1 January 2013

Markets leading macro in 2013…

…but what could go wrong

The Indian market's 25% return in 2012 despite a deteriorating macro has been driven by the onset of a reforms-based *'hope-trade'* since June'12, with capital inflows at US$23bn. Current estimates do point to near-term macro relief, part of which the market is already pricing in, and we expect the trend to continue in 2013, even as a below-par growth trajectory (FY14E growth at 5.8%) limits a wholesale re-rating.

Factors that could work against a macro revival include below-potential growth, China-led commodity inflation, further currency pain and populist reforms. We believe reformist policy would be the single most important driver of markets this year.

Our Dec'13 Sensex target of 22,500 based on a 14.5x target P/E multiple (assuming zero re-rating) implies 16% upside from current levels. In light of the impending macro revival, we have positioned our portfolio to play the cyclical recovery, turning more constructive on high-quality beta names. Our top-picks for 2013 – SBIN, TTMT, LT, UTCEM, UNSP – clearly reflect our strategy.

- **Domestic macro revival on horizon:** Growth in India has slipped for three years now, and while there's no case for a rapid revival, our macro estimates point to a gradual recovery in FY14 growth, likely at 5.8%. Industry and Services are expected to perform better in FY14, albeit marginally, led by policy rate cuts and continued reform momentum.

- **Global outlook appears better:** Global growth is likely to recover marginally this year, with all major geographies except the Eurozone expected to better their economic performance in 2013, supported by lower interest rates. This augurs well for FII sentiment as this investor segment continues to dominate market performance in India.

- **Earnings to bottom out in Q3FY13:** After five quarters of continuous disappointment, we expect earnings to bottom out in Q3FY13, with upgrades likely to outnumber downgrades thereafter, albeit marginally, led by (1) a domestic demand revival resulting in improving topline growth, (2) margin expansion led by falling input costs and the overhang of a China slowdown, and (3) lower cost of funds on likely rate cuts. Of course, such a revival is strongly dependent on the macro.

- **Dec'13 Sensex target at 22,500:** We set a Dec'13 Sensex target of 22,500, indicating a 16% upside from current levels based on a target P/E multiple of 14.5x CY14E earnings. We believe this is reasonable given current domestic and global market conditions. At 14.5x, the market would trade at ~10% discount to its LTA of 16x, a discount that reflects the medium-term output gap and attendant macro factors.

- **So what could go wrong:** Likely as it might seem, a positive spin to the India story is unfortunately not a given. A number of factors that could work against this include (1) below potential growth locally, (2) delayed global recovery, (3) China-led commodity inflation, (4) further pain on the INR and (5) populism in a pre-election year.

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Fig 1 - Sensex 12-month forward P/E band

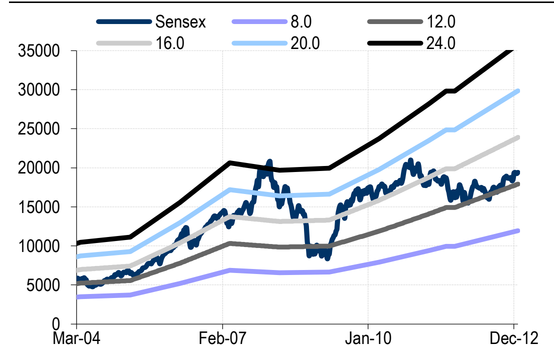

Fig 2 - RCML large-cap portfolio stance (bps)

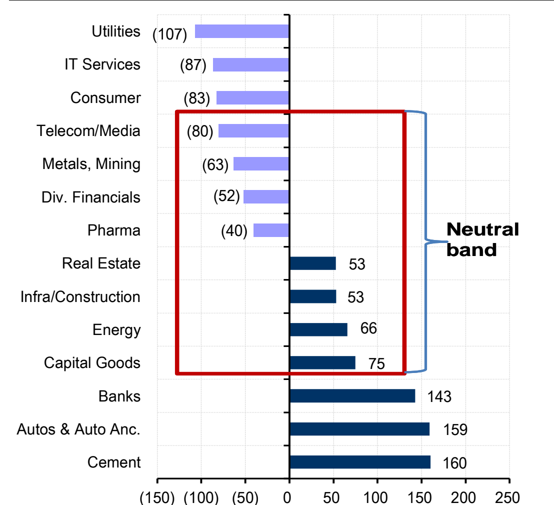

Fig 3 - Top picks for 2013

Large-cap Longs	Mid-cap longs	Shorts
State Bank of India	JK Lakshmi Cement	BHEL
Tata Motors	TechM – Satyam	PNB
Larsen & Toubro	Yes Bank	REC
UltraTech Cement	LIC Housing Fin.	Mphasis
United Spirits	Sun TV	

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Top five large-cap ideas for 2013

Fig 4 - Top five large-cap picks – Valuation

Stock	CMP	RCML Target	Upside	FY14 PE	FY14 PB	FY14 RoE	FY14 EV/EBIDTA	FY14 EPS growth
State Bank of India	2,378	2540	6.8%	9.6	1.5	16.4	NA	17.6%
Tata Motors	310	320	3.3%	7.4	1.8	27.5	4.0	18.8%
UltraTech Cement	1,968	2250	14.3%	14.7	2.8	21.2	8.3	25.4%
Larsen and Tourbo	1,618	1820	12.5%	16.7	2.4	15.3	12.0	15.8%
United Spirits	1,899	2100	10.6%	30.7	3.1	12.9	17.9	118.8%

Source: RCML Research

Top five mid-cap ideas for 2013

Fig 5 - Top five mid-cap picks – Valuation

Stock	CMP	RCML Target	Upside	FY14 PE	FY14 PB	FY14 RoE	FY14 EV/EBIDTA	FY14 EPS growth
JK Lakshmi Cement	163	165	1.5%	6.9	1.2	18.3	4.4	18.0%
Tech Mahindra	921	1200	30.3%	8.1	2.0	26.5	5.6	9.4%
Satyam Computers	105	140	33.3%	8.4	2.1	19.4	4.0	11.6%
LIC Housing Finance	293	300	2.4%	10.6	2.0	19.8	NA	25.9%
Yes Bank	463	475	2.6%	11.4	2.1	22.3	NA	14.9%

Source: RCML Research

Top short ideas for 2013

Fig 6 - Top five short picks – Valuation

Stock	CMP	RCML Target	Upside	FY14 PE	FY14 PB	FY14 RoE	FY14 EV/EBIDTA	FY14 EPS growth
BHEL	228	200	(12.1%)	10.1	1.7	17.5	4.7	(14.3%)
Punjab National Bank	843	825	(2.1%)	4.8	0.8	18.2	NA	25.1%
Rural Electrification Corp	242	210	(13.2%)	5.9	1.3	23.4	NA	17.4%
Mphasis	385	300	(22.1%)	10.4	1.6	NA	5.2	(2.1%)

Source: RCML Research

Note: All prices in the note are as of 28 December 2012 close.

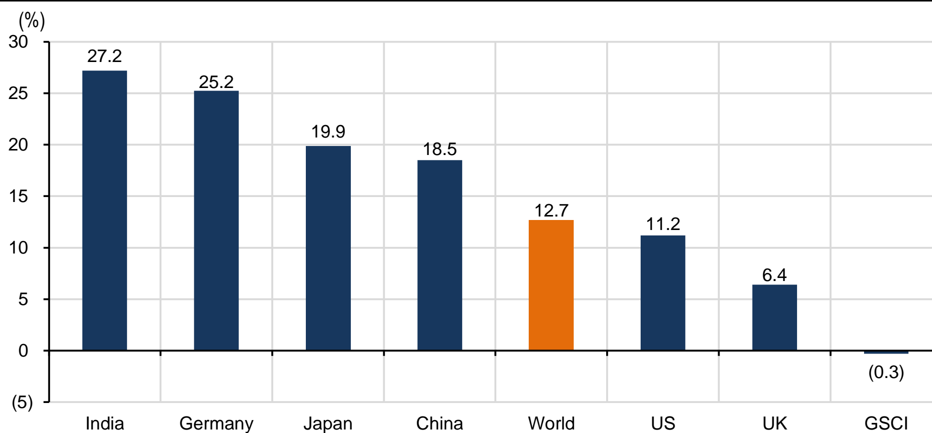
Markets would lead the macro this year

As they price in a macro revival

Indian markets have been on a 'hope-trade' rally, with Sensex up 10% since early June and 18% since Sep diesel price hike

Indian markets have had an exciting second half of the year, rising ~10% since early June (~18% since 13 September when the diesel price hike was announced), on the 'hope-trade' of reforms – in stasis for nearly two years – beginning with news of a change of guard at the finance ministry, followed by the return of market-favourite P. Chidambaram at the helm of affairs, and continuing with a host of positive market-friendly announcements. Growth weakened in major geographies, especially the Eurozone, but liquidity continued to slosh around in global markets, with one central bank after another coming up with plans to inject more of it. The resultant capital flows into equities (at US$23bn and counting) more than made up for the drought in 2011. Domestic institutions, of course didn't participate, given their redemption pressures, but more on that later.

Fig 7 - Performance of major markets worldwide (last 12M)



Source: Bloomberg, RCML Research

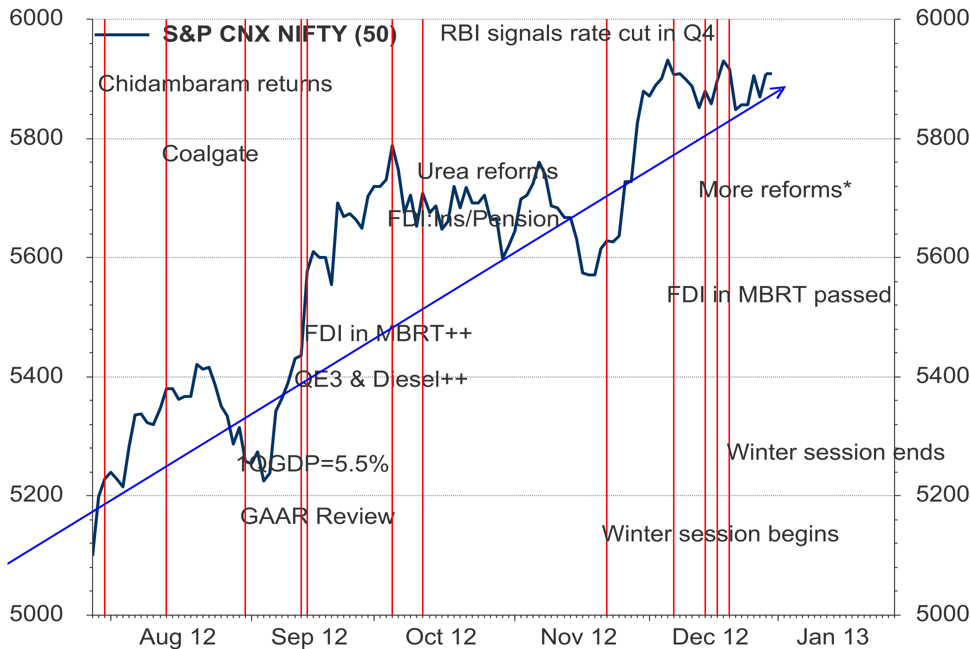
The important point to note here is that ushering in reforms solved only one of the three *domestic* ills that plagued Indian markets in 2011, viz., falling growth, stubborn inflation, and policy paralysis. With its recent rhetoric and actions, the Govt. seems to have finally acknowledged the seriousness of the macro downfall, and one hopes to see the reform momentum continue, at least till we get close enough to the general elections.

Markets leading macro in 2013…

…but what could go wrong

Strategy
INDIA

Fig 8 - Markets rallying on reform momentum



Source: Datastream, RCML Research *More reforms announced on 14th Dec – CCEA cleared Land Acquisition Bill, Cabinet Committee on Investment creation (watered down version of the earlier proposed National Investment Board), and the new Urea Investment Policy.

As for the other two factors, viz., growth and inflation, not much can be averred about a growth revival in FY14. Consensus expectations for FY14 point to a marginal revival – we expect 5.8% growth, up from 5.5% this fiscal. Indeed, the Planning Commission's downgrade of the XII Plan growth target from 9% to 8.2% first, then to 8%, and thereafter the PM terming even that *'ambitious'*, illustrates a continued reality-check of sorts on the part of the Govt., and they are usually the most optimistic!

We expect growth to revive marginally in FY14 to 5.8%, provided the reform momentum continues

Inflation, however, might finally see some respite this year, particularly with the recent figures on the 'core' component of the WPI basket, at 4.3%, down to 2010-levels. While the possibility of a disappointing rebound in 2013 cannot be ruled out, finished goods prices do seem to be responding to a weaker macro. Add to that some of the most dovish commentary from the central bank in many quarters, and one would be forgiven for turning sanguine about inflation in 2013. Our base case looks at a 50bps cut in policy rates in Jan-Mar, followed by more in the latter part of the year.

With inflation showing signs of cool off, we expect the RBI to start cutting rates to boost growth

Our base case looks at a 50bps cut in Q4FY13

We see the market already pricing in some of the good news of this relief in the ongoing 'hope-trade', and expect the trend to continue in 2013. A below-trend growth trajectory does limit chances of a wholesale re-rating, but the undercurrent for the markets remains that of a policy-led macro revival this year.

In the following pages, we take a deeper look at the anatomy of this revival, the factors working for and against the markets, along with their odds.

What could go wrong this year

A number of things

We've been here before…

If the Indian markets continue their current trajectory, 2013 would mark the third time in five years the benchmark Sensex would have touched the 20,000 mark. The last two occasions didn't end up being conducive for the markets. The index stayed at the 20,000 mark for less than a month in both cases, then slid more than 20%, well within a year, with painful recoveries. **Would this time be any different? Let's consider the odds:**

Macro revival this year would not be rapid, but slow, with considerable dependency on domestic and global cues falling in place before growth gets closer to the long-term potential

A number of factors need to fall in place for the macro to revive

Maybe it would…

A number of factors point to the markets getting third-time lucky this year.

1) **Domestic macro recovery –** Growth has skidded off track for three years now, and while there's probably no case for a rapid recovery, our macro estimates point to a gradual recovery in the next fiscal, with both Industry and Services expected to perform better, albeit marginally.

2) **Inflation coming around –** Wholesale inflation is finally coming off after more than three years of 7%+ levels. Recent prints on the WPI basket, especially on the so-called 'core' inflation, point to a deepening impact of aggregate demand on prices. In other words, the economic slowdown is limiting price inflation, which in turn frees the central bank to respond to the second aspect of the business cycle we find ourselves in today.

3) **Rate cuts reform momentum –** Rates are likely to come down aggressively as the RBI catches up on the response to stagnant growth. To be sure, a cut in policy rates is as likely to serve as a signal to kick-start investment in the economy as it would help in debt-servicing. We expect the repo to be cut by 50bps in the Jan-Mar quarter, followed by another 50bps, depending on the inflation trajectory.

4) **Global recovery –** Global growth is likely to recover marginally this year, with all major geographies except the Eurozone expected to better their economic performance in 2013, supported by interest rates which are likely to remain low till 2014. For the Indian market, beleaguered by low growth, stubborn inflation, and policy paralysis in 2011, the stars definitely seem to be aligning.

Global growth indicators look set to outperform 2012, with growth in many large geographies slated to be higher, esp. from 2HCY13

Or maybe not…

Likely as it might seem, a positive spin to the India story is unfortunately not a given. There are a number of factors that could either go awry or fail to fire for the macro to rekindle above-potential growth.

Key risks to our thesis of a hope-trade rally are: lower-than-expected growth domestically and delayed global recovery; China-led commodity inflation; further pain on the INR; and populism in a pre-election year

1) **Below-potential growth locally and delayed global recovery –** Three years of fiscal mismanagement, willful and inadvertent delay in taking crucial policy decisions, together with a global post-GFC economy still trying to sputter back to life, have not just taken macro growth figures down 300bps from peak, but also below *potential*. What this means is that a recovery might well be in the offing, but extended over many years and not helped by a below-trend global economy. And if there are surprises on that front, they might not all be pleasant.

2) **China-led commodity inflation** – Commodity inflation, for instance, is likely to be subdued this year on growth concerns in China, where estimates range between 7% and 8% for 2013. Any positive surprise there would have a cascading impact on global commodities, with India importing that inflation in short order on its twin deficits. India's risk-on status is bond fide, but also subject to its commodity dependence. A current account deficit likely to top 4% this fiscal and the Govt.'s deficit at ~6% leaves little room for further deterioration.

