Prabhudas Lilladher

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India Strategy & Top Ideas

Indian Markets – Bracing for a likely Fiscal Wobble?

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July 2013 - Weakest services PMI growth since April 09, contraction in manufacturing PMI for the first time since March 09 & a six-monthly high in 8-Core sector growth

- **Services PMI** slipped from 47.9 in July 13 to 47.6 in August 13 - the weakest since the lows of global financial crisis in April 2009. The survey showed that the new business index fell to a four-year low of 46.6 in August 13 from 47.8 in July 13 - a second consecutive month of demand decline. Another point of worry was the biggest one-month fall in nearly a year of the business optimism sub-index indicating that the firms were less optimistic about the future. Service providers have indicated that a range of raw materials, labour, fuel and transport costs increased over the month. Despite robust cost inflation, private sector firms raised their prices only marginally amidst reports of increased competitive pressures.
- **Manufacturing PMI** for Aug 13 fell to 48.5 from 50.1 from July 13 - first time that manufacturing has contracted since March 2009. This was led by a decline in new orders, especially export orders. Subdued client demand and fragile economic conditions led to the fastest rate of contraction in new orders since Feb 2009. Increased competitive pressures and weaker demand from key export clients led to new businesses from abroad falling for the first time after 11 months. Although firms raised their selling prices in an attempt to pass on their increased cost burden, heightened competitive pressures limited manufacturers’ pricing power.
- **Growth in eight core infrastructure industries** that constitutes nearly 40% of IIP rose to a six-month high at 3.1% in July 13, lower than 4.5% in July 12 but sharply higher than 0.1% recorded in June 13. On a YoY basis, Crude oil (-1.2%) and Natural gas (-16.1%) sectors were laggards, while Fertilizers (0.4%), Cement (0.8%), Coal (1.2%), Petroleum refining (5.1), Electricity (5.2%) and Steel (7%) showed positive growth. Sustenance of growth in leading sectors like Steel and Electricity looks difficult as growth in steel comes on a very low base in July 12 (1.2% YoY) and electricity growth is based primarily on 33% spurt in hydro-electric generation. Although coal-based generation has grown at 5.6%, a fall in coal output in May and June as well as a sharp 6.5% drop in capacity utilization of coal-based plants in July is pointing towards an imminent slowdown in future. Cumulative growth rate in April-July 13 marks a slowdown of 1.9% vis-à-vis 6.3% YoY and 3.9% for FY13. **Since July 12, although core sector has grown for 11 months, IIP has grown for only 6 months.**

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Slowest pace of GDP growth in Q1FY14 in atleast four years; July 13 - Rise in WPI at fastest pace since Feb 13 and Marginal easing of CPI & food elevation though both remain elevated & hover near double digits

- **GDP in Q1FY14** fell to 4.4%, slowest pace in atleast four years dragged down by contraction in mining (-2.8% vis-à-vis 0.4% YoY) and manufacturing (-1.2% vis-à-vis -1%). Agriculture grew at 2.7% as against 2.9% in Q1FY13, while services sector growth slowed to 8.9% vis-à-vis 9.3% YoY. GDP in Q1FY13 had grown at 5.4% and in Q4FY13 at 4.8%. A major contributor to growth was government expenditure (9.4% increase in community, social and personal segment), while private consumption growth weakened further to 1.6% and investments fell by 1.2% YoY, indicating weak business sentiment due to slowdown in project take-offs and continuance of supply-side bottlenecks.

- **IIP** had fallen by 2.2% in June 13 as against a fall of 2% in June 12. It was dragged down by flat electricity generation (0% vis-à-vis 8% YoY) and fall in mining (-4.1% vis-à-vis -1.2% YoY) & manufacturing (-2.2% vis-à-vis 3.2% YoY). 13 out of 22 broad manufacturing categories recorded a fall in June 13 versus 11 categories in May 13. The key segments of capital goods (-6.6% vis-à-vis -27.7% YoY) and consumer durables (-10.5% vis-à-vis +9% YoY) contracted, while consumer non-durables grew (5% vis-à-vis -0.5% YoY).

- **WPI for July 13** rose at the fastest pace since February 13 at 5.79% YoY vis-à-vis 4.86% in June 13. It has moved beyond RBI's comfort zone of 5% due to elevated food prices and increased cost of imports due to the falling Rupee. Non-food manufacturing inflation (a gauge of pricing power among manufacturers), which has remained subdued off late, has also ticked up at 2.35% in July 13 versus 2.02% in June 13.

- **CPI for July 13** eased marginally to 9.64% versus 9.87% in June 13 due to softening of prices of cereal, pulses, fruits and sugar. Food inflation (constituting around 50% of CPI), though down marginally to 11.24% as against 11.84% in June 13, remains highly elevated.

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Narrowing trade deficit in July 13 due to sharp YoY rise in exports & plunge in gold imports but a worryingly high fiscal deficit for the period April-July 13 at 62.8% of full year's target

- July 13 saw a sharp 11.64% YoY rise in exports (US$25.63bn) of pharma, textiles, chemicals & heavy machinery and a 6.2% YoY contraction in imports (US$ 38.10bn) due to slowing domestic demand. Gold & Silver imports plunged massively to US$2.97bn in July 13 versus US$4.47bn in June 13 due to RBI's severe restrictions on imports, impact of rise in import duties as well as seasonally weak demand for jewellery for weddings from June to August. Gold & Silver imports in April (US$7.5bn) and May (US$8.4bn) had risen massively. **Trade deficit** at US$12.26bn has remained nearly flat in July 13 vis-à-vis US$12.25bn in June 13 and sharply lower than US$18.29bn in April 13 and US$20.71bn in May 13. In the period April-July 13, exports rose 1.72% to US$98.29bn, while imports grew at 2.82% to US$160.73bn leading to a trade deficit of US$62.44bn vis-à-vis US$59.69bn for the same period last year.

- **India's fiscal deficit** for April-July 13 zoomed to Rs3.4lakh crores or almost 62.8% of FY14's budgeted target vis-à-vis 51.51% of the budget estimate in April-July 12. The government has projected a fiscal deficit of Rs5.42lakh crores for FY14 or 4.8% of GDP as against 4.9% achieved in FY13. Net tax receipts for the period stood at Rs1.45lakh crores, while the total expenditure has risen to Rs5.21lakh crores.

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Will the govt. contain fiscal deficit by cutting revenue deficit as promised or will it wield the axe on crucial increase in Plan Expenditure nixing hopes of revival in capex cycle?

- In FY13, the Finance Minister had contained fiscal deficit to 4.9% of GDP by wielding a savage cut in plan expenditure to the tune of Rs1000bn (around 7% of budgeted expenditure or 1% of GDP) from a budgeted Rs5210bn to Rs4292bn. He has resolved to slash the fiscal deficit further to 4.8% of GDP in FY14. However, this time around he intends to cut revenue deficit to 3.3% of GDP and has projected a 29.4% increase in plan expenditure to Rs5553bn by massively increasing allocations to government's flagship schemes like Sarva Siksha Abhiyan (for education), Gram Sadak Yojana (for roads), JNNURM (for urban renewal), National Health Mission, Integrated Child Development etc. spelling out clearly government's priorities.

- It was expected that this sharp rise in plan expenditure in FY14 would translate into increased aggregate demand from government in many soft and hard infrastructure sectors and help kick-start economic growth. This is all the more necessary due to a sharp plunge in private sector investments as a result of investment climate continuing to remain weak due to massive time & cost overruns in project approvals & implementation, high leverage, deteriorating cash flows, erosion of asset quality & muted credit confidence. The government has made a valiant attempt to clear long-pending industrial & infrastructure projects through Cabinet Committee of Investments and Project Monitoring Group under the Cabinet Secretariat. In addition to clearing 157 projects worth Rs1.6lakh crores till end-July 13, CCI has cleared 87 more infrastructure & industrial projects entailing an investment of Rs1.83 lakh crores in the month of Aug 13. The projects cleared include 18 in the power sector entailing an investment of Rs85000 crores and the rest in Roads, Railways, Petroleum & Natural Gas.

Will the sharply trimmed GDP forecasts for FY14 & skittish markets blow a hole in estimates of net tax receipts, disinvestment proceeds and telecom receipts?

