b>	<b>14.2</b>		<b>0.3</b>	<b>0.3</b>		<b>3.7</b>
<b>Construction Materials</b>																													
ACC	SELL	1,436	1,250	(13)	270	3.8	188	58	67	78	19	16	16	25	21	18.4	13	11.1	9.4	2.7	2.5	2.2	11.2	12.0	12.7	1.2	1.2	1.2	13.2
Ambuja Cements	REDUCE	214	195	(9)	425	5.9	1,986	7.7	9.7	11.3	1.8	26	17	28	22	19.0	9.0	7.3	6.1	2.0	1.9	1.8	7.2	8.8	9.7	1.7	1.7	1.7	11.6
Dalmia Bharat	ADD	—	2,335	—	—	0.0	192	15.0	36	48	0.8	140	33	NM	NM	NM	1.7	1.4	1.0	0.0	0.0	0.0	2.7	6.3	7.9	—	—	—	2.1
Grasim Industries	ADD	804	1,030	28	529	7.4	657	77	85	96	63	9.9	13.1	10.4	9.5	8.4	6.8	6.5	5.9	0.9	0.8	0.7	8.7	8.9	9.3	0.7	0.7	0.7	18.4
India Cements	REDUCE	84	102	21	26	0.4	308	3.8	7.0	9.1	16	85	29	22	12.0	9.3	7.7	6.4	5.8	0.5	0.5	0.5	2.2	4.0	5.0	1.2	1.2	1.2	7.9
J K Cement	ADD	724	800	10	56	0.8	70	45	70	69	4.1	55	(1.0)	16.1	10.4	10.5	10.4	9.3	7.6	2.3	1.9	1.7	15.0	20	16.9	1.1	1.1	1.1	0.5
JK Lakshmi Cement	ADD	296	320	8	35	0.5	118	4.6	23	31	3.5	386	39	64	13.2	9.5	10.8	6.7	5.4	2.4	2.0	1.7	3.7	16.7	19.6	0.7	0.7	0.7	0.3
Orient Cement	ADD	75	110	47	15	0.2	205	2.0	7.6	11.7	(7.8)	283	53	38	9.8	6.4	9.2	5.6	4.1	1.5	1.4	1.2	4.0	14.5	19.5	2.0	2.7	2.7	0.1
Shree Cement	SELL	15,918	11,750	(26)	555	7.8	35	339	512	642	(15)	51	25	47	31	25	20	14	11.4	5.7	4.9	4.2	12.7	17.0	18.2	0.3	0.3	0.3	6.4
UltraTech Cement	SELL	3,861	2,760	(29)	1,060	14.9	275	103	148	187	17	43	27	37	26	21	17	14	11.3	3.7	3.3	2.9	10.4	13.4	14.9	0.3	0.3	0.3	16.7
<b>Construction Materials</b>	<b>Cautious</b>				<b>2,970</b>	<b>41.6</b>					<b>24</b>	<b>31</b>	<b>20</b>	<b>24</b>	<b>18.1</b>	<b>15.1</b>	<b>10.1</b>	<b>8.5</b>	<b>7.3</b>	<b>2.0</b>	<b>1.8</b>	<b>1.6</b>	<b>8.3</b>	<b>10.0</b>	<b>10.9</b>	<b>0.7</b>	<b>0.7</b>	<b>0.7</b>	<b>77</b>