3) **Further pain on the INR** – While we expect the INR to remain in the 53-55 band for now, further deterioration of India's trade account, worsening of global sentiments impacting foreign inflows and weakening of domestic growth and inflation could likely result in the currency shooting up again to 56-57 levels.

4) **Populism in a pre-election year** – Lastly, we must not forget the reform expectations of the market from the Govt. in these dire economic conditions. As the Kelkar Committee Report (2012) pointed out in September last, India's economic conditions are likely to degenerate to those in the early 90's if urgent ameliorating steps aren't taken. In a pre-election year, however, political considerations and exigencies take precedence. Remember the farm-loan waiver before the last General Elections followed by programs like NREGA. Why should this time be any different? Which brings us to the all-important question:

Can the Govt. deliver?

Hope trade and the global backdrop remain the market's drivers in our view. And for the first leg, i.e., the hope trade, the ball remains firmly in the Govt.'s court. We reckon chances are higher than 50:50, but the onus remains on the Govt. this year.

Govt. action is the single most important factor for markets this year

If the reform momentum and rhetoric continues, the global backdrop of easy liquidity amid anaemic growth would ensure an encore of capital flows to Indian equities in 2013, taking the markets higher. If it fails – and there are diverse reasons why it should in a pre-election year – so could the markets.

It can be safely expected that populist measures and announcements are likely to get strident towards the second half of the year, but whilst we get there, a fiscally prudent budget, action on pending legislation like the Insurance and Pension bills, clarity on coal linkages, facilitating MoEF clearances, and managing the fuel and fertilizer subsidy (regular hikes in diesel prices, for instance) are merely some of the many steps that would assuage market sentiment, and invite capital inflows.

There are no two ways about this: 2013 for India would be driven by policy, with both the macro, and market performance contingent on how it shapes up.

Our examination of macro health conditions in the following pages would commence with aggregate demand and growth, continue with inflation and monetary expectations, and culminate with the external sector.

Economic recovery on the horizon

Growth to bottom out in Q3FY13; expect FY13 GDP growth at 5.5%...

We expect GDP growth to bottom out in Q3FY13 with FY13 growth likely to come in at 5.5%

India's GDP grew 5.4% in 1HFY13, much lower than the 7.3% in 1HFY12 and the 8.4%/8.4%/6.5% in FY10/FY11/FY12, led by a mix of global (slowdown in advanced economies, Europe crisis, higher crude prices) and domestic factors (below-normal *Kharif* rainfall, tight monetary policy impacting investments, impediments in project completion). We expect growth to bottom out in Q3FY13 followed by a marginal pick-up in Q4, thanks to improving domestic macroeconomic indicators (IIP, PMI, business optimism index).

A pick-up in the investment cycle, however, is still far off due to weak domestic and global demand, with industrial GDP growth expected to recover marginally to 3.8% for FY13 (majorly led by an uptick in H2FY13) versus 3.4% in FY12. The services sector, the largest chunk of national income, is also expected to remain weak at 7.0% in FY13 versus 8.9% in FY12. A delayed and erratic southwest monsoon, significantly impacting *Kharif* production (-10% YoY as per the first advance estimates), could lead to muted agriculture growth of 2.3% in FY13 despite an improved outlook for the *Rabi* cropping season. Overall, we expect GDP growth at 5.5% in FY13.

…FY14 to see a gradual cyclical recovery; expect GDP growth at 5.8%

Economic growth should see a gradual revival in FY14 led by monetary easing and reform push. We expect FY14 GDP at 5.8%

Improving macroeconomic indicators, expansive monetary policy from Q4FY13 onwards (expect 100-150bps cut in CY13 with 50bps in Q4FY13 alone) and further reform push by the Govt. (GST, DTC, GAAR, etc.) should result in a gradual recovery in FY14. However, the dampened investment demand due to a series of policy rate hikes over the last two years to curtail inflation will take a while to pick up. We expect FY14 industrial GDP growth at 3.9%. Normal monsoons and a low base should support agricultural GDP growth in FY14 with our estimate at 2.5%. The services sector, however, is expected to remain in low gear till Q2FY14 with a muted pick-up thereafter. We estimate FY14 services sector GDP growth at 7.4%. Overall, we expect FY14 GDP growth to revive marginally to 5.8%.

Structurally, we remain positive on India owing to its demographic dividend, rising incomes, strong consumption story and vibrant rural economy.

Fig 9 - India's GDP growth expectations by industry

(%)	FY12	FY13E	FY14E	Comments
GDP	**6.5**	**5.5**	**5.8**	Improving macroeconomic indicators, monetary easing and further reform push by the Govt. should result in a gradual economic recovery in FY14.
By industry				
Agriculture	2.8	2.3	2.5	Erratic and below-normal southwest monsoon to impact FY13 growth despite an improved outlook for the *Rabi* cropping season. Expectations of a normal monsoon in FY14 *Kharif* season and a low base should support growth in FY14.
Industry	3.4	3.8	3.9	Weak domestic and global demand would likely impact industrial GDP growth in FY13. Monetary easing in Q4FY13 and FY14 should result in a pick-up in investment activity in FY14, albeit at a slower rate.
Services	8.9	7.0	7.4	Services sector is expected to remain weak in H1FY14 with a subsequent pick-up thereafter. Private investment should see a revival because of easing of rates.

Source: RCML Research

Rate cut a key market expectation

Markets pricing in lower rates through the year

After following a monetary tightening policy for the last three years to bring inflation under control, the RBI has finally turned more dovish, as suggested by its commentary during the 3QFY13 mid-quarter monetary policy. "*…decline in core inflation has been comforting. In view of inflation pressures ebbing, monetary policy has to increasingly shift focus and respond to the threats to growth from this point onwards. Liquidity conditions will be managed with a view to supporting growth as stated in the SQR, thereby preparing the ground for further shifting the policy stance to support growth. Overall, recent inflation patterns and projections provide a basis for reinforcing our October guidance about policy easing in the fourth quarter.*"

The RBI's commentary has turned quite dovish and signals aggressive monetary easing from here-on

We expect a minimum 50bps cut in Q4FY13 followed by more in the latter part of the year

Inflation finally showing signs of moderation

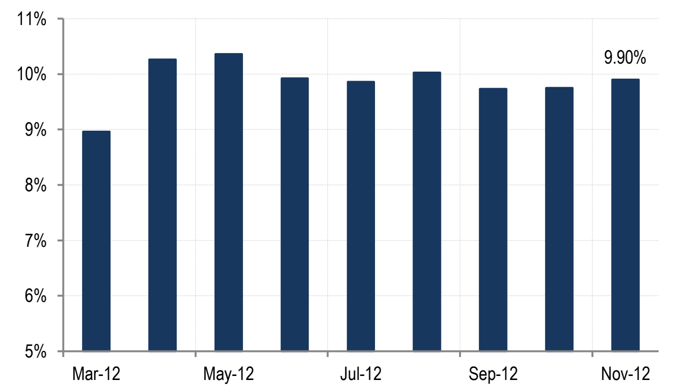
Since the RBI started its restrictive monetary policy from the beginning of 2010, wholesale inflation has cooled off, albeit at a slower-than-expected rate, from an average of 9.6% in FY11 to 9.0% in FY12 to 7.6% in FY13 to date (Apr-Nov'12). While core inflation (non-food manufacturing inflation) at 4.4% looks much more under control now, food and fuel inflation still remain high. Retail inflation at 10%+ levels too is still at stubbornly high levels and remains a cause for concern.

We expect average WPI inflation for FY13 at 7.4%

Fig 10 - WPI inflation trend

Source: MOSPI, RCML Research

Fig 11 - CPI inflation trend



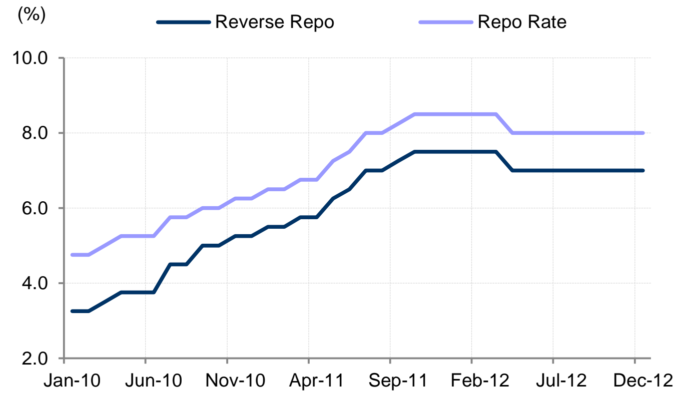
Source: MOSPI, RCML Research

Going forward, while we don't see a significant improvement in headline WPI inflation over the near term on the low base effect, excess capacity in some sectors and softening commodity prices due to global growth concerns (especially China) should prevent it from shooting up any further. A near-term diesel hike remains the key risk, notwithstanding the negative impact due to a weak currency. We expect WPI inflation to be at 7.2% by Mar'13 if the current trend continues (average at 7.4% for FY13) and improve further in FY14 to average at 7.0% (as food and primary article inflation come down on expectations of normal FY13 *Rabi*/FY14 *Kharif* monsoons).

Excess capacity and softening commodity prices would likely result in further decline in WPI inflation; we expect an avg. print of 7.0% in FY14

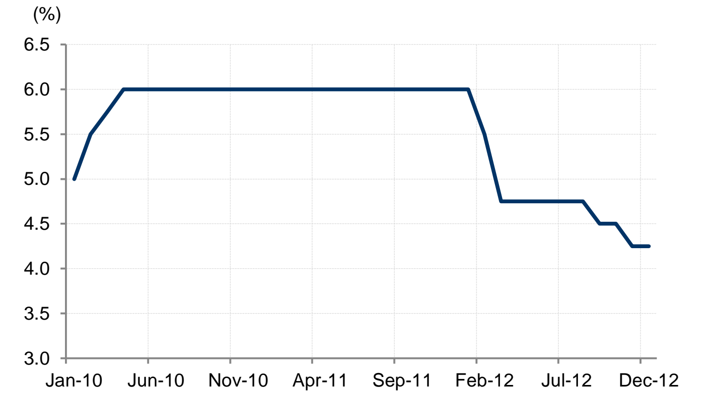
With inflation likely to remain in check now, we expect the RBI to cut repo by 50bps in Q4FY13 and by another 50-100bps in FY14, albeit more staggered, to spur growth. Accordingly, we expect an exit repo rate of 7.5% by Mar'13 and 6.5% by Mar'14. In addition, CRR cuts in the future (50bps cut in FY13 to date) cannot be ruled out if liquidity pressures persist.

Fig 12 - RBI policy rates



Source: RBI, RCML Research

Fig 13 - CRR trend



Source: RBI, RCML Research

INR remains on the radar

Albeit less so than in 2011 and 2012

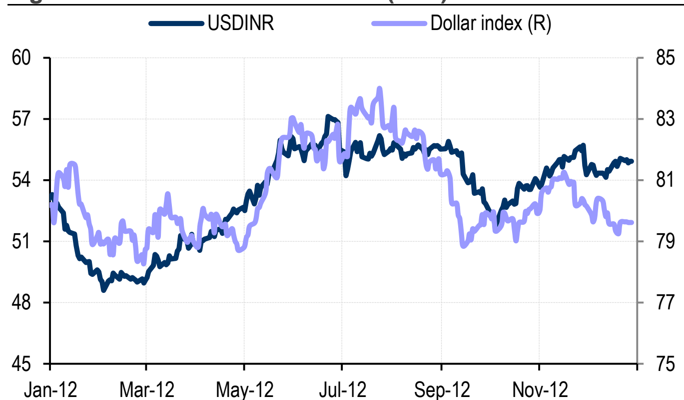
Expect INR to remain in 53-55 band

The INR – our top long-term indicator for the market – depreciated 3.3% in 2012 and hit record lows of Rs57.2/US$ on 27 June 2012, led by global risk aversion impacting flows, a widening CAD and concerns on domestic growth and inflation. Despite our expectations of the macro bottoming out in FY13 and a gradual recovery in FY14, we believe the INR would continue to trade in a band of 53-55 on account of a worrisome trade account and bleaker global outlook. We believe any sharp INR appreciation (to 51-52 levels) would likely result in dollar purchases by the RBI to recoup lost reserves (down US$24bn since Aug'11).

A worrisome trade account in a still-weak global environment would likely keep the INR in a 53-55 range, with temporary overshoots possible

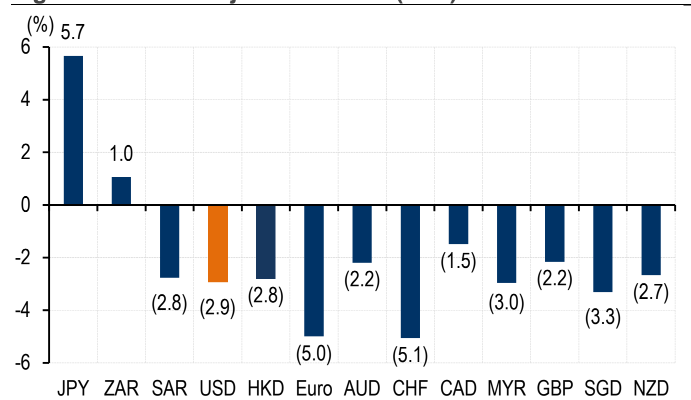
Any sharp revival would be followed by dollar purchases by the RBI

Fig 14 - USDINR vs. Dollar index (12M)



Source: Datastream, RCML Research.

Fig 15 - INR vs. major currencies (12M)

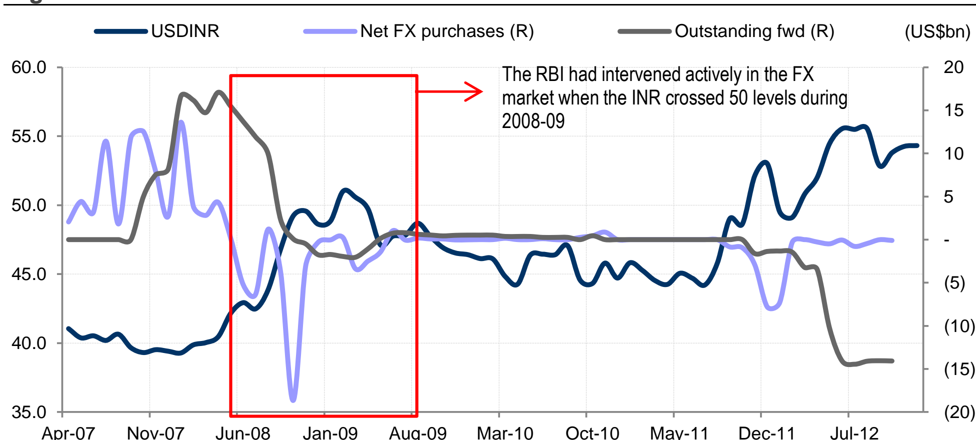


Source: Datastream, RCML Research

While the RBI has been intervening in the forex markets, albeit not so aggressively (net dollar sales of US$2.2bn in FY13 to date with net outstanding positive in currency swaps at US$14.1bn), maintaining their stance of direct intervention only in case of extreme INR volatility, it has been undertaking non-interventionist measures as well to arrest the currency's slide.

With net dollar sales at just US$2.2bn in FY13 to date, the RBI continues to favour non-interventionist measures to arrest the INR fall

Fig 16 - RBI intervention in the forex market



Source: RBI, RCML Research

Markets leading macro in 2013…

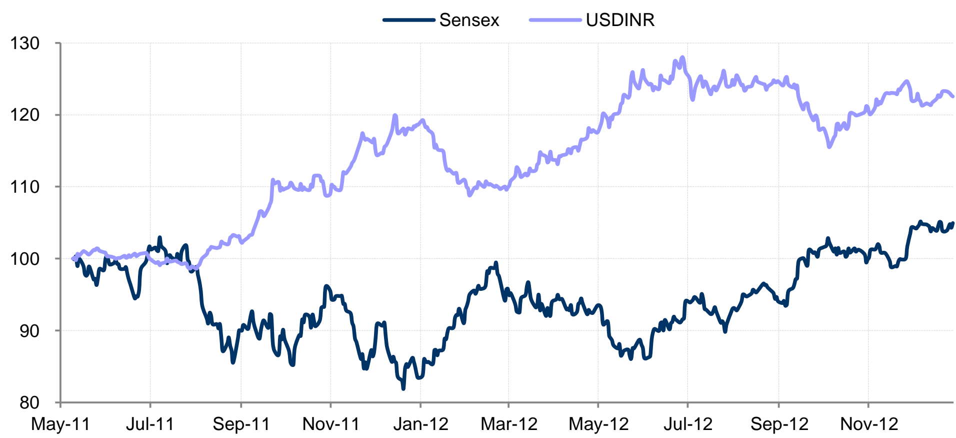
…but what could go wrong

INR and markets are positively related

The chart below of normalised USD-INR and Sensex over the past 18 months highlights the clear relationship between the INR and the Indian markets. As the INR first fell on US downgrade concerns (along with other Asian currencies) and then on growth and CAD concerns, the markets fell in tandem. More recently, the sharp inflow of capital in the beginning of the year perked up both, with the RBI pitching in.