- FY14's budget is pivoted around an assumption of nominal and real GDP growth at 13.4% and 6.5%, respectively. In view of the slowing economy, RBI and Prime Minister's Economic Advisory Council Chairman Dr. C Rangarajan have already slashed their projections for FY14's GDP growth to 5.5% and between 5.0 to 5.5%, respectively. Although we acknowledge that better-than-normal & widespread monsoons can help agriculture sector grow by 4-5% adding 0.3-0.4% to GDP, the faltering growth in manufacturing & mining and slowdown in services has the potential to bring down GDP to sub-5% levels in FY14.

- In view of emerging wide divergences of budgetary assumptions of real GDP growth rate of 6.5% (nominal GDP growth of 13.4%) and current estimates of sub-5% (nominal GDP growth of around 11%) as well as the worrying trends in fiscal deficit figures for April-July 2013, we believe that the fiscal deficit target for FY14 is a tad optimistic to achieve. Gaping holes are likely to emerge in various revenue and expenditure heads like net tax receipts, disinvestment proceeds, telecom receipts, subsidies and interest payments.

- The budget has made no significant change in Income Tax rates & slabs yet Income tax is budgeted to go up by 20.2% in line with similar growth last year. Corporate tax collections are budgeted to rise by 16.9% on the expectation of revival in the economy & doubling of corporate surcharge from 5% to 10%. Growth in excise and service tax collections at 18.1% and 36.1%, respectively in FY13 was led by an increase in the peak rate from 10% in FY 12 to 12% in FY13. With the peak slabs remaining at 12% and no more services coming under the ambit of service tax, it looks like the government is banking on the Amnesty Scheme for service tax evaders to boost service tax collections in FY14. FY14's budgeted 35.8% increase in service tax collections on a large base in FY13 clearly looks too ambitious. Excise and Customs collections have been assumed to rise at a much more modest 14.9% and 13.6%, respectively, though it needs to overcome the hurdle of an almost stagnant industrial sector.

Contd…

- FY13 had seen a massive underachievement in proceeds from telecom sector from a budgeted Rs582bn to Rs194bn due to failure of 2G spectrum auction yet the government has built in a target of Rs408bn in FY14 from telecom sector receipts. Although in FY13, bulk of the receipts were assumed to come from spectrum auction, the rest were expected from annual revenue share licence fee and spectrum usage charge. Most of the operators who won spectrum were given the option of deferred payment and some also had the option to adjust the entry fee they paid in 2008. Eventually bids worth only Rs94bn were received and a significant part of this was adjusted against license fee paid in 2008 by the operators. In FY14, Rs200bn has been assumed to come from spectrum auction. It remains to be seen how this stiff target will be achieved.
- Having failed to achieve its disinvestment target of Rs300bn in FY13 (it managed to raise Rs240bn), the government has budgeted an even higher target of Rs400bn in FY14. In view of the imminent tapering of bond purchases by the US Fed either in September 13 or latest by December 13, there is dwindling interest in emerging markets in general and in particular those markets like India which has high CAD. An avalanche of FII equity flows due to abundant global liquidity was mainly responsible for the buoyancy in Indian equity markets in CY12 and from Jan to May 13 (before the Fed's announcement of tapering). FY14's disinvestment ambitious target needs to overcome these headwinds. So far the government has raised a mere Rs13.25bn through stake sale in six companies - MMTC, Neyveli, Hind. Copper, National Fertilisers, STC and ITDC.
- Government has also assumed a further inflow of Rs158bn from sale of stakes in non-government companies like Balco, Hindustan Zinc, sale of shares from SUUTI (ITC, Axis Bank, L&T etc). This looks likely to be achieved. So far this year, the government has not raised any amount under this head.

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With Rupee on a slippery slope, fuel subsidies balloon upsetting fiscal maths

- Budget assumes a 10.3% drop in total subsidies to Rs2311bn from Rs2577bn. A precipitous decline from around Rs54 in end-February 2013 to the current levels of Rs67 has led to an unprecedented ballooning of under-recoveries in diesel, kerosene and LPG as well as increase in fertilizer subsidies. Every Re1 depreciation vis-à-vis US Dollar leads to Rs8000cr rise in fuel under-recoveries. Thus, the plunge in Rupee has lead to under-recoveries rising by Rs1040bn on an annual basis. Assuming 40% of the under-recoveries would be forced upon upstream oil companies like ONGC, OIL & GAIL, rest 60% i.e. Rs624bn would have to be borne by the government swelling its fuel subsidy bill.

- The tensions in Middle East (Libya, Iran, Egypt and now an imminent strike on Syria by the US) are likely to keep crude markets on the boil. The price of Indian crude basket in Rupee terms has risen from Rs5908.40/barrel (in USD terms 109.74/barrel) as on February 27, 2013 to Rs 7464.26/barrel (in USD terms 111.59/barrel) as on September 3, 2013. Every $1 increase in international crude prices leads to Rs4000cr of additional under-recoveries. Under-recoveries on diesel have increased from a low of Rs2/litre a few months back to around Rs10/litre, kerosene at Rs33/litre and LPG at Rs412/cylinder. Total under-recovery estimates for FY14, which were pegged at Rs800bn in May 13, could now surpass Rs1500-1600bn not much different from FY13.

Giant stride to restore fiscal health needed- Complete deregulation of diesel prices or partial deregulation i.e. fixed per unit subsidy for diesel, kerosene & LPG, the rest of the price market-linked

- Government is allowing increase in diesel prices at a glacial pace of Rs0.5/litre per month. **A swift and surgical intervention is needed to drastically reduce the under-recoveries** by announcing a hefty Rs5-8/litre increase in diesel prices as also bringing down under-recoveries in kerosene and LPG. If there is one bold measure that the government can adopt that has the potential to transform the attitude of both foreign and domestic investment community towards India, it is to boldly deregulate diesel prices. Although this would feed into the country's already stubborn and elevated inflation, it would send an unambiguous signal to investors that India is well and truly back on the path of fiscal rectitude from one of fiscal profligacy. If this is too bold a measure to adopt in an election year, especially in view of the rise in inflation that would follow, the government must atleast cap the subsidy in Rupee terms on each litre of diesel (say Rs3-4/litre) and kerosene (Rs20/litre) and each cylinder of LPG (Rs200-250/cylinder). This would help investors assess the total subsidy burden that the government would have to bear on an annual basis and partially link auto and cooking fuel prices to international prices acting as an effective mechanism to regulate domestic demand. This would go down as a **giant stride for restoring India's fiscal health**.
- We believe that the likely shortfall in net tax receipts, disinvestment & telecom receipts and above all the ballooning of the fuel subsidies will leave the government with no option but to drastically axe the hefty 29.4% budgeted increase (Rs1300bn) in plan expenditure. This would augur ill and push back all hopes of revival in economic activity particularly led by government spending in case of soft & hard infrastructure sectors.

Food Security Bill - Triumph of political populism & expediency over fiscal restraint; Estimates of actual costs vary widely. Moody's terms it 'credit negative'

- In these times of acute fiscal stress, government's passage of Food Subsidy Bill (FSB) has sent out a signal that political expediency in an election year triumphs over fiscal restraint. Although the Food Minister is categorical that the current food subsidy which is Rs1090bn when adjusted to recent census would increase to Rs1130bn. Additional burden due to passage of FSB would be Rs100bn i.e. total food subsidy would rise to Rs1230bn.
- Although the bill hopes to increase coverage from 45% to 67% of the country's population with cheaper grain (Rice at Rs 3/kg, wheat at Rs 2/kg and coarse cereals at Rs 1/kg) by allowing 5 kg/person/month, the Minister estimates total food grains required to be procured would go up by just 2m tones from 60m kg currently to 62mn kg as food grains distributed is likely to come down from 35kg/family currently to 5 kg/person/family.
- These estimates are widely contested by many. The head of government's Commission for Agricultural Prices Dr. Ashok Gulati estimates that the food bill would double to Rs2400bn per year with Rs660bn being spent in the first year to increase agricultural production to meet FSB's demand.
- Moody's estimates that the food subsidy bill would rise from 0.8% of GDP to 1.2% of GDP exacerbating government's already weak finances and terms it a 'credit negative'. As the roll-out over the entire country would take not less than 6-9 months, the full impact of the FSB will be evident only in FY15 but it would add to the structural burdens that the fisc has to carry.

Land Acquisition Bill - Will it slowdown rather than facilitate faster roll-out of industrial & infrastructure projects?