Source: Company, Bloomberg, Kotak Institutional Equities estimates

## Kotak Institutional Equities: Valuation summary of KIE Universe stocks

Company	Rating	Price (Rs)	Fair Value	Upside	Mkt cap.		O/S shares	EPS (Rs)			EPS growth (%)			P/E (X)			EV/EBITDA (X)			P/B (X)			RoE (%)			Dividend yield (%)			ADVT 3mo
		22-Jan-19	(Rs)	(%)	(Rs bn)	(US\$ bn)	(mn)	2019E	2020E	2021E	2019E	2020E	2021E	2019E	2020E	2021E	2019E	2020E	2021E	2019E	2020E	2021E	2019E	2020E	2021E	2019E	2020E	2021E	(US\$ mn)
<b>Consumer Durables &amp; Apparel</b>																													
Crompton Greaves Consumer	SELL	224	190	(15)	140	2.0	627	6.0	7.2	8.5	16	21	17	37	31	26	23	20	17	12	9.7	7.4	39	35	32	0.9	1.1	—	1.5
Havells India	SELL	711	520	(27)	445	6.2	625	13.4	17	20	21	23	18	53	43	36	34	27	23	11	9.2	8.1	21	23	24	0.7	0.8	1.0	10.8
Page Industries	SELL	22,510	22,300	(1)	251	3.5	11	410	501	599	32	22	20	55	45	38	35	29	24	23	18	15	47	45	43	0.8	1.0	1.2	17.0
TCNS Clothing Co.	BUY	715	740	3	44	0.6	64	20	22	27	31	10.6	20	36	32	27	22	17	13	7.8	6.1	4.8	25	21	20	—	—	—	0.3
Vardhman Textiles	ADD	1,080	1,300	20	62	0.9	56	119	130	141	(6.1)	9.1	8.5	9.0	8.3	7.6	6.9	6.4	5.7	1.1	1.0	0.9	12.9	12.8	12.6	1.9	2.8	2.8	0.3
Voltas	SELL	540	490	(9)	179	2.5	331	17	19	22	(3.7)	11.5	20	32	29	24	25	21	18	4.1	3.7	3.3	13.4	13.5	14.5	0.6	0.7	0.8	10.4
Whirlpool	SELL	1,463	1,220	(17)	186	2.6	127	35	41	49	26	19	17	42	35	30	26	22	18	8.6	7.3	6.3	22	22	22	0.4	0.6	1.0	1.0
<b>Consumer Durables &amp; Apparel</b>	<b>Cautious</b>				<b>1,306</b>	<b>18.3</b>					<b>11.9</b>	<b>17</b>		<b>38</b>	<b>32</b>	<b>27</b>	<b>24</b>	<b>20</b>	<b>17</b>	<b>6.9</b>	<b>6.0</b>		<b>18.3</b>	<b>18.7</b>	<b>19.0</b>	<b>0.7</b>	<b>0.9</b>		<b>41</b>
<b>Consumer Staples</b>																													
Bajaj Consumer Care	ADD	351	405	15	52	0.7	148	15	17	19	7.8	10.1	9.1	23	21	18.9	18	15	13	11	11	11	47	53	57	4.0	4.0	4.3	0.5
Britannia Industries	ADD	3,154	3,063	(3)	758	10.6	240	51	63	75	21	24	20	62	50	42	41	33	28	18	14	12	32	32	31	0.6	0.7	0.9	12.9
Colgate-Palmolive (India)	ADD	1,307	1,185	(9)	355	5.0	272	27	32	37	16	15	16	48	41	35	28	24	21	21	18	16	46	47	47	1.2	1.5	1.8	9.4
Dabur India	REDUCE	433	345	(20)	765	10.7	1,762	8.7	10.0	11.5	11.8	15	14.8	50	43	38	42	36	31	14	12	10	27	29	29	0.9	1.0	1.3	18.5
GlaxoSmithKline Consumer	RS	7,210	—	—	303	4.2	42	212	235	260	27	10.8	10.5	34	31	28	24	21	18	7.7	6.9	6.3	24	24	24	1.2	1.5	1.7	4.3
Godrej Consumer Products	REDUCE	793	645	(19)	810	11.4	1,022	16	18	21	11.4	14.8	15	50	44	38	35	31	26	11	9.2	8.1	23	23	23	0.7	0.8	0.9	10.2
Hindustan Unilever	REDUCE	1,750	1,600	(9)	3,788	53.1	2,160	29	34	39	18	18	13.8	61	52	45	42	35	31	47	39	33	83	83	79	1.2	1.4	1.5	39
ITC	ADD	290	330	14	3,548	49.7	12,275	9.8	11.1	12.4	9.9	12.8	12.5	30	26	23	19	17	15	6.5	6.1	5.7	21	22	24	2.0	2.3	2.7	40
Jyothy Laboratories	ADD	194	210	8	71	1.0	364	5.6	6.4	7.4	27	13.8	16	35	30	26	24	21	18	5.3	4.7	4.1	16.5	16.4	16.7	0.5	0.8	1.0	0.6
Marico	ADD	374	350	(7)	483	6.8	1,291	7.0	8.7	10.2	11.8	24	17	53	43	37	38	30	25	18	16	14	34	40	42	1.3	1.5	1.7	9.7
Nestle India	ADD	11,216	10,600	(5)	1,081	15.1	96	171	200	230	35	17	15	66	56	49	38	33	28	29	27	24	46	49	52	1.0	1.2	1.4	12.9
Tata Global Beverages	ADD	212	240	13	134	1.9	631	7.7	9.0	10.1	4.7	17	13.1	28	24	21	16	14	12	1.8	1.8	1.7	6.8	7.6	8.3	1.4	1.7	1.9	6.0
United Breweries	REDUCE	1,459	1,260	(14)	386	5.4	264	22	29	36	5.1	29	24	65	50	41	33	27	23	12	10.0	8.3	20	22	22	0.2	0.3	0.5	12.1
United Spirits	REDUCE	599	540	(10)	435	6.1	727	10.9	13.9	17	43	28	25	55	43	34	33	27	22	13	8.7	6.1	27	24	21	—	0.3	0.4	14.1
Varun Beverages	REDUCE	794	700	(12)	145	2.0	183	14.9	20	25	29	32	25	53	41	32	18	15	13	7.3	6.3	5.4	14.5	16.7	18.0	0.3	0.1	0.3	1.0
<b>Consumer Staples</b>	<b>Cautious</b>				<b>13,116</b>	<b>183.7</b>					<b>16</b>	<b>16</b>	<b>14.5</b>	<b>45</b>	<b>38</b>	<b>34</b>	<b>29</b>	<b>25</b>	<b>22</b>	<b>12</b>	<b>11</b>	<b>9.6</b>	<b>27</b>	<b>28</b>	<b>28</b>	<b>1.2</b>	<b>1.5</b>	<b>1.7</b>	<b>192</b>
<b>Diversified Financials</b>																													
Bajaj Finance	REDUCE	2,622	2,200	(16)	1,515	21.2	575	66	88	114	52	33	29	40	30	23	—	—	—	7.9	6.4	5.1	22	24	25	0.3	0.3	0.4	72
Bajaj Finserv	ADD	6,436	6,400	1—	1,024	14.3	159	240	303	375	37	26	24	27	21	17.2	—	—	—	4.2	3.5	3.0	17.4	18.0	18.7	0.2	0.2	0.2	19.3
Bharat Financial Inclusion	NA	954	—	—	134	1.9	139	53	63	77	63	19	22	17.9	15.1	12.3	—	—	—	3.5	2.8	2.2	22	20	20	—	—	—	13.8
Cholamandlam	ADD	1,139	1,425	25	178	2.5	156	83	101	126	42	21	24	13.7	11.3	9.1	—	—	—	3.0	2.5	2.0	23	23	23	0.9	1.1	1.3	5.8
HDFC	ADD	1,979	2,150	9	3,404	47.7	1,676	53	62	73	(30)	17	19	37	32	27	—	—	—	4.5	4.2	3.8	13.1	13.6	14.8	1.0	1.2	1.4	78
IIFL Holdings	REDUCE	443	470	6	141	2.0	319	30	34	39	4.3	12.9	17	14.8	13.1	11.3	—	—	—	2.2	1.9	1.7	16.8	16.1	16.6	1.4	1.6	1.9	1.2
L&T Finance Holdings	REDUCE	137	145	6	274	3.8	1,996	11.7	13.0	15.0	59	11.2	16	11.7	10.6	9.1	—	—	—	2.0	1.7	1.5	17.7	17.7	17.7	1.5	1.8	1.7	16.3
LIC Housing Finance	BUY	475	590	24	240	3.4	505	42	52	66	(3.5)	23	27	11.3	9.2	7.3	—	—	—	1.6	1.4	1.2	15.0	15.6	17.3	1.4	1.7	2.1	11.9
Magma Fincorp	BUY	105	145	38	28	0.4	237	12.2	17	20	25	39	20	8.7	6.2	5.2	—	—	—	1.0	0.9	0.8	13.0	15.7	16.4	1.7	2.4	2.9	0.1
Mahindra & Mahindra Financial	ADD	436	475	9	269	3.8	614	24	27	33	36	14.0	20	18.4	16.1	13.4	—	—	—	2.7	2.5	2.2	14.7	14.9	16.0	1.2	1.4	1.7	11.6
Muthoot Finance	ADD	542	510	(6)	217	3.0	400	43	43	48	0.3	0.6	10.2	12.6	12.5	11.4	—	—	—	2.4	2.1	1.9	21	18.0	17.4	1.8	1.8	2.0	9.8
PNB Housing Finance	REDUCE	879	975	11	147	2.1	167	58	68	81	(9.7)	17	20	15.2	13.0	10.8	—	—	—	2.1	1.8	1.6	14.2	14.4	15.4	0.4	0.4	0.4	3.7
Shriram City Union Finance	ADD	1,770	1,875	6	117	1.6	66	142	158	189	41	11.8	19	12.5	11.2	9.4	—	—	—	2.0	1.8	1.5	15.8	15.6	16.2	1.0	1.1	1.3	0.4
Shriram Transport	BUY	1,096	1,450	32	249	3.5	227	107	124	143	55	16	16	10.3	8.8	7.6	—	—	—	1.7	1.5	1.3	16.7	16.8	16.9	1.4	1.6	2.0	21
<b>Diversified Financials</b>	<b>Neutral</b>				<b>7,937</b>	<b>111.2</b>					<b>7.5</b>	<b>19</b>	<b>21</b>	<b>25</b>	<b>21</b>	<b>17.2</b>				<b>3.7</b>	<b>3.2</b>	<b>2.8</b>	<b>14.8</b>	<b>15.5</b>	<b>16.3</b>	<b>0.8</b>	<b>1.0</b>	<b>1.1</b>	<b>264</b>

