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MARKET OUTLOOK & DIWALI PICKS

FUNDAMENTAL

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MARKET OUTLOOK & DIWALI PICKS – SAMVAT 2075

The ongoing Indian calendar year, Samvat 2074, has been quite disappointing for equity investors with the broader markets ending up just 4% (till date). Especially, the past two months have been brutal for equity market investors with steep correction after crisis-ridden IL&FS defaulted on its interest payment, triggering liquidity concerns among non-banking finance companies (NBFCs). The overall fall in markets was also accentuated by many other adverse factors such as increasing crude oil prices, tightening of monetary policy by US Fed, trade wars between US and China, falling rupee and widening current account deficit in India. Two key factors (crude and currency) have turned favourable because of which Nifty has pulled back from the recent low of 10,000.

We can break down the outlook for Samvat 2075 into two halves. The first half - six months from now till the Central elections could be challenging but will also provide opportunity for long term investors to accumulate stocks from long term perspective. The second half could be a function of election outcome and markets reverting back to earnings growth and valuations. We also need to monitor and factor in the global events and global outlook on an ongoing basis while making the investment case for Indian equities. Due to its sheer outperformance US markets now account for more than 60% of global market capitalization while the emerging markets account for just ~22%. Though most emerging markets have corrected sharply they still run the risk of any sharp correction in the US markets.

Global trade war and risk of further rate hikes by Fed are bigger headwinds for global equity markets. Global growth has been very strong for last three years providing the platform for healthy equites returns, especially in the US markets. If the US-China Trade war escalates and simultaneously crude remains at elevated levels then it could lead to global slowdown which will have its impact on global equity markets. US may impose full 25% import duty on goods worth USD 200 bn (from Jan'19). If this materializes then there could be another round of currency depreciation in emerging markets led by China (allowing Yuan to depreciate Vs USD).

On the domestic front, consumption and government expenditure have been the major drivers for economy in the last two-three years. Corporate credit offtake still remains weak even though capacity utilization rates have improved for Corporate India. Consumption growth could be more rural driven going forward, led by higher MSPs and governments focus on increasing rural income. Given tight fiscal conditions and weak macros it is difficult to assume very high government expenditure. Also the liquidity constraint being faced by NBFCs could lead to some kind of slowdown in credit offtake in the second half of FY19.

Local flows through SIPs has been the main saving grace for equity markets in India at a time when FIIs have been consistent sellers. The flows into mutual funds is broad based and spread across various market-cap orientation whereas the FII concentration is mainly in the large caps and larger mid caps. We expect the SIP culture to continue which should provide cushion to markets in any major fall. Assuming 3-4% of annual household savings gets channelized into equities could mean annual local inflows of ~USD 15 bn into equities. FII flows will be a function of global bond yields, currency and outlook on emerging markets.

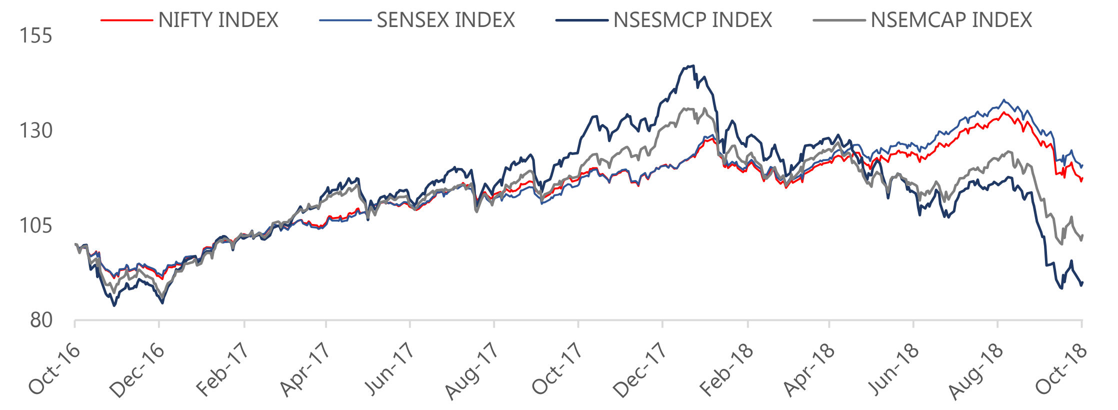
Second quarter earnings season is underway and we can expect full year earnings downgrades to be higher than earnings upgrades. This along with reduction in valuation multiples could lead to downside revision in many stock prices. It is ideal to build in a 4-5% reduction in consensus estimates to derive at the realistic valuation of Nifty and Sensex. After witnessing a 10% correction from the peak, Nifty valuation has come down to 16.6x one year Fw earnings (closer to the 10 year average). Though Nifty valuations have come closer to the 10 year average the scope of any hefty re-rating seems less likely (considering the spread of Bond yield & equity yield).

Based on Bloomberg consensus estimates, the one year Fw PE of Mid Cap Index has now come down to 16.3x as compared to 16.6x of Nifty. Similar to Nifty there could be earnings downgrade risk in the estimates of Mid Cap Index, which could be more visible after Q2-FY19 results.

On a bottoms up basis risk-reward ratio has turned attractive for large parts of the Indian market. Bottom-up valuations are supportive for most parts of the market and earnings outlook reasonable which draws some comfort. However, from a top down approach there are still challenges and uncertainties that will create hurdles for the market. We expect India's currency and interest rates to be stable if oil prices were to remain around USD 75/bbl. Since valuations have moderated for both Nifty and mid caps market could become range wide for some time.

To summarize, we remain cautious on the market due to global factors and macro headwinds. Investors need to have bottoms up approach and pick & choose good quality, beaten down stocks from respective sectors. To weather the on-going volatility which may remain till middle of next year (i.e. till Central elections), it is ideal to have higher allocation into safer large caps and good quality mid caps (with strong management pedigree, strong earnings growth and reasonable valuations). One can re-access the situation and re-shuffle their holdings post-election outcome. The next few months would provide good buying opportunity for Long term investors. Conservative investors may spread their buying across the next few months to average out any rise or decline in the market.