- The Land Acquisition Bill cleared by the Parliament is likely to address the recurring protests from land-owners who are bitterly opposed to acquisition of their land for various projects without adequate compensation. The Bill addresses these concerns by mandating a minimum threshold of four times the market value of land in rural areas and two times in urban areas and consent of atleast 80% of project-affected-people for private projects and 70% for PPP projects. A comprehensive resettlement & rehabilitation policy (R&R) has been prescribed.
- A section of Industry fears that the bill would lead to long delays in obtaining consent for projects, increase land acquisition costs and render many projects unviable. The R&R clauses have been found to be too onerous. As Land is a State subject, populism may force State Governments to tilt more in favour of landowners denting a further blow to the process of industrialization and urbanisation in the country.

Pensions Bill - Finally sees light of the day with FDI cap at 26%. Proposal for a hike in FDI in Insurance to 49% goes for a hike

- Parliament has accorded nod to the Pensions Bill which aims to create a Pensions Regulator (Pensions Fund Regulatory Development Authority or PFRDA) and help extend pensions benefits to more people. Pure pension products would now come into the market. At present most of the pure pension products in the market are linked with insurance coverage. The bill provides for 26% FDI in pension sector or as may be approved for insurance sector whichever is higher.
- Currently FDI cap in insurance sector stands at 26% and is unlikely to be raised to 49% due to bitter opposition from many Opposition parties (BJP, Left, TMC, AIADMK etc) and some of UPA's outside supporters like the SP.
- PFRDA's new pension system (NPS) has been made compulsory for all new government recruits, except armed forces, who have joined after January 1, 2004 and it has been opened to all Indian citizens from 2009. NPS allows investors to invest in stock markets with a cap on equity investment and allowing subscribers to choose a fund manager of their choice. A subscriber seeking minimum assured returns has been provided an option to invest in such schemes as notified by the regulator.

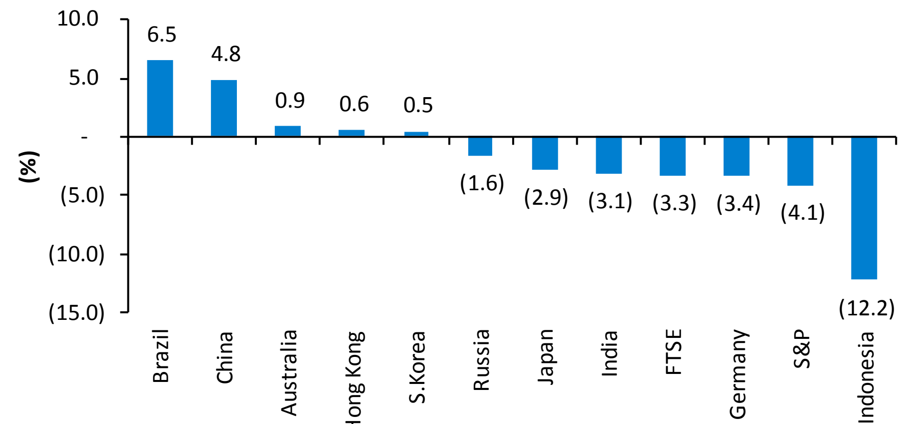
Legislative & Administrative reforms - Miles to go & Promises to keep but will it be a casualty of busy Polls calendar?

- Several key reform initiatives expected by the markets to stimulate investments and kick-start growth like passage of GST bill, dismantling of monopoly of Coal India & allowing commercial miners to bridge the yawning gap between domestic consumption and production, allowing private sector participants in the slothful behemoth of Indian Railways by unleashing the power of lower passenger fares, better frequency, timely & more comfortable journeys and increased investments, DTC and increase in FDI cap in Insurance & Pensions sector are unlikely to see the light of the day due to bitter political confrontation among political parties.
- A busy political calendar with four crucial states of Delhi, Madhya Pradesh, Rajasthan & Chhattisgarh are slated to go to polls around Dec 2013 followed by national polls in May 2014 may constrain the government from carrying out some politically unpopular but economically necessary reforms. In all the four states going for polls, the Ruling Congress Party is pitted against the Principal Opposition Party BJP.

Prabhudas Lilladher — Global Equity Market Performance

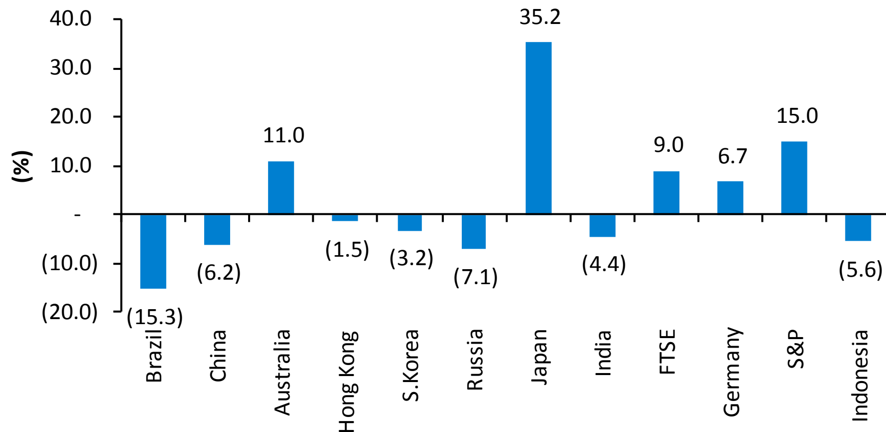
- **MoM - Indian markets facing multiple headwinds:** Ballooning fuel subsidies, rising inflation due to sliding Rupee, slowing economy upsetting revenue receipts, FSB exacerbating govt.'s already weak finances, Land bill spooking investors, adoption of tight monetary & fiscal stance to stabilize Rupee obliterating all hopes of easy rates and fears of stoppage & reversal of foreign flows after start of tapering render India vulnerable
- **YoY:** Emerging markets with large CAD like Indonesia, Brazil and India suffer the most. Developed countries lead the rally.

