

Equity Market Outlook

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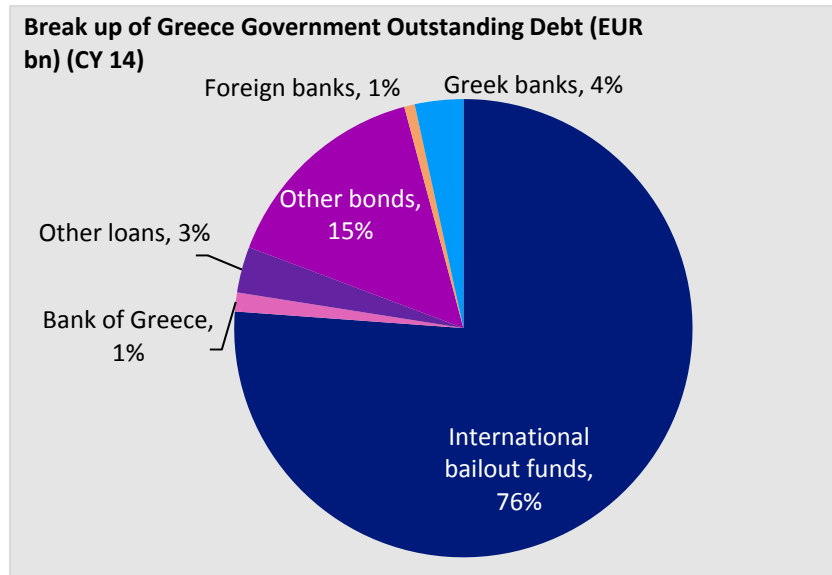
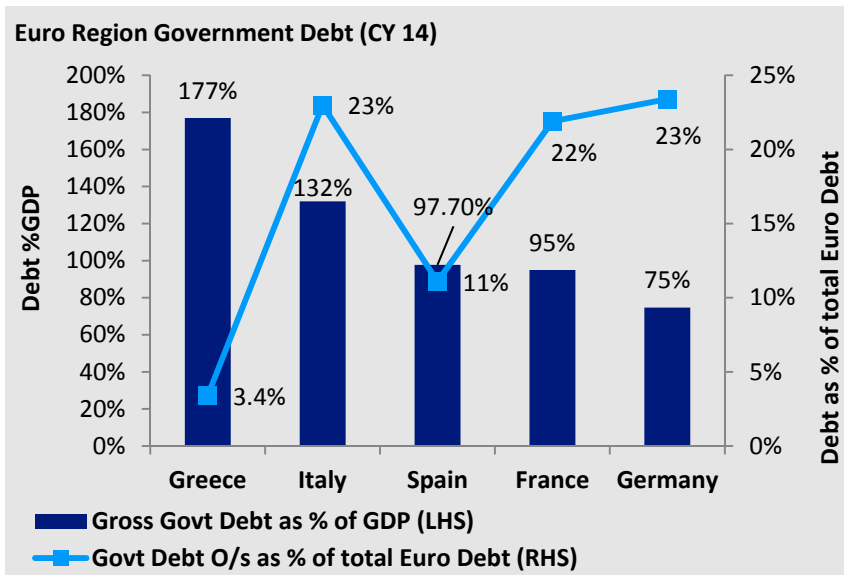


Equity Market Outlook

- India's economic indicators are exhibiting mixed outcomes
- Key driver for growth – investment cycle is undergoing slow and gradual recovery
- Early FY16 fiscal trends are positive and if this persists the government may be able to avert the fourth quarter fiscal spending freeze that has been in place in recent years.
- On the external front, trade deficit and current account deficit has witnessed a meaningful improvement
- Weak demand environment and fall in inflationary expectations are creating a headroom for further monetary easing
- Amidst El Nino concerns, Monsoon has provided a respite till date – 16% above normal
- For 4Q15, Sensex earnings were down 9% YoY and were 4% below market estimates
- Sensex valuation is at 21% premium to the long term average; in an expensive zone