Sensex, BSE, Small cap - Midcap performance



Source: Bloomberg

Nifty - Top 5 Stocks (19th October 2017 to 2nd November 2018)

Company	Price on 19th October 2017	Price on 2nd November 2018	Change
Tech Mahindra Ltd	458	691	50.7%
Tata Consultancy Services Ltd	1292	1913	48.1%
Titan Co Ltd	607	871	43.5%
Infosys Ltd	463	662	42.9%
JSW Steel Ltd	254	353	39.1%

Source: Bloomberg

Nifty - Bottom 5 Stocks (19th October 2017 to 2nd November 2018)

Company	Price on 19th October 2017	Price on 2nd November 2018	Change
Tata Motors Ltd	427	190	-55.4%
Hindustan Petroleum Corp Ltd	460	240	-47.8%
Bharti Infratel Ltd	460	262	-43.0%
Yes Bank Ltd	358	209	-41.6%
Bharat Petroleum Corp Ltd	508	302	-40.5%

Source: Bloomberg

International factors to watch in SAMVAT 2075

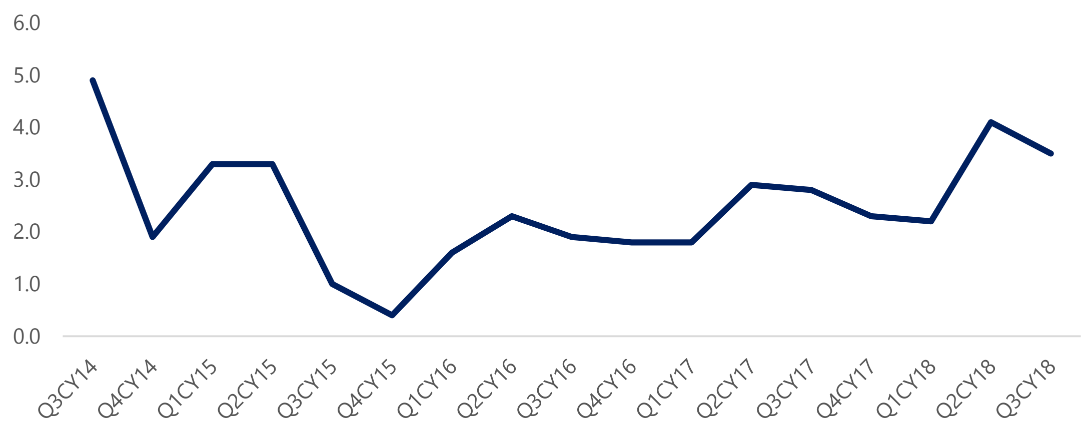
Global growth (to slow down in CY18/CY19)

Global growth for CY18 and CY19 is projected to remain steady at its CY17 level, but its pace is less vigorous than projected in April 2018 and it has become less balanced. Downside risks to global growth have risen in the past six months and the potential for upside surprises has receded. Global growth is projected at 3.7% for CY18 and CY19 (0.2% lower for both years than forecast in April 2018 by IMF). The downward revision reflects surprises that suppressed activity in early 2018 in some major advanced economies, the negative effects of the trade measures implemented or approved between April and mid-September, as well as a weaker outlook for some key emerging market and developing economies arising from country-specific factors, tighter financial conditions, geopolitical tensions, and higher oil import bills.

US GDP growth and rate hike

US GDP grew at a solid 4.2% pace in the second quarter of 2018, its best pace since 2014, boosting hopes that the economy is ready to break out of its decade-long slumber. The growth rate for Q2CY19 is also the third-best growth rate since the Great Recession. The US economy continued with its juggernaut even in the third quarter of CY18 growing ahead of expectation at 3.5% (versus expectation of 3.4%). The next big question is whether the growth spurt sustainable. We believe that going forward, the pace of expansion will slow as the effects of tax cuts made by the government fades, companies pull back in the face of foreign tariffs, trade war and a strong dollar and the Federal Reserve raises interest rates further.

US GDP growth (%)



Source: Bloomberg

US Fed hiked the interest rates by 25 bps, each in June 2018 and September 2018 meeting (strikingly removed the phrase "accommodative" monetary policy after keeping it for years); and almost confirmed one more hike in December 2018 meeting. This will be followed by three more interest rate hikes in 2019 and two more hikes in 2020. By then, Fed rate is expected to reach 3.50-3.75%, the highest level at least in a decade. This should trigger further spiking of bond yields globally, as central bankers across the world can't stay back for long without coming off their respective accommodative monetary policies.

US-China Trade war (to hurt global economy)

Since January, a sequence of US tariff actions on solar panels, washing machines, steel, aluminum, and a range of Chinese products, plus retaliation by trading partners has complicated global trade relations. In September end the US slapped a 10% tariff on USD 200 bn of goods coming from China. In response China responded with duties on USD 60 bn on US products. If there is no resolution till end of December then the 10% duty levied by US on USD 200 bn of

Chinese goods will go up to 25% from the first day of 2019. Moreover, if China retaliates then US President has vowed to impose duties on a further USD 267 bn in Chinese imports.

A full-blown trade war could be very bad for global trade in 2019. IMF in its latest report has warned that the protectionist measures could hinder business investment, disrupt global supply chains, slow the spread of productivity-boosting technologies and raise the price of consumer goods costing global economy US$430 billion or 0.5% growth by 2020. It has cut its GDP growth projections of China for next year to 6.2% (down 0.2% from three months ago).

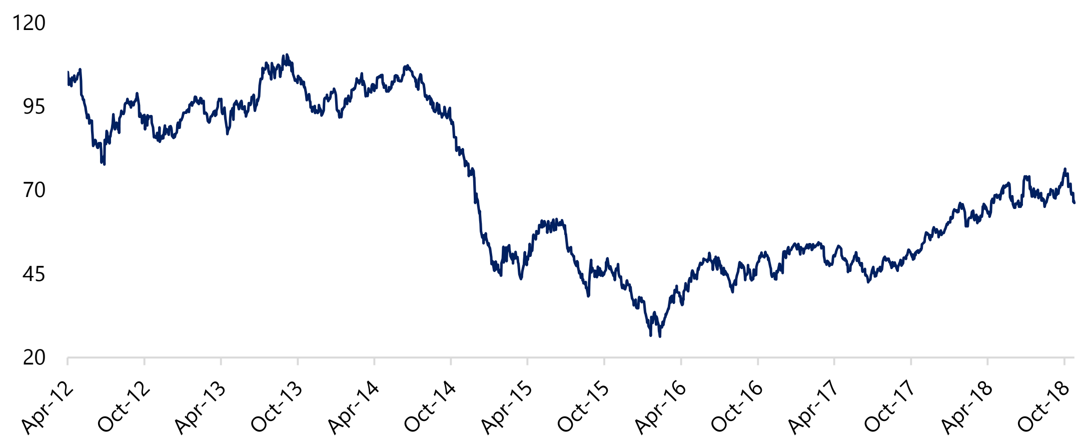
Brent crude prices (could remain firm; Manageable up to USD 80/bbl)

The International Energy Agency (IEA), in its October Oil Market Report has moderated its global oil demand outlook. IEA now forecasts a growth of 1.3 million barrels per day (mbpd) for 2018 and 1.4 mbpd for 2019, respectively, a reduction of 110,000 mbpd for both years from previous predictions. This is due to a weaker economic outlook, trade concerns, higher oil prices and a revision to Chinese data.

Among the most important supply-side factors weighing on pricing expectations are US shale oil production, global oil reserves and OPEC oil supply. US oil production has increased steadily over the past five years, reaching a record high of 11.2 million barrels per day (mbpd) in October 2018. But infrastructure within the biggest US shale producing area, the Permian basin, has not kept pace with rising output. This indicates that shale production is not increasing in near term. Also, core OPEC members are not doing 'everything it takes' to fill in the gap in supply declines from Iran estimated at 3.5 mpbd. Deceleration in the global oil industry's reserves and the reserve replacement ratio is also concerning. The global reserve replacement ratio, measured as total oil and gas discoveries relative to production, declined to 11 percent in 2017 from over 50 percent in 2012, according to energy research firm Rystad Energy.

