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ECONOMIC GROWTH

September 2020

Market Outlook

- Dollar index
- Economic recovery
- Rising FII flows
- Government divestment
- Top picks

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Sanjeev Zarbade
Sanjeev.zarbade@kotak.com
+91 22 6218 6424

MARKET OUTLOOK FOR SEPTEMBER 2020

Major global markets rallied in August

The month of August saw the US markets further rallying on the back of continued ample liquidity support and global pool of low-yielding debt driving investors into riskier assets. Hopes of an early availability of Vaccine also kept sentiments high. On a YTD basis, the S&P 500 is now trading in the positive zone, though bulk of the gains have been driven by the five tech stocks (Facebook, Amazon, Apple, Microsoft and Google). Indian markets also participated in the global rally, as foreign fund flows were robust - aided by sharp decline in the US Dollar. On the US economy side, there has been some slack in recent employment numbers even as Covid-19 infections are not falling at a desired pace. This prompted the Fed to move to an average inflation target – meaning rates are likely to stay low even if inflation rises a bit in the future. The US Dollar index continued to remain weak as rising Covid infections, weakening economic growth and rising fiscal deficit weighed on the USD.

Despite rising cases of infections and some stagnation in economic indicators, the Indian equities continued to rally aided by robust foreign fund flows. The month of August saw the highest FII purchases at USD 635 cr in CY20 (Bloomberg and Kotak Institutional Equities). Surprisingly, FII flows in other emerging Asian markets were negative for the month. The market rally in Indian equities was more broad based as the Mid and Small cap indices outperformed sharply relative to the Sensex. Beaten down sectors like Realty, Power, Banks saw smart gains.

During the month, the demand for industrial products like Diesel and Power remained subdued, indicating that the pace of economic recovery post lockdown is stalling. Consumer inflation remained at higher levels despite demand contraction in the economy. This has left little room for the RBI to cut rates. Real interest rates have already become zero. In this backdrop, investors are hoping for a fresh stimulus from the government to boost demand. The Maharashtra government has already announced a three percentage point cut in stamp duty, to encourage real estate sales. To shore up revenues, the government is working on completing the stake sale process of about 23 public sector companies whose divestment has already been cleared by the Cabinet. (Financial Express).

Earnings Outlook

We expect net profits of the Nifty-50 Index to rise by 2% and 34.3% in FY21E and FY22E, respectively. We would clarify that FY21E estimates are not very relevant given the impact of Covid pandemic on domestic and global economy, which will result in a sharp decline in both volumes and profitability in many sectors. We would note that the modest decline in net profits in FY21E hides bigger decline in operating profits as FY20 profit was impacted negatively by large adventitious and inventory losses of the downstream oil companies and RIL. We expect a steep recovery in the net profits of the Nifty-50 Index in FY22E from the low levels of FY21E.

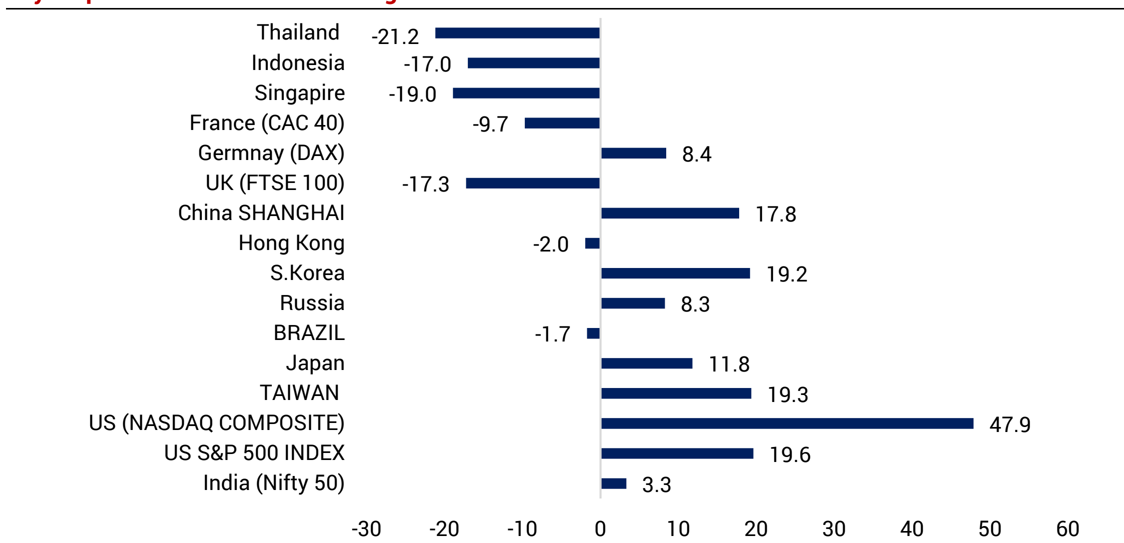
Valuation and Outlook

At this juncture, we can loosely demarcate the Indian market into three parts—'Covid-proof', 'Covid-recovery' and 'value'. The 'Covid-proof' sectors (consumer staples, IT services, pharmaceuticals, and telecom) are mostly fully valued with current prices above pre-Covid levels despite earnings downgrades in most cases. The 'Covid-recovery' sectors are fairly valued with high upside or downside risks depending on how the Covid-19 situation evolves. The 'value' sectors (Utility stocks and PSUs) continue to languish at low valuations and have seen re-rating in a few cases on specific 'value-unlocking' steps being taken by the majority shareholders/management. Last three months have seen sectoral rotation which has led to rerating in some of the underperforming sectors and large cap stocks. There has been a broad

catch-up rally in most mid and small caps even though earnings hit is higher in these segments. Active participation of retail investors in direct equities has gone up abruptly, which is reflected in the sharp up moves in small cap stocks.

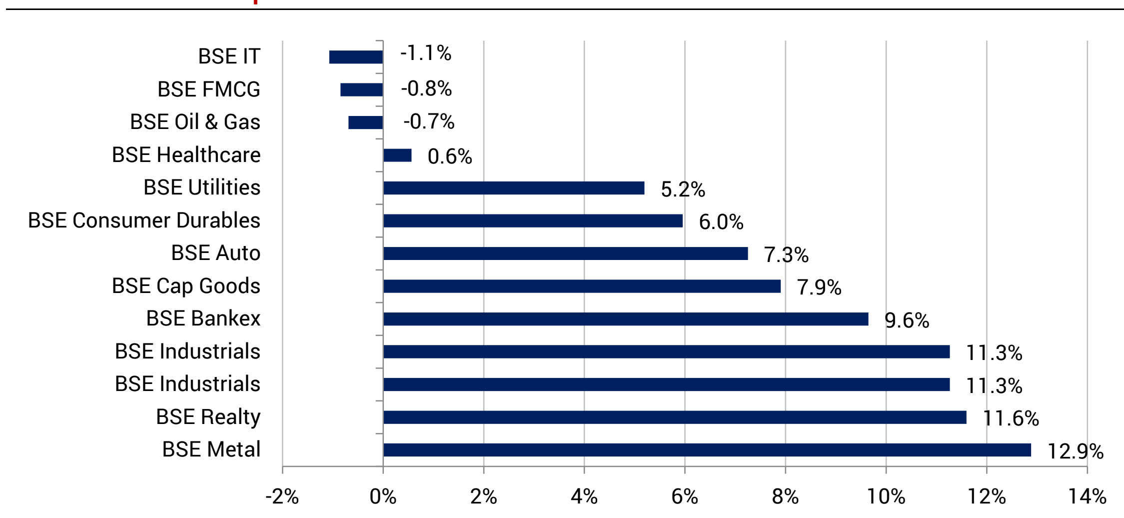
On the valuation front, the gap between G-sec bond yield and earnings yield has begun to widen as market valuations have inched up. Today, the Earnings yield based on Nifty-50 Fw PE of 22x works to just 4.5% whereas the 10 Yr G-Sec yield today stands at 6.18%. We doubt bond yields can fall sharply from current levels unless the RBI was to adopt a very unorthodox approach in terms of negative real interest rates. We do expect inflation to come down but that may not warrant a rate cut by the RBI. The Nifty-50 on our updated earnings is trading at 25.3x on FY21E and 18.8x on FY22E. The one year forward PE of Nifty at 22x looks very expensive. The overall risk-reward balance has become unfavorable. Hence one needs to remain ultra-cautious on markets from hereon. It will be ideal to have a bottoms up approach on individual stocks based on their merit. In value stocks, one needs to differentiate between value trap and growth oriented companies. The valuation gap between large-caps and mid-caps has narrowed in August, however, the mid & small cap space is vast and there is still some scope for individual stock picking.