Month-on-Month



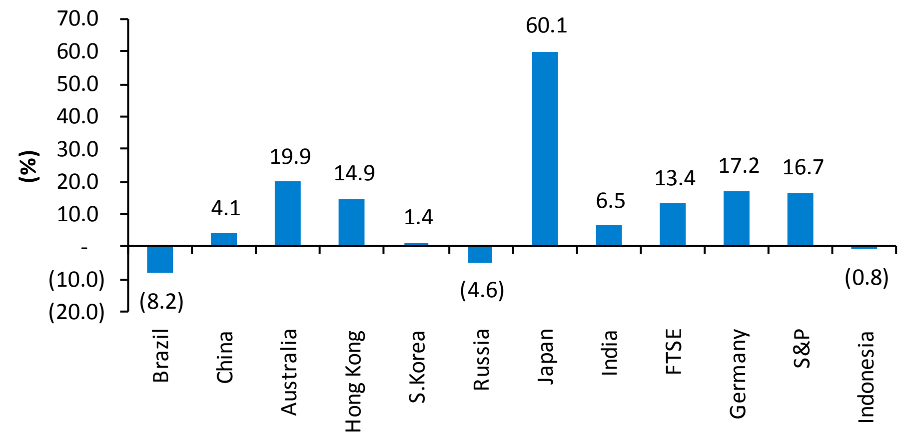
Source: Bloomberg, PL Research

Calendar Year-to-date



Source: Bloomberg, PL Research

Year-on-Year

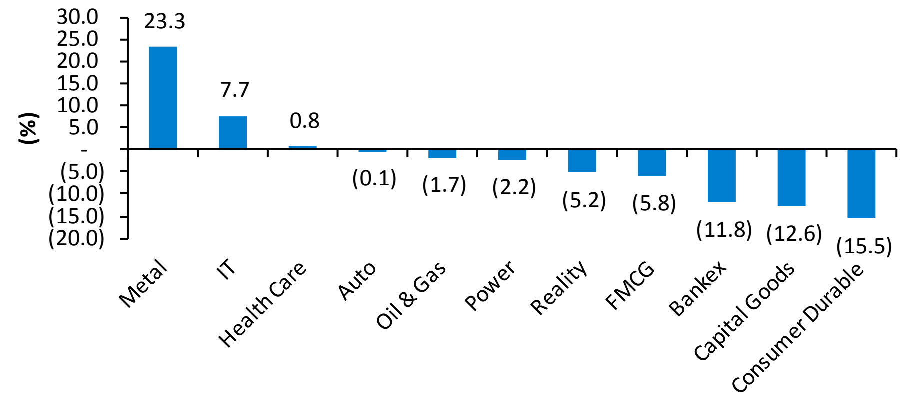


Source: Bloomberg, PL Research

Indian Equities – Sector Performance

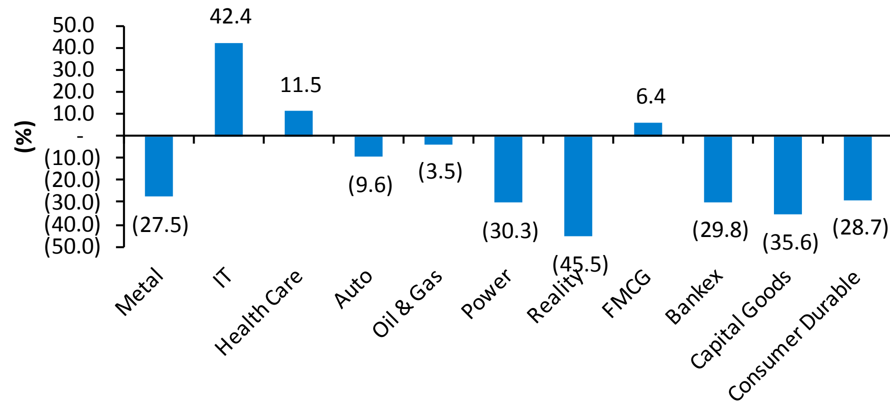
- **MoM:** Metals show a stellar performance on the back of improving data in China & Europe, Falling Rupee rendering imports expensive and providing a leg-up to exports.
- IT proves to be a 'safe haven' in an environment of precipitous slide in Rupee and US economy (its largest market) gathering strength.
- Sharp rise in interest rates singe 'interest rate sensitive' sectors like Capital Goods, Banks and Reality.

Month-on-Month



Source: Bloomberg, PL Research

Calendar Year-to-date



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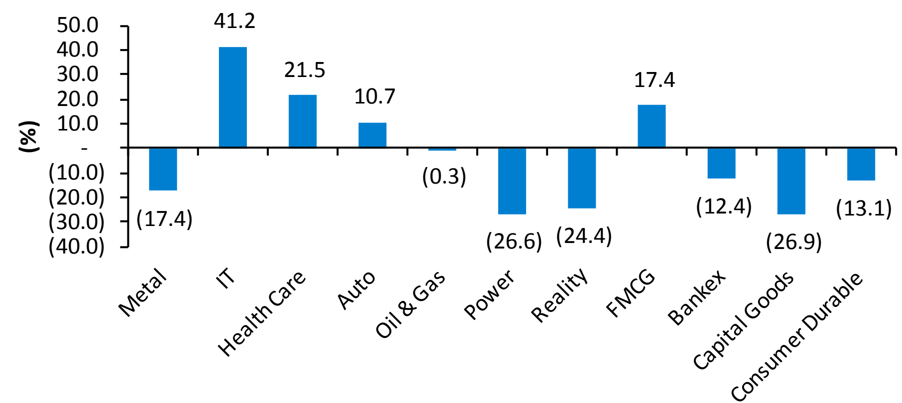
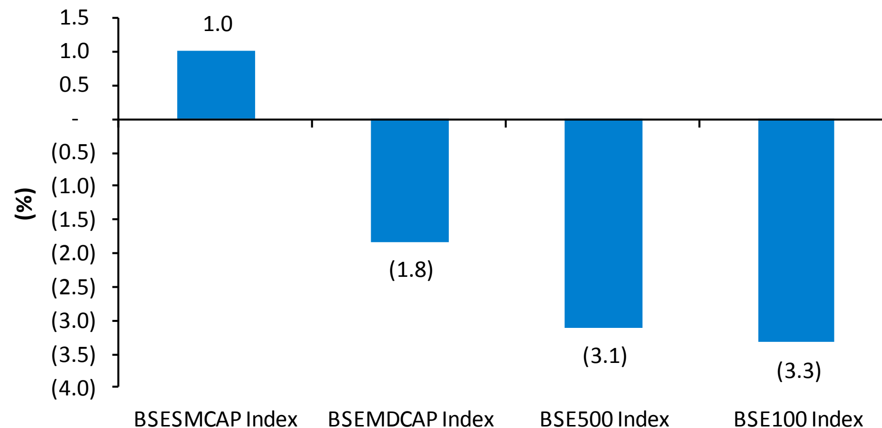


Source: Bloomberg, PL Research

India: Market cap-wise Performance

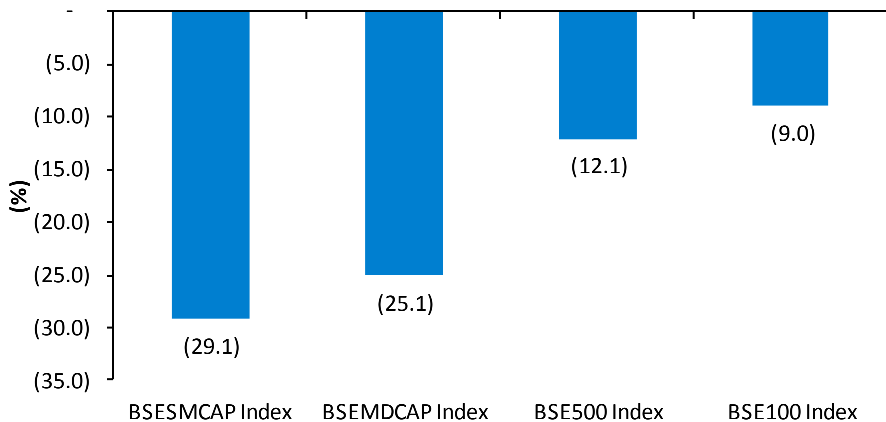
- **MoM:** Small & Mid caps outperform Large caps. Large caps bear the brunt of FII selling in liquid names.