For India, crude prices between USD 70-80/bbl is manageable and the economy can absorb it. Key risk to India comes when crude price goes above USD 80/bbl and sustains above that for a longer period of time.

Crude Oil Movement ($/barrel)



Source: Bloomberg

Domestic factors to watch in SAMVAT 2075

After a good FY18, both in terms of policy reforms such as Goods and Service Tax (GST) and Insolvency & Bankruptcy Code (IBC) along with capital market performance, FY19 is turning out to be a weak year for Indian markets. Indian stocks are currently jostling weak emerging markets, rising global interest rates, higher oil prices, depreciating INR & increasing global interest rate. From the economy perspective, the country is currently experiencing stable growth & lower levels of inflation but rising current account deficit. Also the economy is weathering challenges like weak private sector capex, lower than estimated GST revenues and direct tax collections, slow disinvestment and estimated cut in government expenditure to contain fiscal deficit to target of 3.3%.

Important things to watch out for in SAMVAT 2075

ECONOMIC

Economic Indicators for India

Parameter	Latest	Projection	Remark
CPI	3.77% for September	3.9-4.5% in H2FY19 with soft food prices	No rate hike expected in December policy
Disinvestment	Rs.100 bn achieved in H1FY19 (Target of Rs.800 bn for FY19)	Underachievement by 20%	Stake sale in ONGC/Coal India Sale of SUUTI stake in ITC, AXIS Bank Buyback by PSUs
GST revenue	Rs.6.79 trillion collected in 7MFY19 (Target of Rs.12.4 trillion for FY19)	Underachievement	Government may cut expenditure to contain Fiscal deficit
Direct taxes	Rs.4.44 trillion collected in H1FY19 (Target of Rs.11.5 trillion)	Close to achievement	Government has refunded ~Rs.1 trillion which is more 90% of the refunds for FY19
Fiscal Deficit	3.5% of GDP in FY18	3.3% of GDP in FY19	Government is confident in achieving fiscal deficit target
CAD	1.9% of GDP in FY18	4.2% of GDP in FY19	Higher crude prices to Increase CAD

Source: Industry

GST collections and fiscal mathematics - Fiscal Deficit to remain under 3.5% in FY19

Total GST collection was at Rs 1,007 bn in October (compared to Rs 944 bn in September). The increase in the GST revenues can be attributed to the festive season sale (October could see similar collections) and may not sustain beyond it. For 7MFY19, CGST would be around Rs 2.6 trillion with unallocated IGST at Rs 128 bn. SGST would likely be around Rs 3 trillion. The number of returns filed in October was similar to that in September at 6.7 mn.

We note that the required run-rate for the rest of F005919 is around Rs 1.24 trillion. The government has reiterated its commitment to stick to the budgeted GFD/GDP of 3.3%. However, the GST run-rate poses significant challenges to the fiscal math. The government is looking to bridge the shortfall through higher-than-budgeted (1) direct taxes (somewhat possible) and (2) divestments (difficult). We believe without reduction in revenue expenditure it will be difficult to stick to the budgeted GFD/GDP, which is important from a macro-prudential basis. We maintain our FY19E GFD/GDP at 3.5% factoring around Rs 500-600 bn of lower CGST revenue, under achievement of disinvestment targets and some reduction in capital expenditure.

Monthly GST revenue

Month	CGST	SGST	IGST	IGST (imports)	Compensation cess	Total GST	Total filings (mn)
Apr-18	187	257	505	212	86	1035	6.0
May-18	159	217	491	244	73	940	6.2
Jun-18	160	220	495	245	81	956	6.5
Jul-18	159	223	500	249	84	966	6.6
Aug-18	153	212	499	265	76	940	6.7
Sep-18	153	211	501	253	80	945	6.7
Oct-18	165	228	534	269	80	1007	6.7

Source: Ministry of Finance

Direct taxes collection could potentially surprise in FY19

Net collections in direct taxes was reported at Rs.4.44 trillion in first half of FY19 (+ 14% YoY) and formed 38.6% of the annual budget estimate of Rs.11.5 trillion. This is in line with the trend of six-monthly collections in the last two years. We believe that the overall growth in direct tax collections for H1 FY19 is not so encouraging, despite the steep increase in the growth rate in Corporate Advance Tax collections compared to last two years.

However, we are not too perturbed as this is due to massive tax refunds issued in H1FY19 till date. The government refunded Rs.1.03 trillion in 6 months, which is more than 90% of the entire refunds of FY19. The government in its recent statement continued to reiterate that it is extremely confident in meeting its direct tax collection target of Rs11.5trn.

Direct tax collection of the central government

% growth	H1FY17	H1FY18	H1FY19
Net Direct tax collection	8.95	15.8	14
Advance corporate tax	8.14	8.1	16.4
Advance personal tax	44.5	30.1	30.3
6 Month collection % of annual target	38.7	39.4	38.6

Source: Ministry of Finance

Current Account Deficit

The trade deficit has softened to USD 14bn in the month of September which though on the higher side is substantially below its recent trend of USD 17-18bn seen in the previous two months. For H1FY19, the combined trade deficit is at USD 95bn (vs. USD 77bn in H1FY18). Our institutional team has increased the FY9E CAD/GDP figure to 3.2% based on revised average crude price of USD 80/bbl.

Trade Summary data

USD bn	Sep-18	Aug-18	Sep-17	YoY %	H1FY19	H1FY18
EXPORTS	**27.8**	**25.9**	**23.4**	**18.8**	**135.3**	**117.2**
of which Petroleum	4.4	3.9	3.5	25.7	24.1	16.5
of which Engineering	7	6.9	7.3	-4.1	39.9	35.7
of which Garments	1.1	1.3	1.7	-35.3	7.7	9.2
of which Jewelry	3.7	3.3	4.8	-22.9	20.8	21.4
IMPORTS	**41.9**	**45.2**	**38**	**10.3**	**258.3**	**222.4**
of which Petroleum	10.9	11.8	8.2	32.9	69.8	46.5
of which Gold	2.6	3.6	1.7	52.9	17.6	17
of which Electronics	5.7	5.8	5.1	11.8	31.5	27.6
CORE IMPORTS	**28.4**	**29.8**	**28.1**	**1.1**	**170.9**	**159**
TRADE DEFICIT	**-14.0**	**-17.4**	**-9.4**		**-95.0**	**-77.0**

Source: Industry

INR to the USD (could range between 70 & 77)

Indian Rupee will be driven by the following factors: 1) State of capital flows between developed markets and EM; 2) Domestic growth outlook; 3) Financial sector stability; 4) Political stability and 5) Oil prices. So far in 2018, improving growth outlook in America allowed Fed to become aggressive in monetary policy tightening and that along with trade war caused capital flows to reverse direction from EM towards US markets. If capital flows reverse direction from US to EM, led by slowdown in US economic growth, then Rupee can be a beneficiary of the rising flows into EMs and India. Oil prices can remain elevated due to strong global growth and tight global oil supplies, which can continue to be drag on Rupee. Therefore, in base case scenario, a range of 70-77 can be seen in the pair over the next 12 months

INR vs. USD

Source: Bloomberg

State elections – harbinger to general elections

In October, Election Commission of India (EC) announced polling schedule for Assembly elections in five states - Chhattisgarh, Madhya Pradesh, Mizoram, Rajasthan and Telangana. Chhattisgarh will vote in two phases, other states will vote in a single phase. Counting of votes in all the five states will be done on December 11. Past results in upcoming elections in 3 states – Rajasthan has witnessed alternate government formations, while MP and Chhattisgarh have been ruled by BJP for the past 15 years. We believe these elections are important, as they will be seen as an indication of people's mood towards the ruling party and could also be a precursor to the upcoming general election scheduled somewhere in Apr-May'19.