1-year performance of benchmark global indices



Source: Bloomberg

1-month BSE sectoral performance



Source: Bloomberg

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TOP INVESTMENT IDEAS

Company	Rating	Price (Rs) 1st Sep 20	Fair Value (Rs)	Upside/ Downside (%)	Mkt cap. (Rs Cr)	EPS (Rs) FY21E	EPS (Rs) FY22E	EPS growth (%) FY21E	EPS growth (%) FY22E	P/E (x) FY21E	P/E (x) FY22E	P/BV (x) FY21E	P/BV (x) FY22E	RoE (%) FY21E	RoE (%) FY22E
JSPL	BUY	218	270	23.9	22,251	8.6	19.0	213.0	120.0	25.3	11.5	0.6	0.6	2.7	5.7
Bharti Airtel	BUY	547	710	29.8	2,98,282	4.8	13.8	NM	NM	114.0	39.6	4.6	4.3	3.8	12.1
GAIL	BUY	96	140	45.2	43,477	7.6	11.0	-42.1	44.8	12.7	8.8	1.0	0.9	7.7	10.6
JK Lakshmi	BUY	263	340	29.3	3,096	16.0	27.4	-32.0	71.4	16.4	9.6	1.7	1.4	10.6	16.2
PGCIL	BUY	180	220	22.2	94,299	22.0	25.0	6.3	16.1	8.2	7.2	1.3	1.2	17.2	18.3
DCB Bank	BUY	89	150	68.5	2,773	9.3	10.3	-14.7	10.4	9.6	8.6	0.9	0.9	8.7	8.9
Avenue Supermarts	SELL	2,241	1,480	-34.0	1,45,176	20.0	39.0	-4.4	92.8	112.1	57.5	11.8	9.8	11.1	18.4
ICICI Lombard	SELL	1,251	950	-24.1	56,833	32.1	34.3	22.0	7.0	39.0	36.5	7.7	6.7	21.0	20.0

Source: Kotak Institutional Equities. For details refer to KIE India Daily report dated 1st September 2020; Note: Earnings season has started and KIE would be changing their earnings estimates, price targets and ratings of above companies as and when their results are out in near future.

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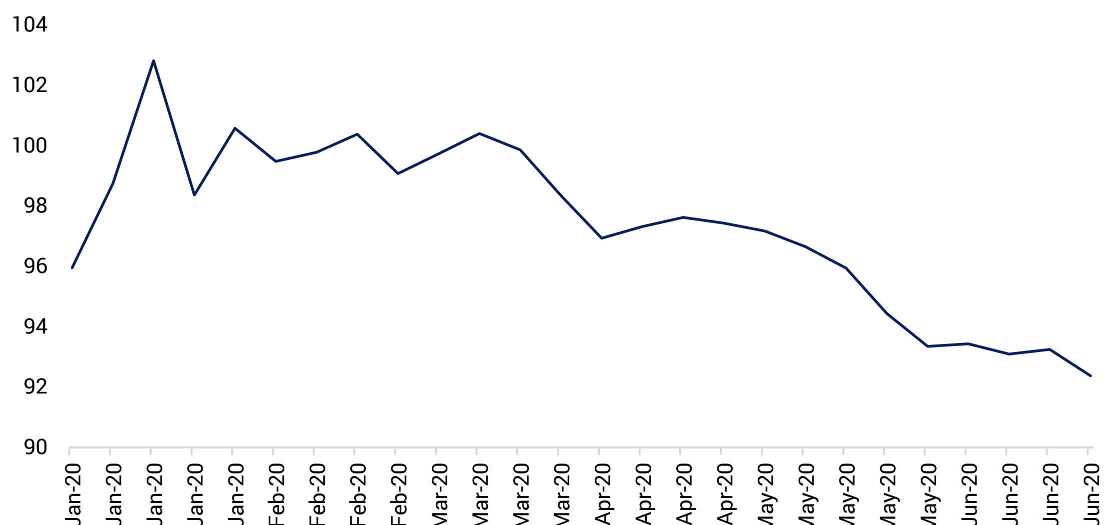
INTERNATIONAL MARKETS

US Dollar declines to two year low on signs of stalling economic recovery

During the month, the US Dollar slipped to two-year low as investors were worried that a recovery in the economy would be hampered by delay in limiting the spread of the Covid-19 virus. High-frequency data suggests the economy is losing steam in recent weeks after a rebound from rock-bottom levels hit in April. The U.S. Labor Department data showed initial claims for unemployment benefits increased to a seasonally adjusted **11 lakh** in the week ending August 15, a sign that recovery in the employment market is stalling.

US Dollar Index



Source: Bloomberg

Fed announces historic changes to monetary policy strategy

In a major reset of the Fed's monetary policy, the Fed Chairman announced the following changes -

- Policy shift to "average inflation targeting". That means the central bank will be more inclined to allow inflation to run higher than the standard 2% target before hiking interest rates.
- In addition to the inflation change, the Fed shifted its approach to employment in a way that will focus on those at the lower end of the income spectrum. As a practical matter, the move means the Fed will be less inclined to hike interest rates when the unemployment rate falls, so long as inflation does not creep up as well.
- Investors and traders welcomed the policy as it meant that the Fed's zero interest rate policy will be in place even longer.

Eurozone – Uncertainty on economic outlook

European Central Bank policy makers expressed uncertainty at their latest policy meeting about the economic outlook and the extent to which they'll have to deploy monetary stimulus (Source: Bloombergquint). Top ECB policymakers voiced fears that the labour market was lagging behind the rest of the economy at their monetary policy meeting last month. Chief Economist Philip Lane stressed that the ECB expects a very gradual recovery after the initial rebound and suggested a clear willingness to do more if needed in order to bring inflation back to target.

US and China trade talks resume

U.S. and Chinese trade negotiators resumed discussions about implementing the phase one agreement between the two countries. The discussions started after a planned six-month review of the deal set for Aug. 15, which was delayed by US President Donald Trump. Tensions between the world's two largest economies have escalated over the last two years, beginning with a focus on trade and spilling over into technology and finance.

Crude Oil prices inched up in August

Daily Brent crude oil spot price averaged $44.6 per barrel in August. EIA expects monthly Brent spot prices will average $43/bbl during the second half of 2020 and rise to an average of $50/bbl in 2021. From an Indian standpoint, lower crude prices will be supportive in reducing inflation which has risen in recent months and also help in reducing the current account deficit and fiscal deficit.

Crude oil price (USD/barrel)

Source: Bloomberg

DOMESTIC MARKETS

Update on economic developments

Q1FY21 – GDP contracts more than expected.

Real GDP growth was at (-)23.9% (much lower than our estimate of (-)16%; consensus at (-)18.8% and (-)18%). Private consumption contracted 26.7% while investment (GFCF) contracted 47.1% (inventory and valuables also contracted). Government spending, as expected, grew 16.4%. We assume a gradual recovery towards pre-Covid level in the large segments such as manufacturing, construction, and trade. We revise down our FY21E GDP estimate to (-)11.5% from our earlier estimate of (-)5.8% factoring in weak investment and consumption growth cycle reflecting in weak manufacturing, construction, and trade segments. Unless the Covid spread is brought under control, discretionary consumption will remain under pressure, we believe. Given this, the government should focus on (1) ensuring adequate resources are available to states to spend at a local level, (2) easing administrative hurdles towards manufacturing/construction, (3) shift resources towards pushing construction (infrastructure projects and real estate), and (4) ensuring permanent employment/income generation instead of temporary income sources.

Another rate cut unlikely in near future

July CPI inflation came in significantly higher than expected at 6.93% as against an upward revised print of 6.23% for June amid increasing momentum. Despite weakness in economic activity, core inflation went up further to 5.4% (5.1% in June). We expect CPI inflation to remain high over the next few months owing to the persistence of supply-side disruptions. Gold prices are also likely to retain pressure on core inflation. At the same time, excise duty hikes have been passed through and there are signs of some moderation in pump prices in August. On the policy front, we believe that July CPI reading will squeeze the space for additional monetary easing in the near term. Given the MPC's guidance related to awaiting a durable reduction in CPI inflation before easing the repo rate further, we see limited scope for a rate cut until the December policy. The MPC may then take a call depending on the inflation trajectory.

Current account surplus likely in FY21. Rupee to remain in 74-77.5 range.