Source: Company, Bloomberg, Kotak Institutional Equities estimates

## Kotak Institutional Equities: Valuation summary of KIE Universe stocks

Company	Rating	Price (Rs)	Fair Value	Upside	Mkt cap.		O/S shares	EPS (Rs)			EPS growth (%)			P/E (X)			EV/EBITDA (X)			P/B (X)			RoE (%)			Dividend yield (%)			ADVT 3mo
		22-Jan-19	(Rs)	(%)	(Rs bn)	(US\$ bn)	(mn)	2019E	2020E	2021E	2019E	2020E	2021E	2019E	2020E	2021E	2019E	2020E	2021E	2019E	2020E	2021E	2019E	2020E	2021E	2019E	2020E	2021E	(US\$ mn)
<b>Electric Utilities</b>																													
CESC	BUY	682	790	16	90	1.3	133	89	106	114	1.6	19	8.4	7.7	6.5	6.0	6.7	5.9	5.4	0.7	0.7	0.6	8.6	10.7	10.7	1.9	1.9	1.9	7.5
JSW Energy	REDUCE	69	66	(4)	113	1.6	1,640	4.8	5.8	6.6	58	20	13.4	14.2	11.9	10.5	5.9	5.0	4.3	0.9	0.9	0.8	6.9	7.7	8.1	—	—	—	0.8
NHPC	ADD	25	30	18	261	3.6	10,260	2.8	2.9	3.7	16	4.3	26	9.0	8.6	6.9	7.7	7.5	6.5	0.8	0.8	0.8	9.5	9.6	11.5	6.2	6.0	7.7	1.7
NTPC	BUY	143	190	33	1,177	16.5	8,245	14.3	16	19	14.1	12.1	16	10.0	8.9	7.7	8.9	7.8	6.5	1.1	1.0	0.9	11.2	11.6	12.4	3.0	3.4	3.9	21
Power Grid	BUY	190	250	32	992	13.9	5,232	19	22	25	22	16	11.0	9.9	8.5	7.7	7.3	6.6	6.2	1.6	1.5	1.3	17.5	18.1	18.0	3.4	3.9	4.3	12.0
Tata Power	BUY	76	90	18	207	2.9	2,705	6.3	6.9	9.7	17	10.6	40	12.2	11.0	7.9	9.8	9.9	9.3	1.2	1.1	1.0	10.5	10.5	13.0	—	—	—	7.6
<b>Electric Utilities</b>	<b>Attractive</b>				<b>2,840</b>	<b>39.8</b>					<b>17</b>	<b>13.0</b>	<b>16</b>	<b>10.0</b>	<b>8.9</b>	<b>7.6</b>				<b>1.2</b>	<b>1.1</b>	<b>1.0</b>	<b>11.7</b>	<b>12.2</b>	<b>13.0</b>	<b>3.1</b>	<b>3.4</b>	<b>3.9</b>	<b>51</b>
<b>Fertilizers &amp; Agricultural Chemicals</b>																													
Bayer Cropscience	SELL	4,280	3,550	(17)	147	2.1	34	94	114	135	7.4	21	19	46	38	32	28	23	19	7.3	6.3	5.5	17.0	18.0	18.6	0.4	0.5	0.6	0.5
Dhanuka Agritech	ADD	410	500	22	20	0.3	49	25	28	31	(0.9)	9.1	10.5	16.1	14.8	13.4	11.7	10.0	8.6	2.8	2.4	2.1	18.4	17.6	17.1	1.3	1.4	1.6	0.2
Godrej Agrovet	ADD	501	580	16	96	1.3	189	13.0	18	22	12.9	35	0.0	39	29	23	21	16	13	5.0	4.3	0.0	13.9	16.3	17.4	0.4	0.5	0.7	0.6
Kaveri Seed	SELL	557	515	(8)	37	0.5	66	34	34	37	7.3	0.1	8.3	16.2	16.2	15.0	13	13	11.3	3.9	3.4	2.9	26	22	21	1.4	1.8	1.8	3.6
PI Industries	BUY	864	850	(2)	119	1.7	138	30	38	46	11.5	30	19	29	22	18.8	21	16	13	5.3	4.4	3.7	19.6	21	21	0.5	0.7	0.8	1.2
Rallis India	ADD	167	195	16	33	0.5	195	8.8	10.5	11.1	1.7	20	5.4	19.1	15.9	15.1	13	10.5	9.4	2.6	2.3	2.2	13.8	15.4	15.0	2.2	2.4	2.6	0.9
UPL	ADD	763	650	(15)	389	5.4	507	47	54	60	9.5	14.7	11.4	16.2	14.2	12.7	10.7	9.1	7.9	3.5	3.0	2.5	24	23	21	1.2	1.4	1.6	21
<b>Fertilizers &amp; Agricultural Chemicals</b>	<b>Attractive</b>				<b>841</b>	<b>11.8</b>					<b>9.0</b>	<b>17</b>	<b>13.4</b>	<b>22</b>	<b>18.4</b>	<b>16.2</b>	<b>14</b>	<b>11.7</b>	<b>10.1</b>	<b>4.2</b>	<b>3.6</b>	<b>3.0</b>	<b>19.5</b>	<b>19.4</b>	<b>18.8</b>	<b>0.9</b>	<b>1.1</b>	<b>1.3</b>	<b>28</b>
<b>Gas Utilities</b>																													
GAIL (India)	BUY	333	455	37	751	10.5	2,255	32	33	35	55	3.5	8.0	10.5	10.2	9.4	6.7	6.4	5.8	1.7	1.5	1.4	16.8	15.8	15.6	3.3	3.5	3.8	25
GSPL	SELL	179	180	0	101	1.4	564	17	14.4	13.6	39	(12.9)	(5.7)	10.9	12.5	13.2	4.7	4.9	4.7	1.7	1.6	1.4	17.1	13.2	11.2	1.4	1.2	1.1	1.0