The INR and the Sensex have moved in tandem, more so in the recent past

Fig 17 - USD-INR and Sensex since May'11 (based to 100)



Source: RCML Research

The Indian market's movements since the so-called 'hope-trade' began have also been intricately linked with the currency. While the markets shot up on the reform news, and the INR appreciated as well, pain on the current account quickly drove it to around 51.8 levels, and it's been a downhill ride ever since.

Since 1990, 69% of the times a depreciating INR has coincided with a falling Sensex and *vice versa*

Not that this is a near-term story

We examined quarterly (to reduce near-term noise) returns on the USD-INR and the Sensex over two decades (1990-2012), and found that this relationship holds strong, and more so over recent periods, as foreign inflows became the dominant driver of the Indian markets.

Let's look at the details then

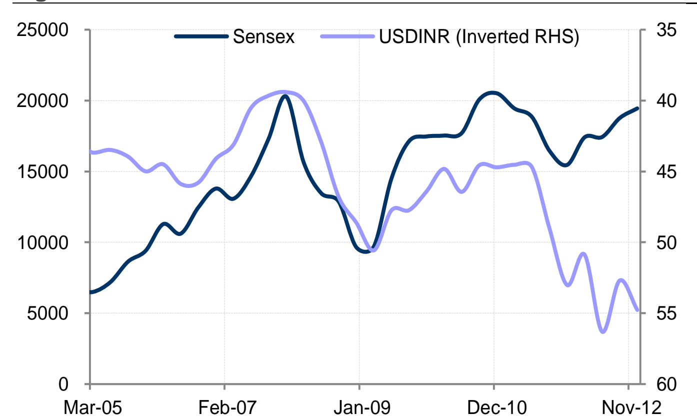
Historically, 69% of the times since 1990, the INR's quarterly movement has been mimicked by the Sensex (depreciating INR coinciding with a falling Sensex and vice versa). The trend has only become more prominent since 2005 when nearly 75% of the times the rupee and the Sensex moved together.

Fig 18 - Quarterly returns on Sensex and INR

Quarterly data % of times	Falling Sensex	Rising Sensex
1990-2012	69% of the times Sensex and INR have moved together	
Falling Rupee	23.3	**37.2**
Rising Rupee	**31.4**	8.1
2005-2012	75% of the times Sensex and INR have moved together	
Falling Rupee	17.2	**31**
Rising Rupee	**44.8**	6.9
Mar'08 onwards:	72% of the times Sensex and INR have moved together	
Falling Rupee	23.8	**33.3**
Rising Rupee	**38.1**	4.8

Source: RCML Research

Fig 19 - Sensex and USD-INR



Source: RCML Research

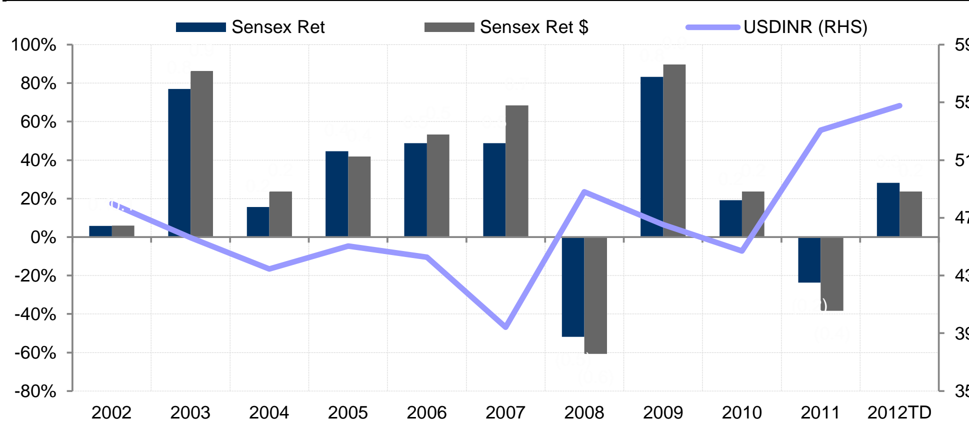
Markets leading macro in 2013…

…but what could go wrong

Currency remains an overhang on the markets for now

While our estimates show a good 15% return in 2013, the INR clearly remains a key overhang. Local currency dynamics are most relevant for foreign investors as the relative difference in INR- and dollar-returns on the Sensex over the past decade shows. And foreign investors remain the most relevant part of our markets for now. FII ownership in the BSE500 universe has been rising and is now amongst the highest ever in the Indian markets. If the INR deteriorates meaningfully from current levels, we could see a decline in fresh foreign capital inflows which could result in muted market performance.

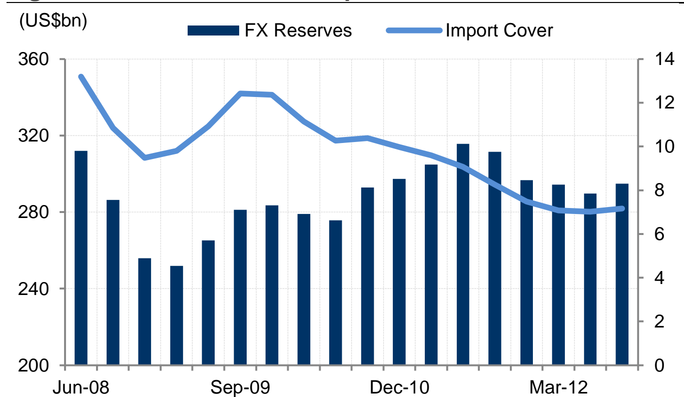
Fig 20 - Sensex returns in INR and USD terms



Source: RCML Research

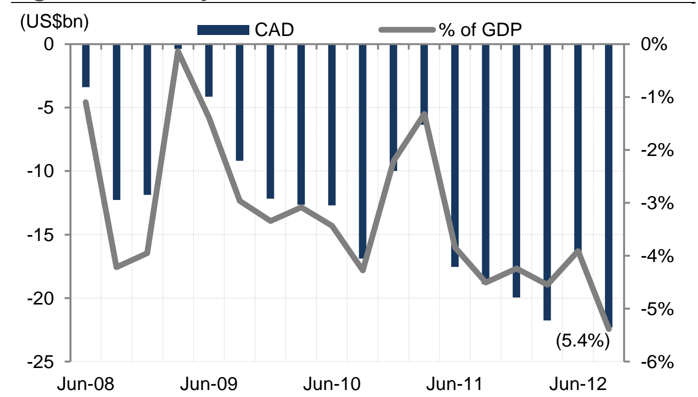
The relative difference in the INR- and dollar-returns on the Sensex over the last decade indicates the relevance of local currency dynamics for FIIs

Fig 21 - Govt. reserves vs. import cover



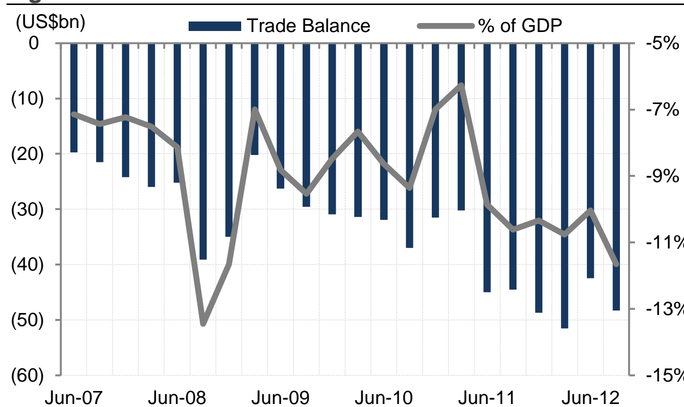
Source: RCML Research, RBI

Fig 22 - Quarterly CAD trend



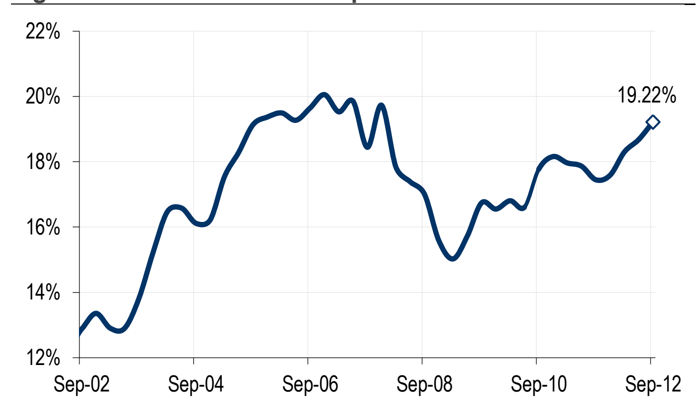
Source: RCML Research, RBI

Fig 23 - Trade deficit trend



Source: RCML Research, RBI

Fig 24 - BSE500: FII ownership trend



Source: RCML Research

External situation looks a tad better in FY14

Global growth outlook remains bleak in 2013

The World Economic Outlook published by the IMF in October'12 indicates a slow recovery in activity across the globe. Growth in advanced economies has weakened largely led by fiscal consolidation and a still-weak financial system. Low growth and uncertainty in these economies are in turn affecting emerging and developing economies through both trade and financial channels. Output is expected to remain sluggish in advanced economies but still relatively solid in many emerging and developing economies. Unemployment is likely to stay elevated in many parts of the world with financial conditions expected to remain fragile.

Global growth is expected to see a slow recovery in 2013, with the IMF projecting global output growth at 3.3%/3.6% for 2012/2013

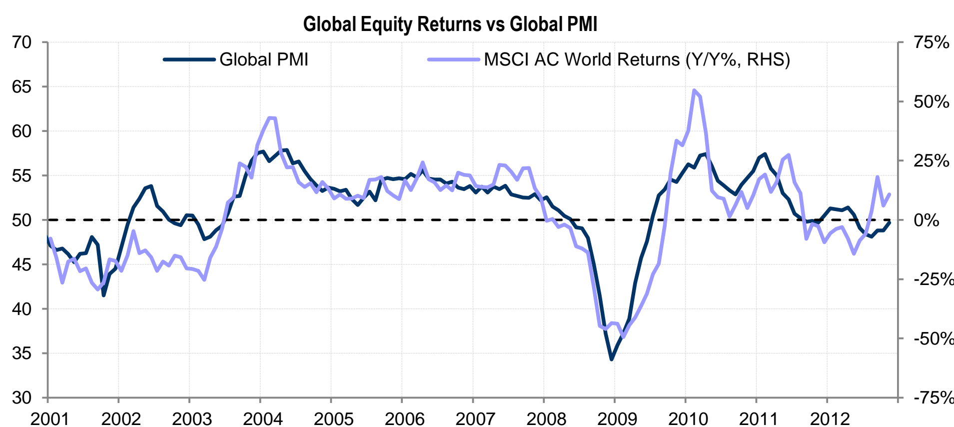
The IMF projects global output growth for 2012/2013 at 3.3%/3.6% versus 3.7% in 2011, marginally higher than the UN's forecast of 3.0% and 3.3% for 2012 and 2013 respectively. Escalation of the Eurozone crisis, the US fiscal cliff and a hard landing in China remain key impediments to global growth.

Fig 25 - IMF and UN forecasts of GDP growth for major countries

(%)	2010	2011	IMF **		UN ***	
			2012E	2013E	2012E	2013E
US	2.4	1.8	2.2	2.1	2.1	1.7
UK	1.8	0.8	-0.4	1.1	NA	NA
China	10.3	9.2	7.8	8.2	7.7	7.9
Eurozone	2.0	1.4	-0.4	0.2	-0.5	0.3
Germany	4.0	3.1	0.9	0.9	NA	NA
Japan	4.5	-0.8	2.2	1.2	1.5	0.6
India	10.1	6.8	4.9	6.0	5.5	6.1
World*	**5.0**	**3.7**	**3.3**	**3.6**	**3.0**	**3.3**

Source: IMF, UN. * Output growth. ** IMF forecasts as per the WEO released in October 2012. *** Latest forecasts published on 18 December 2012.

Fig 26 - Equities and growth remain highly correlated



Source: RCML Research, Bloomberg, MSCI

With growth showing a slow recovery in developed markets, we could see continued liquidity infusion into EMs, esp. India given recent policy reforms

Capital flows

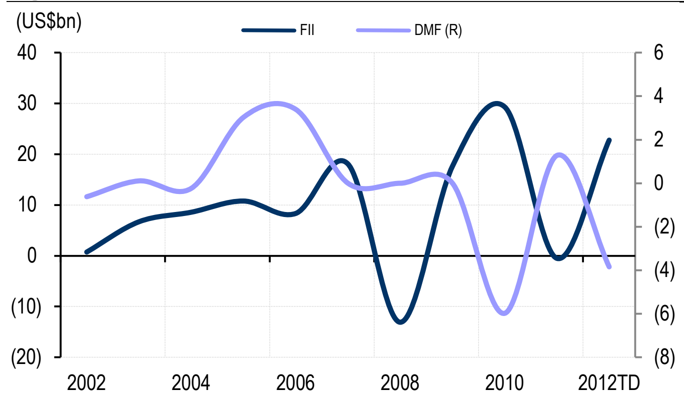
Tough to repeat 2012, and composition might change

FIIs continue to dominate the market performance

Emerging market equities were on the risk-on radar in 2012, thanks to an extended growth revival in developed markets, with Indian equities seeing net foreign inflows of US$23.3bn. This was after a bad 2011, when Indian equities saw net FII outflows of US$512mn. Net FII flows into debt have also stood robust at US$6.7bn in 2012, albeit down 21% compared to 2011 – the year that saw the second highest debt flows in the last decade. With strong 25% market returns in 2012, FIIs continue to dominate market performance even as domestic mutual funds (DMF) remain net sellers.

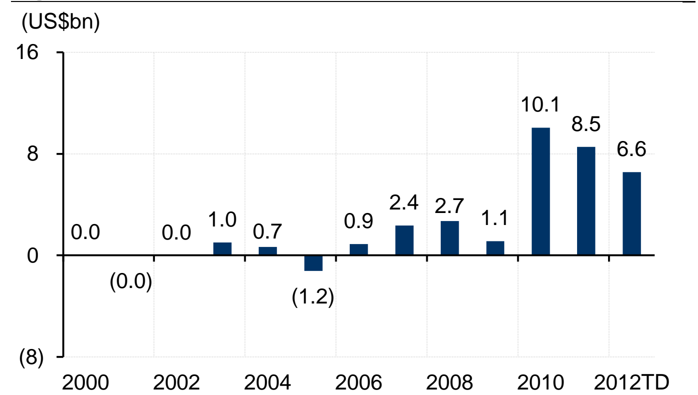
FII continue to dominate market performance with net inflows at US$23.3bn into equities and US$6.7bn into debt

Fig 27 - FII/DMF net inflows into equities



Source: Bloomberg, RCML Research

Fig 28 - FII net inflows into debt



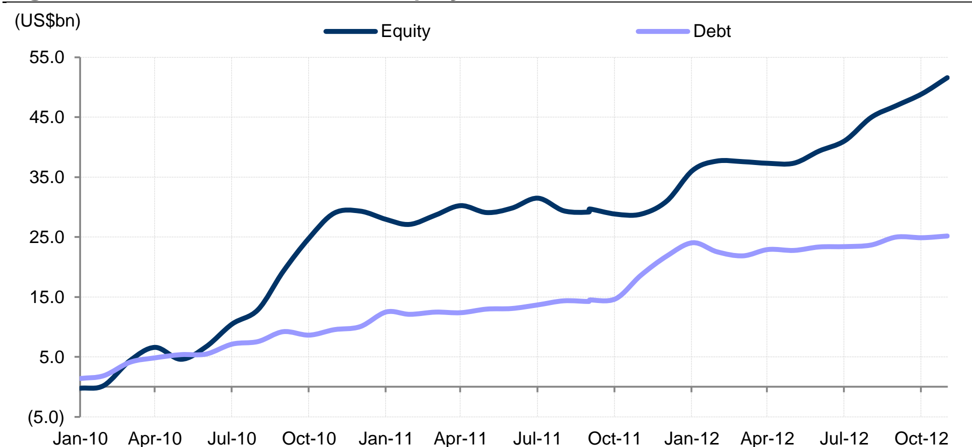
Source: Bloomberg, RCML Research

Expect higher incremental FII flows into debt securities

While we expect another 15-16% upside on the markets in 2013 led by improving domestic macroeconomic indicators (growth, inflation), it's tough to see FII flows repeating 2012. However, the Govt. has recently raised the FII debt limit in Govt. securities and corporate bonds by another US$5bn each to US$25bn and US$50bn respectively, taking the total investment limit in domestic debt to US$75bn (we could see further relaxation in these limits in future). Thus, FII flows into debt would likely get a further boost, thereby bringing additional long-term funds into India. Incrementally, therefore, we could see the FII flow composition changing more towards debt than equities.