Global Macro

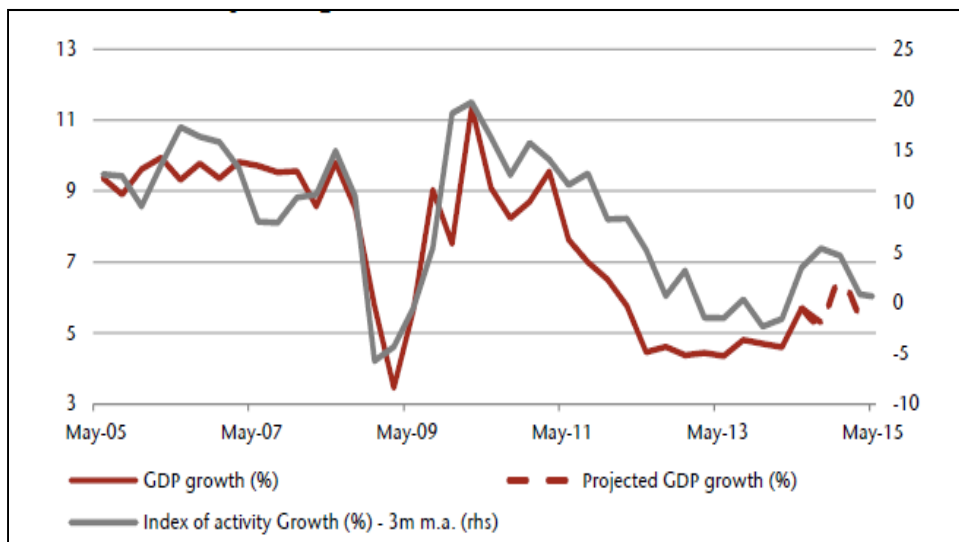
Greece Debt Crisis -Manageable



- While Greece has a large government debt to GDP ratio of 177%, its total debt outstanding as percentage of Total Euro Debt is only 3.4%
- Also unlike 2010 where larger portion of the debt was owned by Euro region banks, current Greece debt is largely owned by international bailout funds namely European Central Bank and International Monetary Fund
- Systemic risk to European banking system – unlikely
- However key challenge for Euro region is to stop the contagion effect spreading to other vulnerable economies like Italy and Spain who have high government debt as % of GDP and are much larger in size

India – Economic activity - Mixed Bag

Activity Index Growth - Muted

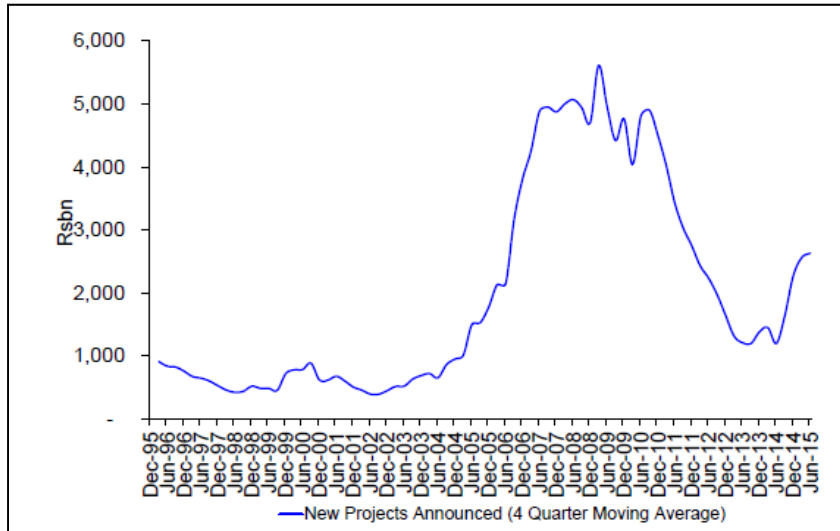


- Economic indicators are showing mixed trends
- Capital Goods production and imports, electricity production, port traffic reported an improvement
- However there was weakness in cement and steel demand, railway traffic, exports and 2 wheeler sales