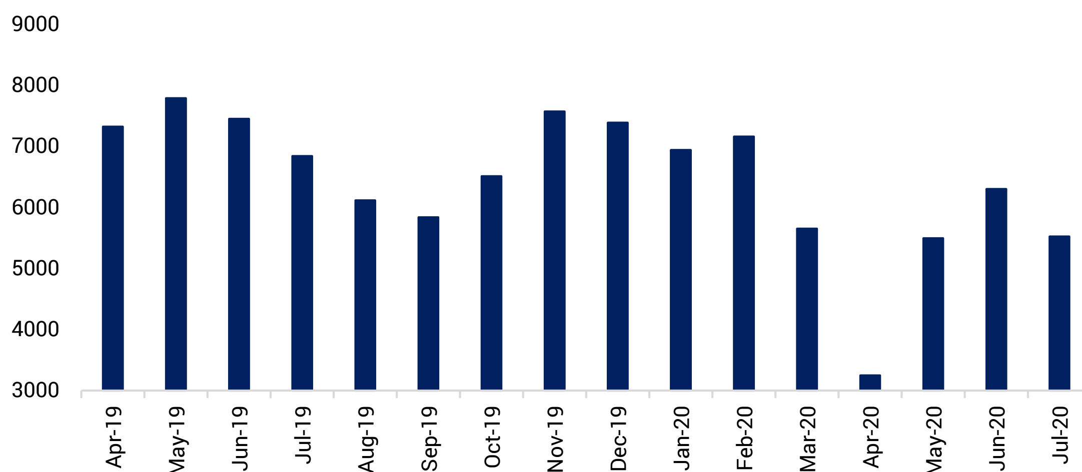
July exports fell by 10.2% on year-on-year basis to US$2,360 cr, but registered a sequential growth of 7.9% on month-on-month basis. Given the low crude oil prices, oil exports (US$180 cr) fell by 49.3%. Meanwhile, non-oil exports have almost recovered to last year's levels, falling by just 3.8%. July imports contracted 28.4% to US$2850 cr but registered a sequential growth of 34.8%, due to normalization in domestic economic activity. July trade balance turned back to deficit owing to a sharp sequential pick-up in import activity, mirroring the trend in high frequency data as economic activity starts normalizing. With oil prices likely to remain stable (average of US$40/bbl), we expect the current account to register a surplus ~0.5% of GDP. On the capital account front, we expect FDI flows to remain buoyant.

The INR outlook will also depend on the extent of global liquidity, US-China tensions, geopolitics and the proliferation of Covid-19. We continue to see USD-INR in the range of 74-77.5.

High frequency economic indicators show some degree of stagnation

We note that certain high-frequency economic indicators show some level of stagnation— (1) diesel sales declined 19.3% in July 2020 versus 15.4% in June 2020; diesel volumes are a good indicator of freight movement and general economic activity, and (2) Electricity consumption in India, over the seven day period ending August 26, was 10% lower than electricity consumption in the similar period in 2019. June IIP growth fell by 16.6% as against a fall of 33.9% in May (slight upward revision).

Monthly high speed diesel consumption (000) tons



Source – Kotak Institutional Equities Report.

FY2021 monsoon: normal rainfall till now

Till August 26, cumulative rainfall was 8% above long-term average (LTA). On a cumulative basis, spatial distribution of monsoon has been normal across most parts of India though parts of North and West India have been deficient. of the 36 sub-divisions, to date, three have received deficient rainfall, 21 have received normal rainfall, and 12 have received excess rainfall. As of August 28, the total kharif acreage was 7.2% higher than the same period last year. (Source: IMD and Kotak Institutional Equities)

Cumulative rainfall till 26th August is in surplus on an All India basis

Region	Surplus/Deficiency (%)
All India	8
East & Northeast India	4
Northwest India	(9)
Central India	19
South Peninsula	13

Source: IMD and Kotak Institutional Equities dated 29th Aug 2020

Events to watch out in near term

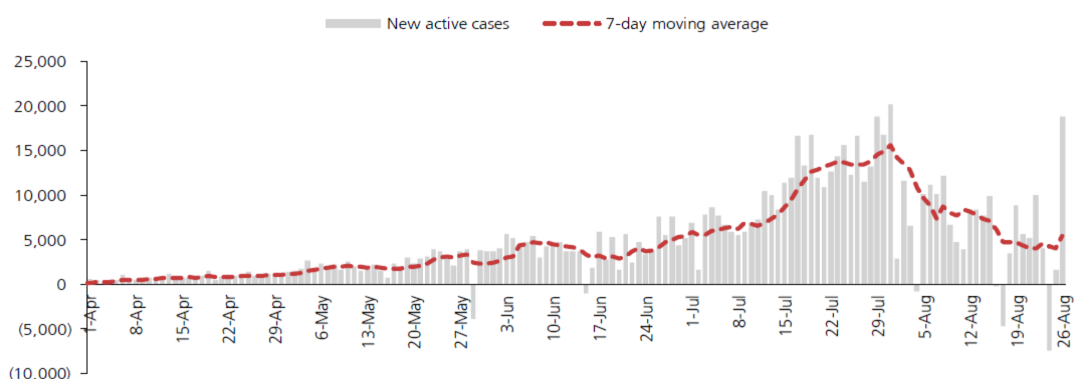
Covid19 update in India as on 26th August, 2020, improving but long way to go

The Covid-19 situation did not see much change over the past month with (1) recovery rates continuing to improve; (2) fatality rates remaining low and (3) 'active' cases continuing to rise steadily. A few states have regressed with a sharp increase in cases although there is improvement in a few major cities. However, the number of active cases is yet to plateau. Thus, India will have to live through the Covid-19 pandemic with a great deal of uncertainty for longer, until fresh cases don't start declining.

Few highlights

- The number of recoveries continued to increase, thus, leading to a fall in the growth of active cases
- At the onset of the pandemic, Covid-19 was a predominantly an urban issue. New cases in rural districts, as a proportion of total daily new cases, increased from ~25% at the start of May to more than 60% at the start of August. Over the past week, however, this proportion has flattened and may have started to come down.
- The mortality rate from Covid-19 continued to fall and the case fatality rate is below 2%.
- We also note that decent progress in Covid-19 vaccine trials, with Russia deploying a vaccine on completion of Phase-2 trials. In such a scenario, we ascribe low probability to any major economic disruption in the form of a large-scale lock-down. Also, the continuation of recent 'recovery' trends and the announcement of an effective vaccine would have far-reaching implications for markets especially to sectors that have been worse affected by the pandemic.

Seven-day moving average of change in active cases did not change meaningfully



Source – Kotak Institutional Equities Report.

The Covid-19 crisis requires medical solution, urgently.

News from across the globe on potential vaccine progress is lifting broader market sentiment. Currently markets are desperate to latch onto any positive developments in the vaccine field.

Status update on Vaccines

- Six vaccine candidates have started Phase 3 clinical trials (last stage before regulatory approval) -- the last step of testing to prove efficacy and safety before seeking approval from regulators -- and three are Chinese.
- To date, just one coronavirus vaccine has been approved. Sputnik V (formerly known as Gam-COVID-Vac and developed by the Gamaleya Research Institute in Moscow) was approved by the Ministry of Health of the Russian Federation on 11 August. However, experts have raised considerable concern about the vaccine's safety and efficacy given it has not yet entered Phase 3 clinical trials.
- Moderna's potential coronavirus vaccine generated a promising immune response in elderly patients in an early stage clinical trial.
- In India, Serum Institute of India's trial for 'Covishield' vaccine developed by the University of Oxford started on August 25th in Pune.

Fresh stimulus measures and reforms

The government has recently hinted at a fresh set of measures – including a review of GST on two-wheelers and possibly a second stimulus, once Covid-19 subsides. The government is also monitoring the stress in the hospitality, tourism, aviation, real estate and construction, which are among the worst affected by the pandemic. There could be more steps and measures aimed at alleviating the hardships due to crippling demand contraction.

In its annual report, the RBI has outlined several reform proposals that need urgent attention. These include - targeted public investment funded by monetisation of assets in steel, coal, power, land, railways and privatisation of major ports by central and state governments under an independent regulator. This could be the way forward to revive private sector investment. To make the manufacturing sector competitive, the RBI suggested the need for creating infrastructure of global standards and an efficient bankruptcy procedure.

Disinvestment Program

The government is working on completing the stake sale process of about 23 public sector companies whose divestment has already been cleared by the Cabinet. The final call as to which are the sectors which are going to be called 'strategic' is not made yet, that has to be announced, but in such Strategic sectors, the public sectors units will be limited to a maximum of four. As per our estimates, the government can raise around Rs 1.6-2.4 lakh crores only (based on current market capitalization) if it was to successfully exit from non-strategic PSUs and trim holdings up to 51% stake in 'strategic' PSUs. Privatization, although delayed, may lead to improvement in earnings/FCF profile and unlock value for minority shareholders.