Month-on-Month



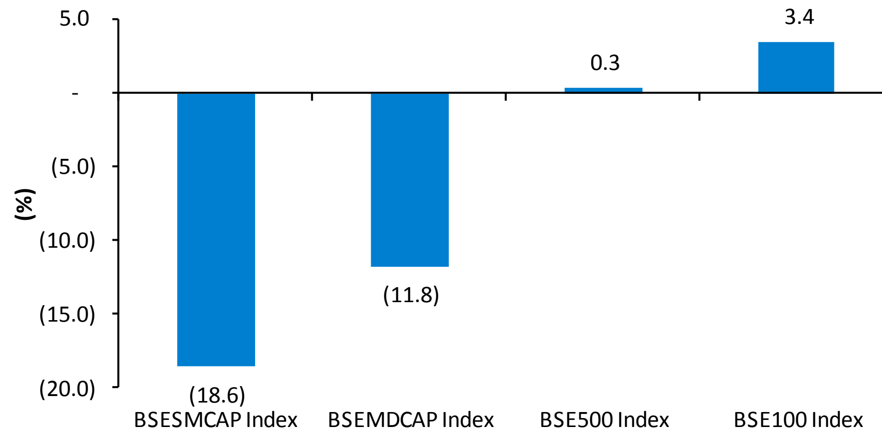
Source: Bloomberg, PL Research

Calendar Year-to-date



Source: Bloomberg, PL Research

Year-on-Year

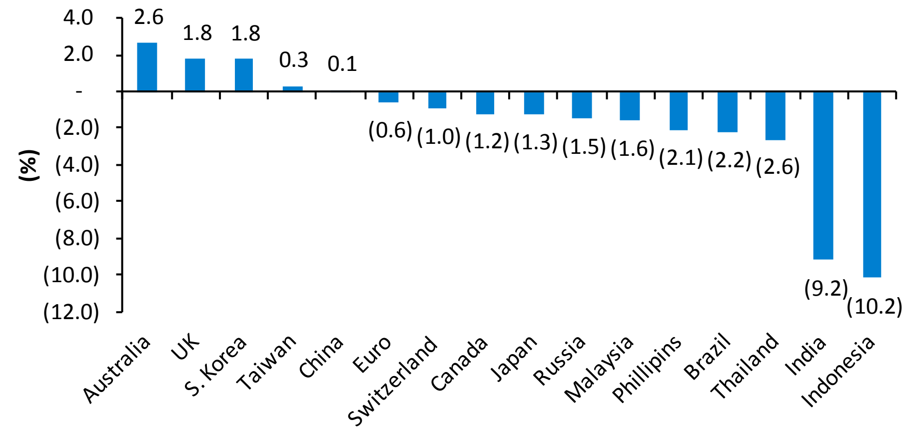


Source: Bloomberg, PL Research

Global Currency Movement

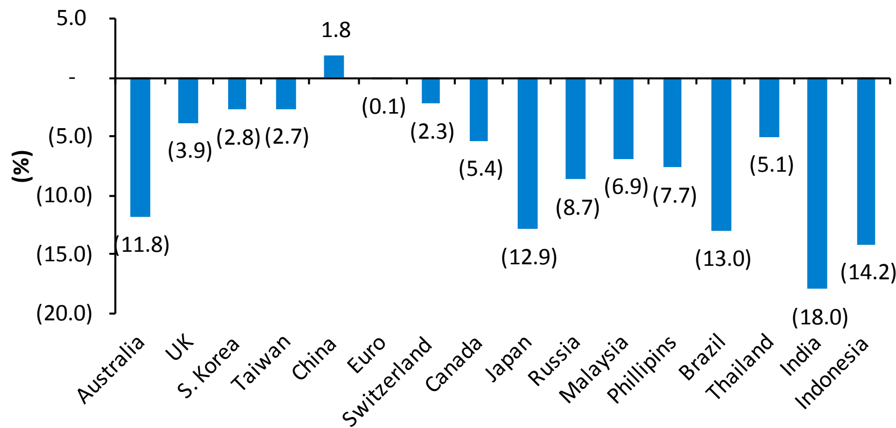
- **MoM:** Emerging economies like Indonesia, India & Brazil with large CAD bear the brunt and see their currencies plummeting sharply.

Month-on-Month



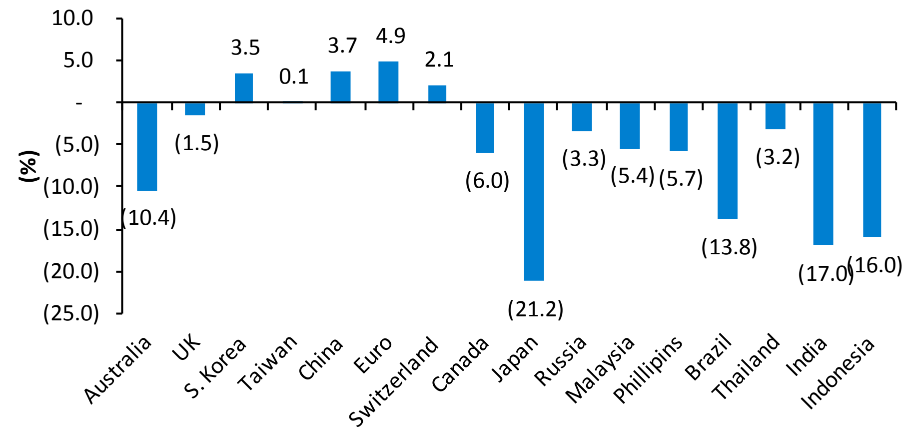
Source: Bloomberg, PL Research

Calendar Year-to-date



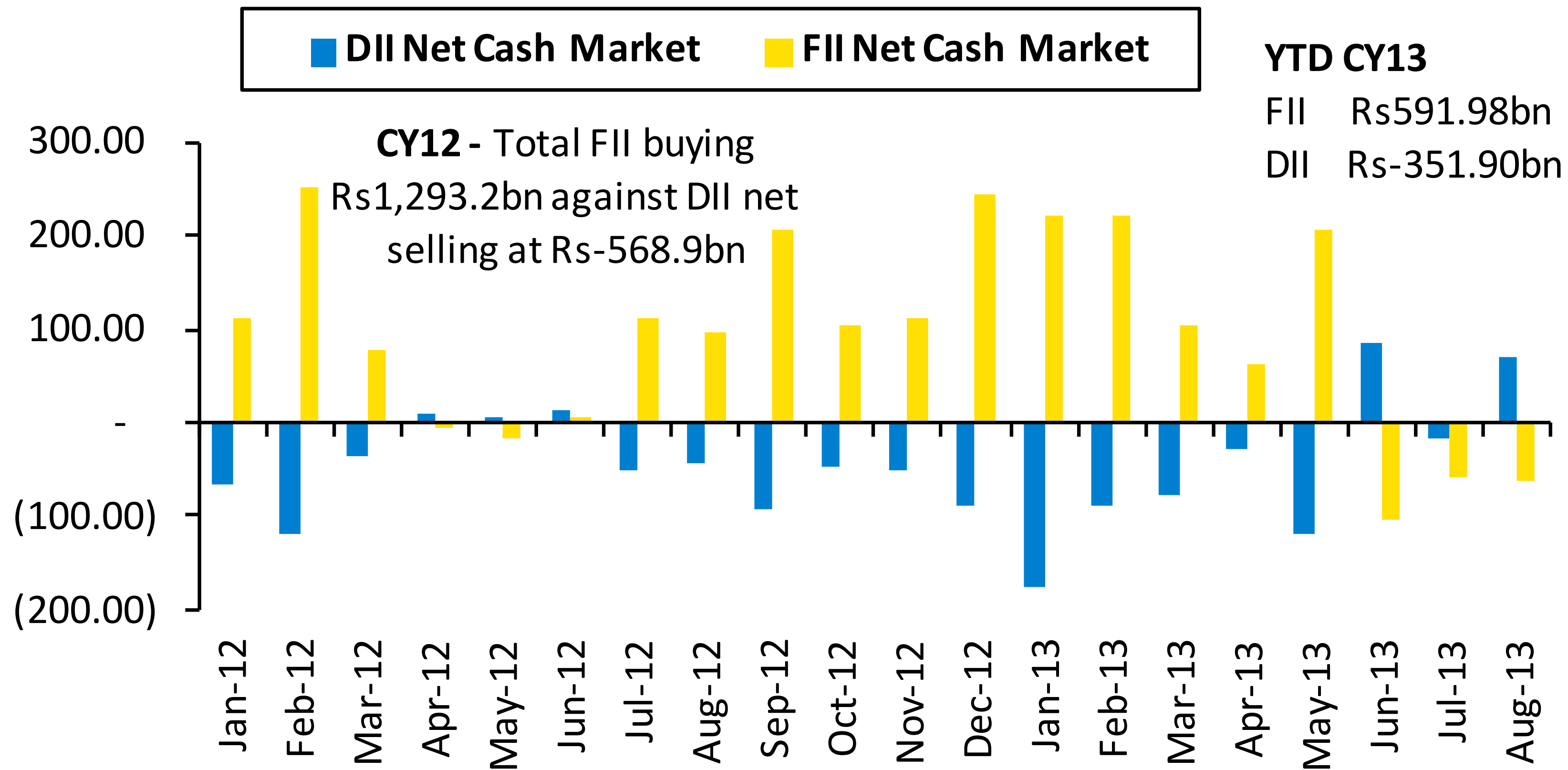
Source: Bloomberg, PL Research

Year-on-Year



Source: Bloomberg, PL Research

India: FII/DII Equity Flows

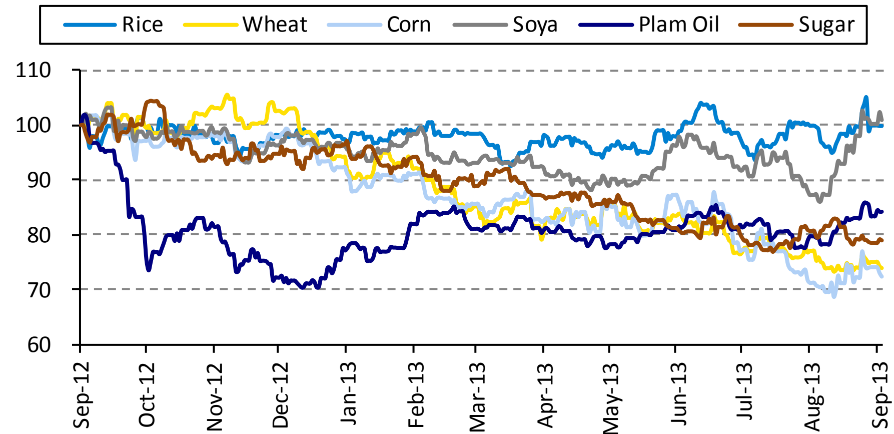


- FII turn net sellers of equity to the tune of Rs62.0bn as against a selling of Rs59.09bn in July.
- DII turn net buyers of equity to the tune of Rs69.09bn as against a selling of Rs15.41bn in July.
- FII outflows in the debt market in August reduced to Rs86.59bn from Rs126.51bn in July. September 1-3 continues to see outflows of Rs14.5bn.