With relaxed FII debt limits, we could see more FII inflows into debt than equities

Fig 29 - Cumulative FII flows into equity and debt since Jan'10



Source: SEBI, RCML Research

DIIs likely to repeat a lacklustre 2012

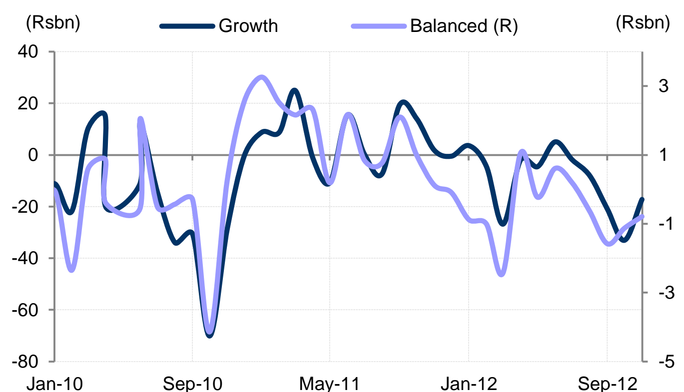
Our views about the market aiming to nudge 20,000 for the third time also somewhat reflects the attitude of the retail investor in India. With 9.5% ownership of the top 500 companies, and ~30% share of trading, the Indian public provides useful liquidity to the markets, but has increasingly stayed away, given the underperformance of equities versus most other asset classes in the last five years. This in turn has resulted in redemptions, rather than fresh inflows on the 25% market return this year, as many investors see their stocks reach (at last) their entry levels of 2008, or 2010. Domestic mutual funds have as a result been sellers this year (net outflows worth US$3.8bn), even as foreign investors have pumped in US$23.3bn.

DII's have been net sellers in 2012, thanks to higher redemptions than fresh inflows

A repeat of lacklustre 2012 is not unlikely given retail investor sentiment

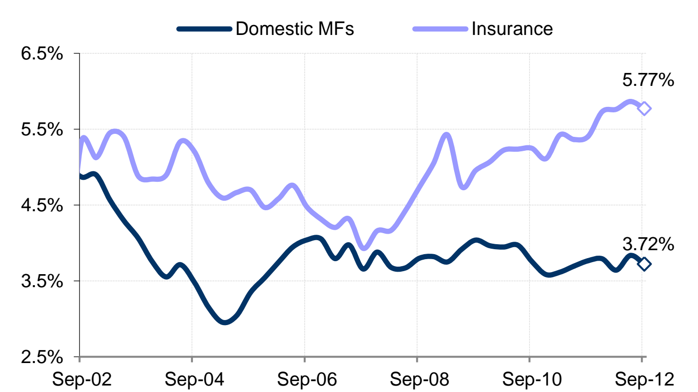
Investments in gold and real estate have tapered off as the slowdown progresses to the third year; we believe it could take another year at least for a return of retail interest. And while the Jan-Mar quarter has been traditionally the best for insurance money (~50% of annual inflows), we might yet see a repeat of a lacklustre 2012.

Fig 30 - Net inflows into growth and balanced mutual funds



Source: AMFI, RCML Research

Fig 31 - BSE500: DII ownership trend



Source: RCML Research

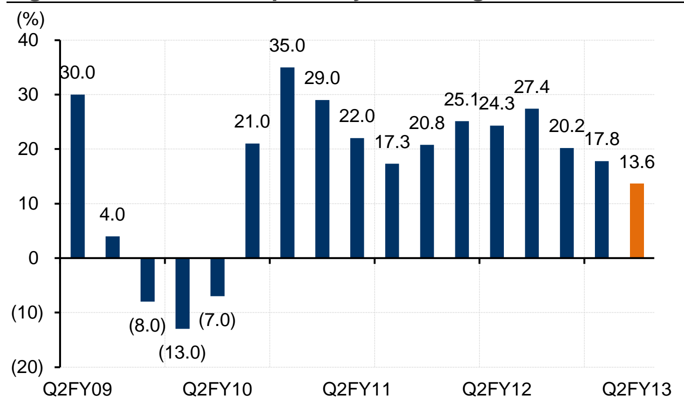
Earnings

Likely to bottom out in Q3FY13

The earnings trajectory remains downbeat for the fifth quarter, with the second quarter rustling up 11% growth (Sensex ex-oil) versus expectations of 12%. Sales growth for the narrow market (Sensex ex-oil) has reflected the slowdown, falling steadily over the last two years from 22% in Q2FY11 to 13.6% in Q2FY13, leading earnings lower, after they had fallen on weaker margins.

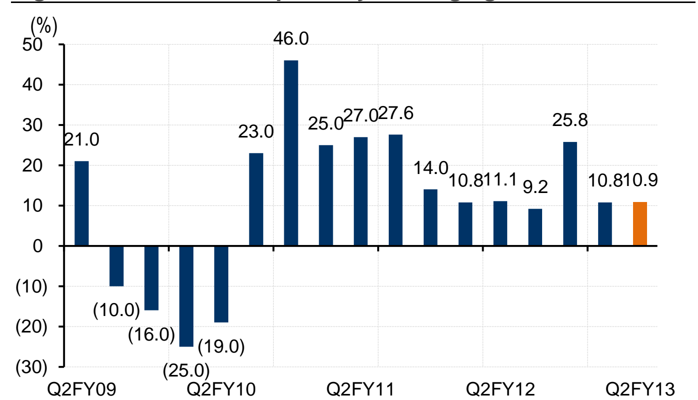
Revenue growth has been on a declining trend since the last four quarters

Fig 32 - Sensex ex-oil quarterly revenue growth trend



Source: RCML Research

Fig 33 - Sensex ex-oil quarterly earnings growth trend



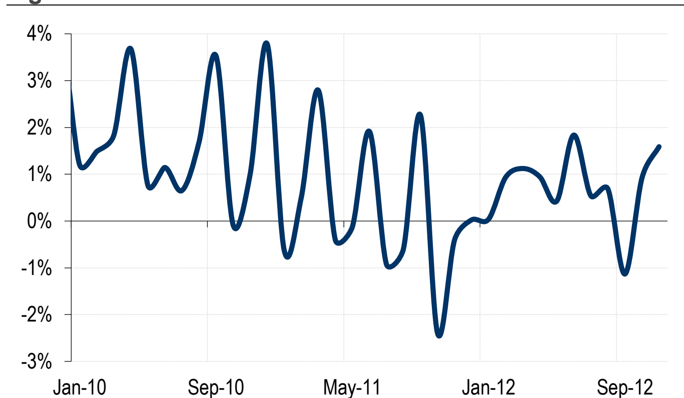
Source: RCML Research. Note: Q4FY12 numbers influenced by SBIN (very low base in Q4FY11)

We expect earnings to bottom out in Q3FY13, with upgrades likely to outnumber downgrades thereafter, albeit marginally, led by a revival in domestic demand resulting in an improvement in topline growth, and margin expansion led by (a) decline in input costs on INR appreciation and overhang of a China slowdown, and (b) lower cost of funds on likely rate cuts which should help support companies with highly leveraged balance sheets. Of course, such a revival is strongly dependent on the macro.

We expect earnings to bottom out in Q3FY13 with upgrades likely to outnumber downgrades thereafter

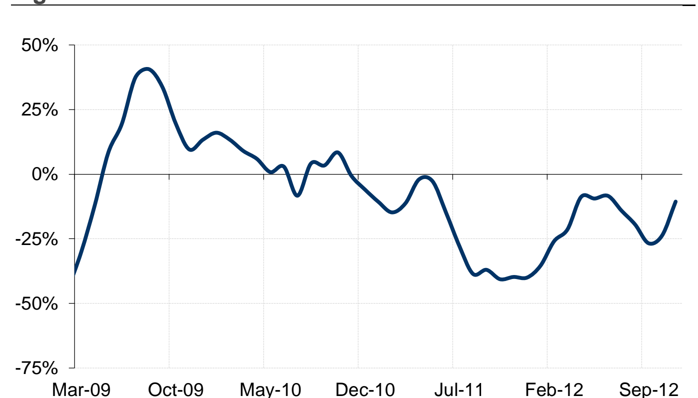
We, however, choose to remain conservative in our estimates. Our bottom-up analysis of stocks indicates an FY13E/FY14E Sensex EPS of Rs1,223/Rs1,394, slightly behind consensus forecasts of Rs1,266/Rs1,446 and implies growth of 5%/14%.

Fig 34 - MSCI India 12-month forward EPS trend



Source: Datastream, RCML Research

Fig 35 - MSCI India ERI



Source: Datastream, RCML Research

Valuations

Cheap but range-bound with meaningful re-rating unlikely

Current market valuations at 14.3x are cheap but we expect it to be range-bound with India unlikely to re-rate meaningfully from current levels

Current market valuations at 14.3x earnings (12-month forward) are not expensive, but they haven't been so for the past two years either. Compared with the long-term average trend (10y at 21x, and last 5y at 16x), India does not look expensive, but the lower valuations are also a function of a lower ROE trend, and the general domestic and global growth trajectory.

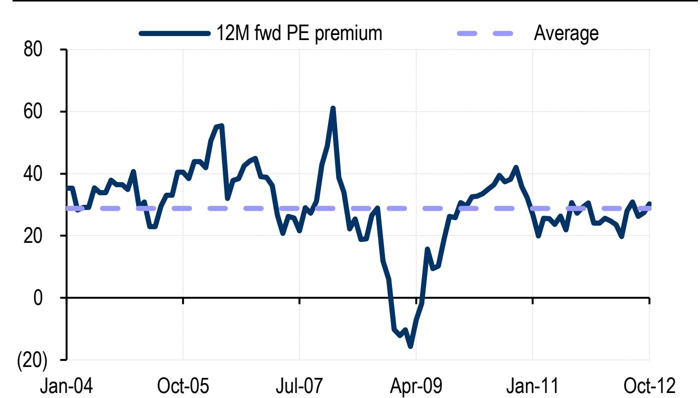
While valuations have stayed range-bound over the last few years and actually trended downwards, there is significant divergence across sectors, with a widening valuation differential between defensives and quality on one hand, and beta and cyclicals on the other. Infrastructure and Capital Goods stocks are trading at 14-15x, implying ~20% discount to the five-year average (see Fig 29), while the Consumer Staples sector still trades at ~30x+ levels (see Fig 30). While the differential has narrowed over the last quarter of the year in the 'hope-trade', it's still meaningful. We believe the discount in industrials' valuation would narrow further this year, if not turn into premium, given the expected uptrend in the macro.

Overall, we believe the market valuation discount to the LTA would sustain in 2013 too, with India unlikely to re-rate meaningfully from current levels.

Fig 36 - Sensex 12M fwd PE

Source: Bloomberg, RCML Research

Fig 37 - MSCI India premium/discount over MSCI EM Asia



Source: Bloomberg, RCML Research

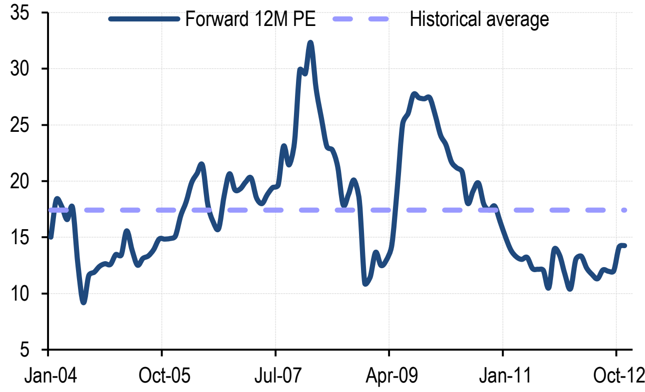
Fig 38 - Sensex PE band

Source: Bloomberg, RCML Research

Fig 39 - Sensex PB band

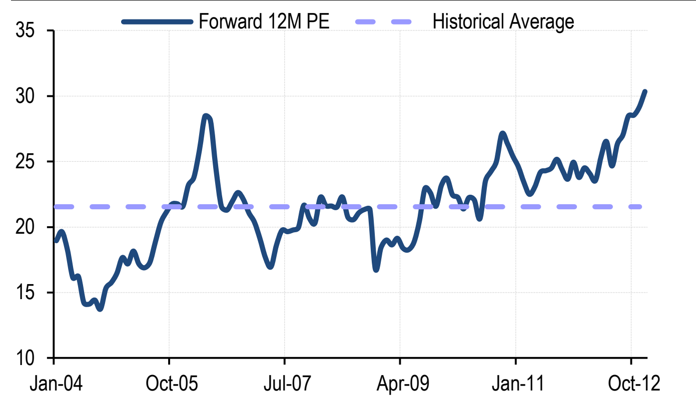
Source: Bloomberg, RCML Research

Fig 40 - Industrials 12M fwd PE



Source: Bloomberg, RCML Research

Fig 41 - Consumer Staples 12M fwd PE



Source: Bloomberg, RCML Research

Sensex target for Dec 2013

Base case scenario: 16% upside with zero re-rating

Our Sensex target builds in no valuation upside, and is based on a 10% discount to the LTA. We maintain our target valuation for Mar'13, and extend it to Dec'13.

Our base case gives a Dec'13 Sensex target of 22,500 based on a 12-month forward P/E multiple of 14.5x CY14E

We set a December'13 Sensex target of 22,500, indicating a 16% upside from current levels based on a target P/E multiple of 14.5x on CY14E earnings. We believe this is reasonable given current domestic and global market conditions. At 14.5x, the market would trade at ~10% discount to its LTA of 16x, a discount that reflects the medium-term output gap in the broad economy and attendant macro factors.

Since the beginning of 2012, when we estimated the fair multiple for the market at 13x, with an upside of 15% for the year, macro conditions have changed materially, and yet remained in a similar mould. As discussed earlier in the note, GDP growth assumptions have been revised downwards on one hand, with consensus estimates for FY13E now around 5.5% (vs. 7.1% in Jan'12). FY14 estimates are more divergent, with consensus at 6.0%+. Our estimates for FY14 are slightly on the lower side, at 5.8%. India's growth premium, however, remains significant, since the year also saw estimates getting downgraded across most major geographies. While growth is likely to remain low over FY12-13, the long-term trajectory for India remains ~8%, and we believe the market would tend to re-rate as the movement towards trend-growth rate becomes clearer.