Summary of upcoming state elections in CY18

State	No of Assembly seats	Incumbent Government	Election date	Counting
Rajasthan	200	BJP	7th December	11th December
Madhya Pradesh	230	BJP	28th November	11th December
Chhattisgarh	90	BJP	12th and 20th November	11th December
Telangana	119	TRS	7th December	11th December
Mizoram	40	Congress	28th November	11th December

Source: Election Commission of India

Weakness in the NBFC space to continue in near term

The default by IL&FS on SIDBI loans in August 2018 (probably first such default by any large Financial Institution in Indian history) lead to credit rating downgrade by 16 notches (from AA to D) by ICRA. The downgrade led to contagion effect on the sentiment of money markets as they have to provide for mark-to-market on downgraded financial instruments. It is important to note that, the total borrowings of IL&FS currently stands above Rs.900 bn (nearly 1% of the entire Indian banking industry loan book), and the default on SIDBI by them negatively impacted the debt and money markets, with significant liquidity crisis bringing back unpleasant memories of Lehman Brothers bankruptcy episode of 2008.

In a scenario of weak liquidity in money markets, the first pockets that will come under pressure would be NBFCs in general and Housing Financing Companies (HFCs) in particular. The key concern of investors at this point is the rollover of CP/NCDs as mutual funds seem to have taken a cautious stance on NBFCs. The current concern of debt markets largely pertains to wholesale and developer loans. While larger NBFCs may be able to manage liquidity challenges, the focus will shift to their ability to manage ALM in light of any new regulations that might come in from the regulator. Large NBFCs with strong parentage and retail focus will be best placed to ride this tough conditions.

Summary of what is in favor of Indian equities?

- Slowing inflation (RBI may not hike rates in December 2018)
- Central Bank committed to keeping real rates positive
- A low and falling beta, which augurs well in a weak global equity market environment
- IMF expects India's GDP growth at 7.3% in 2018 and 7.4% in 2019
- Strong domestic flows (SIP accounting for ~2/3rd of US$1.5 bn monthly flow)
- Progressive reforms (GST compliance expected to improve as rates come down)

Summary of what is against Indian equities?

- Rising crude oil prices, which could put pressure on growth
- Depreciating Indian Rupee making imports costlier
- Weak Current Account Deficit threat to Fiscal Deficit
- Pre-election period which brings in a lot of uncertainties
- Increasing equity risk premium due to rise in bond yields
- Relatively rich mid-cap valuations (even after the recent drawdown)

Corporate earnings (expect downgrades to future estimates)

During 2014 to 2017, India benefited from strong macros (with very low Crude oil prices, comfortable levels of inflation, under-control dual deficits and benign interest rate scenario with accommodative monetary policies across the world). However, Indian micro scenario in terms of corporate earnings was not that comforting during this period with low single digit corporate earnings growth and multi-decade low levels of bank lending growth. However, starting FY18, while macros have started to face headwinds, there is a clear uptick in Indian corporate earnings. As per equity master, BSE 200 companies (excluding banks) reported sales growth of 14.1% in Q1FY19 and earnings growth of 9.8% YoY.

Quarterly corporate earnings (BSE 200 Cos. excluding banks)

Rs trillion	Q4FY18	Q1FY18	Q1FY19	YoY (%)	QoQ (%)
Sales	165.0	144.3	164.7	14.1	-0.2
PAT	8.8	8.4	9.2	9.8	5.0

Source: Equity Master

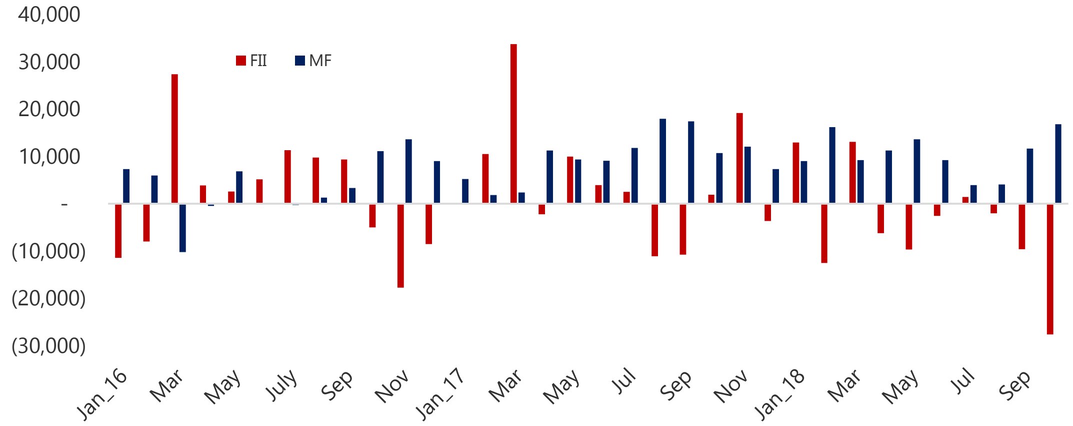
Q2FY19 earnings has not started on a healthy note due to higher crude prices and depreciation of INR. Our Institutional team (KIE) expects 2Q-FY19 earnings of their coverage to be flat on a YoY basis. KIE is building in Nifty earnings growth of 18% in FY19E and 24% in FY20E. Based on Bloomberg Consensus earnings growth of Nifty works to 16% in FY19E and 21% for FY20E. The consensus EPS estimates of Nifty works to Rs.575 for FY19 and Rs.693 for FY20.

Domestic flows (expected to remain strong in Samvat 2075)

Larger awareness, discipline & stability in investments, small ticket investment size (investments can be as small as Rs.500 per month) and attractive past returns have resulted in strong investments in mutual funds through the SIP route. Recent data from AMFI highlighted that, contributions to SIP's in 1HFY19 was reported at Rs.444.9 bn (+52% YoY). We expect the trend to continue over the next one year, providing the required support to Indian markets in any major fall. On a broader basis if we assume 3-4% of household savings to go into equities (which is the historical average) then annual inflows could average ~USD 15 bn. The flows many not be linear but over longer periods the average should reflect.