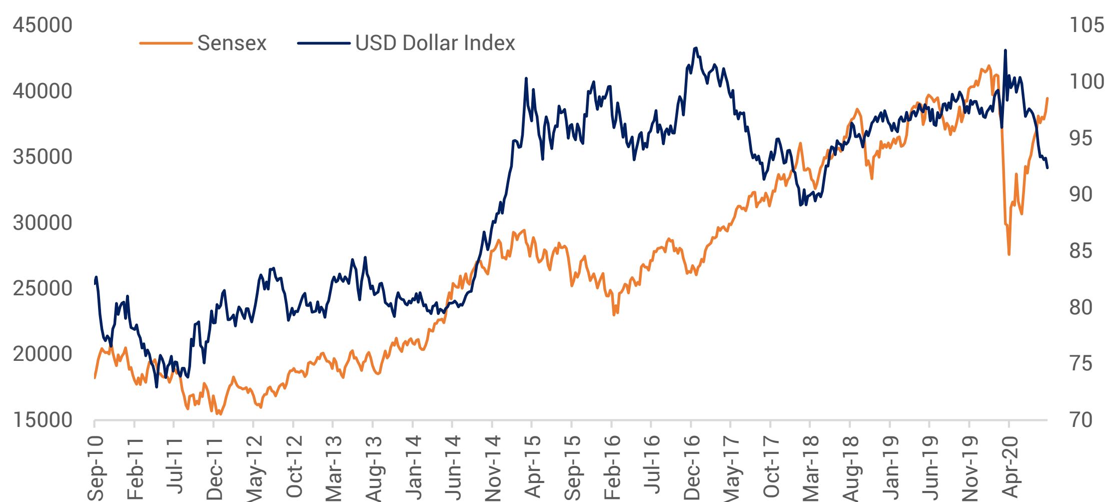
Some of the major Potential PSUs that can be divested

PSU	Market Cap (Rs cr)	Govt Holding (%)
BPCL	88,429	53
Container Corp	23,933	54.8
IRCTC	21,483	87.4
ITI	12,378	90.3
SJVN	9,196	86.8
NLC	7,245	79.2
NALCO	6.688	51.5
RITES	6,143	72
NBCC	4,815	61.8
IRCON	4,211	89.2
EIL	4,224	51.5
BANKS		
BOI	17,777	89.1
IOB	17,423	95.8
CANARA BANK	15,647	78.6

Chart – Kotak Institutional Equities Report.

US Dollar weakness – positive for emerging markets and commodity prices

US Dollar vs Sensex



Source: Bloomberg

The US Dollar index continued to weaken in August as the fiscal position of the US has considerably deteriorated as compared to that of the euro area. Also, the Fed's commitment to unlimited QE requires sustained monetary printing in the US than in the euro area, which is leading to a weaker US dollar. This has positive implications for Emerging market equities and Commodity prices.

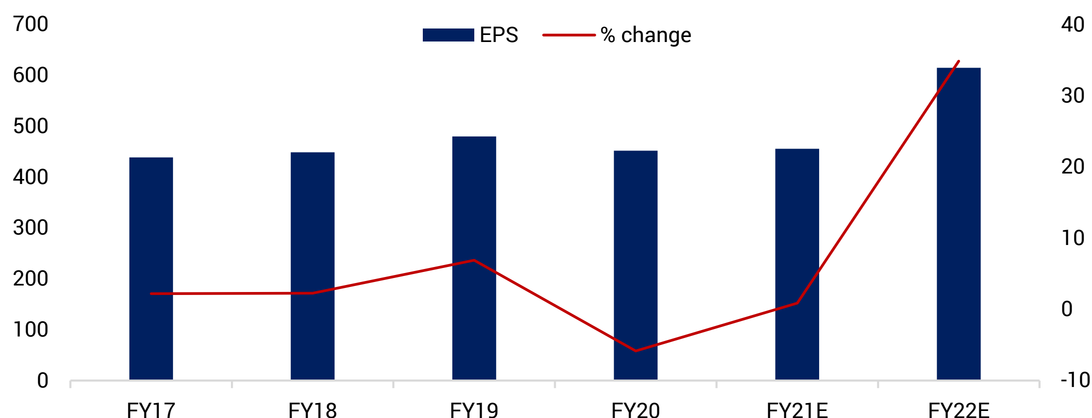
The above chart captures the movement of the dollar index and the Sensex over the last 25 years. It is evident that Sensex and the dollar index have moved in opposite directions on a number of occasions - meaning when the dollar index has weakened, the Sensex has strengthened and vice versa. Just for starters, consider the post Mar-20 scenario. The dollar index is down ~ 10% but the Nifty is up 51% from March 2020 low. The Sensex has been largely driven by portfolio flows from FPIs. It has been seen that portfolio flows tend to gravitate towards emerging markets like India when the dollar shows signs of weakening versus the basket.

Apart from equities, a weak US dollar is clearly positive for commodity prices. This is because consumption of commodities outside US far outweighs that within the US. And so, when the USD declines, commodities become cheaper in non-US local currencies, thus stimulating demand outside the US. With 95% of gold consumers coming from outside the US, the gold price benefits from a weaker US dollar.

Earnings Outlook is dented in FY21E due to Covid-19 but expecting rebound in FY22E

As the Q1FY21 earnings season concludes, we now expect FY21E and FY22E net profits of the Nifty-50 Index to grow at 2% and 34.3% respectively. The slowdown in FY21E Nifty earnings growth is estimated to be driven by Automobiles, Capital Goods, Diversified Financials and Metals and Mining. Banks, Pharma and Commodity Chemicals are expected to report healthy earnings growth for FY21E. However, the earnings growth in Banks remains uncertain on account of slow re-opening of the economy and its impact on NPAs and extension of moratorium on payment of loans. In FY22E, we expect strong broad-based rebound in earnings majorly of Auto, Capital Goods, Cement and Metals and Mining companies.

Trend in Nifty EPS (%)



Source: Kotak Institutional Equities estimates

Highest buying by FIIs in CY20 in August

FIIs were major buyers in the month of August (USD **635 cr**, highest in CYTD). On the other hand, domestic mutual funds were net sellers in August. Systematic Investment Plans (SIP) flows have were steady, though a tad lower on a year-on-year basis.

Monthly SIP flows

Rs cr	FY21	FY20	FY19	FY18	FY17
Total	**32,758**	**100,080**	**92700**	**67190**	**43920**
March		8640	8060	7120	4340
February		8510	8090	6430	4050
January		8530	8060	6640	4100
December		8520	8020	6220	3970
November		8270	7990	5890	3880
October		8250	7990	5620	3430
September		8260	7730	5520	3700
August		8230	7660	5210	3500
July	7831	8320	7550	4950	3330
Jun	7917	8120	7550	4740	3310
May	8370	8180	7300	4580	3190
April	8640	8240	6690	4270	3120

Source: AMFI

KEY SECTORAL OUTLOOK

Automobiles

Two wheeler manufacturers are witnessing recovery in sales volume due to improving retail demand and preference for personal mobility in current situation. We expect two wheeler demand recovery to continue, supported by consumer preference for personal mobility, pent-up demand and dealer channel filling by manufacturers. For the passenger vehicle segment, demand is expected to gradually improve during the course of FY21. Commercial vehicle segment is expected to see slow recovery in demand. Given strong rural economy and normal monsoon, tractor demand is expected to be buoyant.

Banks and diversified financials (NBFCs).

In our view, the pace of economic recovery would be the key for financials stocks and not the proposed resolution framework. A swift recovery in the economy would make such resolutions redundant. In our view, a prolonged NPL cycle could result in de-rating for the Tier-1 names, which are trading at rich multiples. However, a quick recovery in the economy will result in lower concerns about credit costs and sharper re-rating for the Tier-2 and Tier-3 banks and NBFCs.

In our view, a combination of (1) provisions already created by banks and NBFCs in anticipation of higher credit costs, (2) recent and ongoing capital raises and (3) large mark-to-market gains in the investment book of banks may help banks to recognize NPLs/write-off loans and perhaps refocus on lending.

Construction materials

In 1QFY21, cement volumes declined, but realizations saw an improvement on a sequential basis that supported margins. Cement prices seems to have softened (except South) in August 2020 due to seasonality factor. Furthermore, certain cost like pet coke prices has increased recently. Impact of this on margins is expected to reflect in 2HFY21. Cement demand in FY21E is expected to decline in FY21 due to Covid-19 led demand disruption.