Fig 42 - Sensex valuation

	FY11	FY12	FY13E	FY14E
EPS	1,055	1,165	1,223	1,394
EPS growth (%)	27.0%	10.4%	5.0%	14.0%
P/E (x)	18.3	16.6	15.8	13.9
Div. yield (%)	1.4%	1.8%	2.1%	2.3%
P/B (x)	3.7	2.8	2.7	2.4
RoE (%)	18.6%	18.7%	16.9%	17.4%
EV/EBITDA (x)	11.8	9.2	9.3	8.1

Source: RCML Research

Fig 43 - Sensex target valuation – BASE case

Target date (31-Dec-2013)	Sensex
CY14 EPS (Rs)	1,551
EPS growth	14.8%
Target multiple (x)	14.5
Sensex Dec'13 target	**22,500**
Upside (%)	16%

Source: RCML Research

Fig 44 - Sensex EPS and PE sensitivity

		EPS				
		1,351	1,363	1,551	1,565	1,578
		12.8%	13.8%	14.8%	15.8%	16.8%
P/E (x)	13.5	18,239	18,400	20,941	21,124	21,306
	14.0	18,914	19,082	21,717	21,906	22,095
	14.5	19,596	19,770	22,500	22,696	22,892
	15.0	20,265	20,445	23,268	23,471	23,674
	15.5	20,941	21,126	24,044	24,253	24,463

Source: RCML Research

Markets leading macro in 2013…

…but what could go wrong

Our analysis illustrates that market re-rating could range anywhere between 2 points (Jan'12-Mar'12) and 6 points (Feb'09-Jun'09) depending on the macro picture

Since the beginning of the 'hope-trade' in June and amid the continued favourable global backdrop – our two drivers of the market in 2H12 (driving against a weak macro) – the market has moved up 10%, tapering off only when either of these factors faltered, in the sense that we either had the reform rhetoric easing off, or a risk-off globally (fiscal cliff talk, global growth downgrades, etc.). Earnings over this period have, however, been weak but largely in line with expectations, with Sensex ex-oil profits rising ~11% each in the first and second quarters.

If one therefore tries to analyze this market movement independent of changes in earnings, the period 2005-12 offers some interesting takeaways. Four rallies in this period (we are careful to keep earnings largely stable) illustrate that market re-rating, in effect, multiple expansion, could range anywhere from 2 points (Jan'12-Mar'12) to 6 points (Feb'09-Jun'09), depending on the state of the macro. Sector contributions to these rallies are typically led by cyclicals (financials and industrials).

Extant macro conditions are, it can be argued, worse than all across this period. Growth is not only worse, but even potentially so (in the sense of lower potential economic growth creating an output gap), and seems likely to remain around these levels for now.

Fig 45 - Anatomy of previous rallies in India

	Jun-05 to May-06		Sep-07 to Nov-07		Feb-09 to Jun-09		Jan-12 to Mar-12		Average	
	%Cont.	Change in PE Pts.	%Cont.	Change in PE Pts.	%Cont.	Change in PE Pts.	%Cont.	Change in PE Pts.	%Cont.	Change in PE Pts.
MSCI India		6.0		4.9		6.2		2.1		5.7
CS	16%	10.8	1%	0.7	0%	0.2	-2%	(0.7)	6%	3.9
CD	8%	6.4	2%	1.8	4%	7.0	7%	1.7	4%	5.1
Energy	12%	4.4	20%	5.4	19%	5.3	10%	1.6	17%	5.1
Financials	10%	3.9	40%	7.9	30%	8.0	45%	3.2	27%	6.6
Healthcare	3%	3.7	1%	1.2	2%	3.2	1%	0.5	2%	2.7
Industrials	12%	8.3	20%	8.5	19%	12.6	13%	4.0	17%	9.8
IT	18%	5.2	0%	(0.2)	11%	5.4	2%	0.2	10%	3.5
Materials	7%	5.1	4%	2.8	7%	5.8	14%	2.7	6%	4.6
Telecom	11%	18.2	7%	7.9	3%	6.2	4%	3.2	7%	10.8
Utilities	2%	4.0	7%	11.1	5%	4.9	7%	2.6	4%	6.7
PE Range		12.4 - 18.3		17.5 - 22.4		9.9 - 16.1		12.2 - 14.3		
Max Prem. to EM		54%		52%		27%		42%		
Rally Duration		11.1 Months		2 Months		4 Months		2 Months		
Total Return		76%		29%		67%		16%		
Net FII Flow (US$mn)		9,734		7,970		5,942		7,876		
Avg. Monthly FII Flow (US$mn)		811		2,657		1,188		3,938		
Net DMF Flow (US$mn)		4,419		(44)		690		(910)		
	Apr-03 to Jan-04		Apr-05 to May-06		Mar-07 to Jan-08		Feb-09 to Oct-09			
	%Cont.	PE Change	%Cont.	PE Change	%Cont.	PE Change	%Cont.	PE Change		
Cyclicals	27%	6.7	25%	4.7	30%	7.8	34%	2.6		
Defensives	33%	8.7	15%	4.8	10%	3.6	10%	1.3		
IT	18%	5.2	0%	(0.2)	11%	5.4	2%	0.2		
Energy	12%	4.4	20%	5.4	19%	5.3	10%	1.6		
Financials	10%	3.9	40%	7.9	30%	8.0	45%	3.2		

Source: RCML Research

Bull case scenario

Our bull-case scenario analysis shows an upside of ~25% from current levels assuming a 12-month target multiple of 15.5x (vs. 14.5x for the base case) and FY14 earnings growth of 15% (vs. 14% for the base case). The would likely happen if the following factors are in place: (1) the economy grows at a faster-than-anticipated rate with inflation remaining within the comfort range, (2) the Govt. continues with its reform push which is more pro-growth and less populist in nature, and (3) the global economy shows a faster-than-expected recovery.

Our bull case scenario gives a Dec'13 Sensex target of 24,250 based on 15% earnings growth in FY14 and a target multiple of 15.5x

Fig 46 - Sensex target valuation – BULL case

Target date (31-Dec-2013)	Sensex
CY14 EPS (Rs)	1,565
EPS growth	15.0%
Target multiple (x)	15.5
Sensex Dec'13 target	**24,250**
Upside (%)	24.7%

Source: RCML Research

Bear case scenario

We also consider a bear-case scenario, to examine the potential downside from current levels. If we assume that matters worsen further from here, like inflation rising, growth remaining stagnant, and the current account worsening from weak exports and rising commodities, then the market would de-rate – while we may not reach 2008-09 lows of 10x forward earnings, we believe the downside would take the market down to 12.5x-13x multiples. Our analysis indicates that even with a 10% earnings growth in FY14 and 12-month target multiple of 12.5x, we get a limited downside of ~4% from current levels.

Our bear case scenario gives a Dec'13 Sensex target of 18,700 based on FY14 earnings growth of 10% and a target multiple of 12.5x

Fig 47 - Sensex target valuation – BEAR case

Target date (31-Dec-2013)	Sensex
CY14 EPS (Rs)	1,497
EPS growth	13.8%
Target multiple (x)	12.5
Sensex Dec'13 target	**18,700**
Upside (%)	-3.9%

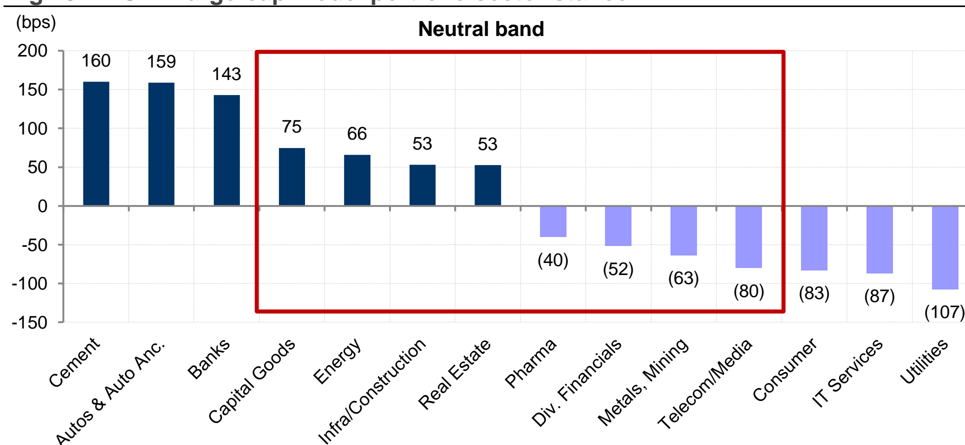
Source: RCML Research

Model Portfolio and Investment Strategy

Focused on quality, turning constructive on beta

As the Indian market continues with its 'hope-trade' rally, thanks to the government's aggressive reform push aimed at driving fiscal consolidation and reviving growth, and the economy sees a gradual recovery, we have become more constructive on high quality beta names. For our model portfolio, we remain heavily OW on Banks and Cement, upgrade Autos from Neutral to OW and remain UW on IT Services and Utilities. We have also downgraded Consumer Staples from Neutral to UW on expensive valuations but remain positive on high-quality consumer discretionary names and upgraded Real Estate from UW to Neutral. For others, we maintain our Neutral stance.

Fig 48 - RCML large-cap model portfolio sector stance



Source: RCML Research

Sector focus

Banking

Banks are the biggest beneficiary of the rate cut cycle

Prefer PSUs over private banks

We maintain our OW stance on the Banking sector as it is the biggest beneficiary of the RBI's monetary policy easing, which would lead to a reversal of sentiment on the sector. SBIN remains our top pick in the large-cap space as pressure on the asset quality front has virtually reached peak levels and is already priced in. In the mid-cap space, we like YES (among our top 5 mid-cap picks) because of its healthy asset quality, scope for market share gains and improving liability. We have withdrawn BOB from our portfolio on asset quality concerns and management change, and have replaced it with BOI owing to the latter's improving asset quality and operating performance as well as attractive valuations. In the large-cap private space, we have ICICIBC and HDFCB in our model portfolio.

Diversified Financials

Prefer only mortgage financing companies in the NBFC space, with our top pick being LICHF

The anticipated policy rate cuts in 2013 auger well for mortgage loan demand which in turn is positive for housing finance companies. In this space, we like (1) LICHF – one of our top picks in the mid-cap space owing to its robust asset quality, strong growth potential in mortgage financing and high earnings visibility, and (2) HDFC – strong advances and earnings growth profile, stable asset quality and reasonable valuations given its leadership position in the housing finance segment. Overall, however, we maintain our Neutral stance on the sector.

Markets leading macro in 2013…

…but what could go wrong

Auto & Auto Ancillaries

Upgraded Autos from Neutral to OW with our top pick being TTMT

We have turned incrementally positive towards the Consumer Discretionary space and have upgraded the Auto sector from Neutral to OW, particularly the two-wheeler and CV segments. We upgrade TTMT from Neutral to OW, with the stock now among our top 5 large-cap picks for 2013, thanks to a robust revenue growth profile led by higher-than-expected JLR volumes and recovery in the domestic CV segment. We also like MM as a good play on the rural consumption story. In the two-wheeler space, we have BJAUT in our model portfolio.

Cement

Remain OW on Cement as it remains a cleaner, low-risk proxy for the infra sector. UTCEM our top pick here

While we could see some near-term weakness in the Cement sector on account of the muted outlook for Q3FY13 earnings, we maintain our OW stance from a 12-month view as it remains a cleaner, low-risk proxy for the infrastructure sector. We like UTCEM in this space – also one of our top 5 large-cap picks for 2013 – owing to its robust brand equity, strong regional diversification, capacity expansion and healthy balance sheet.

IT Services

Maintain UW stance on limited earnings upgrades and a weak tech-spending environment

However, we like TECHM/SCS on strong earnings growth profile and attractive valuations

We remain cautious and maintain our UW stance on the IT Services sector due to limited earnings upgrades, a weak tech-spending environment and an as-yet bleak global outlook which could put pressure on volumes/margins. However, within the sector, we like SCS and TECHM, as the merged entity would become the fifth largest IT player with a strong earnings growth profile and attractive valuations. TECHM/SCS are also among our top 5 mid-cap picks for 2013. Among large-cap players, while INFO is expected to continue to disappoint on earnings and margins, explaining our UW stance, TCS remains a better play on any pick-up in tech demand. We also reduce HCLT from OW to Neutral in our model portfolio.

Energy

Remain Neutral weight on the Energy sector

We remain Neutral on the Energy sector and prefer ONGC over RIL as ONGC is a pure E&P company whereas capital allocation in unrelated businesses is a key threat in RIL. Also, while ONGC's crude and natural gas production is expected to increase upon completion of IOR/EOR (Improved/Enhanced Oil Recovery) by Mar'13, JV with CAIR and commissioning of marginal fields, the KG-D6 output for RIL continues to decline. We also like CAIR especially after the government allowed the company to continue exploring the producing Rajasthan field beyond the 7-year exploration period stipulated. We maintain our positive view on GAIL too, on an expected bottoming of transmission volumes and increase in tariffs. While OMCs are good short-term trading bets on cheap valuations, from a 12-month perspective, we continue to prefer upstream companies like ONGC/GAIL as potential plays on the upstream reform story.

Metals & Mining

China slowdown has made us remain Neutral on Metals

Prefer HZ and TATA as good quality plays

Barring the surge in commodity prices over the last few months, especially in iron ore, prices have remained muted through the year with iron ore prices declining 42% from ~US$145+ levels in Apr'12 to US$86 in Sep'12 led by global growth concerns and muted demand due to a slowing Chinese economy. However, prices shot up again to US$140 in Dec'12. We believe the commodities' super-cycle is over but we could see 3-6 months of mini-cycles, with the key risk to this being a resurgent China. We therefore remain Neutral on the sector and prefer HZ and TATA as good quality plays.

Consumer

Given expensive valuations post strong stock outperformance, we remain cautious on Consumer Staples stocks like HUL and ITC, but remain selective buyers in high quality Consumer Discretionary names such as UNSP and TTAN. While UNSP is among our top 5 large-cap picks for 2013 on potential re-rating after Diageo's acquisition of a controlling stake in the company, we also like TTAN as a long-term play on India's discretionary spending supported by a strong earnings growth profile.

Remain cautious on Consumer Staples due to expensive valuations

Prefer high-quality discretionary names like UNSP (top pick) and TTAN

Telecom / Media

We remain negative on the Telecom sector and prefer to stay out of it due to high reputational and regulatory risks (zero weight in our model portfolio). We, however, continue to like the Media space and have a big OW on SUNTV (also among our top 5 mid-cap picks for 2013) on improving business fundamentals and lower political risks. It remains one of the key beneficiaries of the India digitization theme.

Recommend staying away from the Telecom sector on regulatory risks

Remain positive on Media space – SUNTV is our top pick

Capital Goods / Infra-Construction / Real Estate

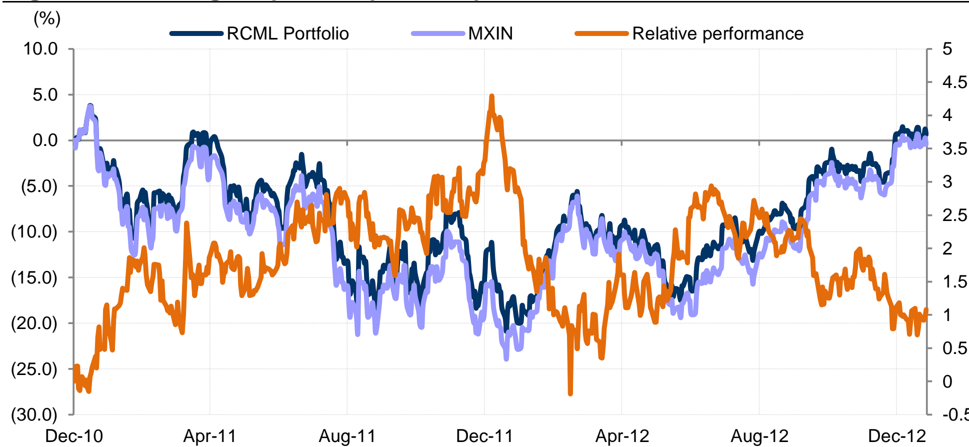
We like LT in the infrastructure/construction space as a high quality beta play and it remains one of our top 5 large-cap picks for 2013 as the company's diversified presence in various segments (hydrocarbons, metals, infrastructure and process engineering) gives it the resilience to withstand any slowdown. In the Capital Goods sector, our picks are KKC and CRG. We have upgraded Real Estate from UW to Neutral on the back of anticipated rate cuts and improving demand. DLF is our top pick in the sector as the company is on track to meet its mid-term deleveraging target, further supported by a potential pick-up in operations and improving macro conditions.