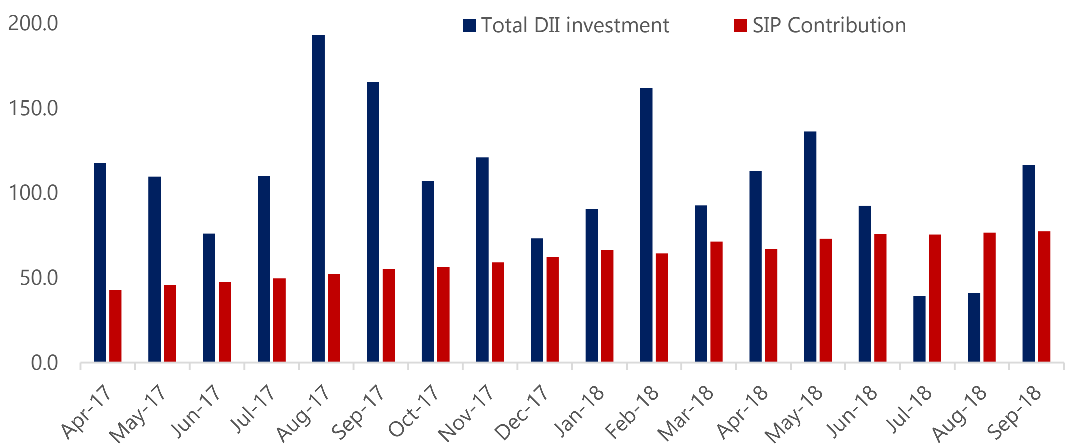
YTD in this calendar year FIIs have sold stocks worth USD 5.7 bn whereas domestic Mutual Funds have bought stocks worth USD 15.92 bn. Other emerging markets like S.Korea, Taiwan, Indonesia & Thailand have seen YTD outflows ranging between USD 4bn to USD 10 bn.

FII & Mutual Fund investment (Rs cr)



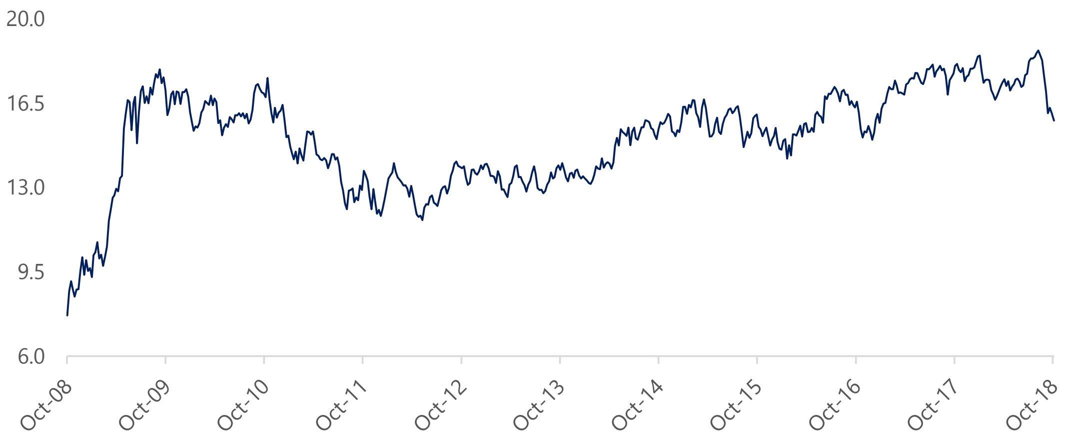
Source: Bloomberg

DII investment vs. SIP flow (Rs bn)



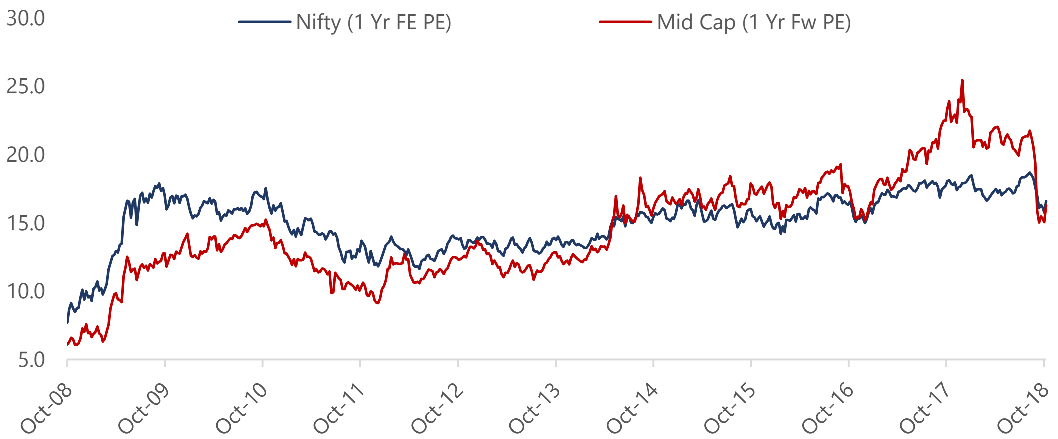
Source: Bloomberg

Nifty: 1 Yr forward PE chart



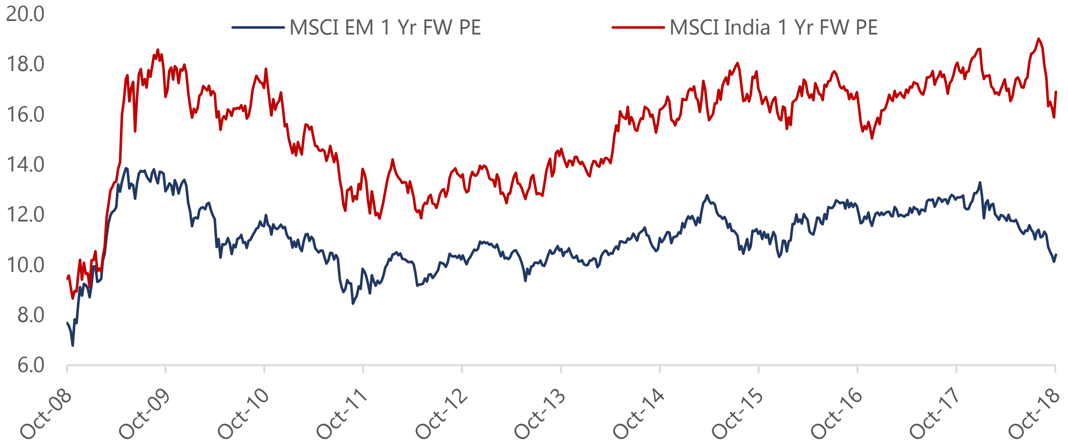
Source: Bloomberg

Mid Cap Vs Nifty Valuations (1 Yr Fw PE chart)



Source: Bloomberg

MSCI India VS MSCI EM (1 Yr FW PE Chart)



Source: Bloomberg

Sectoral Preferences

We prefer the following sectors in SAMVAT 2075

Banks (prefer large private sector banks)

We believe that the IL&FS default (leading to low liquidity levels in the system) and rising interest rates in India will make it tougher for wholesale- funded institutions to raise capital. Funding cost for wholesale funded institutions is increasing – which will hamper growth, margins and potentially asset quality. The imminent slowdown in NBFC growth should benefit large private banks, which were constrained by liability growth trailing asset growth. The RBI's move to ease the mandatory liquidity coverage ratio (LCR) requirements for banks should further improve liquidity for banks. We expect large banks to accelerate loan growth and improve spreads (both assets and liabilities) over the next three years.