IT services

In order to increase business resiliency, pivot to new business models and reduce operating costs, large companies across industries are focusing on continued or higher investments in innovative capabilities and transformation. This will percolate to pull forward of transformation spending, we opine. We believe acceleration in IT services spending can support around 10% growth for many IT companies. Needless to say, TCS and Infosys will be at the forefront of the transformation even as other companies also benefit. Just to highlight, Retailers plan to invest in online platforms and strengthen omni-channel capabilities. Similarly, Consumer firms plan to expand ecommerce sales. Notably, most BFS firms have indicated healthy technology spending outlook in the near term driven by increased digital adoption and pervasive and pivotal role of technology.

Capital Goods

Several Capital Goods majors shared a bleak outlook on capex revival. Though ordering from government projects have continued in the current fiscal, the size of projects has become smaller and lots of projects have gone for retendering and renegotiations. Water, Food & Beverages, pharma and fertilizer did better during the quarter but new investment decisions are taking longer time in finalization. For ordering activity to revive, the government needs to fast-track investments across segments such as T&D, power, renewables, railways, smart infrastructure, etc. to see results over a longer time-frame.

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Metals and Mining

Most companies in Metals and mining industry continue to ramp up volumes on a sequential basis with recovery in domestic demand and strong exports prices. Most companies are gradually recovering the 1QFY21 loss in volumes led by a combination of improvement in domestic demand and higher exports. As far as ferrous (steel) space is concerned, domestic steel consumption declined by 29% in July 2020 whereas production was down by just 21% yoy in July led by export support. Higher domestic steel prices and favorable geographic shift would aid blended realizations. Domestic iron prices remain subdued relative to regional prices whereas coking coal price reduction would accrue in 2QFY21E. We see a sharp margin recovery in 2QFY21E, ahead of seasonal (second half) demand tailwinds.

Consumer Products

The Fear of loss of jobs and income has made people circumspect even as things have started improving post unlock. Macro challenges continue to persist and companies are hopeful of a demand pickup by the end of this year or early next year. While the months of April and May continued to be weak, July/August saw mid-single-digit growth. There is high demand for personal wash products, household care and select food items. Margin outlook is positive with benign crude and other raw material prices (except dairy). Furthermore, low media intensity, strict control of overhead costs and Ind-AS 116 impact should help reported EBITDA margins, even as operating leverage will be a drag for most names. Rural is now growing faster than urban given (a) lower Covid-led disruption, (b) good harvest season and (c) government initiatives. Companies are taking initiatives to support distribution network – judicious deployment of credit to support trade and insurance for distributor partners, among others. They have further accelerated steps to drive digital adoption in the trade.

Pharmaceuticals

Earnings of most of the pharma companies were better as the performance was largely led by significant cost savings and market share gains. However, the benefit was offset to some extent by subdued performance in US. Also API sales showed strong growth trend, this was mainly due to a) less inclination to buy from Chinese players, b) COVID led higher off take of medicines, c) restocking to some extent and d) favourable pricing. As the lockdown eases, marketing spend in the domestic formulation segment is expected to gradually increase. However, the pandemic has led companies to re-evaluate their cost savings initiatives due to increased use of digital mediums. Thus we expect improvement in profitability of domestic formulation segment. Also with reduced inclination of buying from Chinese suppliers, we expect better growth prospects in API space. Reduced international travel is also expected to keep regulatory risk under check of companies, which have sites under compliance.

Construction

Q1FY21 results for most of the construction companies were better than estimates on account of better than expected ramp-up in terms of execution post Covid-19 led lockdown. Most of the construction companies have reported improvement in labour availability on month on month basis. Construction companies are expecting improved efficiency at project sites post monsoon. Construction players under our coverage are targeting improved order inflows in the coming quarters from sectors like roads, railways, urban infra, etc based on pipeline of projects. Orders from NHAI has also ramped up with 1200 km of projects already awarded and another 1800 km to be awarded by Sept 2020. With gradual ramp-up of execution and inflows, we expect uptick in revenue for the construction companies under coverage from H2FY21.

Real estate

Demand for real estate amongst the top Indian cities fell by 70% yoy to 3.8 cr sq. ft in Q1FY21, with launches fell by 80% yoy to 2 cr sq. ft. (Source: PropEquity, Kotak Institutional Equities) Covid-19 led lockdown has negatively impacted real estate demand and impacted execution of projects at sites due to migration of labours. During the lockdown, many real estate developers relied on online/digital channels for selling their projects. In a recent development, the Government of Maharashtra has approved a temporary reduction in stamp duty in the state from 5% to 2% upto December 31, 2020 and to 3% upto March 31, 2021. The move by Maharashtra could prompt other states to follow a similar path to give a temporary relief to the sector. The temporary reduction in stamp duty will likely support sales of Mumbai-centric players like Oberoi Realty, Godrej Properties, Sunteck Realty, etc. On the commercial side, collections from office portfolio was relatively better, while rebate/rent waiver were offered to the tenants in case of malls impacted the business. We believe that the current pandemic will further aid industry consolidation as weak players struggle to survive the absence of sales in a year of heightened economic uncertainty.

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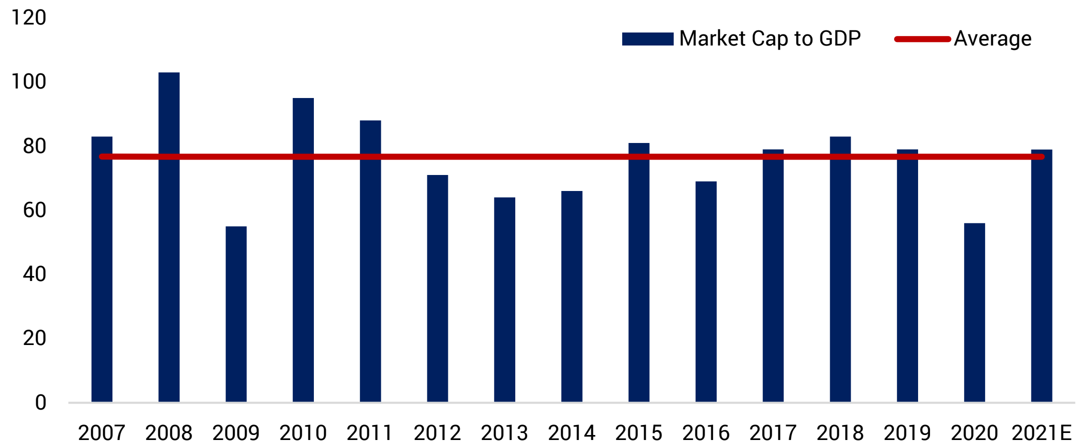
VALUATIONS

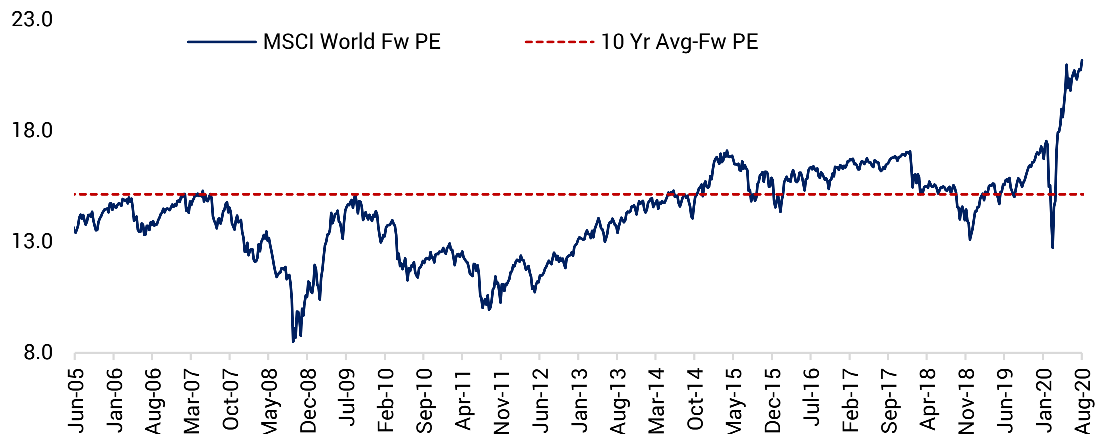
India's market cap to GDP ratio (%)



Source: Kotak AMC and Kotak Securities - Private Client Group

Based on Bloomberg consensus estimates the MSCI World Index trades at 21.2x on one Yr Fw basis. The Fw PE on CY21E works to 19.4x which is way above the previous peaks of 17x seen in last 15 years