Prabhudas Lilladher Global Agricultural Commodities

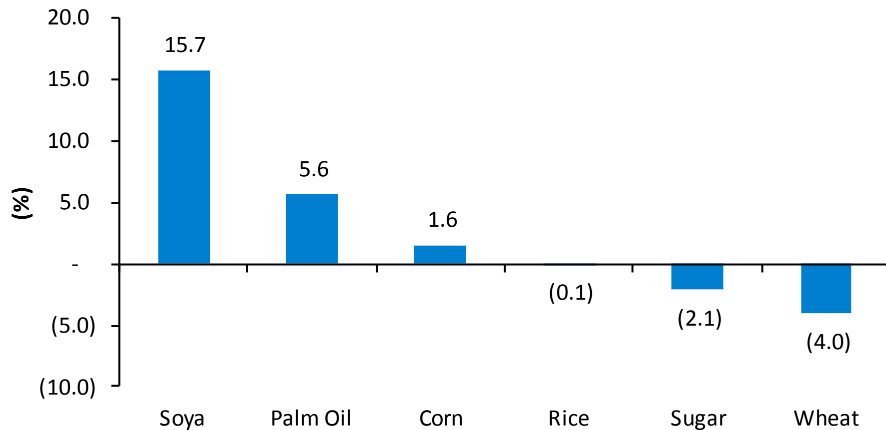
- **YoY:** Palm Oil price have declined globally as supply has outpaced demand. World stockpiles in Palm Oil have surged to a record high while demand growth is the slowest in 12 years.
- Corn prices have declined as favourable weather has increased yield prospects in the US.
- Sugar surplus globally has put pressure on prices and is likely to keep them under check.

Performance of Global Agricultural Commodities



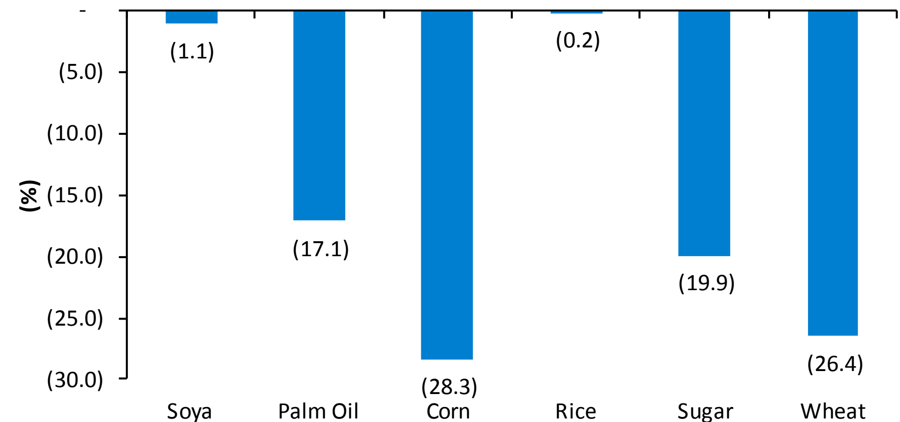
Source: Bloomberg, PL Research

Month-on-Month Performance



Source: Bloomberg, PL Research **Price in US$*

Year-on-Year Performance

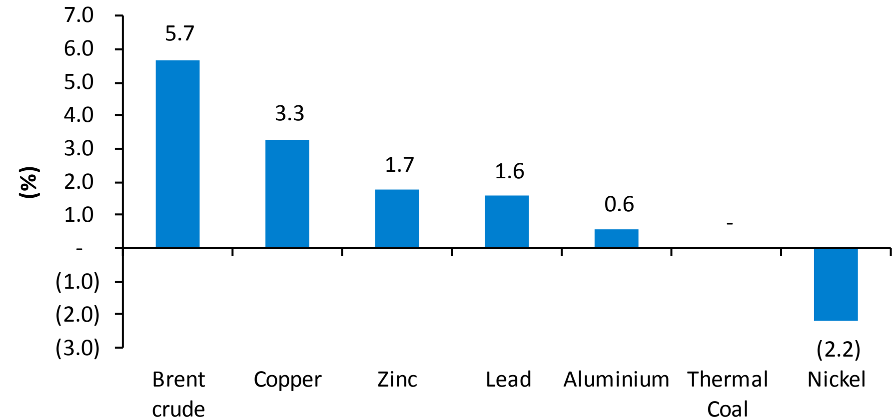


Source: Bloomberg, PL Research **Price in US$*

Global Industrial Commodities

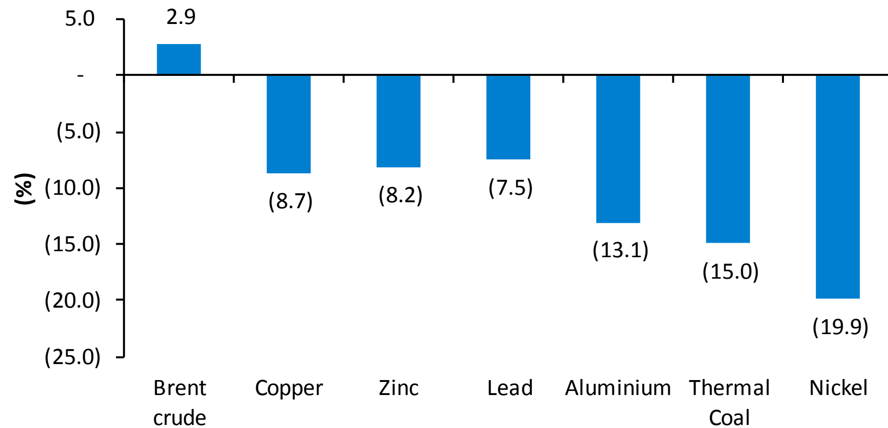
- **MoM:** Base metal prices rose due to positive economic data from China and Europe.
- Brent Crude rose due to rising geo-political tensions in the Middle East particularly concerns of US strike on Syria.

Month-on-Month



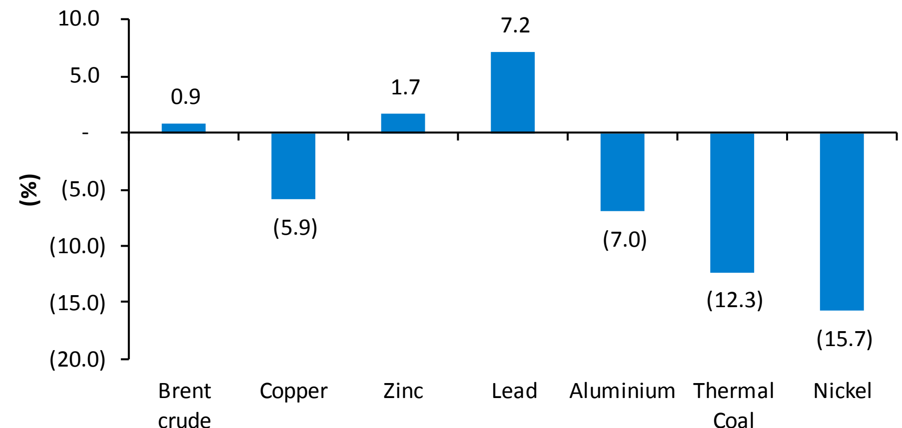
Source: Bloomberg, PL Research **Price in US$*