Consumption (FMCG: strong volume growth & outlook)

For FMCG (1) trade conditions have normalized across channels, (2) they are witnessing gradual improvement in demand and positive trend in urban and rural growth. Rural growth has outpaced urban demand; (3) have favourable GST regime ;(4) are experiencing soft commodity prices and may exhibit margin expansion in H2FY19; (5) Management commentary has been positive. We expect most of the companies in the consumer space to report strong numbers in FY19.

Consumer Durables (Big beneficiary of GST rate reduction)

The growth in the Indian consumer durables industry continues to be driven by rising penetration. As the impact of various new initiatives (reduction in GST rates) by the Government start reaching to the larger population, we clearly see the aspiration of better living driving up demand for discretionary products like durables. E-commerce platforms have emerged as key catalysts by providing access beyond traditional distribution channels. We remain positive on room AC market, though in the near term there are challenges in terms of excess inventory and cost pressures.

Information Technology (Currency to aid earnings growth)

We remain positive on the Indian IT sector despite the outperformance of Nifty IT index till date in CY18. Companies are witnessing a pickup in growth in FY19 and are pricing in modest acceleration in FY20. The faster growth shown by midcap IT companies till now was mainly due to smaller base and lower exposure to legacy business. But going forward as industrialization of digital picks up, we believe large Indian IT companies and select midcap companies will be in a better position to capture market.

Metals (larger players are better positioned)

For ferrous, we believe that Improving domestic demand and strong macro factors should drive volume growth. This coupled with resolution on NCLT asset & expansions should drive incremental supply (top players to benefit as they gain incremental market share). Raw material prices are expected to be favorable (spreads to sustain). On the non-ferrous front, we believe aluminum stands to gain compared to other base metals, backed by supply disruption in China and increase in cost push. Expectation of higher government spending on infra in a pre-election year might giving some respite to domestic demand and prices, which could augur well for domestic metal companies.

Oil and Gas (bullish on natural gas space)

We estimated crude to be in the range of US$80 to $90 per barrel amidst uncertainties of increase in supply from Shale and OPEC, disruption of supply from Iran and strong global demand for crude. Higher crude prices and depreciating rupee is positive for upstream oil companies (like ONGC). However it is negative for Oil marketing companies (OMCs) in an election heavy year. This was also reflected in Rs.1/ltr cut in the retail fuel price and OMCs were asked to bear the burden, raising questions on deregulation of the sector and earnings uncertainty for OMCs. In the oil and gas space, we are bullish on the natural gas sector mainly because of better cost economics, government thrust on less polluting fuel, and increasing RLNG capacity.

Pharma (Under owned with improving prospects)

The sector should report improved earnings growth in the next one year driven by good specialty and complex approvals in US, decreasing compliance risk in the US, INR depreciation and strong prospects of the domestic market. The under-ownership of the sector also should correct as we move ahead.

Our Fundamental Diwali Picks for SAMVAT 2075

Fundamental Diwali picks – Samvat 2075

Company	CMP as on 2nd November	TP (Rs)	Upside (%)	FY20 PE (x)
Maruti Suzuki*	7,135	8200	14.9	20.5
Vedanta Limited*	226	330	45.4	6.8
ITC limited*	283	330	16.2	25.4
ICICI Prudential*	352	475	35.3	34.2
Supreme Industries	996	1205	21.1	23.1
Jubilant Foodworks*	1,080	1370	26.5	37.3
Quess Corp	752	1072	42.9	24.6

*Source: Kotak Securities – Private Client Research; * Kotak Institutional Equities*

Performance of our Fundamental Diwali picks of last year (Samvat 2074)

Company	Reco given at (Rs)	Target (Rs)	Target achieved	Target Date
Asian Granito	485	603	Yes	12th Jan 2018
Engineers India	151	182	Yes	7th Dec 2017
Genus	60	75	Yes	2nd Jan 2018
Maruti	7,830	9,061	Yes	11th Dec 2017
TV 18 broadcast	40	47	Yes	24th Nov 2017
VIP	264	325	Yes	22nd Nov 2017
Cochin Shipyard	563	740	Open	NA / CMP Rs.388
FIEM Industries	896	1254	Open	NA / CMP Rs.609
MRPL	127	155	Open	NA / CMP Rs.82.5
Shree Cement	18,500	22,716	Open	NA / CMP Rs.14786

Source: Kotak Securities – Private Client Research

ITC Ltd

Analyst: Rohit Chordia/ Jaykumar Doshi/ Aniket Sethi

Current Market Price (Rs)*	Target Price (Rs)	Potential Upside (%)	52 Week H/L (Rs)	Mkt Cap (Rs mn)*
283	330	16.5%	323 / 250	3287683

** As on 2 Nov 2018*

Investment Argument

- Cigarette volume increased by 7% in Q2FY19, which saw a significant improvement from 1% growth in Q1FY19 (and -7% in Q2FY18).
- EBIT growth in hotels (+267%, off a low base) and other FMCG (Rs 585 mn versus Rs 205 mn in 2QFY18) was encouraging and so was the EBIT performance of the paperboards (+13% YoY).
- For Agri business, ITC management has highlighted stable demand environment with visible signs of recovery, especially in the rural markets.
- In Personal care, the recently acquired 'Nimyle' range of herbal floor cleaners was extended to new markets even as it recorded robust growth in existing markets
- The stock is reasonably priced with cigarette business trading at sub-20X implied PE.
- We remain positive; ITC is the only large-cap stock in the sector where the current valuations factor in a less-than-super-optimistic view of the future.
- We value the cigarette business at 24X post-tax EBIT and the FMCG business as 5X EV/sales.

Financials

(Rs mn)	FY18	FY19E	FY20E
Sales	**402,547**	**430,943**	**476,579**
Growth (%)	1.5	7.1	10.6
EBITDA	**151,681**	**166,963**	**192,197**
EBITDA margin (%)	37.7	38.7	40.3
PBT	164,388	181,102	206,088
Net profit	**109,466**	**120,433**	**136,018**
EPS (Rs)	8.9	9.8	11.1
Growth (%)	7.8	9.9	12.8
ROE (%)	22.6	22.6	23.9
ROCE (%)	27.8	27.8	30.2
Working Capital	19,202	(1,419)	(2,747)
P/E (x)	31.8	28.9	25.4

Source: Bloomberg, Company, Kotak Institutional Equities

This one pager on the company is extracted from last KIE update dated October 26, 2018 and it does not contain events beyond that date. We take no obligation to update the KIE recommendations. Above company recommendation is of KIE which has a different rating system than Kotak PCG as disclosed in the end of the report (before Disclaimer). It is advisable to read the full KIE report before taking any investment decision on the above company recommendation.