Indraprastha Gas	SELL	283	240	(15)	198	2.8	700	12.0	13.7	15	16	14.0	11.5	24	21	18.5	15	13	11.3	4.9	4.3	3.8	22	22	22	1.0	1.3	1.7	7.6
Mahanagar Gas	ADD	906	930	3	89	1.3	99	56	60	64	16	7.7	5.4	16.2	15.0	14.2	9.4	8.5	7.9	3.8	3.4	3.1	25	24	23	2.4	3.0	3.5	3.5
Petronet LNG	BUY	223	280	26	334	4.7	1,500	16	18	21	15	14.3	12.9	14.0	12.2	10.8	9.2	7.8	6.7	3.1	2.8	2.6	23	24	25	3.6	4.1	5.1	9.1
<b>Gas Utilities</b>	<b>Attractive</b>				<b>1,474</b>	<b>20.6</b>					<b>38</b>	<b>5.4</b>	<b>8.3</b>	<b>12.5</b>	<b>11.8</b>	<b>10.9</b>	<b>7.6</b>	<b>7.1</b>	<b>6.4</b>	<b>2.2</b>	<b>2.0</b>	<b>1.8</b>	<b>17.6</b>	<b>16.8</b>	<b>16.6</b>	<b>2.9</b>	<b>3.1</b>	<b>3.6</b>	<b>46</b>
<b>Health Care Services</b>																													
Apollo Hospitals	ADD	1,294	1,230	(5)	180	2.5	139	24	29	35	190	17	23	53	45	37	21	18	16	5.2	4.8	4.4	10.1	10.9	12.4	0.5	0.6	0.7	11.6
Aster DM Healthcare	BUY	160	240	50	81	1.1	505	4.9	8.0	11.9	77	63	49	33	20	13.5	13	9.5	7.5	2.6	2.4	2.0	8.4	12.5	16.3	—	—	—	0.3
Dr Lal Pathlabs	REDUCE	1,030	910	(12)	86	1.2	83	24	28	34	17	18	22	43	37	30	26	22	18	9.1	7.7	6.4	23	23	23	0.5	0.5	0.7	1.6
HCG	BUY	195	270	38	17	0.2	85	(1.2)	1.0	3.7	(178)	179	281	NM	202	53	17	13	10.8	3.3	3.2	3.0	NM	1.6	5.9	—	—	—	0.3
Narayana Hrudayalaya	ADD	187	265	42	38	0.5	204	2.7	5.9	8.5	7.1	119	44	69	32	22	18	13	10.1	3.5	3.2	2.8	5.2	10.5	13.4	—	—	—	0.2
<b>Health Care Services</b>	<b>Attractive</b>				<b>402</b>	<b>5.6</b>					<b>69</b>	<b>40</b>	<b>36</b>	<b>48</b>	<b>35</b>	<b>25</b>	<b>18</b>	<b>15</b>	<b>12</b>	<b>4.4</b>	<b>4.0</b>	<b>3.5</b>	<b>9.2</b>	<b>11.6</b>	<b>13.9</b>	<b>0.3</b>	<b>0.4</b>	<b>0.4</b>	<b>13.9</b>
<b>Hotels &amp; Restaurants</b>																													
Coffee Day Enterprises	NR	288	—	—	61	0.9	211	7.6	10.1	12.5	127	34	24	38	28	23	12	10.8	9.9	2.4	2.2	0.0	6.5	8.1	9.2	—	—	—	0.7
Jubilant Foodworks	BUY	1,166	1,370	18	154	2.2	132	24	33	43	67	37	30	48	35	27	24	18	14	12	8.9	6.8	28	29	29	0.2	0.3	0.3	36
Lemon Tree Hotels	ADD	69	80	17	54	0.8	786	0.4	1.2	2.0	147	175	67	154	56	34	34	21	16	6.3	5.7	5.3	4.2	10.7	16.4	—	—	1.4	0.5
<b>Hotels &amp; Restaurants</b>	<b>Attractive</b>				<b>269</b>	<b>3.8</b>					<b>87</b>	<b>46</b>	<b>33</b>	<b>52</b>	<b>36</b>	<b>27</b>	<b>30</b>	<b>15</b>	<b>13</b>	<b>5.7</b>	<b>4.9</b>	<b>4.3</b>	<b>11.0</b>	<b>13.8</b>	<b>15.9</b>	<b>0.1</b>	<b>0.1</b>	<b>0.5</b>	<b>37</b>
<b>Insurance</b>																													
HDFC Standard Life Insurance	ADD	384	435	13	774	10.8	2,007	6.5	8.1	9.8	18	24	21	59	47	39	—	—	—	15	13	11	26	29	31	0.4	0.5	0.6	5.5
ICICI Lombard	SELL	845	720	(15)	384	5.4	454	26	32	36	35	24	15	33	27	23	—	—	—	7.1	6.0	5.0	23	24	23	0.7	0.9	1.0	6.0
ICICI Prudential Life	BUY	345	480	39	495	6.9	1,436	8.9	10.3	12.3	(21)	16	20	39	33	28	—	—	—	6.5	5.6	4.9	18.1	18.1	18.7	0.4	0.5	0.6	6.0
Max Financial Services	BUY	436	510	17	117	1.6	268	6.3	6.4	6.5	37	1.8	1.8	70	68	67	—	—	—	—	—	—	8.3	8.0	7.8	0.5	0.5	0.5	4.2
SBI Life Insurance	BUY	620	790	27	620	8.7	1,000	12.7	14.3	16	10.8	12.4	12.1	49	43	39	—	—	—	8.2	7.0	6.1	18.0	17.5	17.0	0.3	0.4	0.4	2.6
<b>Insurance</b>	<b>Attractive</b>				<b>2,391</b>	<b>33.5</b>					<b>6.8</b>	<b>18</b>	<b>17</b>	<b>46</b>	<b>39</b>	<b>33</b>				<b>8.6</b>	<b>7.4</b>	<b>6.5</b>	<b>18.6</b>	<b>19.1</b>	<b>19.4</b>	<b>0.3</b>	<b>0.4</b>	<b>0.4</b>	<b>24</b>