Calendar Year-to-date



Source: Bloomberg, PL Research **Price in US$*

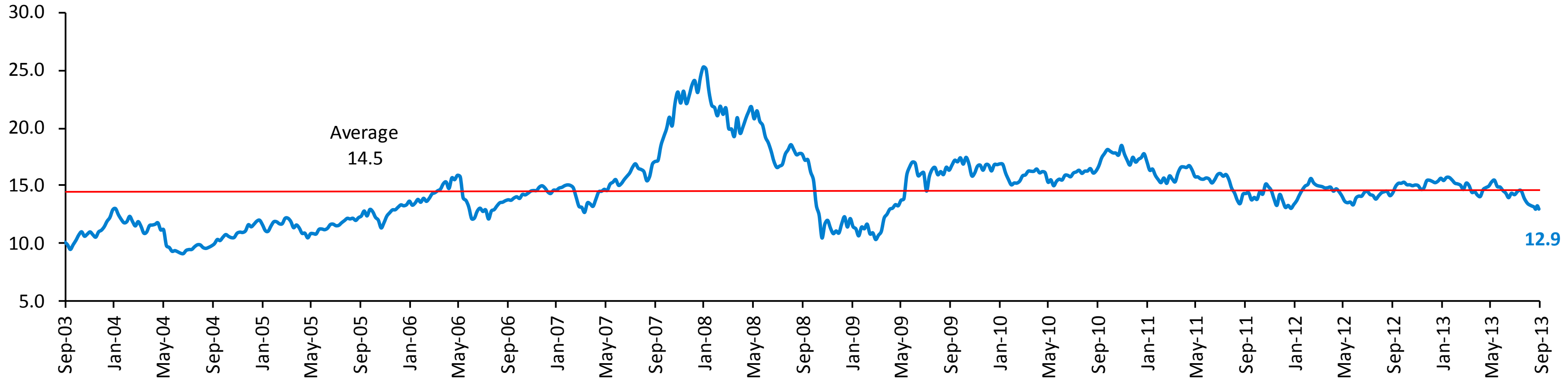
Year-on-Year



Source: Bloomberg, PL Research **Price in US$*

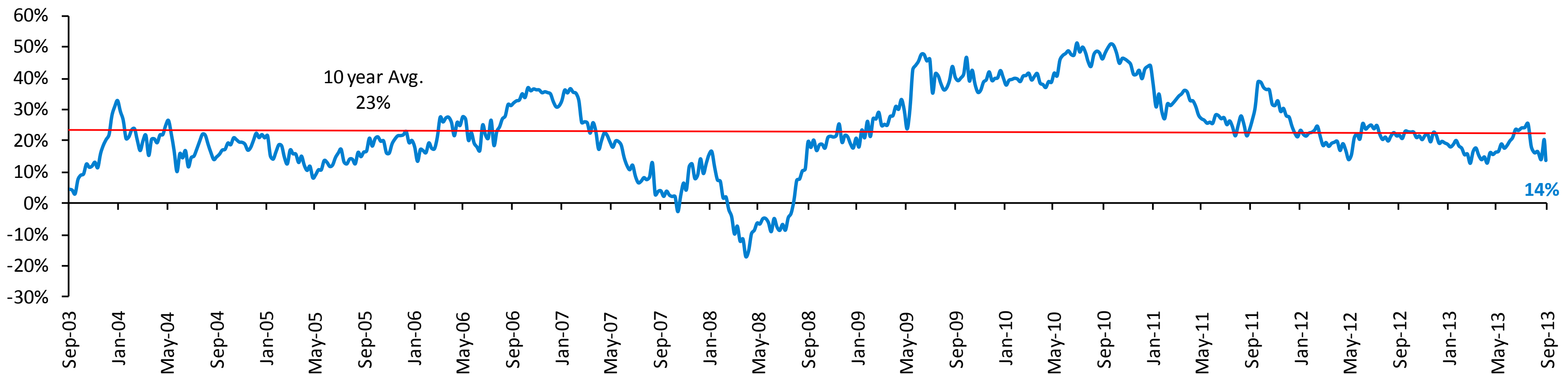
Nifty Valuations: Historic Trends

Nifty 1-year forward P/E



Source: Bloomberg, PL Research

MSCI India Premium to MSCI Asia (Ex-Japan)



Source: Bloomberg, PL Research

Indian Markets

- We estimate the free-float EPS for NIFTY companies in FY13, FY14, FY15 at Rs356.6, Rs392.7 and Rs460.2, respectively, representing a YoY growth of 1.4%, 10.1% and 17.2%, respectively. Technology (21.1% YoY growth), FMCG (13.9% YoY growth) and Auto (13.9% YoY growth) are expected to lead the charge in PAT growth in FY14. Cement (-1.9% YoY growth), Metals (-1.8% YoY growth), Engg & Power (2.4% YoY growth) and BFSI (6.2% YoY growth) would be the laggards. **Slowing economic growth, plunging Rupee, elevated interest rates and as-yet-tepid global growth environment make us believe that the estimated earnings growth in FY14 and FY15 runs a strong risk of downgrades as we move forward.**

- NIFTY at 5488 is currently trading at 15.3x FY13, 13.9x FY14E and 11.8x FY15E estimated free-float earnings. As the chart below indicates, the last ten-year average for NIFTY's one-year forward PE is at 14.5x. Thus, NIFTY is currently trading at 12.9x one-year forward earnings (EPS for year-ending August 2014 is Rs 420.8) i.e. at 11% discount to its last 10-years average of one-year forward multiple.

- The chart above indicates MSCI India's premium to MSCI Asia (excluding Japan) over the last ten years. The average of the last 10-year's premium is 23% and the current premium is at 14%, indicating a de-rating of the market due to worsening macro-economic conditions.

- Markets would continue to remain choppy and trade within a range of 5100 to 5700 levels over the medium term.

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Bountiful monsoons act as benign divine intervention to help cool food & consumer inflation, Plunge in Rupee to provide a leg-up to mostly non-differentiated (price-led) merchandise & service exports but with a lag, Terms of trade turning favourable

- Tailwind in the form of benign divine intervention of bountiful monsoons is expected to yield rich harvest. A 9% increase in overall area under cultivation with 25% increase in area under cultivation for pulses and 15% increase in case of oil seeds respectively which have been the key contributors to persistently elevated inflation hints at a cool-off in food and consumer inflation post-harvest.
- A sharp around 25% fall in Rupee over the last four odd months should provide, with a lag, boost to India's merchandise (textiles, leather, gems & jewellery, chemicals, auto & auto ancillary and engineering) and services exports (IT and BPO) both of which are essentially non-differentiated i.e. price-led. An improving US, Chinese & Japanese economy and Europe showing tentative signs of revival should augur well for our exports. A relatively less mauling received by some of our competitors in the export arena like South Korea, China, Bangladesh, Thailand and Philippines should lead to favourable terms of trade for India. This should help narrow trade and current account deficit and structurally improve India's external account.

Ballooning fuel subsidies, rising inflation due to sliding Rupee, slowing economy upsetting revenue receipts, FSB exacerbating govt.'s already weak finances, Land bill spooking investors, adoption of tight monetary & fiscal stance to stabilize Rupee obliterating all hopes of easy rates and fears of stoppage & reversal of foreign flows after start of tapering render India vulnerable

- Multiple headwinds ravaged the markets during the month. A sharp 9.2% MoM plunge in Rupee is leading to fears of ballooning of fuel subsidies and upsetting the government's resolve to contain fiscal deficit to 4.8% of GDP in FY14 by cutting revenue deficit. Rupee's slide will eventfully feed into rising inflation necessitating tighter monetary stance. Slowing GDP growth is likely to result in a shortfall in net tax receipts as well other non-tax revenues.

- Passage of fiscally irresponsible bill like the FSB in such fiscally fragile times sends a wrong signal to already attentive rating agencies. Fears of massive delays in land acquisition for industrial and housing projects and increase in costs rendering many projects unviable after passage of the Land Bill dejects a section of Industry hoping to help revive investment cycle.

- Obliterating all hopes of an accommodative monetary stance in the medium term is the absolute necessity to keep the monetary policy tight to stabilize the Rupee by breaking the vicious cycle of plunging currency leading to higher inflation leading to further drop in currency. This tight monetary policy must be complemented by a tight fiscal policy to keep tight lid on inflation and ensure better fiscal consolidation which would eventually crowd-in efficient private sector investments. Willy-nilly GDP growth over the next few years is bound to be a casualty.

- Financial stability of the system would necessitate arresting the slide in currency by controlling inflation and making do with lower growth. All this would be playing out amidst fears of sudden stoppage & reversal of foreign capital flows due to sooner-than-expected tapering of US$85bn of monthly bond purchases by the US Fed. With its large CAD of US$88bn or 4.8% of GDP in FY13 and likely to range between US$70bn or 3.7% of GDP (as per the Finance Minister) in FY14 to around US$80bn, dependence on fickle FII flows, large debt rollovers/repayments in FY14 (US$172bn or 60% of forex reserves), India remains vulnerable to an external shock.