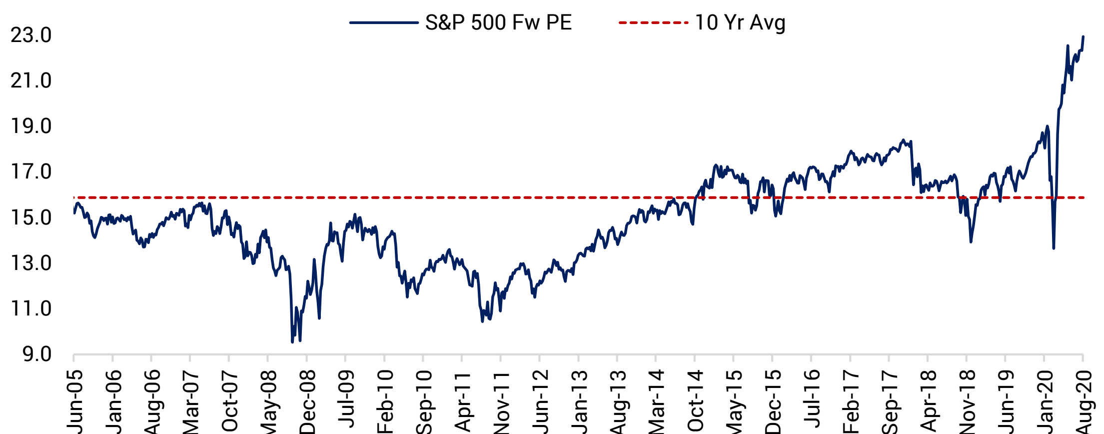
MSCI World Index: Fw PE chart



Source: Bloomberg & Kotak Securities – Private Client Group

Based on Bloomberg consensus estimates the S&P 500 Index is trading at 22.9x on 1 Yr Fw basis. The 2 Yr Fw PE of 19x is also higher than the previous peak of 18x. The Fw PE is almost 700 bps higher than the 10 Yr Avg Fw PE of

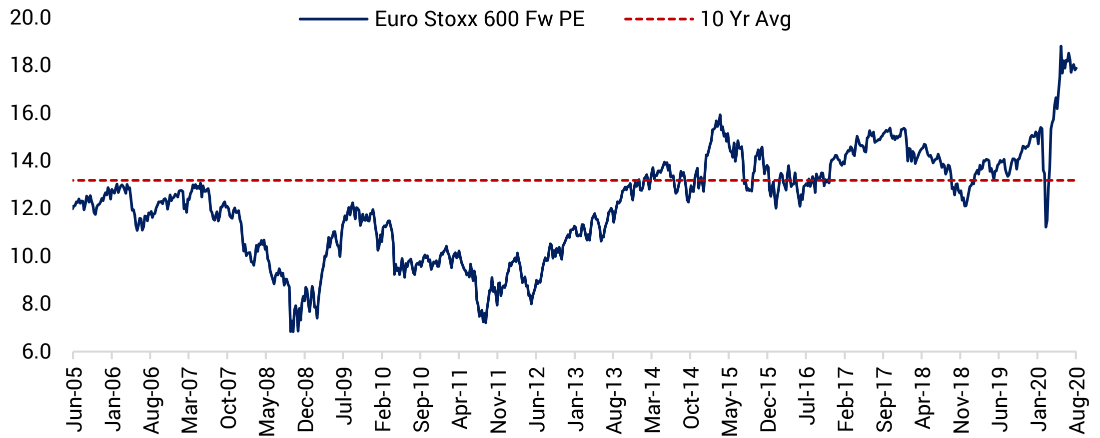
S&P 500 Index: Fw PE chart



Source: Bloomberg & Kotak Securities – Private Client Group

The Euro Stoxx 600 Index, based on Bloomberg estimates trades at 17.9x on 1 Yr Fw basis. On CY21E it trades at 16.1x, which is at par with its 15 year peak of ~16x. The Fw PE is 470 bps higher than the 10 Yr Avg Fw PE of 13.1x.

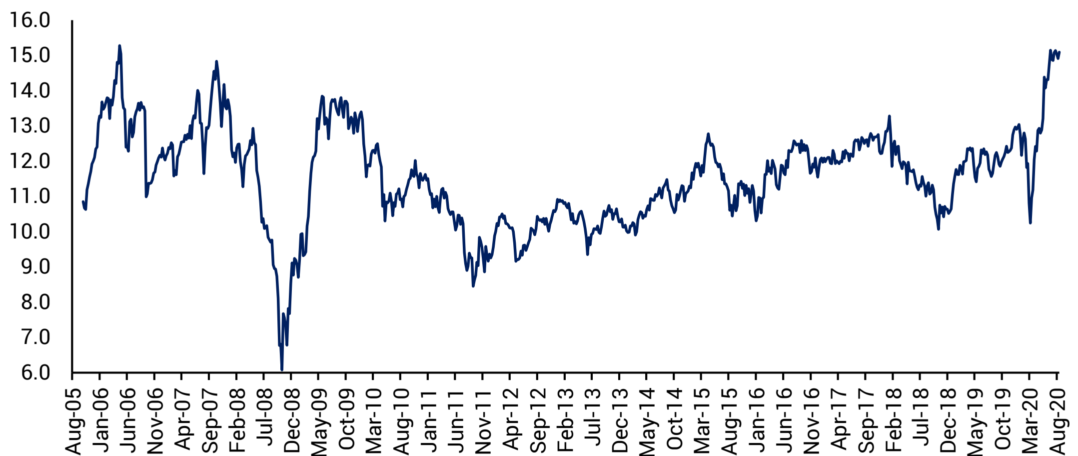
Euro Stoxx 600 Index: Fw PE chart



Source: Bloomberg & Kotak Securities – Private Client Group

Based on Bloomberg estimates the MSCI EM Fw PE is now trading near its 15 year peak of ~15x. In the last 5 years the Fw PE had peaked out at ~13x.

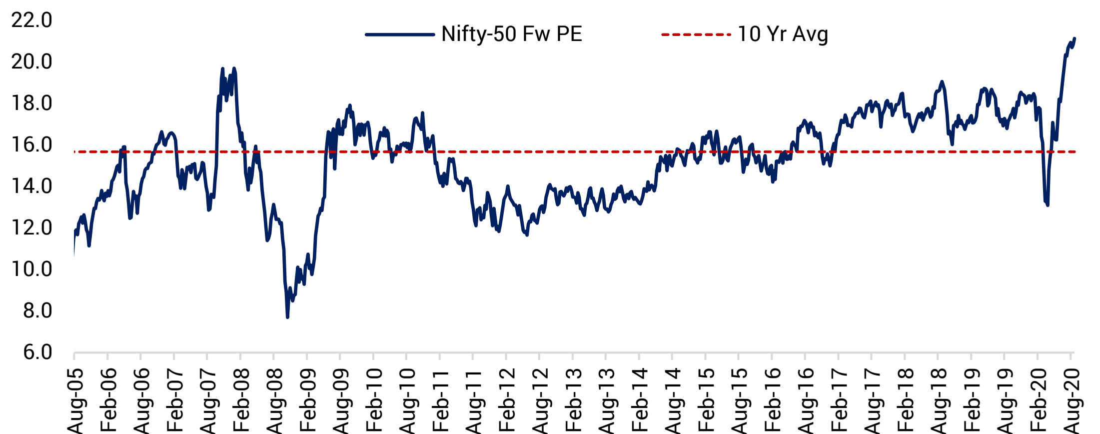
MSCI Emerging Markets: Fw PE chart (on 1 Yr Fw PE basis)



Source: Bloomberg & Kotak Securities – Private Client Group

Based on Bloomberg estimates the Nifty-50 trades at 21.1x on 1 Yr Fw basis. If we consider FY22E, which builds in 37% earnings growth then valuations look reasonable at 17.3x

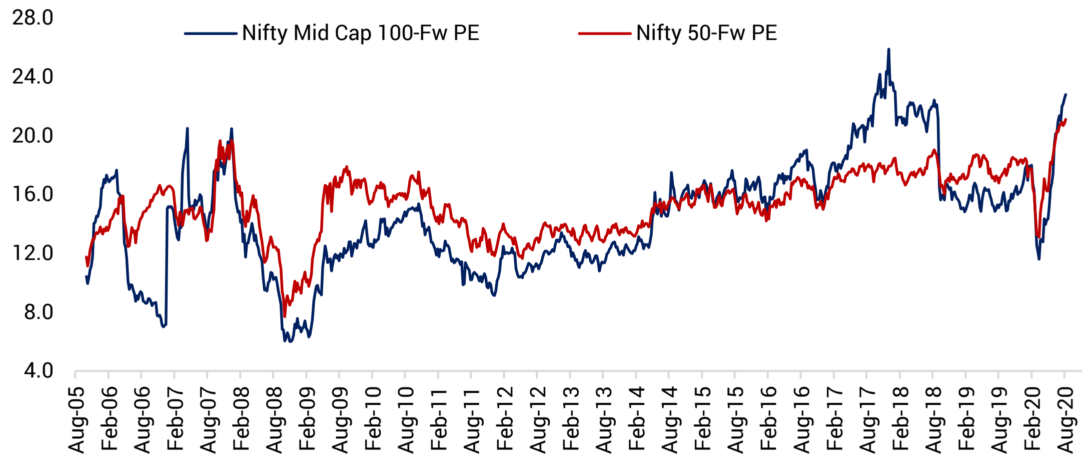
Nifty-50 Index: Fw PE chart



Source: Bloomberg & Kotak Securities – Private Client Group

Nifty Mid Cap 100 Index now trades at a premium over Nifty-50 on Fw valuations. Based on Bloomberg estimates the 1 Yr Fw PE of Nifty-50 works to 21.1x whereas that of Nifty Mid Cap 100 Index works to 22.8x.