Source: Company, Bloomberg, Kotak Institutional Equities estimates

## Kotak Institutional Equities: Valuation summary of KIE Universe stocks

Company	Rating	Price (Rs)	Fair Value	Upside	Mkt cap.		O/S shares	EPS (Rs)			EPS growth (%)			P/E (X)			EV/EBITDA (X)			P/B (X)			RoE (%)			Dividend yield (%)			ADVT 3mo
		22-Jan-19	(Rs)	(%)	(Rs bn)	(US\$ bn)	(mn)	2019E	2020E	2021E	2019E	2020E	2021E	2019E	2020E	2021E	2019E	2020E	2021E	2019E	2020E	2021E	2019E	2020E	2021E	2019E	2020E	2021E	(US\$ mn)
<b>Internet Software &amp; Services</b>																													
Info Edge	ADD	1,627	1,660	2	199	2.8	121.6	26	33	40	16	28	21	62	49	40	48	36	29	7.4	6.7	6.0	13.4	14.5	15.8	0.5	0.5	0.6	5.1
Just Dial	ADD	481	545	13	32	0.5	67.4	30	31	33	39	5.1	6.8	16.3	15.5	14.5	9.0	7.9	6.8	3.4	2.8	2.4	20	19.8	17.9	0.6	0.6	0.7	14.9
<b>Internet Software &amp; Services</b>	<b>Attractive</b>				<b>231</b>	<b>3.2</b>					<b>22</b>	<b>19</b>	<b>16</b>	<b>45</b>	<b>38</b>	<b>33</b>	<b>33</b>	<b>27</b>	<b>23</b>	<b>6.4</b>	<b>5.7</b>	<b>5.0</b>	<b>14.2</b>	<b>15.0</b>	<b>15.4</b>	<b>0.5</b>	<b>0.5</b>	<b>0.6</b>	<b>19.9</b>
<b>IT Services</b>																													
HCL Technologies	ADD	941	1,100	17	1,310	18.4	1,409	74	78	81	18	5.6	4.5	12.8	12.1	11.6	8.3	7.5	6.8	2.9	2.5	2.2	25	22	20	0.9	3.3	3.5	29
Hexaware Technologies	REDUCE	332	360	9	99	1.4	302	20	23	25	20	13.6	12.3	16.7	14.7	13.1	12	9.7	8.5	4.3	3.7	3.2	28	27	26	2.4	2.4	3.0	7.2
Infosys	ADD	745	760	2	3,256	45.6	4,350	36	40	44	11.2	10.6	10.9	21	18.8	16.9	15	13	11.5	4.8	4.4	4.0	24	24	25	3.5	3.0	3.2	86
L&T Infotech	ADD	1,778	2,000	12	308	4.3	175	86	96	112	35	11.9	16	21	18.5	15.9	15	13	11.0	6.5	5.3	4.3	35	31	30	1.4	1.5	1.7	5.2
Mindtree	ADD	920	1,000	9	151	2.1	165	45	52	61	31	14.1	17	20	17.8	15.1	13	11.0	9.3	4.7	4.0	3.4	25	24	24	1.5	1.7	2.0	21
Mphasis	SELL	871	900	3	169	2.4	193	55	63	65	26	13.4	2.7	15.7	13.9	13.5	10.7	9.8	9.0	2.8	2.8	2.6	18.5	19.8	20	2.3	2.9	3.4	5.7
TCS	REDUCE	1,902	1,825	(4)	7,137	100.0	3,829	83	91	100	23	10.3	9.6	23	21	19.0	17	15	14	7.1	6.6	6.3	33	33	34	1.7	3.4	3.7	77
Tech Mahindra	ADD	714	865	21	630	8.8	891	48	56	64	11.9	18	14.1	15.0	12.7	11.1	8.8	7.1	6.0	2.9	2.5	2.1	21	21	20	1.3	1.4	1.6	28
Wipro	REDUCE	347	355	2	1,568	22.0	4,507	20	24	26	19	19	9.2	17.2	14.4	13.2	11.2	9.2	8.3	2.6	2.4	2.2	17.0	17.5	17.5	0.4	2.9	3.2	21
<b>IT Services</b>	<b>Cautious</b>				<b>14,628</b>	<b>204.9</b>					<b>16</b>	<b>10.8</b>	<b>9.6</b>	<b>19.7</b>	<b>17.7</b>	<b>16.2</b>	<b>14</b>	<b>12</b>	<b>10.9</b>	<b>4.7</b>	<b>4.3</b>	<b>3.9</b>	<b>24</b>	<b>24</b>	<b>24</b>	<b>1.9</b>	<b>3.1</b>	<b>3.3</b>	<b>279</b>
<b>Media</b>																													
DB Corp.	ADD	180	210	17	33	0.5	184	16	20	23	(6.4)	24	14.9	10.9	8.8	7.7	6.0	4.8	4.1	1.8	1.6	1.5	15.5	19.1	20	2.2	5.6	6.9	0.3
DishTV	ADD	34	51	49	63	0.9	1,925	1.0	2.4	3.2	329	140	32	34	14.2	10.8	3.5	2.8	2.3	12	9.3	6.5	40	75	71	—	—	—	4.5
Jagran Prakashan	REDUCE	111	110	(1)	33	0.5	311	10.0	11.1	12.7	3.5	10.8	15	11.1	10.0	8.7	4.8	4.3	3.7	1.7	1.7	1.6	15.0	17.2	19.3	4.5	8.1	8.1	0.2
PVR	RS	1,599	NA	-	75	1.0	47	37	51	65	38	37	28	43	31	25	16	12	10.4	6.3	5.3	4.5	15.5	18.3	19.8	0.2	0.3	0.4	8.0
Sun TV Network	REDUCE	519	670	29	205	2.9	394	35	37	41	22	6.8	10.5	14.8	13.9	12.6	9.8	9.0	7.8	4.1	3.8	3.5	29	28	29	3.9	4.3	4.8	15.3
Zee Entertainment Enterprises	REDUCE	425	430	1	408	5.7	960	17	20	22	14.7	15	11.9	25	21	19.2	14	13	11.3	4.7	4.2	3.7	20	21	20	1.1	1.3	1.6	29
<b>Media</b>	<b>Attractive</b>				<b>817</b>	<b>11.4</b>					<b>23</b>	<b>20</b>	<b>14.6</b>	<b>20</b>	<b>17.1</b>	<b>14.9</b>	<b>9.3</b>	<b>8.2</b>	<b>7.2</b>	<b>4.3</b>	<b>3.8</b>	<b>3.4</b>	<b>21</b>	<b>22</b>	<b>23</b>	<b>1.8</b>	<b>2.3</b>	<b>2.7</b>	<b>57</b>
<b>Metals &amp; Mining</b>																													
Hindako Industries	BUY	204	280	38	457	6.4	2,229	29	27	29	33	-6.9	7.9	7.0	7.5	7.0	4.9	4.7	4.3	0.7	0.7	0.6	11.2	9.4	9.3	0.6	0.6	0.6	28
Hindustan Zinc	REDUCE	260	235	(10)	1,100	15.4	4,225	20	20	21	(6.0)	-0.1	7.3	13.1	13.1	12.2	8.0	7.4	6.6	3.2	2.9	2.7	24	23	23	7.7	3.8	4.1	4.5
Jindal Steel and Power	REDUCE	138	165	20	133	1.9	968	5.3	7.4	15	163	39	106	26	18.6	9.1	6.3	6.1	5.3	0.4	0.4	0.4	1.7	2.3	4.7	—	—	—	26
JSW Steel	SELL	278	285	3	672	9.4	2,406	31	23	27	14.6	(25)	18	9.0	12.0	10.2	6.3	7.6	6.8	2.1	1.8	1.6	25	16.0	16.5	1.2	1.2	1.2	23
National Aluminium Co.	BUY	61	82	35	117	1.6	1,933	9.7	7.1	6.9	233	(26.1)	-3.2	6.3	8.5	8.8	2.7	3.8	4.0	1.1	1.1	1.1	17.3	12.5	12.1	9.9	9.9	9.9	5.6
NMDC	REDUCE	91	115	27	286	4.0	3,164	12.3	10.1	10.6	5.2	(19)	5.1	7.3	9.0	8.6	4.4	5.4	5.0	1.1	1.1	0.0	15.5	11.9	12.0	6.1	6.1	6.1	5.6
Tata Steel	ADD	457	610	34	517	7.2	1,205	90	81	93	34	(10.2)	15	5.1	5.6	4.9	5.2	5.8	5.5	0.8	0.8	0.7	17.3	14.2	14.9	2.2	2.2	2.2	60
Vedanta	BUY	192	290	51	712	10.0	3,717	19	30	32	-13.1	60	6.1	10.2	6.4	6.0	5.5	4.3	3.9	1.1	1.0	0.9	10.8	16.2	15.7	4.2	4.7	5.0	37
<b>Metals &amp; Mining</b>	<b>Attractive</b>				<b>3,994</b>	<b>55.9</b>					<b>16</b>	<b>-0.6</b>	<b>11.3</b>	<b>8.6</b>	<b>8.7</b>	<b>7.8</b>	<b>5.6</b>	<b>5.6</b>	<b>5.1</b>	<b>1.2</b>	<b>1.1</b>	<b>1.0</b>	<b>14.1</b>	<b>13.0</b>	<b>13.2</b>	<b>4.1</b>	<b>3.2</b>	<b>3.3</b>	<b>24</b>