Maruti Suzuki India Ltd

Analyst: Hitesh Goel/ Nishit Jalan

Current Market Price (Rs)*	Target Price (Rs)	Potential Upside (%)	52 Week H/L (Rs)	Mkt Cap (Rs mn)*
7135	8200	14.9%	10000 / 6500	2155477

** As on 2 Nov 2018*

Investment Argument

- We believe MSIL's capacity will be booked for next three years as volumes can grow at 10% CAGR over this period.
- Gujarat plant will stabilize over the next one year, which will lead to improvement in EBITDA margin for the company.
- Company indicated that once they reach production of 750,000 units in Gujarat, vendor localization levels will reach at Gurgaon levels, this could add 100 bps to the EBITDA margin.
- Raw material imports are 18% of sales in 2QFY19 (5% is direct imports and 13% is indirect imports). 5.7% of sales is royalty cost. 7% of net sales are exports. 60% of royalty payments are in JPY now and the rest 40% are in INR.
- The company added 315 new dealers in FY2018; of this, 140 dealers were added for the commercial vehicle segment where Maruti has around 190 dealers currently.
- The company is guiding towards capex of Rs50 bn in FY2019E, which will be incurred towards engine capacity expansion, product development, R&D, maintenance expenses and Rs10 bn spend towards acquisition of land for dealers.

Financials

(Rs mn)	FY18	FY19E	FY20E
Revenues	**797,627**	**895,645**	**1,044,289**
Growth (%)	17.2	12.3	16.6
EBITDA	**120,615**	**129,633**	**159,716**
EBITDA margin (%)	15.1	14.5	15.3
Adj. Net profit	**32,816**	**36,326**	**45,174**
Adj. EPS (Rs)	256	281	349
Adj. EPS Growth (%)	5.1	9.8	24.3
Book value (Rs/share)	1,401	1,597	1,841
Free cash flow	79,201	36,953	74,237
ROE (%)	19.5	18.7	20.3
Net debt/equity	-0.8	-0.8	-0.8
P/E (x)	27.9	25.4	20.5

Source: Bloomberg, Company, Kotak Institutional Equities

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Vedanta Ltd

Analyst : Abhishek Poddar/ Tarun Lakhotia/ Prayatn Mahajan

Current Market Price (Rs)*	Target Price (Rs)	Potential Upside (%)	52 Week H/L (Rs)	Mkt Cap (Rs mn)*
226	330	46.1%	356 / 197	839670

* As on 2 Nov 2018

Investment Argument

- The company's zinc volume growth is expected to increase from 2HFY19 onwards led by commissioning of mines in India/RSA in 2Q/3QFY19—we expect strong increase in zinc earnings from 2H.
- We expect strong improvement in VEDL's zinc earnings in 2HFY19 led by (1) ramp-up of Gamsberg project—VEDL expects 75 kt of volumes in 2HFY19 at low production cost of US$800-1,000/ton, (2) increase in Skorpion, BMM volumes at Zinc International as 1H was impacted by higher waste mining, low grades—this should aid in significant reduction in costs too.
- VEDL's net-debt declined to Rs264 bn in September 2018 from Rs299 bn in June 30, 2018 (this excludes buyer's credit of US$700-750 mn).
- The company earned operating cash flows of Rs38.9 bn during 2QFY19 while cash flows were also aided by working capital release of Rs23 bn. The capex for the quarter was Rs25.5 bn.
- VEDL expects FY2019E capex at US$1.5 bn largely towards oil & gas and zinc operations. The capex in FY2020E can increase to US$1.8 bn due to US$600 mn expected investment for Electrosteel Steels expansion and Lajigarh refinery expansion to 4 mtpa.
- The company declared interim dividend of Rs17/share.

Financials

(Rs mn)	FY18	FY19E	FY20E
Sales	**918,660**	**910,114**	**1,011,645**
Growth (%)	27.2	(0.9)	11.2
EBITDA	**251,640**	**273,423**	**330,982**
EBITDA margin (%)	27.4	30.0	32.7
PBT	166,720	160,830	218,379
Adj. Net profit	**80,250**	**83,672**	**123,043**
EPS (Rs)	21.6	22.5	33.1
Growth (%)	9.6	4.2	47.1
ROAE (%)	12.9	17.5	16.5
ROACE (%)	9.5	11.6	11.6
P/E (x)	10.5	10.0	6.8

Source: Bloomberg, Company, Kotak Institutional Equities

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ICICI Prudential Life Insurance

Analyst: Nischint Chawathe/ M B Mahesh/ Dipanjan Ghosh/ Shrey Singh

Current Market Price (Rs)*	Target Price (Rs)	Potential Upside (%)	52 Week H/L (Rs)	Mkt Cap (Rs mn)*
352	475	34.8%	461 / 302	505893

* As on 2 Nov 2018

Investment Argument

- An underpenetrated market, an increasing share of financial assets in savings along with market leader LIC ceding market share lend long term structural growth to India's private life insurance sector
- Strong bancassurance model – ICICI Prudential Life has substantial backing from ICICI Bank, with the banking channel contributing more than 50% of Annualized Premium Equivalent (APE)
- Persistency ratio has improved markedly across all buckets driven by improved selling practices, with 13th month persistency at 87.8% in FY18 (vs 82.4% in FY16) and 61st month persistency improving to 54.8% in FY18 from 46% in FY16
- ICICI Prudential Life has historically employed a ULIP heavy strategy, with ULIPs contributing 84.1% of FY17 APE. However, protection business APE was 7.7% of total APE in 2QFY19 (from 3.9% in FY17); illustrating management's focus on sustaining momentum in the higher margin protection business

Financials

(Rs mn)	FY18	FY19E	FY20E
Annualized Premium Equivalent	**77,900**	**81,800**	**96,500**
APE growth (%)	17.5%	5.0%	18.0%
Value of New Business	12,900	14,700	17,900
VNB margin	16.5%	18.0%	18.5%
EVOP	37,000	33,000	39,000
PAT	**16,198**	**12,777**	**14,786**
EPS (Rs)	11.3	8.9	10.3
BVPS	45.8	52.9	61.2
RoE (%)	25.0%	18.1%	18.1%
EV	188,000	211,000	244,000
RoEV	16.5%	12.5%	15.3%
P/E (x)	31.2	39.6	34.2
P/BV (x)	7.7	6.7	5.8
P/EV (x)	2.5	2.2	1.9
P/EVOP (x)	13.0	14.0	12.0

Source: Bloomberg, Company, Kotak Institutional Equities

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Jubilant Foodworks Limited (JUBI)

Analyst: Rohit Chordia/ Jaykumar Doshi/ Aniket Sethi

Current Market Price (Rs)*	Target Price (Rs)	Potential Upside (%)	52 Week H/L (Rs)	Mkt Cap (Rs mn)*
1080	1370	26.8%	1578 / 795	142540

* As on 2 Nov 2018

Investment Argument

- JUBI opened 23 net new Domino's stores in Q2FY19 taking total count to 1,167. Store expansion pace has accelerated and is in line with management guidance of 75 stores in FY19
- SSG remains the single-most important variable that will determine the broad shape of JUBI's financials and the management is confident of continuously improving the same.
- The company is currently witnessing inflation in fuel and manpower costs, however RM costs environment (especially dairy products) is favorable. Additionally, there could be cost savings from ongoing productivity improvement program.
- Dunkin donuts (DD) drag on margins reduced to 50 bps for 2Q from 55 bps in 1QFY19. The company reiterated it is on track for DD breakeven by 4QFY19E. It has also indicated that ongoing re-branding of Dunkin Donuts in the US would not impact India.
- Regarding anti-profiteering investigation, management informed that investigation is pending and it expressed confidence that its argument will be accepted.