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Nifty Valuation

	Weight-age (%)	FY12	FY13	FY14E	FY15E
Banking & Fin.	**25.1%**				
PER (x)		12.0	10.4	9.8	8.3
PAT Growth (%)		26.8	15.1	6.2	19.1
Technology	**16.3%**				
PER (x)		31.6	25.3	20.9	18.8
PAT Growth (%)		20.3	24.6	21.1	11.6
FMCG	**13.1%**				
PER (x)		42.1	34.6	30.3	25.1
PAT Growth (%)		35.5	21.8	13.9	21.0
Oil & Gas	**13.0%**				
PER (x)		10.1	9.7	9.2	8.1
PAT Growth (%)		13.6	3.9	6.2	12.7
Auto	**8.8%**				
PER (x)		11.9	12.8	11.2	9.3
PAT Growth (%)		23.1	(6.8)	13.9	20.0
Eng. & Power	**7.4%**				
PER (x)		10.6	10.2	9.9	9.3
PAT Growth (%)		5.8	4.1	2.4	7.3
Pharma	**6.7%**				
PER (x)		79.4	28.1	28.2	18.6
PAT Growth (%)		(51.3)	182.2	(0.3)	52.1
Metals	**4.4%**				
PER (x)		10.0	10.2	10.4	9.4
PAT Growth (%)		1.2	(2.1)	(1.8)	10.7

	Weight-age (%)	FY12	FY13	FY14E	FY15E
Cement	**2.9%**				
PER (x)		17.1	13.2	13.4	11.8
PAT Growth (%)		10.1	29.6	(1.9)	13.8
Telecom	**2.0%**				
PER (x)		27.9	52.2	27.6	17.9
PAT Growth (%)		(29.6)	(46.6)	89.1	54.1
Real Estate	**0.3%**				
PER (x)		18.4	29.6	19.6	15.8
PAT Growth (%)		(20.5)	(37.8)	50.4	24.1
Nifty as on Sep 4	**5,448**				
EPS (Rs) - Free Float		**351.9**	**356.6**	**392.7**	**460.2**
Growth (%)		**8.1**	**1.4**	**10.1**	**17.2**
PER (x)		**15.5**	**15.3**	**13.9**	**11.8**
EPS (Rs) - Free Float					
Nifty Cons.		**351.9**	**356.6**	**402.3**	**469.6**
Var. (PLe v/s Cons.) (%)		**-**	**-**	**(2.4)**	**(2.0)**
Sensex as on Sep 4	**18,568**				
EPS (Rs) - Free Float		**1,149.8**	**1,128.8**	**1,238.3**	**1,456.9**
Growth (%)		**8.5**	**(1.8)**	**9.7**	**17.6**
PER (x)		**16.1**	**16.4**	**15.0**	**12.7**
Sensex Cons.		**1,149.8**	**1,128.8**	**1,292.8**	**1,507.2**
Var. (PLe v/s Cons.) (%)		**-**	**-**	**(4.2)**	**(3.3)**

Top Pick Summary

	CMP (Rs.)	TP (Rs)	*Upside*	Mcap (Rs bn)	Revenue Growth (%)		Earnings Growth (%)		RoE (%)		PER (x)		P/BV (x)	
					2014E	2015E	2014E	2015E	2014E	2015E	2014E	2015E	2014E	2015E
Large Cap														
ITC	300	366	*22.0%*	2,369.4	17.4	14.7	17.6	21.4	36.5	38.6	27.2	22.4	9.2	8.1
Infosys	3,113	3,700	*18.9%*	1,780.5	30.0	12.3	20.3	11.8	25.9	24.3	15.7	14.1	3.7	3.1
HDFC Bank	564	700	*24.1%*	1,342.1	21.0	18.8	24.7	21.9	20.3	20.8	16.6	13.6	3.1	2.6
Wipro	481	600	*24.7%*	1,185.4	20.0	11.8	27.6	16.1	25.2	24.4	15.1	13.0	3.5	2.9
NTPC	130	167	*28.5%*	1,071.9	12.7	10.6	16.1	6.3	12.5	12.2	10.1	9.5	1.2	1.1
ICICI Bank	818	1,100	*34.5%*	947.1	17.1	13.1	11.4	13.5	13.3	13.8	10.2	9.0	1.3	1.2
Larsen & Toubro	699	1,091	*56.0%*	646.5	13.3	15.2	4.5	16.5	15.6	16.3	13.6	11.7	2.0	1.8
Bajaj Auto	1,889	2,083	*10.3%*	546.5	3.2	14.1	18.3	16.6	39.6	38.3	15.9	13.6	5.8	4.8
Hindustan Zinc	122	141	*16.0%*	514.9	4.8	3.9	(5.6)	5.4	18.6	17.3	8.0	7.6	1.4	1.2
NMDC	122	147	*21.0%*	481.7	0.5	14.1	(8.3)	10.1	20.4	20.7	8.3	7.5	1.6	1.5
Hero Motocorp	1,927	2,176	*13.0%*	384.8	7.3	14.1	3.5	32.7	39.2	42.4	17.6	13.3	6.3	5.1
Dr.Reddy's Laboratories	2,275	2,414	*6.1%*	386.4	9.3	10.2	9.9	10.5	24.4	23.4	21.0	19.0	4.9	4.0
Adani Port & SEZ	124	165	*33.1%*	247.8	28.2	21.9	15.1	23.6	25.4	24.6	13.3	10.7	2.9	2.4
Ranbaxy Laboratories	445	559	25.8%	188.0	9.0	12.9	150.4	33.7	44.1	38.9	8.1	6.1	2.9	2.0
Shree Cement	3,635	4,473	*23.1%*	126.7	10.6	14.2	(26.5)	28.6	17.5	18.4	16.9	13.2	2.7	2.2
Mid-Caps														
Britannia Industries	749	885	*18.2%*	89.5	15.8	16.9	37.4	33.0	44.7	47.4	27.8	20.9	11.3	8.9
ING Vysya Bank	434	560	*29.0%*	67.2	24.8	16.9	4.5	25.0	13.3	13.0	10.5	8.4	1.1	1.0
United Phosphorus	134	185	*37.7%*	59.5	12.5	11.6	11.6	13.7	18.8	18.2	6.3	5.5	1.1	0.9
Crompton Greaves	84	108	*29.2%*	53.6	8.9	11.5	40.8	63.2	9.8	14.5	14.2	8.7	1.3	1.2
MindTree	1,047	1,300	*24.2%*	43.4	31.0	12.0	37.4	12.2	30.4	26.1	9.3	8.3	2.5	1.9
Persistent Systems	583	750	*28.8%*	23.3	30.4	14.7	34.8	11.5	22.5	21.0	9.2	8.3	1.9	1.6
KSB Pumps	194	249	*28.2%*	6.8	3.3	7.3	14.5	15.4	14.7	15.3	10.2	8.8	1.4	1.3
MT Educare	96	130	*35.5%*	3.8	36.4	22.0	35.8	30.3	22.8	26.0	15.5	11.9	3.3	2.9

Disclaimer

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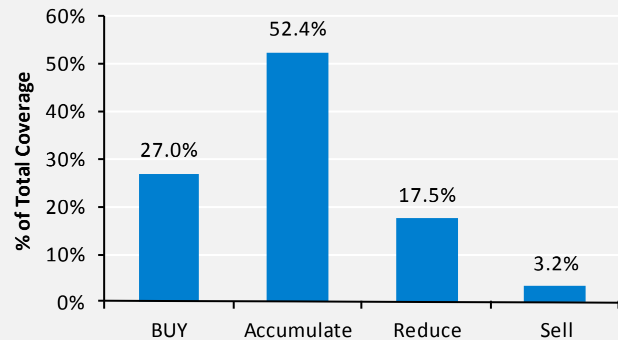

PL's Recommendation Nomenclature

BUY	:	Over 15% Outperformance to Sensex over 12-months	**Accumulate**	:	Outperformance to Sensex over 12-months
Reduce	:	Underperformance to Sensex over 12-months	**Sell**	:	Over 15% underperformance to Sensex over 12-months
Trading Buy	:	Over 10% absolute upside in 1-month	**Trading Sell**	:	Over 10% absolute decline in 1-month
Not Rated (NR)	:	No specific call on the stock	**Under Review (UR)**	:	Rating likely to change shortly

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