Source: Company, Bloomberg, Kotak Institutional Equities estimates

## Kotak Institutional Equities: Valuation summary of KIE Universe stocks

Company	Rating	Price (Rs)	Fair Value	Upside	Mkt cap.		O/S shares	EPS (Rs)			EPS growth (%)			P/E (X)			EV/EBITDA (X)			P/B (X)			RoE (%)			Dividend yield (%)			ADVT 3mo	
		22-Jan-19	(Rs)	(%)	(Rs bn)	(US\$ bn)	(mn)	2019E	2020E	2021E	2019E	2020E	2021E	2019E	2020E	2021E	2019E	2020E	2021E	2019E	2020E	2021E	2019E	2020E	2021E	2019E	2020E	2021E	(US\$ mn)	
<b>Oil, Gas &amp; Consumable Fuels</b>																														
BPCL	REDUCE	354	275	(22)	767	10.7	1,967	30	33	36	(25)	10.0	8.1	11.7	10.7	9.9	8.6	7.6	7.0	1.9	1.7	1.6	16.6	16.8	16.6	3.4	3.8	4.1	26	
Coal India	ADD	228	290	27	1,414	19.8	6,207	23	24	25	107	3.8	1.6	9.7	9.4	9.2	7.1	6.3	6.0	5.8	6.7	7.7	6.0	66	78	8.8	11.0	11.0	24	
HPCL	SELL	242	185	(24)	369	5.2	1,524	28	27	29	(33)	(3.7)	7.6	8.6	9.0	8.3	7.7	8.2	8.1	1.4	1.3	1.2	17.1	15.1	15.1	4.7	4.5	4.9	27	
IOCL	SELL	136	120	(12)	1,320	18.5	9,479	15	15	17	(25)	(2.1)	12.8	8.8	9.0	8.0	5.2	5.1	4.5	1.1	1.0	1.0	12.8	11.8	12.5	4.5	4.4	5.0	30	
Oil India	BUY	171	200	17	194	2.7	1,135	22	26	26	(9.6)	15	1.2	7.6	6.6	6.5	5.1	4.4	4.4	0.7	0.6	0.6	8.9	9.8	9.4	5.2	6.0	6.1	3.7	
ONGC	BUY	144	190	32	1,852	25.9	3,752	19	22	21	11.3	12.1	-3.4	7.4	6.6	6.9	3.7	3.4	3.3	0.8	0.7	0.7	10.7	11.3	10.3	4.7	5.2	5.2	23	
Reliance Industries	SELL	1,235	1,070	(13)	7,307	102.3	5,922	67	78	89	13.0	17	14.2	18.5	15.8	13.8	12	10.3	8.6	2.2	2.0	1.8	11.8	12.3	12.5	0.5	0.6	0.6	144	
<b>Oil, Gas &amp; Consumable Fuels</b>	<b>Attractive</b>				<b>13,224</b>	<b>185.2</b>						<b>5.4</b>	<b>10.3</b>	<b>7.3</b>	<b>12.4</b>	<b>11.3</b>	<b>10.5</b>	<b>7.8</b>	<b>7.0</b>	<b>6.3</b>	<b>1.6</b>	<b>1.5</b>	<b>1.4</b>	<b>13.3</b>	<b>13.5</b>	<b>13.3</b>	<b>2.7</b>	<b>3.1</b>	<b>3.2</b>	<b>279</b>
<b>Pharmaceuticals</b>																														
Aurobindo Pharma	ADD	789	785	(1)	462	6.5	584	41	59	67	-0.8	43	12.6	19.0	13.3	11.8	13	9.0	7.9	3.3	2.7	2.3	19.0	21	19.2	0.7	0.8	0.9	30	
Biocon	SELL	669	345	(48)	401	5.6	601	9.5	15	19	53	61	21	70	44	36	34	23	19	6.4	5.8	5.1	9.6	13.9	14.3	0.5	0.8	1.0	17.7	
Cipla	BUY	507	600	18	409	5.7	805	20	26	35	14.7	28	37	25	19.7	14.3	14	11.2	8.3	2.6	2.3	2.1	10.6	12.5	14.5	0.8	1.1	1.5	20	
Dr Reddy's Laboratories	REDUCE	2,640	2,400	(9)	438	6.1	166	109	134	160	85	23	20	24	19.7	16.5	14	9.8	7.9	3.1	2.7	2.4	13.5	13.9	14.5	0.6	0.8	0.9	32	
Laurus Labs	BUY	375	460	23	40	0.6	106	14.9	28	33	(6.1)	85	21	25	13.6	11.3	12	8.0	6.9	2.5	2.1	1.8	10.1	16.5	15.6	—	—	—	0.3	
Lupin	REDUCE	865	830	(4)	392	5.5	450	27	37	48	(30)	39	30	33	24	18.1	16	11.2	8.8	2.7	2.4	2.2	8.5	10.8	12.0	0.5	0.6	0.8	22	
Sun Pharmaceuticals	ADD	419	475	13	1,005	14.1	2,406	16	22	26	5.8	35	22	26	19.3	15.9	14	9.9	8.1	2.5	2.2	2.0	9.8	12.1	12.5	0.5	1.0	1.3	89	
Torrent Pharmaceuticals	NR	1,918	—	—	325	4.5	169	46	61	78	14.3	32	28	42	32	25	17	15	13	6.3	5.5	4.7	15.0	17.4	19.3	0.7	0.9	1.2	6.1	