Financials

(Rs mn)	FY18	FY19E	FY20E
Sales	**30,184**	**35,786**	**41,965**
Growth (%)	17	18.6	17.3
EBITDA	**4,401**	**6,105**	**7,808**
EBITDA margin (%)	14.6	17.1	18.6
PBT	2,968	4,958	6,840
Net profit	**1,921**	**3,223**	**4,429**
EPS (Rs)	14.6	24.3	33.3
Growth (%)	191.7	67.2	36.9
ROE (%)	21.7	28.0	28.7
ROCE (%)	28.8	37.4	38.2
P/E (x)	74.0	44.4	32.4

Source: Bloomberg, Company, Kotak Institutional Equities

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Quess Corp Ltd

Analyst: Sumit Pokharna

Current Market Price (Rs)*	Target Price (Rs)	Potential Upside (%)	52 Week H/L (Rs)	Mkt Cap (Rs mn)*
752	1072	42.6%	1303 / 675	109827

* As on 2 Nov 2018

Investment Argument

- Quess, India's leading integrated business service provider, has an exceptional financial track record - Sales/PAT grown at a CAGR of 56%/110%, respectively during the last seven years supported by both organic and inorganic growth.
- The company alluded its focus on execution and balance sheet management to boost its long term earnings growth.
- Operating margin improvement will be supported by better product mix, improvement in operations of DIGIMAX solutions, turnaround of Monster and other efficiency improvement. The company expects an operating margin of 6% by Q4FY19end. Further, in the medium to long term margin, it expects operating margin to improve to 8%.
- The staffing industry requires minimal capital investment but sees disproportionate increase in profitability and return ratios on gaining scale/volume. The company's management is strategically focusing on client acquisition, mining existing clients (catering wider services to existing clients) to achieve scale and improving operating level efficiency.

Financials

(Rs mn)	FY18	FY19E	FY20E
Sales	**61,673**	**85,870**	**100,879**
Growth (%)	42.9	39.2	17.5
EBIDTA	**3,485**	**4,866**	**6,119**
EBIDTA margin (%)	5.65%	5.67%	6.07%
PBT	2,611	3,661	4,970
PAT	**3,097**	**3,368**	**4,473**
PAT Margin (%)	5.0	3.9	4.4
EPS (Rs)	21.2	23.1	30.6
Growth (%)	154.1	8.8	32.8
CEPS	26.3	30.9	38.9
Book Value (Rs / Share)	169.1	194.3	224.9
Dividend per Share (Rs)	0.0	0.0	0.0
ROE (%)	16.1	12.7	14.6
ROCE (%)	17.9	15.0	16.2
Net cash/(debt)	5,679	8,641	10,463
Net working capital (Days)	48	44	45
P/E (x)	35.5	32.6	24.6
P/BV (x)	4.4	3.9	3.3
EV/Sales (x)	1.7	1.2	1.0
EV/EBITDA (x)	29.9	20.8	16.2

Source: Company, Kotak Securities – Private Client Research

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Supreme Industries Ltd

Analyst: Pankaj Kumar

Current Market Price (Rs)*	Target Price (Rs)	Potential Upside (%)	52 Week H/L (Rs)	Mkt Cap (Rs mn)*
996	1205	20.9%	1490 / 944	126563

* As on 2 Nov 2018

Investment Argument

- Supreme Industries Ltd (SIL) is one of the major players in the plastic pipes business with established brand equity and diverse presence across other business segments such as packaging, industrial products, plastic furniture, etc.
- SIL has track record of generating high ROCE of ~30-35% with low debt/equity and strong positive operating cash flows driven by 1) efficient utilization of assets 2) diverse products mix with increasing share of high margins value added products 3) better working capital management v/s its peers.
- SIL management has guided for 10% growth in volume with 14.5-15% EBITDA margin in FY19E driven by robust plastic demand across most of the segments and increased contribution from high margin value added products.
- SIL is increasing capacity across segments which would help in maintaining volume growth. It is adding 50,000 tonne per annum capacity every year in FY19E-FY21E with total capex of Rs 12-13 bn funded largely through internal accruals.
- The company is positive on composite cylinder business and expects order from domestic as well as international market in FY19E.
- We expect earnings to grow at faster pace in the longer run on improved volume growth outlook for the company, focus on increasing share of value added products and its ability to pass on increase in raw material prices.

Financials

(Rs mn)	FY18	FY19E	FY20E
Sales	**49,663**	**57,656**	**67,243**
Growth (%)	11.3	16.1	16.6
EBITDA	**7,871**	**8,781**	**10,519**
EBITDA margin (%)	15.8	15.2	15.6
PBT	6,028	6,731	8,302
Net profit	**3,971**	**4,434**	**5,469**
EPS (Rs)	31.3	34.9	43.0
Growth (%)	5.4	11.7	23.3
CEPS (Rs)	44.4	49.8	60.0
Book value (Rs/share)	149.1	170.0	199.0
Dividend per share (Rs)	12.0	12.0	12.0
ROE (%)	22.1	21.9	23.3
ROCE (%)	30.1	30.2	33.6
Net cash (debt)	(2,164)	(1,702)	86
Net Working Capital (Days)	43	39	36
P/E (x)	31.9	28.6	23.1
P/BV (x)	6.7	5.9	5.0
EV/Sales (x)	2.6	2.2	1.9
EV/EBITDA (x)	16.4	14.6	12.0

Source: Company, Kotak Securities – Private Client Research

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Rating Scale (Kotak Securities – Private Client Research)

Definitions of ratings

BUY	–	We expect the stock to deliver more than 12% returns over the next 12 months
ACCUMULATE	–	We expect the stock to deliver 5% - 12% returns over the next 12 months
REDUCE	–	We expect the stock to deliver 0% - 5% returns over the next 12 months
SELL	–	We expect the stock to deliver negative 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.
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.

Rating scale for 1 month portfolio

Benchmark	–	Nifty
Time horizon	–	1 month
Short term buys	–	Stocks expected to outperform the benchmark Nifty in the said time horizon

Rating Scale (Kotak Institutional Equities)

Ratings and other definitions/identifiers

Definitions of rating

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 target prices are also on a 12-month horizon basis.

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NA = Not Available or Not Applicable. The information is not available for display or is not applicable.

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