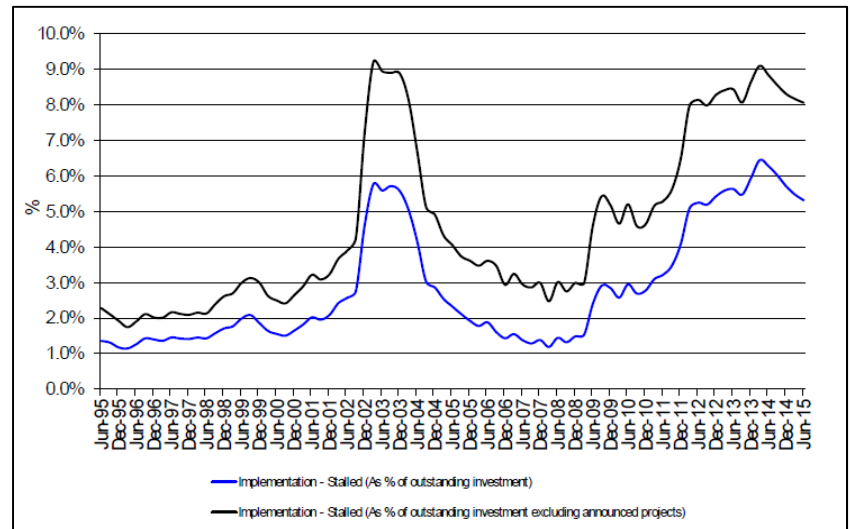
India - Investment Cycle

Intermittent Recovery Underway

Quarterly New Project announcements (Rs bn) – Rebound from lows



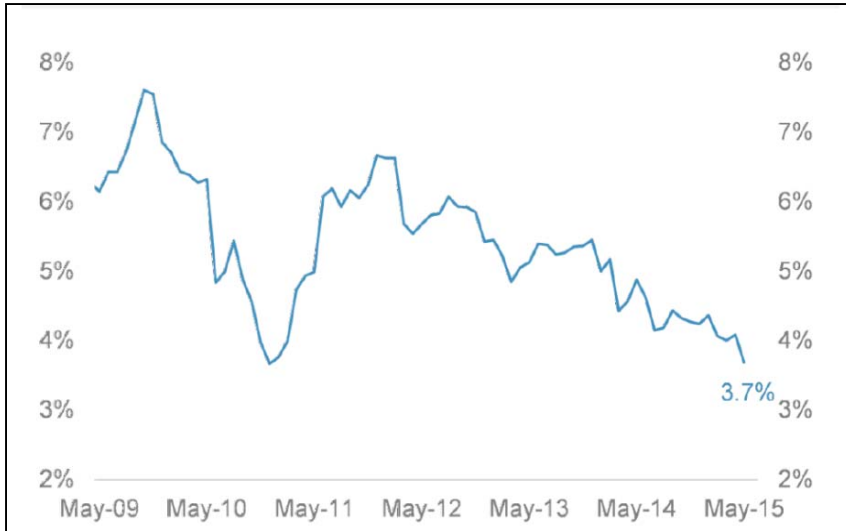
Projects under implementation but stalled as % of total O/S Projects



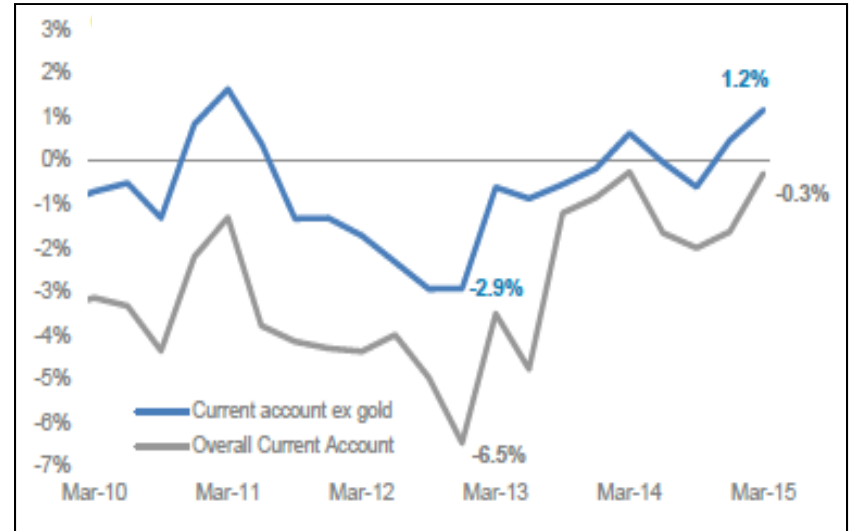
- New project announcements continued their revival trend posting 33% YoY growth in FY1Q16. However the pace of growth was lower as compared to previous 3 quarters
- Also projects under implementation but stalled showing only marginal improvement as they declined 2% QoQ and 8% YoY

India – Twin Deficit- Improvement visible

Fiscal Deficit (12M Trailing Sum % of GDP)