We only like LT in the Infrastructure space

Remain Neutral on Capital Goods and like KKC and CRG in the space

We have upgraded Real Estate from UW to Neutral on improving demand and likely rate cuts. Top pick is DLF

Fig 49 - RCML large-cap model portfolio performance



Source: RCML Research, Bloomberg

Our model portfolio has outperformed the benchmark (MSCI India) by ~1% since inception (Dec'10)

Fig 50 - RCML model portfolio performance

Sector	Name	MktCap** (US$mn)	Weight (%)	RCML target (Rs)	Upside/ downside	Rating	1W	MTD	YTD	1YR
Autos	Bajaj Auto	11,246	1.50	1,970	(7.8)	BUY	2.4	10.7	34.2	32.5
	Mahindra & Mahindra	10,406	3.00	1,060	14.7	BUY	(1.4)	(2.2)	35.3	34.6
	Tata Motors	16,753	3.00	320	3.3	BUY	3.4	12.9	73.6	71.8
Banks	ICICI Bank	23,878	4.50	1,125	(1.5)	HOLD	1.7	4.0	66.8	63.8
	HDFC Bank	29,238	6.50	670	(1.1)	HOLD	0.2	(3.7)	58.7	54.1
	State Bank of India	29,182	4.75	2,540	6.8	BUY	1.9	9.6	46.8	47.7
	Bank of India	3,526	1.50	400	18.0	BUY	1.6	20.7	27.3	22.9
	Yes Bank	3,028	2.00	475	2.6	BUY	0.0	0.0	0.0	0.0
Div. Financials	HDFC	23,164	9.50	825	(0.9)	BUY	0.5	(1.1)	28.2	26.1
	LIC Housing Finance	2,654	2.50	300	2.4	BUY	5.4	10.3	32.2	29.7
Real Estate	DLF	6,958	1.50	285	26.9	BUY	2.3	6.9	22.7	16.6
Capital Goods	Crompton Greaves	1,316	0.50	160	38.5	BUY	2.3	1.0	(8.0)	(6.9)
	Cummins India	2,595	1.00	550	5.4	BUY	3.3	8.0	49.5	52.4
Infra/Const.	Larsen & Toubro	18,078	4.00	1,820	12.5	BUY	1.9	(2.9)	62.6	57.1
Cement	Ultratech Cement	9,825	3.50	2,250	14.3	BUY	(0.8)	0.7	69.6	67.7
Metals	Hindustan Zinc	10,411	2.00	155	13.7	BUY	(1.7)	(2.1)	14.5	14.4
	Tata Steel	7,619	2.50	440	2.7	BUY	(0.3)	11.1	27.8	23.5
Energy	Cairn India	10,990	2.50	400	25.0	BUY	2.5	(2.8)	2.1	1.7
	GAIL (India)	8,033	2.50	445	26.6	BUY	0.9	(0.2)	(8.5)	(10.9)
	Oil & Natural Gas Corp.	40,402	3.00	320	20.4	BUY	1.8	0.4	3.5	2.0
	Reliance Industries	48,185	4.00	790	(6.0)	HOLD	2.1	5.9	21.3	13.8
Coal	Coal India	40,695	1.50	360	1.7	HOLD	0.4	(3.3)	17.7	18.4
Consumer	Hindustan Unilever	20,387	3.00	540	3.7	HOLD	(1.1)	(3.3)	27.7	26.3
	ITC	41,369	4.25	295	2.0	HOLD	0.5	(3.1)	43.6	43.0
	Titan Industries	4,553	1.00	280	(0.3)	BUY	0.4	(9.9)	64.5	61.8
	United Spirits	4,521	2.25	2,100	10.6	BUY	(1.7)	(4.7)	286.7	247.0
IT	HCL Technologies	7,907	1.00	575	(8.1)	HOLD	(0.5)	(4.4)	61.2	60.0
	Infosys	23,906	5.50	2,500	7.8	HOLD	1.1	(4.9)	(16.2)	(16.6)
	TCS	44,544	5.00	1,325	4.7	HOLD	0.6	(3.6)	9.0	8.2
	Satyam Computer Svs.	2,238	1.75	140	33.3	BUY	2.5	3.2	61.9	63.9
Pharma	Cipla	6,075	2.50	NA	NA	NR	(0.6)	0.6	30.3	29.1
	Dr. Reddy's Labs.	5,646	2.50	NA	NA	NR	0.4	0.2	15.8	16.7
Media	Sun TV Network	3,029	2.00	400	(5.0)	BUY	2.9	3.2	53.6	50.0
Utilities	Power Grid	9,579	2.00	130	14.6	HOLD	(0.9)	(3.9)	13.5	13.2

Source: Bloomberg, RCML Research. NR = Not rated. **Prices as of December 28th, 2012.

Fig 51 - RCML model portfolio valuations

Name	CMP**	Mkt Cap	P/E (x)		P/BV (x)		EPS growth (%)		RoE (%)	RoCE (%)	Div. yield	EPS CAGR
	(Rs.)	(US$m)	FY13E	FY14E	FY13E	FY14E	FY13E	FY14E	FY13E	FY13E	FY13E	FY12-14E
Autos												
Bajaj Auto	2,137	11,246	20.0	16.4	7.8	6.3	0.5	21.7	44.3	37.7	2.8	10.6
Mahindra & Mahindra	924	10,406	18.2	15.9	3.8	3.2	15.0	14.7	23.9	17.5	1.3	14.8
Tata Motors	310	16,753	8.8	7.4	2.3	1.8	(18.0)	18.8	30.1	17.1	0.9	(1.3)
Banks												
ICICI Bank	1,142	23,878	16.4	14.0	2.0	1.8	25.1	16.9	12.8	NA	1.7	21.0
HDFC Bank	678	29,238	23.8	19.1	4.5	3.8	29.6	25.1	20.6	NA	0.8	27.3
State Bank of India	2,378	29,182	11.3	9.6	1.7	1.5	20.5	17.6	15.8	NA	1.7	19.0
Bank of India	339	3,526	6.6	5.1	0.9	0.8	11.5	27.5	14.2	NA	2.4	19.2
Yes Bank	463	3,028	13.1	11.4	2.8	2.1	28.0	14.9	23.9	NA	0.8	21.2
Div. Financials												
HDFC	833	23,164	25.9	22.6	5.1	4.7	15.5	14.4	22.5	NA	1.3	15.0
LIC Housing Finance	293	2,654	13.0	10.3	2.2	1.9	21.2	25.9	18.2	NA	1.6	23.5
Real Estate												
DLF	225	6,958	21.8	21.5	1.4	1.4	43.4	1.2	7.4	5.7	1.8	20.5
Capital Goods												
Crompton Greaves	116	1,316	29.5	11.9	1.9	1.7	(33.8)	147.7	6.7	5.3	1.2	28.0
Cummins India	522	2,595	23.2	19.5	6.2	5.3	12.9	19.2	28.1	25.0	2.2	16.0
Infra/Construction												
Larsen & Toubro	1,618	18,078	19.3	16.7	2.7	2.4	10.8	15.8	15.9	6.3	1.0	13.3
Cement												
Ultratech Cement	1,968	9,825	18.5	14.7	3.5	2.8	22.8	25.4	20.6	14.8	0.3	24.1
Metals, Mining												
Hindustan Zinc	136	10,411	8.9	8.3	1.8	1.5	16.8	8.2	21.8	16.3	-	12.4
Tata Steel	428	7,619	44.6	9.4	0.9	0.9	(53.8)	375.4	1.8	1.2	-	48.2
Energy												
Cairn India	320	10,990	5.7	6.0	1.1	0.9	35.5	(5.1)	20.3	18.6	2.3	13.4
GAIL (India)	352	8,033	11.6	10.9	1.8	1.6	5.7	6.2	16.8	12.0	2.3	6.0
ONGC	266	40,402	9.1	8.2	1.5	1.3	(3.5)	11.2	16.9	13.5	4.1	3.6
Reliance Industries	840	48,185	14.1	12.6	1.3	1.2	(11.0)	11.9	9.8	5.7	1.3	(0.2)
Coal India	354	40,695	12.2	11.6	4.3	3.5	1.0	5.1	39.0	26.4	2.9	3.0
Consumer												
Hindustan Unilever	521	20,387	34.1	28.8	22.4	18.9	23.5	18.5	89.7	59.9	1.6	21.0
ITC	289	41,369	30.4	25.5	10.8	10.0	19.3	19.1	37.0	33.3	1.9	19.2
Titan Industries	281	4,553	33.5	26.6	8.7	6.8	24.1	26.1	34.5	30.7	0.4	25.1
United Spirits	1,899	4,521	67.2	30.7	4.9	3.1	82.2	118.8	7.5	6.4	0.2	99.6
IT Services												
HCL Technologies	626	7,907	14.5	13.4	3.6	3.1	24.3	8.3	27.4	23.0	1.6	16.0
Infosys	2,318	23,906	14.2	13.5	3.7	3.4	12.5	5.2	26.2	23.1	2.4	8.8
TCS	1,265	44,544	18.1	16.5	6.4	5.1	28.2	9.7	38.4	36.1	1.7	18.6
Satyam Com. Svs.	105	2,238	9.3	8.4	2.8	2.1	6.6	11.6	25.3	29.7	-	9.1
Pharma*												
Cipla	416	6,075	21.8	20.1	3.8	3.3	34.3	8.2	18.2	NM	0.8	20.6
Dr. Reddy's Labs	1,827	5,646	19.1	17.4	4.5	3.7	13.8	9.9	25.7	NM	0.8	11.8
Telecom & Media												
Sun TV Network	421	3,029	22.5	19.4	6.2	5.7	8.8	15.6	28.7	26.5	2.2	12.2
Utilities												
Power Grid	113	9,579	14.1	11.7	2.1	1.8	15.8	20.8	15.3	7.0	2.0	18.3

Source: Bloomberg, RCML Research. *Consensus estimates for Pharma stocks. **Prices as of December 28th, 2012.

Stock Picks for 2013

Top large-cap long ideas for 2013

State Bank of India

Amongst the biggest beneficiaries of economic revival/monetary easing

Asset quality pressures are at their peak and should ease from here

- SBIN would be amongst the biggest beneficiaries of any economic revival/monetary easing. The bank has witnessed significant pressure on asset quality, particularly in the mid-corporate and SME segments. However, we believe this stress is at near-peak levels and any improvement in macro outlook could significantly reduce the pressure on asset quality in these segments.
- The bank's asset restructuring has remained much lower than peers. While restructuring could continue in the near term due to a general slowdown in the economy, policy reforms in stressed sectors like Power and a continued focus on deleveraging by large corporates could reduce the risks on restructured assets.
- NIM pressure should be limited as the pick-up in LDRs (loan-to-deposit ratio) in Q4FY13 and re-pricing of residual bulk deposits would support margins. A strong liability franchise marked by high CASA would support NIMs in the long term.
- Despite a sharp run-up YTD, we note that valuations are still lower than the 5-year average (large private banks are already trading at a premium to 5-year averages). While SBIN is trading at a premium to other large PSU banks, we expect this to sustain given its strong liability franchise and pricing power.

Fig 52 - State Bank of India – Key financials

Y/E 31 Mar (in Rsmn)	FY11	FY12	FY13E	FY14E
Net interest income	325,264	432,911	455,885	527,696
Net revenues	483,510	576,425	632,512	720,222
Pre-provision profits	253,356	315,735	344,056	390,615
Adj. PAT	82,645	117,073	141,045	165,906
Adj. EPS (INR)	130.2	174.5	210.2	247.2
ROE (%)	12.6	15.7	15.8	16.4
ROA (%)	0.7	0.9	1.0	1.0
P/BV (x)	2.7	1.7	1.7	1.5
P/E (x)	21.2	12.0	11.3	9.6

Source: RCML Research

Tata Motors

Improving JLR volumes and recovery in the CV segment should drive TTMT growth

- We believe that JLR's volumes will improve with the new Range Rover shipments starting in December and the new F-Type coming out in Q4FY13. Further, the Chinese market has started to show a marked improvement, with its share in retail volumes increasing to 23% for TTMT in November from 18% in October. The contribution from a third production shift at the UK-based Halewood manufacturing facility along with new launches (RR Sport, F-Type, variants of existing models) and growing strength in the Chinese market bode well for the company's volumes in the next two years.
- Further, we expect a recovery in the domestic CV cycle in the next 3-6 months with interest rate cuts, pre-election spending and a favourable base for FY14. We estimate 9-10% growth in domestic volumes (CV and passenger vehicles) in FY14/FY15.
- We expect the company to deliver a revenue/PAT CAGR of 15%/18% over FY13-FY15. We believe the upgrade cycle could continue with better-than-expected volumes from JLR and a likely recovery in the domestic CV cycle, leading to a stock re-rating to Rs360-370 – implying 20%+ upside from current levels.

Fig 53 - Tata Motors – Key financials

Y/E 31 Mar (in Rsmn)	FY11	FY12	FY13E	FY14E
Revenue	1,231,333	1,656,545	1,968,410	2,239,888
EBITDA	177,800	237,005	259,644	301,095
Adjusted net profit	90,426	140,986	115,545	137,230
Adjusted EPS (Rs)	30.3	42.4	34.8	41.3
Adjusted EPS growth (%)	-65.6%	40.1%	-18.0%	18.8%
DPS (Rs)	4.6	3.3	3.3	3.3
ROIC (%)	30.0	38.7	22.6	20.8
Adjusted ROAE (%)	67.7	51.7	30.1	27.5
Adjusted P/E (x)	10.1	7.2	8.8	7.4
EV/EBITDA (x)	5.6	4.4	4.7	4.0
P/BV (x)	4.1	2.8	2.3	1.8

Source: RCML Research

UltraTech Cement

Strong brand equity, regional diversification and comfortable balance sheet

Capacity expansion plans on track – should drive future growth

- UTCEM enjoys strong brand equity across the country with volumes spread uniformly across regions, thus diversifying region-specific risks. We expect 8-9% dispatch growth over the next two years, further aided by a soft base.
- The company plans to expand its capacity by 9.2mtpa in Chhattisgarh and Karnataka by 2014. It is also exploring both organic and inorganic growth opportunities to strengthen its leadership position, and is looking to enhance capacity by 50% to 75mtpa. We believe UTCEM would be a major beneficiary of an expected pick-up in cement volumes in the next 2-3 years as its expansion plans remain on track.
- UTCEM has a strong balance sheet with a comfortable D/E ratio of 0.3x and robust operating cash flows of ~Rs34bn in FY12. Cash and cash equivalents are also healthy at Rs37bn (or Rs136/sh) while planned capex totals Rs110bn over FY12-FY14.
- The stock looks attractive at current EV/EBITDA of 10.8x FY13 and 8.3x FY14 estimates. We expect a revenue/earnings CAGR of 12%/21% over FY12-FY15.

Fig 54 - UltraTech Cement – Key financials

Y/E 31 Mar (Rsmn)	FY11	FY12	FY13E	FY14E
Revenue	154,099	181,664	204,131	234,585
EBITDA	46,907	40,007	51,599	65,738
Adjusted net profit	31,347	23,889	29,336	36,794
Adjusted EPS (Rs)	114.4	87.2	107.0	134.3
Adjusted EPS growth (%)	15.3%	-23.8%	22.8%	25.4%
DPS (Rs)	6.00	6.00	6.00	6.00
ROIC (%)	29.7	18.4	18.3	19.0
Adjusted ROAE (%)	31.5	20.8	20.6	21.2
Adjusted P/E (x)	17.3	22.7	18.5	14.7
EV/EBITDA (x)	6.7	10.4	10.8	8.3
P/BV(x)	2.9	3.2	3.5	2.8

Source: RCML Research

Larsen & Toubro

- LT has a diversified infrastructure portfolio. We expect robust revenue growth of 16% in FY14 backed by a strong order book (Rs1.53tn) and healthy order inflows. Management has guided for order inflows of Rs805bn-840bn in FY13E (up 15-20% YoY) – expect orders from upstream, ferrous metals, roads and buildings (factories, residential and commercial).

- LT's valuation provides downside support. Moreover, rate cuts, a pick-up in domestic capex, and increase in order inflows from the Middle East will lead to outperformance from current levels.
- Further, unlocking of value in LT's IDPL arm (asset development arm) is likely in CY13 which provides another near-term trigger.