<b>Pharmaceuticals</b>	<b>Neutral</b>				<b>3,471</b>	<b>48.6</b>					<b>8.7</b>	<b>36</b>	<b>23</b>	<b>28</b>	<b>21</b>	<b>16.8</b>	<b>15</b>	<b>11.1</b>	<b>9.1</b>	<b>3.1</b>	<b>2.7</b>	<b>2.4</b>	<b>11.1</b>	<b>13.3</b>	<b>14.4</b>	<b>0.6</b>	<b>0.9</b>	<b>1.1</b>	<b>218</b>	
<b>Real Estate</b>																														
Brigade Enterprises	BUY	206	290	41	28	0.4	136	22	27	34	99	25	24	9.4	7.5	6.0	8.6	7.0	5.3	1.1	1.0	0.9	12.4	13.8	15.0	1.2	1.2	1.2	0.4	
DLF	RS	180	—	—	321	4.5	1,784	7.5	6.9	14.3	(70)	-8.4	107	24	26	12.6	24	29	13	0.9	0.9	0.8	3.8	3.4	6.7	1.1	1.1	1.1	15.3	
Godrej Properties	SELL	734	400	(45)	168	2.4	216	7.1	23	24	(35)	231	4.2	10.3	31	30	173	28	28	4.9	4.3	3.7	5.8	14.6	13.3	—	—	—	2.7	
Oberoi Realty	BUY	448	460	3	163	2.3	340	46	34	57	265	(27)	66	9.6	13.1	7.9	10.7	16	5.7	1.7	1.6	1.3	21	12.5	18.0	0.4	0.4	0.4	2.5	
Prestige Estates Projects	ADD	216	270	25	81	1.1	375	6.4	7.5	8.1	(35)	17	7.5	34	29	27	11.1	11.5	11.6	1.7	1.6	1.5	5.0	5.6	5.8	0.7	0.7	0.7	0.7	
Sobha	REDUCE	505	474	(6)	48	0.7	95	23	36	24	2.4	52	(33)	21	14.2	21	12.0	9.1	11.3	2.2	2.0	1.9	9.0	14.8	9.1	1.4	1.4	1.4	1.2	
Sunteck Realty	REDUCE	336	360	7	49	0.7	140	17	17	38	8.9	3.6	123	20	19.5	8.7	15	14	5.7	1.7	1.5	1.3	8.5	8.2	16.2	0.3	0.3	0.3	1.1	
<b>Real Estate</b>	<b>Neutral</b>				<b>858</b>	<b>12.0</b>					<b>(33)</b>	<b>1.9</b>	<b>58</b>	<b>21</b>	<b>21</b>	<b>13.0</b>	<b>17</b>	<b>17</b>	<b>10.3</b>	<b>1.4</b>	<b>1.3</b>	<b>1.2</b>	<b>6.7</b>	<b>6.5</b>	<b>9.4</b>	<b>0.7</b>	<b>0.7</b>	<b>0.7</b>	<b>24</b>	
<b>Retailing</b>																														
Aditya Birla Fashion and Retail	BUY	203	230	13	157	2.2	773	2.3	3.7	5.6	51	59	53	88	56	36	26	20	16	12	10	7.9	15.0	20	24	—	—	—	3.4	
Avenue Supermarts	SELL	1,358	915	(33)	847	11.9	624	15	20	26	25	32	29	88	67	52	51	38	30	15	12	9.9	18.7	20	21	—	—	—	0.0	
Titan Company	REDUCE	983	800	(19)	872	12.2	888	16	20	25	28	25	20	60	48	40	40	31	25	14	12	10	26	27	27	0.5	0.6	0.7	36	
<b>Retailing</b>	<b>Cautious</b>				<b>1,876</b>	<b>26.3</b>					<b>28</b>	<b>30</b>	<b>26</b>	<b>72</b>	<b>56</b>	<b>44</b>	<b>42</b>	<b>32</b>	<b>26</b>	<b>14</b>	<b>12</b>	<b>9.8</b>	<b>20.0</b>	<b>21</b>	<b>22</b>	<b>0.2</b>	<b>0.3</b>	<b>0.3</b>	<b>39</b>	
<b>Speciality Chemicals</b>																														
Castrol India	SELL	166	140	(16)	164	2.3	989	6.9	7.4	8.1	0.6	7.3	8.9	24	22	21	15	14	13	16	16	16	66	70	77	3.3	3.8	4.1	2.8	
Pidlite Industries	REDUCE	1,153	915	(21)	585	8.2	508	20	24	28	6.2	22	18	59	48	41	38	32	27	14	12	10	26	27	27	0.6	0.7	0.8	9.5	
S H Kelkar and Company	BUY	173	240	39	25	0.3	145	7.2	9.5	11.4	(3.4)	32	20	24	18.2	15.1	18	13	11.3	2.7	2.4	2.2	11.6	14.0	15.1	1.0	1.2	1.6	0.4	
SRF	BUY	2,071	2,200	6	119	1.7	57	100	132	150	24	32	14.1	21	15.7	13.8	11.9	9.5	8.1	2.9	2.5	2.2	15.0	17.3	17.0	0.6	0.7	0.8	12.7	
<b>Speciality Chemicals</b>	<b>Neutral</b>				<b>894</b>	<b>12.5</b>					<b>7.7</b>	<b>21</b>	<b>14.8</b>	<b>38</b>	<b>31</b>	<b>27</b>	<b>23</b>	<b>19</b>	<b>17</b>	<b>8.8</b>	<b>7.7</b>	<b>6.7</b>	<b>23</b>	<b>24</b>	<b>24</b>	<b>1.1</b>	<b>1.3</b>	<b>1.4</b>	<b>25</b>	