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



Source: Bloomberg & Kotak Securities – Private Client Group

BHARTI AIRTEL LTD

CMP: Rs.547 **Fair Value: Rs.710** **Reco: BUY** **Mkt Cap: Rs.2,98,282 Cr**

- Bharti remains a solid play on one of the two mutually exclusive events likely to play out in the Indian wireless industry 1) market stays a 3-player one or 2) market consolidates further.
- 1QFY21 Overall revenues of Rs23,938 cr (+0.9% qoq, +15.4% yoy) were in line with our estimate. EBITDA stood at Rs10,407 cr, (+2% qoq), 0.6% ahead of our estimate.
- India Revenues came in at Rs12,877 cr, -0.6% qoq, +19% yoy, 0.7% above our estimate. Implied (Average Revenue Per User) ARPU stood at Rs152/sub/month (flat qoq).
- Management said that the current tariffs are still at low levels. They have guided for ARPUs to move to Rs200 in the short term and Rs300 in the medium term.
- Bharti is looking to develop new streams of revenues and drive efficiencies through its digital platform. It has built content offerings through partnerships.
- Bharti has set up a dedicated team to look at cost rationalization measures amid the Covid-led disruption. Adoption of digital channels has also helped reduce commission costs.
- We expect the company to generate free cash flows of Rs.29,561 cr in the next three years. We reiterate BUY with a fair value of Rs710, valuing on sum of the parts (SOTP) basis.

Note: The above is brief note on the company, based on the research report and update available (dated: 30th July 2020) on our website at:

https://www.kotaksecurities.com/research_report/recommendation/indiadaily.html

JINDAL STEEL & POWER LTD

CMP: Rs.218 | **Fair Value: Rs.270** | **Reco: BUY** | **Mkt Cap: Rs.22,251 Cr**

- JSPL's consolidated adjusted EBITDA of Rs2,263 cr (+4% yoy, +2% qoq) hit record highs and was ahead of our estimates led by outperformance across segments. (1) India steel division reported volumes of 1.56 mn tons (+3% yoy), realizations declined by 16% yoy whereas costs declined by 21% yoy led by usage of SMPL iron ore (~65% of the requirement), lower coal, other consumables costs and operational leverage.
- Jindal Power EBITDA of Rs370 cr (+2% yoy) was ahead of our estimates (Rs2.7 bn) on higher prices and lower costs. Power generation declined by 27% yoy to 2.2 bn units due to lower demand led by Covid-19. Lower coal costs resulted in EBITDA/unit of Rs1.9.
- JSPL expects to conclude the Oman divestment in near future. The deal would reduce JSPL's net debt by Rs6000-6500 cr or by 17% and reduce net debt/EBITDA to 3.4x from 3.9x for FY21E. Further, it would reduce concerns on lumpy debt repayments in FY21E.
- Leverage remains high for Tata Steel and least for JSPL.
- JSPL has guided for 7-7.5 mn tons of domestic steel volumes in FY21E and aims to operate at rated capacity of 8.6 mn tons in FY22E. Further, it aims to reduce net debt to Rs15,000 cr by FY23-end from Rs36,000 cr as of FY20. The management expects costs to further reduce driven by decline in coking coal costs (US$25-30/ton) and operating leverage in 2QFY21.
- We value the stock on Sum of the parts basis (SOTP) and arrive at a fair value of Rs270.

Note: The above is brief note on the company, based on the research report and update available (dated: 23rd July 2020 & 5th August 2020) on our website at:

https://www.kotaksecurities.com/research_report/recommendation/indiadaily.html

JK LAKSHMI CEMENT LTD (JKLC)

CMP: Rs.263 **Fair Value: Rs.340** **Reco: BUY** **Mkt Cap: Rs.3,096 Cr**

- Demand improved month on month in May-July 2020, with July volumes being higher on a yoy basis. However, demand has started to moderate in both East and North markets from August 2020 due to seasonal weakness and easing of pent-up demand.
- In 1QFY21, the company reported revenues of Rs825 cr which was down by 21% over 1QFY20. Cement volumes declined by 18% yoy to due to extension of the lockdown in key markets. Operating profit declined by 16% yoy to Rs143 cr. Operating profit /tonne declined 9% over 4QFY20 to Rs750/tonne (+3% yoy). Net profit in 1QFY21 stood at Rs44cr.
- Fixed costs are likely to reduce in FY21 as the ongoing consulting project with BCG has concluded.
- The company's capex expenditure for FY21 on a consolidated basis remains limited to Rs200 cr. Due to Covid-19, the company had put on hold its expansion plans. The company now plans to announce capacity expansion in North India for a planned capex of Rs1200-1400 cr. The company has the necessary land for the same and aims to commission the plant in two years.
- The company's consolidated gross debt stood at Rs2000 cr as of June FY20. The company has cash reserves of Rs700 cr. Consolidated net debt reduced to Rs1300 cr as of 1QFY21 from Rs1500 cr in 4QFY20. The company has repayment of Rs400 cr in the next two years.
- Stock is trading at a discount to our fair multiple of 6x EV/EBITDA (Enterprise value / Earnings before interest, taxes, depreciation, and amortization), and its historic mean. Our Fair Value of Rs340/share is based on 6x June FY22E EBITDA (operating profit).

Note: The above is brief note on the company, based on the research report and update available (dated: 8th August 2020) on our website at:

https://www.kotaksecurities.com/research_report/recommendation/indiadaily.html

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GAIL (INDIA) LTD

CMP: Rs.96 **Fair Value: Rs.140** **Reco: BUY** **Mkt Cap: Rs.44,477 Cr**

- Gas demand has recovered materially across all segments, with overall transmission volumes back to ~109 mcm/d and gas marketing volumes at ~89 mcm/d currently.
- Gas volumes at upcoming Urja Ganga Project are expected to ramp up to around 10 mcm/d during FY22 and up to 16 mcm/d in the subsequent year led by off-take of gas by four fertilizer projects (Baruani, Durgapur, Gorakhpur and Sindri), three refineries (Barauni, Haldia and Paradip) and several CGD areas along the network.
- PNGRB is carrying out deliberations with key stakeholders on the regulation for unified pipeline tariffs and is likely to notify it in the coming months.
- Kochi-Mangalore pipeline is likely to be commissioned shortly.
- The company may incur capex of around Rs.6000 cr in FY21.
- We remain constructive on the stock expecting the company to benefit from implementation of unified tariffs, assuming PNGRB attempts to improve returns on under-utilized pipelines and enhance economics for upcoming large pipeline projects.
- We expect GAIL to benefit from inclusion of natural gas in GST, as it will remove stranded taxes on input gas for its LPG/petchem production segments; its dominant presence in the value chain also makes it well-positioned to gain from higher demand of gas in the long run.
- Our SoTP-based fair value based on March 2022 estimates is Rs140.