Best infrastructure play

Impending rate cuts, pick-up in domestic capex and healthy order-book to drive future growth

Fig 55 - Larsen and Toubro – Key financials

Y/E 31 Mar (Rsmn)	FY11	FY12	FY13E	FY14E
Revenue	520,438	643,131	715,199	831,553
EBITDA	76,774	87,700	94,596	110,059
Adjusted net profit	42,509	46,369	52,761	61,107
Adjusted EPS (Rs)	68.7	75.7	83.9	97.2
Adjusted EPS growth (%)	-24.1%	10.3%	10.8%	15.8%
DPS (Rs)	12.5	16.5	16.5	16.5
ROIC (%)	8.0	6.7	7.1	7.9
Adjusted ROAE (%)	18.6	17.0	15.9	15.3
Adjusted P/E (x)	23.6	21.4	19.3	16.7
P/BV (x)	4.0	2.7	2.7	2.4

Source: RCML Research

United Spirits

- Diageo's acquisition of a controlling stake in UNSP would help re-rate the stock as it eliminates the key overhang of UB group debt concerns.
- Diageo will pay Rs57.2bn for a 27.4% stake in UNSP (with Rs33bn likely to be injected into UNSP). We believe a majority of the cash infusion into UNSP would go toward servicing debt with the D/E ratio likely to improve from 1.6x in FY12 to ~0.4x in FY14. We expect return ratios to improve from 4-5% now to 14-15% in the next two years.
- We believe the company could earn margins of 18-20% over the medium term (from the current ~13% levels).
- We have upgraded our earnings estimates for UNSP by ~50% each for FY14/FY15 post the deal on account of improvement in leverage, which would be earnings accretive, and gradual margin expansion from the depressed levels currently. We believe there is potential for a sharp re-rating of the business given the company's market positioning and PE premium commanded for a cleaner structure.

Diageo's acquisition to help eliminate the key overhang of UB group debt concerns

Sharp re-rating potential led by improvement in leverage and margin expansion

Fig 56 - United Spirits – Key financials

Y/E 31 Mar (Rsmn)	FY11	FY12	FY13E	FY14E
Revenue	73,762	91,865	108,206	125,968
EBITDA	11,525	10,603	14,161	17,551
Adjusted net profit	4,312	1,987	3,621	9,144
Adjusted EPS (Rs)	34.3	15.8	28.8	62.9
Adjusted EPS growth (%)	-61.1%	-53.9%	82.2%	118.8%
DPS (Rs)	2.6	2.8	3.0	3.2
ROIC (%)	7.6	4.7	6.7	8.5
Adjusted ROAE (%)	14.3	4.3	7.5	12.9
Adjusted P/E (x)	29.9	38.4	67.2	30.7
EV/EBITDA (x)	16.1	13.7	22.5	17.9
P/BV (x)	3.1	1.6	4.9	3.1

Source: RCML Research

Top mid-cap long ideas for 2013

JK Lakshmi Cement

Capacity expansion to drive volume growth

Expect upgrade cycle to continue with better-than-expected results

- JKLC's presence in high-growth regions (Northern and Western markets, mainly in Rajasthan and Gujarat) and plans to expand capacity from 5.3mmt to 8.3mt by FY14 would aid volume growth going forward. The company plans to commission 2.7mtpa of capacity at Durg (Chhattisgarh) in Oct-Dec'13, with an outlay of Rs12.5bn over the next two years. Further, additional capacity at Udaipur Cement Works would take the overall capacity to over 9.5mtpa by FY15. JKLC is currently running at 95-100% capacity utilisation which is well ahead of the industry.
- We estimate volume growth of 10%-12% for FY13-FY15. JKLC would be a key beneficiary of rising utilisation levels in Northern/Western India along with the limited addition of incremental capacity in these regions.
- The company uses pet-coke as a major fuel and hence is insulated from movement in coal prices.
- JKLC has been reporting strong results in the past 2-3 quarters, leading to smart upgrades in consensus estimates. The stock is currently trading at 4.4x FY14E/3.7x FY15E earnings and we expect a revenue/PAT CAGR of 13%/15% over FY13-FY15. We believe the upgrade cycle could continue with better-than-expected results from the company, driving a stock re-rating to Rs180-200 levels.

Fig 57 - JK Lakshmi Cement – Key financials

Y/E 31 Mar (Rsmn)	FY11	FY12	FY13E	FY14E
Revenue	13,188	17,111	21,970	24,533
EBITDA	1,832	3,209	5,068	6,032
Adjusted net profit	591	1,362	2,311	2,727
Adjusted EPS (Rs)	4.8	11.2	19.6	23.2
Adjusted EPS growth (%)	-94.5%	130.4%	76.1%	18.0%
DPS (Rs)	1.3	1.9	2.2	2.2
ROIC (%)	5.5	10.3	14.6	14.0
Adjusted ROAE (%)	5.7	9.8	18.1	18.3
Adjusted P/E (x)	33.2	14.4	8.2	6.9
EV/EBITDA (x)	5.6	3.7	5.0	4.4
P/BV (x)	0.6	0.7	1.4	1.2

Source: RCML Research

Tech Mahindra/Satyam Computers

TECHM/SCS to emerge as the fifth largest IT player post-merger

Expect valuation discount to narrow given structural changes and anticipate estimate upgrades as both companies execute on growth and margins

- TECHM and SCS combined will be the fifth largest Indian IT player with revenues of US$2.7bn (FY13E). In our view, SCS' size and positioning should enable the combined entity to capture market share and deliver steady earnings growth. We expect the merged TECHM-SCS entity to deliver a 10.5% dollar revenue CAGR over FY12-FY14, broadly in line with the industry. While TECHM could continue to lag behind (expect 1% organic CQGR), growth for the combined entity would be driven by healthy execution at SCS (3% CQGR). SCS has already started seeing an improvement in its deal participation and win rates and, in our view, completion of the merger will further help on this front.

- SCS's operating margins have expanded to 19% from 13.5% in FY12, driven by operational efficiencies and INR depreciation. We estimate that the merged entity would have margins of ~18%, broadly in line with WPRO and HCLT. This is despite our conservative view on TECHM margins (building in 70-100bps overall decline in FY14) given execution risks from recent acquisitions. Overall, we are fairly confident of SCS sustaining margins at 18-19% levels going forward. The weak INR will continue to support margins for Indian IT players.

- TECHM/SCS are currently trading at 9x/8.5x FY13E combined earnings, which is still at a 37% discount to HCLT. Given the structural changes at TECHM/SCS (in line with industry growth and margins), we expect the valuation discount to narrow going forward. We value the merged company on 11x FY14E pro-forma EPS and see a 30%+ upside driven by consensus upgrades and valuation re-rating. We are 7-10% ahead of consensus for FY13/FY14 on both TECHM and SCS and anticipate upgrades to consensus expectations as the companies deliver on growth and margins.

Fig 58 - Satyam Computers – Key financials

Y/E 31 Mar (Rsmn)	FY11	FY12	FY13E	FY14E
Revenue	51,450	63,956	77,187	84,271
EBITDA	4,551	10,214	16,597	17,921
Adjusted net profit	3,335	12,243	13,056	14,569
Adjusted EPS (Rs)	2.8	10.4	11.1	12.4
Adjusted EPS growth (%)	-96.8%	266.9%	6.6%	11.6%
ROIC (%)	282.3	143.3	68.9	62.6
Adjusted ROAE (%)	70.0	58.8	25.3	19.4
Adjusted P/E (x)	23.3	7.7	9.3	8.4
EV/EBITDA (x)	10.2	6.4	5.1	4.0
P/BV (x)	4.5	3.2	2.8	2.1

Source: RCML Research

Fig 59 - Tech Mahindra – Key financials

Y/E 31 Mar (Rsmn)	FY11	FY12	FY13E	FY14E
Revenue	51,402	54,897	67,353	74,085
EBITDA	10,033	9,193	13,681	14,638
Adjusted net profit	6,829	10,987	13,128	14,364
Adjusted EPS (Rs)	54.5	86.5	102.9	112.5
Adjusted EPS growth (%)	-38.2%	58.9%	18.9%	9.4%
DPS (Rs)	4.7	4.7	5.9	7.1
ROIC (%)	38.5	30.2	40.1	34.3
Adjusted ROAE (%)	19.4	29.6	28.9	26.5
Adjusted P/E (x)	12.4	8.3	8.9	8.1
EV/EBITDA (x)	6.5	7.1	6.4	5.6
P/BV (x)	2.5	2.3	2.3	2.0

Source: RCML Research

Fig 60 - TECM-SCS pro-forma financials

(Rsmn unless otherwise stated)	FY12	FY13E	FY14E
Sales	**118,869**	**144,540**	**158,356**
In US$mn	2,465	2,681	3,013
Growth (%)		*8.8%*	*12.4%*
Gross Profit	35,620	48,710	52,585
Gross margin (%)	*30.0%*	*33.7%*	*33.2%*
EBIT	**16,219**	**26,575**	**28,537**
EBIT margin (%)	***13.6%***	***18.4%***	***18.0%***
EBITDA	19,409	30,278	32,559
EBITDA margin	*16.3%*	*20.9%*	*20.6%*
PBT	20,688	27,407	30,644
PAT	**18,481**	**20,620**	**22,727**
EPS (Rs)	**89.4**	**99.8**	**110.0**
Growth (%)		*11.6%*	*10.2%*

Source: RCML Research

LIC Housing Finance

- We like LICHF for its strong underlying growth potential in the mortgage financing space and robust asset quality. We expect the loan book to grow at 22% CAGR over FY12-FY15 which will drive strong PAT growth for the company.
- NIMs have declined significantly in the last two years due to a higher cost of funds, which has resulted in ROE compression from 26% in FY12 to ~18% in FY13 to date. However, with the decline in wholesale rates and re-pricing of its lower-yielding fixed asset portfolio, we expect NIMs to improve gradually in H2FY13 and FY14.
- Valuations are fair at 1.9x FY14E BV and 10.3x FY14E EPS given LICHF's strong positioning in the mortgage financing space, robust asset quality and high earnings visibility.

Strong underlying potential in the mortgage financing space and robust asset quality

Fig 61 - LIC Housing Finance – Key financials

Y/E 31 Mar (Rsmn)	FY11	FY12	FY13E	FY14E
Net interest income	13,719	13,916	15,965	20,256
Net revenues	17,710	16,241	18,633	23,228
Pre-provision profits	15,550	13,870	15,841	19,922
Adj. PAT	9,745	9,142	11,076	13,941
Adj. EPS (Rs)	20.5	18.1	21.9	27.6
ROE (%)	25.8	18.6	18.2	19.8
ROA (%)	2.2	1.6	1.6	1.6
P/BV (x)	2.6	2.3	2.3	2.0
P/E (x)	11.0	14.5	13.3	10.6

Source: RCML Research

Yes Bank

- We remain positive on YES given scope for market share gains, an improving liability profile, healthy asset quality and the easing rates.
- YES is one of the major beneficiaries of savings deposit rate deregulation – this coupled with a higher focus on retail banking and building a strong branch network should lead to a stronger liability profile. Improvement in CASA and a decline in wholesale rates would drive NIM expansion.
- Fee income has remained robust. While pressure on asset quality is increasing, the short-term nature of the loan book and diversified portfolio should support asset quality.
- We expect an earnings CAGR of ~27% over FY12-FY15. ROE could decline from ~23% in FY12/FY13 but should remain healthy at 21%+. The stock is trading at 2.1x one-year forward BV (in line with the 5-year average of 2.2x one-year fwd BV) and 11.4x FY14E EPS, which we believe is attractive given strong earnings growth, an improving liability franchise and healthy asset quality.

Remain positive on YES led by its low market share, strong earnings growth, improving liability franchise and healthy asset quality

Fig 62 - Yes Bank – Key financials

Y/E 31 Mar (Rsmn)	FY11	FY12	FY13E	FY14E
Net interest income	12,469	16,156	22,473	28,782
Net revenues	18,702	24,728	34,279	43,792
Pre-provision profits	11,904	15,402	20,766	26,631
Adj. PAT	7,271	9,770	12,501	15,795
Adj. EPS (Rs)	20.9	27.7	35.4	40.7
ROE (%)	21.1	23.1	23.9	22.3
ROA (%)	1.5	1.5	1.5	1.5
P/BV (x)	2.8	2.8	2.8	2.1
P/E (x)	14.8	13.3	13.1	11.4

Source: RCML Research

Sun TV

- SUNTV is expected to be a prime beneficiary of digitization thanks to its solid franchise and strong market position.
- Management sees no pricing pressure on advertising rates in the Southern broadcasting space and SUNTV's strong market-leading position gives it better bargaining power with advertisers. Management has maintained its guidance of double-digit advertising revenue growth in 2HFY13. Reduction in unsold inventory in smaller channels (no change in ad yields in bigger channels) would likely result in an improvement in average ad yields.
- Digitization in Chennai is progressing well, albeit at a slow pace. Management estimates that only ~0.5mn of the 1.5mn+ C&S households in Chennai have been digitized. The company expects monthly subscription revenues of Rs40mn-50mn from Chennai. The rest of India should also see a pick-up thanks to a-la-carte pricing of channels. Currently SUNTV receives only Rs20mn as revenues from the rest of India.

One of the biggest beneficiaries of compulsory digitization

Successful phase-2 roll-out to provide big boost to subscription revenues

Valuations at 19x FY14 earnings look very attractive

- Successful phase-2 DAS rollout would likely provide a big boost to subscription revenues. SUNTV's channels are leaders in five major cities falling under phase 2, with a combined subscriber base of ~4mn. The subscription revenue uptick could be to the tune of Rs60mn-70mn. This is expected to flow in only after 1QFY14.
- SUNTV had seen an increase in own content last year which resulted in a slight moderation of margins. The company expects content costs to rise 7-10% YoY in FY13 as the proportion of own content comes down. However, it is continuing to invest in Andhra Pradesh and Kerala to gain incremental market share.
- With improving business fundamentals and lower political risk, the stock looks attractive at current valuations of 19x FY14E earnings even assuming zero-growth EPS in the worst case (compared to Zee which is trading at 27x FY13E).

Fig 63 - Sun TV – Key financials

Y/E 31 Mar (Rsmn)	FY11	FY12	FY13E	FY14E
Revenue	20,135	18,472	19,390	22,057
EBITDA	15,779	14,144	14,769	16,780
Adjusted net profit	7,698	6,929	7,542	8,720
Adjusted EPS (Rs)	19.5	17.6	19.1	22.1
Adjusted EPS growth (%)	-77.8%	-10.0%	8.8%	15.6%
DPS (Rs)	8.8	9.5	11.5	13.3
ROIC (%)	51.3	35.2	36.0	44.9
Adjusted ROAE (%)	37.2	29.1	28.7	30.4
Adjusted P/E (x)	22.0	24.5	22.5	19.4
EV/EBITDA (x)	10.7	8.2	10.9	9.3
P/BV (x)	7.9	4.8	6.2	5.7

Source: RCML Research

Top short ideas for 2013

BHEL

- As additional capacities in the domestic BTG space come in, most likely by FY14, India will have an estimated annual BTG capacity of 30-40GW, which is much higher than expected demand. Thus, we believe capacity utilisation levels for the industry are likely to decline and competitive intensity would increase, leading to margin pressure for BHEL over the long term.
- Lower capacity utilisation will lead to lower margins and muted return ratios in the long term.
- Order inflows for FY12 came in at Rs220.1bn (down 60% YoY) while the order inflow CAGR was only ~3% over FY08-FY11 which is likely to put pressure on growth beyond FY12.
- We believe valuations are likely to remain capped in the long run due to concerns over heightened competition and sedate growth in order inflows.

Heightened competition and muted order inflows to result in margin pressures

Fig 64 - BHEL – Key financials

Y/E 31 Mar (Rsmn)	FY11	FY12	FY13E	FY14E
Revenue	422,466	479,789	541,073	493,056
EBITDA	85,854	99,072	99,749	86,846
Adjusted net profit	60,112	70,400	65,114	55,812
Adjusted EPS (Rs)	24.6	28.8	26.6	22.8
Adjusted EPS growth (%)	-72.1%	17.4%	-7.8%	-14.3%
DPS (Rs)	7.2	7.4	7.4	7.4
ROIC (%)	35.3	22.6	19.3	16.4
Adjusted ROAE (%)	33.3	30.9	23.5	17.5
Adjusted P/E (x)	9.4	8.0	8.7	10.1
P/BV (x)	5.0	2.5	1.9	1.7

Source: RCML Research

Punjab National Bank

- PNB has reported significant stress on asset quality with total restructured assets and NPLs increasing to 9.4% and 4.7% respectively. Management outlook on asset quality also remains muted and we are cautious on the bank’s high exposure to sensitive sectors.
- PNB’s liability profile has also remained under pressure with CASA declining to 35-36%. This coupled with stress on asset quality would put a further strain on earnings.
- While valuations are inexpensive at 0.8x FY14E BV, we believe the stock would underperform peers due to concerns on asset quality, a lower provision coverage ratio (down from 90% in Mar’09 to 44% in Sep’12), deterioration in liability profile and a decline in profitability.