Source: Company, Bloomberg, Kotak Institutional Equities estimates

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Company	Rating	Price (Rs)	Fair Value	Upside	Mkt cap.		O/S shares	EPS (Rs)			EPS growth (%)			P/E (X)			EV/EBITDA (X)			P/B (X)			RoE (%)			Dividend yield (%)			ADVT 3mo
		22-Jan-19	(Rs)	(%)	(Rs bn)	(US\$ bn)	(mn)	2019E	2020E	2021E	2019E	2020E	2021E	2019E	2020E	2021E	2019E	2020E	2021E	2019E	2020E	2021E	2019E	2020E	2021E	2019E	2020E	2021E	(US\$ mn)
<b>Telecommunication Services</b>																													
Bharti Airtel	ADD	305	360	18	1,219	17.1	3,997	(8.5)	(9.2)	(4.2)	NM	NM	NM	NM	NM	NM	9.4	8.4	7.1	2.0	2.3	2.5	NM	NM	NM	2.0	2.0	2.0	34
Bharti Infratel	REDUCE	278	270	(3)	514	7.2	1,850	13.2	12.8	14.3	(4.1)	(2.7)	11.6	21	22	19.4	7.9	8.1	7.4	3.2	3.1	3.1	14.7	14.6	16.0	3.9	3.8	4.2	9.9
Vodafone Idea	NR	34	—	—	293	4.1	4,359	(10.7)	(2.4)	(6.9)	NM	NM	NM	NM	NM	NM	33	11.7	10.2	0.4	0.6	0.7	NM	NM	NM	—	—	—	12.6
Tata Communications	ADD	515	580	13	147	2.1	285	(3.8)	2.9	5.0	NM	176	74	NM	178	102	9.9	9.0	8.3	NM	NM	930	NM	NM	NM	1.3	1.5	1.5	2.9
<b>Telecommunication Services</b>	<b>Cautious</b>				<b>2,171</b>	<b>30.4</b>					<b>NM</b>	<b>12.1</b>	<b>24</b>	<b>NM</b>	<b>NM</b>	<b>NM</b>	<b>12</b>	<b>9.2</b>	<b>7.9</b>	<b>1.5</b>	<b>1.4</b>	<b>1.5</b>	<b>NM</b>	<b>NM</b>	<b>NM</b>	<b>2.0</b>	<b>2.0</b>	<b>2.1</b>	<b>59</b>
<b>Transportation</b>																													
Adani Ports and SEZ	BUY	391	403	3	809	11.3	2,071	20	23	29	10.2	10.9	27	19.2	17.3	13.6	14	11.8	10.6	3.4	2.9	2.4	18.7	18.0	19.4	0.3	0.5	0.4	19.5
Container Corp.	SELL	670	590	(12)	326	4.6	487	20	24	28	9.2	21	16	34	28	24	20	16	14	3.3	3.0	2.8	10.0	11.3	12.2	1.5	1.8	1.7	8.5
Gateway Striparks	BUY	108	195	80	12	0.2	109	7.4	5.8	8.5	(3.0)	(21)	46	14.7	18.5	12.7	18	7.2	6.1	1.1	1.9	1.6	7.6	7.4	13.8	—	2.8	2.8	0.3
Gujarat Pipavav Port	BUY	87	136	57	42	0.6	483	4.9	6.1	7.3	20	24	19	17.6	14.2	11.9	9.0	7.2	6.0	2.0	2.0	2.0	11.7	14.3	16.7	4.8	5.9	6.9	0.3
InterGlobe Aviation	BUY	1,121	1,220	9	431	6.0	383	(21)	36	82	(136)	271	124	NM	31	13.7	NM	18	7.2	6.8	5.7	4.2	NM	20	35	—	0.2	0.7	18.1
Mahindra Logistics	REDUCE	502	510	2	36	0.5	71	13.0	19	24	33	45	30	39	27	21	21	15	11.3	7.2	5.9	4.8	20	24	26	—	—	—	0.4
<b>Transportation</b>	<b>Attractive</b>				<b>1,656</b>	<b>23.2</b>					<b>(35)</b>	<b>62</b>	<b>43</b>	<b>35</b>	<b>21</b>	<b>15.0</b>	<b>21</b>	<b>13</b>	<b>9.8</b>	<b>3.8</b>	<b>3.3</b>	<b>2.8</b>	<b>10.9</b>	<b>15.6</b>	<b>18.8</b>	<b>0.5</b>	<b>0.8</b>	<b>0.9</b>	<b>47</b>
<b>KIE universe</b>					<b>106,615</b>	<b>1493.1</b>					<b>16</b>	<b>30</b>	<b>16</b>	<b>22</b>	<b>17.2</b>	<b>14.7</b>	<b>11.0</b>	<b>9.6</b>	<b>8.5</b>	<b>2.7</b>	<b>2.4</b>	<b>2.2</b>	<b>11.9</b>	<b>14.0</b>	<b>14.7</b>	<b>1.4</b>	<b>1.8</b>	<b>1.9</b>	
<b>KIE universe (ex-Oil, Gas &amp; Consumable Fuels)</b>					<b>93,391</b>	<b>1307.9</b>					<b>20</b>	<b>36</b>	<b>19</b>	<b>25</b>	<b>18.5</b>	<b>15.6</b>	<b>12</b>	<b>10.6</b>	<b>9.3</b>	<b>2.9</b>	<b>2.6</b>	<b>2.4</b>	<b>11.6</b>	<b>14.1</b>	<b>15.0</b>	<b>1.3</b>	<b>1.6</b>	<b>1.8</b>	

Notes:

(a) We have used adjusted book values for banking companies.

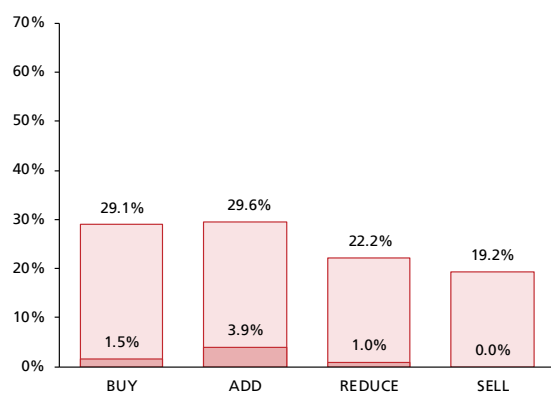
(b) 2019 means calendar year 2018, similarly for 2020 and 2021 for these particular companies.

(c) Exchange rate (Rs/US\$)= 71.40

Source: Company, Bloomberg, Kotak Institutional Equities estimates

**Kotak Institutional Equities Research coverage universe**

Distribution of ratings/investment banking relationships



Percentage of companies covered by Kotak Institutional Equities, within the specified category.

Percentage of companies within each category for which Kotak Institutional Equities and or its affiliates has provided investment banking services within the previous 12 months.

\* The above categories are defined as follows: Buy = We expect this stock to deliver more than 15% returns over the next 12 months; Add = We expect this stock to deliver 5-15% returns over the next 12 months; Reduce = We expect this stock to deliver -5+5% returns over the next 12 months; Sell = We expect this stock to deliver less than -5% returns over the next 12 months. Our target prices are also on a 12-month horizon basis. These ratings are used illustratively to comply with applicable regulations. As of 31/12/2018 Kotak Institutional Equities Investment Research had investment ratings on 203 equity securities.

Source: Kotak Institutional Equities

As of December 31, 2018

**Ratings and other definitions/identifiers**

**Definitions of ratings**

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

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

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

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

Our Fair Value estimates are also on a 12-month horizon basis.

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