Note: The above is brief note on the company, based on the research report and update available (dated: 14th August 2020) on our website at:

https://www.kotaksecurities.com/research_report/recommendation/indiadaily.html

DCB BANK LTD

CMP: Rs.89 **Fair Value: Rs.150** **Reco: BUY** **Mkt Cap: Rs.2,773 Cr**

- In Q1FY21, DCB Bank reported flat revenue growth & earnings yoy led by ~100% yoy growth in provisions. Operating profits grew by 15% yoy due tight cost control.
- In Q1FY21, NII (Net Interest income) growth was at 1% yoy. NIMs (Net Interest Margins) narrowed ~20 qoq to 3.4% due to decline in yield and cost of funds along with excess liquidity. We expect NIMs to stay around 3.4-3.5% over FY21E-23E.
- Loan growth has declined to ~4% yoy in Q1FY21. We expect Loan growth to decline further in FY21E at 0.8% yoy and then increase to 9.5% yoy in FY22E. Deposit growth was muted at 2% yoy while CASA ratio was stable at 22% in Q1FY21. We expect deposit growth of 0.3% in FY21E & 9.5% in FY22E.
- GNPLs (Gross non-performing loans) ratio was flat qoq at 2.4% and Net NPLs (NNPLs) ratio was down 0.2% qoq to 1.1%. Slippages were also negligible given that 25% of loans are under moratorium. We expect GNPLs and NNPLs to increase to 3.7% and 1.7% in near-term.
- We believe that DCB Bank should come out better in this cycle on a relative basis given its cautious approach to growth and underwriting.
- The bank is currently trading at 0.85x FY22E Book value. We maintain our BUY rating on DCB Bank with a fair value of Rs.150 valuing the bank at 1.3x book and 13x June 2022E EPS for Return on equities (RoEs) moving closer to 10% in the medium term.

Note: The above is brief note on the company, based on the research report and update available (dated: 9th August 2020) on our website at:

https://www.kotaksecurities.com/research_report/recommendation/indiadaily.html

POWER GRID CORPORATION OF INDIA LTD

CMP: Rs.180 **Fair Value: Rs.220** **Reco: BUY** **Mkt Cap: Rs.94,299 Cr**

- Q1FY21 PAT of Rs2860 cr (+18% yoy, -10% qoq) was on account of a 49% yoy growth in other income at Rs630 cr on account of higher surcharge income on delayed payments by SEBs.
- PGCIL continues to maintain strong on the ground traction on project execution.
- Management highlighted that there have been near-term challenges to execution post Covid-19 pandemic due to shortage of labor, however, remained confident of execution pace picking up in 2HFY21E.
- The company highlighted that it has Rs23400 cr of immediate upcoming opportunities—Rs16000 cr for renewable transmission works and Rs7400 cr for intra-state works in TBCB in Jharkhand & MP.
- Collections have been improving since June 2020, and saw receivables decline to Rs7500 cr (79 days) as of July 2020.
- We remain positive on Power Grid on account of (1) attractive valuations and an attractive dividend yield, (2) visibility on earnings growth trajectory as the company will capitalize projects aggregating Rs54000 cr over the next three years that will yield 10% CAGR in earnings, and (3) incremental opportunities in intra-state and inter-state transmission as well as to establish a reliable green energy corridor for the development of renewable assets.

Note: The above is brief note on the company, based on the research report and update available (dated: 12th August 2020) on our website at:

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ICICI LOMBARD GENERAL INSURANCE CO LTD

CMP: Rs.1251 **Fair Value: Rs.950** **Reco: SELL** **Mkt Cap: Rs.56,833 Cr**

- ICICI Lombard's strong performance in 1QFY21 was largely driven by lower claims in the motor business likely due to the lockdown even as Covid-related claims in the health segment were high.
- In 1QFY21, ICICI Lombard reported improvement in claim ratio to 69.8% from 75% yoy due to motor business. Health insurance will be a gradual growth story post pandemic with 43% yoy growth in June 2020
- The proposed Bharti Axa deal brings little on the table for ICICI Lombard, apart from its motor business that can provide some synergies. Bharti Axa business is sub-optimal negligible PAT in FY19 and net loss in FY20.
- The Proposed Deal valuation at 7x book FY20 is expensive though lower relative valuation. Bharti Axa is valued at ~27% discount to ICICI Lombard. The combined entity with market share of ~17% (FY20) will be the largest player in the motor OD segment.
- Post the merger, the consolidated EPS is down by 4-7% for FY22-23E. We expect the combined ratio to moderate to 102% for the entity in FY23E from about 100-101% earlier. Our FY23E forecasts are more representative with about 19% RoE (Return on equities).
- Stake sale by promoters will be a key overhang on the stock in the near term. ICICI Lombard trades at 37.3x FY22E earnings & 6.8x FY22E Book value. We retain SELL; Fair value of Rs. 950

Note: The above is brief note on the company, based on the research report and update available (dated: 17th July 2020 & 24th August 2020) on our website at:

https://www.kotaksecurities.com/research_report/recommendation/indiadaily.html

AVENUE SUPARMARTS LTD (DMART)

CMP: Rs.2241 **Fair Value: Rs.1480** **Reco: SELL** **Mkt Cap: Rs.1,45,176 Cr**

- Dmart saw several store closures in Q1FY21 on account of Covid-19 led restrictions. The situation is constantly improving, but the continuous change in local policies are impacting store operations.
- Dmart is witnessing lower footfalls in its stores as social distancing is keeping customers away from crowded locations.
- Dmart is seeing lower sale of general products and apparel categories due to deferment of purchases by the customers.
- The customer mix for Dmart has seen a shift from high income level to mid to lower category due to Covid fear. This may lead to increased demand for low value products (Down-trading).
- Dmart mentioned that store construction activity was muted in Q1FY21 due to the lockdowns and monsoons have impacted the same in Q2FY21. Hence, FY21 store additions would be lower than FY20.
- We are cautious on Dmart due to rich valuations. We maintain Sell on the stock.

Note: The above is brief note on the company, based on the research report and update available (dated: 5th August 2020) on our website at:

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Rating Scale (Kotak Securities – Private Client Group) / Kotak Institutional Equities

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

Fundamental Research Team (Private Client Group)

Rusmik Oza
Head of Research
rusmik.oza@kotak.com
+91 22 6218 6441

Arun Agarwal
Auto & Auto Ancillary
arun.agarwal@kotak.com
+91 22 6218 6443

Amit Agarwal, CFA
Transportation, Paints, FMCG
agarwal.amit@kotak.com
+91 22 6218 6439

Priyesh Babariya
Research Associate
priyesh.babariya@kotak.com
+91 22 6218 6433

Sanjeev Zarbade
Cap. Goods & Cons. Durables
sanjeev.zarbade@kotak.com
+91 22 6218 6424

Jatin Damania
Metals & Mining, Midcap
jatin.damania@kotak.com
+91 22 6218 6440

Purvi Shah
Pharmaceuticals
purvi.shah@kotak.com
+91 22 6218 6432

K. Kathirvelu
Support Executive
k.kathirvelu@kotak.com
+91 22 6218 6427

Sumit Pokharna
Oil and Gas, Information Tech
sumit.pokharna@kotak.com
+91 22 6218 6438

Pankaj Kumar
Midcap
pankajr.kumar@kotak.com
+91 22 6218 6434

Krishna Nain
M&A, Corporate actions
krishna.nain@kotak.com
+91 22 6218 7907

Technical Research Team (Private Client Group)

Shrikant Chouhan
shrikant.chouhan@kotak.com
+91 22 6218 5408

Amol Athawale
amol.athawale@kotak.com
+91 20 6620 3350

Siddhesh Jain
Research Associate
siddhesh.jain@kotak.com
+91 22 62185498

Derivatives Research Team (Private Client Group)

Sahaj Agrawal
sahaj.agrawal@kotak.com
+91 79 6607 2231

Malay Gandhi
malay.gandhi@kotak.com
+91 22 6218 6420

Prashanth Lalu
prashanth.lalu@kotak.com
+91 22 6218 5497

Prasenjit Biswas, CMT, CFTe
prasenjit.biswas@kotak.com
+91 33 6625 9810

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Kotak Securities Limited. Registered Office: 27 BKC, C 27, G Block, Bandra Kurla Complex, Bandra (E), Mumbai 400051. CIN: U99999MH1994PLC134051, Telephone No.: +22 43360000, Fax No.: +22 67132430. Website: www.kotak.com/www.kotaksecurities.com. Correspondence Address: Infinity IT Park, Bldg. No 21, Opp. Film City Road, A K Vaidya Marg, Malad (East), Mumbai 400097. Telephone No: 42856825. SEBI Registration No: INZ000200137 (Member ID: NSE-08081; BSE-673; MSE-1024; MCX-56285; NCDEX-1262), AMFI ARN 0164, PMS INP000000258 and Research Analyst INH000000586. NSDL/CDSL: IN-DP-NSDL-23-97. Our research should not be considered as an advertisement or advice, professional or otherwise. The investor is requested to take into consideration all the risk factors including their financial condition, suitability to risk return profile and the like and take professional advice before investing. Investments in securities market are subject to market risks, read all the related documents carefully before investing. Derivatives are a sophisticated investment device. The investor is requested to take into consideration all the risk factors before actually trading in derivative contracts. Compliance Officer Details: Mr. Manoj Agarwal. Call: 022 - 4285 8484, or Email: ks.compliance@kotak.com.

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