Remain negative on PNB on asset quality concerns, lower provision coverage ratio, deterioration in liability profile and declining profitability

Fig 65 - Punjab National Bank – Key financials

Y/E 31 Mar (Rsmn)	FY11	FY12	FY13E	FY14E
Net interest income	118,073	134,144	152,130	175,386
Net revenues	154,199	176,170	197,403	226,704
Pre-provision profits	90,557	106,143	114,982	131,658
Adj. PAT	44,335	48,842	47,257	59,129
Adj. EPS (Rs)	139.9	144.0	139.3	174.3
ROE (%)	24.4	21.1	16.7	18.2
ROA (%)	1.3	1.2	1.0	1.0
P/BV (x)	1.9	1.2	0.9	0.8
P/E (x)	8.7	6.4	6.0	4.8

Source: RCML Research

Rural Electrification Corporation

Concerns remain on the business structure and coal availability/power project execution

- REC has performed well YTD due to SEB restructuring and power sector reforms. However, we believe long-term challenges remain and our key concerns are: (1) concentrated loan profile, (2) single-product nature of the business, (3) zero balance sheet buffers and (4) risks related to coal availability/power project execution.
- While strong outstanding sanctions would boost loan growth in the near term, growth could decline significantly from FY15 onwards given the sharp fall in incremental project announcements.
- We continue to prefer PSU banks over REC due to their diversified loan profile and attractive valuations.

Fig 66 - Rural Electrification Corporation – Key financials

Y/E 31 Mar (Rsmn)	FY11	FY12	FY13E	FY14E
Net interest income	33,723	39,249	48,734	57,459
Net revenues	36,443	41,315	51,229	60,187
Pre-provision profits	34,801	38,988	48,944	57,478
Adj. PAT	25,732	28,708	35,014	41,120
Adj. EPS (Rs)	26.1	29.1	35.5	41.6
ROE (%)	21.6	20.7	22.7	23.4
ROA (%)	3.4	3.0	3.0	3.0
P/BV (x)	2.0	1.4	1.5	1.3
P/E (x)	9.7	7.1	6.9	5.9

Source: RCML Research

Mphasis

Continued weakness in the HP business to keep overall growth muted, with limited triggers for any earnings recovery

- MPHL has recorded disappointing growth driven by continued weakness in the HP business. Additionally, direct channel growth has also been mixed. MPHL saw US dollar revenues decline 7% in FY12 versus 10-12% growth for the industry. We expect HP revenues to decline by 12-15% in FY13. While some of this could be offset by acquisitions, we note that overall growth will remain below par. The outlook for the HP business remains challenging and 2013 could be another year of growth underperformance. Additionally, the ongoing restructuring at HP could further dim hopes of any revenue recovery.

- MPHL's EBIT margins, at ~17%, are broadly in line with industry players. Given the pressure in top accounts and lower margin mix in direct channels, we see limited room for margin improvement for the company. We note that the direct business has to bear higher S&M costs versus HP, and has a high proportion of the India BPO business. Given the slowdown in growth opportunities, we believe the management has limited margin levers at its disposal.

- MPHL is trading at 10x FY13E EPS, the higher end of mid-cap IT valuations. While dividend payouts (5% yield) and a high cash balance provide some support, we see limited catalysts for an earnings recovery and multiple expansion. Overall, we believe that a muted growth outlook and lacklustre earnings growth are likely to drive continued underperformance into 2013.

Fig 67 - Mphasis – Key financials

Y/E 31 Oct (Rsmn)	FY10	FY11	FY12	FY13E
Revenue	50,365	50,980	53,573	57,861
EBITDA	12,540	9,746	10,489	10,197
Adjusted net profit	10,908	8,218	7,923	7,745
Adjusted EPS (Rs)	52.0	39.1	37.7	36.9
Adjusted EPS growth (%)	-41.0%	-24.8%	-3.6%	-2.1%
DPS (Rs)	4.7	7.6	17.0	9.4
Adjusted ROAE (%)	38.7	22.8	19.1	NA
Adjusted P/E (x)	11.9	10.6	10.2	10.4
EV/EBITDA (x)	9.1	7.1	5.2	5.2
P/BV (x)	3.9	2.2	1.8	1.6

Source: RCML Research

Macro estimates

Fig 68 - Key macroeconomic estimates

Year to 31 March	FY12	FY13E	FY14E	Comments
Real Indicators				
GDP growth (%)	6.5	5.5	5.8	Improving macroeconomic indicators, monetary easing and further reform push by the Govt. should result in a gradual economic recovery in FY14
Agriculture growth (%)	2.8	2.3	2.5	Erratic and below-normal southwest monsoon to impact FY13 growth despite an improved outlook for the *Rabi* cropping season. Expectations of a normal monsoon in FY14 *Kharif* season and a low base should support growth in FY14.
Industry growth (%)	3.4	3.8	3.9	Weak domestic and global demand would likely impact industrial GDP growth in FY13. Monetary easing in Q4FY13 and FY14 should result in a pick-up in investment activity in FY14, albeit at a slower rate
Services growth (%)	8.9	7.0	7.4	Services sector is expected to remain weak in H1FY14 with a subsequent pick-up thereafter. Private investment should see a revival because of easing of rates
External Sector				
Trade deficit (US$ bn)	(185)	(203)	(201)	Trade deficit is expected to widen in FY13 led by weak exports and stickier imports. If the trend continues, 3Q trade deficit could rise by ~17% in over and above the 25% rise in Q2.
Current Account Deficit (US$ bn)	(78)	(84)	(67)	Relatively steadier remittances and mediocre software earnings to support CAD in FY13. 2Q CAD could top 5% of GDP on weaker trade deficit, mediocre IT earnings, and trickling transfers
% to GDP	(4.2)	(4.4)	(3.0)	
Capital Account (US$ bn)	51	49	NA	Recent reforms should result in increased foreign capital inflow in FY13, about enough to support the rising CAD gap. FX reserves unlikely to shoot up
% to GDP	2.8	2.6	0.0	
External Debt (US$ bn)	346	400	450	ECBs remain the biggest component at ~30%. Debt levels under control despite Govt/RBI push towards debt inflows since FY12
% to GDP	18.7	21.4	20.4	
Exchange Rate				
US$/INR - year end	53.3	54.0	52.0	Expect the INR to trade in the 53-55 band for now on widening trade deficit with temporary overshoots likely. The Govt. expectations on reaching 50 only possible on heightened risk-on or surprising reforms, both of which we believe are unlikely for now. Maintain expectations on the RBI wanting to rebuild reserves at 52 levels
% depreciation	19.5	1.3	(3.7)	
Monetary Indicators (%YoY)				
Money supply	13.2	16.0	16.0	Liquidity conditions have remained tight over last couple of months owing to the festive/wedding season and advance tax payouts. We expect more OMOs in the future as this remains the favoured route for the RBI to manage short-term liquidity
Inflation - WPI (Avg.)	8.9	7.4	7.0	WPI inflation has seen a sharp improvement over the last couple of months. But we don't expect a meaningful improvement from here on, at least in the near term on a low base
Fiscal Indicators (%GDP)				
Center's fiscal deficit	5.9	5.8	5.5	Expected to remain stretched in FY13 with upward pressure on our estimates
State fiscal deficit	2.3	3.0	3.0	Fiscal balances remain a matter of concern on SEB worries

Source: RCML Research

Macroeconomic snapshot

Year to 31 March	FY01	FY02	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12	FY13E	FY14E
National Income Indicators*														
Nominal GDP (Rs bn)	21,687	23,483	25,307	28,379	32,422	36,925	42,937	49,864	55,826	65,503	78,756	88,558	99,818	113436
Nominal GDP (US$ bn)	475	494	524	618	721	834	948	1,239	1,216	1,382	1,728	1,847	1,880	2,203
Real GDP growth (%)	4.3	5.5	4.0	8.1	7.0	9.5	9.6	9.3	6.7	8.4	8.4	6.5	5.5	5.8
Agriculture growth (%)	(0.0)	6.0	(6.6)	9.0	0.2	5.1	4.2	5.8	0.1	1.0	7.0	2.8	2.3	2.5
Industry growth (%)	6.0	2.6	7.2	7.3	9.8	9.7	12.2	9.7	4.4	8.4	7.2	3.4	3.8	3.9
Services growth (%)	5.4	6.9	7.0	8.1	8.1	10.9	10.1	10.3	10.0	10.5	9.3	8.9	7.0	7.4
By Demand* (%YoY)														
Consumption	4.8	8.3	2.7	8.7	9.1	17.5	12.3	18.9	17.6	21.5	16.0	10.6	15.4	16.0
Pvt Consm	3.4	6.0	2.9	5.9	5.2	8.6	8.5	9.4	7.2	7.2	8.1	5.5	5.4	6.9
Public Consm	1.4	2.4	(0.2)	2.8	4.0	8.9	3.8	9.6	10.4	14.3	7.8	5.1	10.0	9.1
Gross Fixed Capital Fosmn	(1.4)	15.3	(0.4)	10.6	24.0	16.2	13.8	16.2	3.5	6.8	7.5	5.5	1.3	6.7
Cons; Invst, Savings ** (%GDP)														
Consumption	77.5	77.6	75.9	73.9	70.1	69.2	68.0	67.3	69.4	69.7	68.7	67.7	68.8	70.1
Gross Capital Formation	24.2	25.7	25.0	25.3	32.5	34.3	35.9	38.0	35.4	35.8	34.8	35.5	35.3	36.0
Gross Domestic Savings	23.8	24.9	25.9	29.0	32.4	33.5	34.6	36.9	32.2	33.7	31.5	30.0	28.5	30.0
Real Indicators (%YoY)														
Cement despatches (domestic)	(0.6)	9.8	8.4	5.5	8.5	11.4	9.7	8.0	8.0	10.4	4.5	7.0	9.0	10.0
Commercial vehicle sales	(12.3)	5.4	28.0	36.8	25.5	12.4	32.1	6.2	(22.3)	35.4	31.4	18.9	3.0	5.0
Car sales	(7.5)	(5.5)	9.6	34.3	19.4	7.3	20.6	11.5	9.7	26.9	22.4	4.4	5.0	15.0
Two-wheelers	(0.8)	15.0	15.9	12.8	16.8	15.1	12.3	(5.0)	4.6	24.5	26.5	15.7	10.0	12.0
Diesel consumption							12.4	9.2	7.8	(2.7)	2.1	5.1	7.0	7.0
Electricity growth (%)	4.2	3.2	3.0	6.1	5.2	4.9	7.5	7.8	2.6	7.9	1.4	8.1	6.7	7.0
Fertilizers growth (%)***	0.5	(4.4)	1.6	(2.6)	8.1	(0.4)	(11.5)	5.9	0.3	14.0	3.1	0.2	8.1	-
Urea growth (%)***	(0.7)	(3.4)	(2.0)	2.3	6.3	(0.8)	0.9	(2.1)	0.4	6.0	3.6	0.6	2.6	-
Rest of fertilizers growth (%)***	4.3	4.2	4.4	4.1	4.2	4.2	3.4	3.9	3.9	4.4	4.3	4.3	9.1	-
Aviation passenger km (%)*****	7.6	(5.9)	10.9	13.5	23.8	31.4	41.5	24.5	(11.2)	18.4	20.7	11.7	7.0	-
Crude Steel growth (%)	4.8	4.0	8.0	28.2	12.2	7.0	9.4	6.0	1.2	20.8	5.7	na	7.7	8.2
Coal Dispatches****		203	211	304	235	333	350	375	401	415	516	527	465	481
Port traffic - Import growth(%)*****	(1.8)	0.1	4.9	7.5	10.9	13.5	9.8	10.8	3.7	12.2	2.2	3.6	1.6	6.5
Port traffic - Export growth(%)*****	16.9	7.8	18.6	11.9	13.3	4.3	7.2	12.5	1.1	0.4	0.7	(9.0)	0.8	5.3
External Sector (%YoY)														
Trade deficit (US$ bn)	(6)	(5)	(9)	(14)	(28)	(46)	(59)	(87)	(116)	(109)	(119)	(185)	(203)	(201)
Invisibles (US$ bn)	9.8	15.0	17.0	27.8	31.2	42.0	52.2	75.7	91.6	80.0	84.6	111.6	119.0	133.4
Current Account Deficit (US$ bn)	(2.7)	3.4	6.3	14.1	(2.5)	(6.9)	(9.6)	(15.7)	(27.9)	(38.2)	(45.9)	(78.2)	(84.0)	(67.2)
% to GDP	(0.6)	0.7	1.2	2.3	(0.3)	(0.8)	(1.0)	(1.3)	(2.3)	(2.8)	(2.7)	(4.2)	(4.4)	(3.0)
Capital Account (US$ bn)	8.8	8.6	10.5	16.7	27.7	25.5	45.2	106.6	6.8	50.4	59.7	50.9	49.0	-
% to GDP	1.9	1.7	2.0	2.7	3.8	3.1	4.8	8.6	0.6	3.6	3.5	2.8	2.6	-
Forex Assets (excl agold) (US$	39.6	48.1	71.9	107.5	135.6	144.8	191.9	299.2	241.4	259.7	278.9	264.5	260.0	270.0
Months of imports	9.5	11.9	14.0	16.5	14.6	11.7	12.4	14.4	9.7	10.8	9.1	6.5	6.6	6.6
External Debt (US$ bn)	101.3	98.8	104.9	111.6	133.0	138.1	172.4	224.4	224.5	260.9	305.9	345.8	400.0	450.0
Short Term debt (US$ bn)	3.6	2.7	4.7	4.4	17.7	19.5	28.1	45.7	43.3	52.3	65.0	78.2	90.4	101.7
Exchange Rate														
US$/INR - annual avg	45.6	47.6	48.3	45.9	44.9	44.3	45.3	40.2	45.9	47.4	45.6	47.9	54.5	53.0
% depreciation	7.0	4.3	1.6	(4.9)	(2.1)	(1.5)	2.3	(11.1)	14.1	3.3	(3.9)	5.2	10.7	(3.0)
US$/INR - year end	46.7	48.3	48.0	45.6	43.5	45.1	44.2	39.4	48.4	46.6	44.6	53.3	54.0	52.0
% depreciation	4.8	3.4	(0.6)	(4.9)	(4.7)	3.7	(2.1)	(10.8)	22.7	(3.6)	(4.3)	19.5	1.3	(3.7)
Monetary Indicators (%YoY)														
Money supply	16.8	14.1	14.7	16.8	12.3	21.2	21.3	21.4	19.3	16.9	16.1	13.2	16.0	16.0
Inflation - WPI (Avg)	7.1	3.6	3.4	5.5	6.5	4.5	6.6	4.7	8.1	3.8	9.6	8.9	7.4	7.0
CPI (Avg)	3.8	4.3	4.0	3.9	3.8	4.4	6.7	6.2	9.1	12.4	10.5	9.0	9.8	9.5
Bank credit growth	16.6	11.4	26.6	16.0	26.2	38.0	28.1	22.3	17.5	16.9	21.5	17.0	16.0	17.0
Deposit growth	16.2	25.2	11.6	23.7	19.0	25.4	16.7	15.0	16.7	26.2	21.2	11.8	17.0	17.0
Fiscal Indicators (%GDP)														
Center's fiscal deficit	(5.5)	(6.0)	(5.7)	(4.3)	(3.9)	(4.0)	(3.3)	(2.5)	(6.0)	(6.4)	(4.9)	(5.9)	(5.8)	(5.5)
State fiscal deficit	(4.1)	(4.1)	(3.9)	(4.3)	(3.2)	(2.3)	(1.7)	(1.7)	(2.5)	(3.0)	(2.7)	(2.3)	(3.0)	(3.0)
Combined deficit (Center+State)	(9.6)	(10.1)	(9.7)	(8.6)	(7.1)	(6.3)	(5.0)	(4.3)	(8.5)	(9.5)	(7.6)	(8.2)	(8.7)	(8.5)

Source: CMIE, RBI, CSO, RCML Research
* At constant price ** At current prices ***Government Estimates for FY13 ****Only for CIL *****CMIE Estimates

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