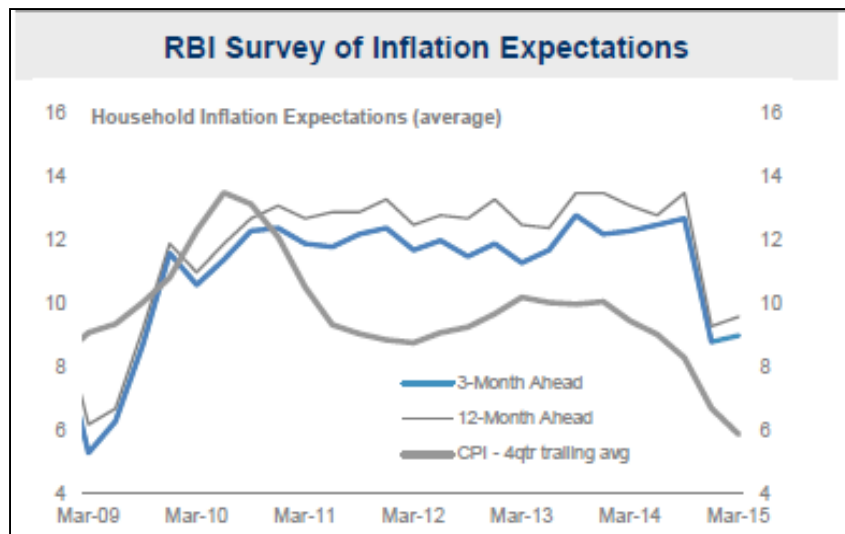
Current Account Deficit



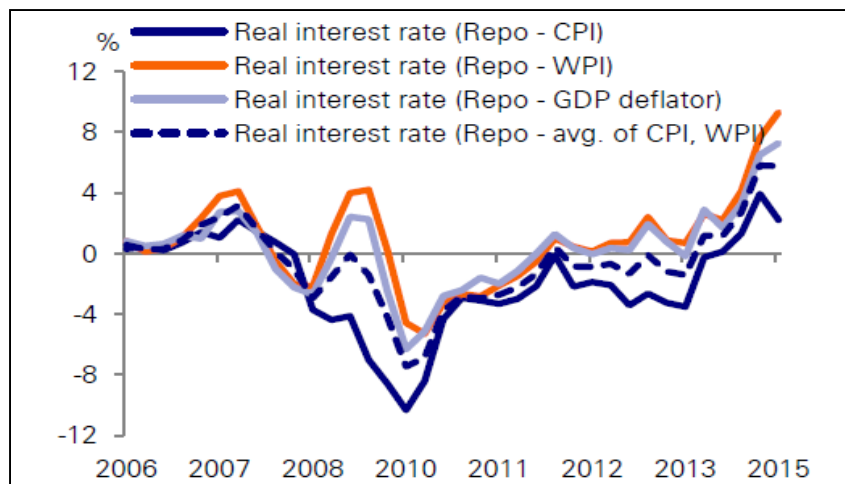
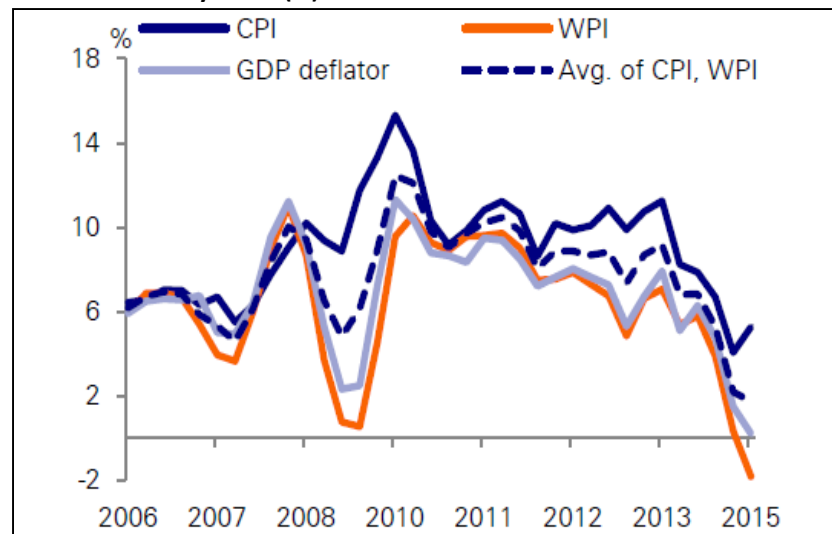
- On a 12 month trailing basis – fiscal deficit decreased to 3.7% of GDP vs 4.1% of GDP in April 2015 and below the budget target of 3.9%
- This bodes well for government to achieve the full year target of 3.9% and the government may be able to avoid the 4th quarter freeze that has been in effect in recent years
- On the external front, trade deficit and current account deficit has witnessed a meaningful improvement

Monetary Policy –Scope for Easing

Inflation downward trend continues



Benchmark Policy Rates (%)



- Reserve Bank of India has highlighted that future course of monetary action would be data dependent depending on Monsoon and food prices
- Fall in inflationary expectation, actual WPI and CPI inflation and current Real Interest rate imply scope for Monetary easing ahead

India – Monsoon- Strong Start

Trends in Daily Rainfall(mm)



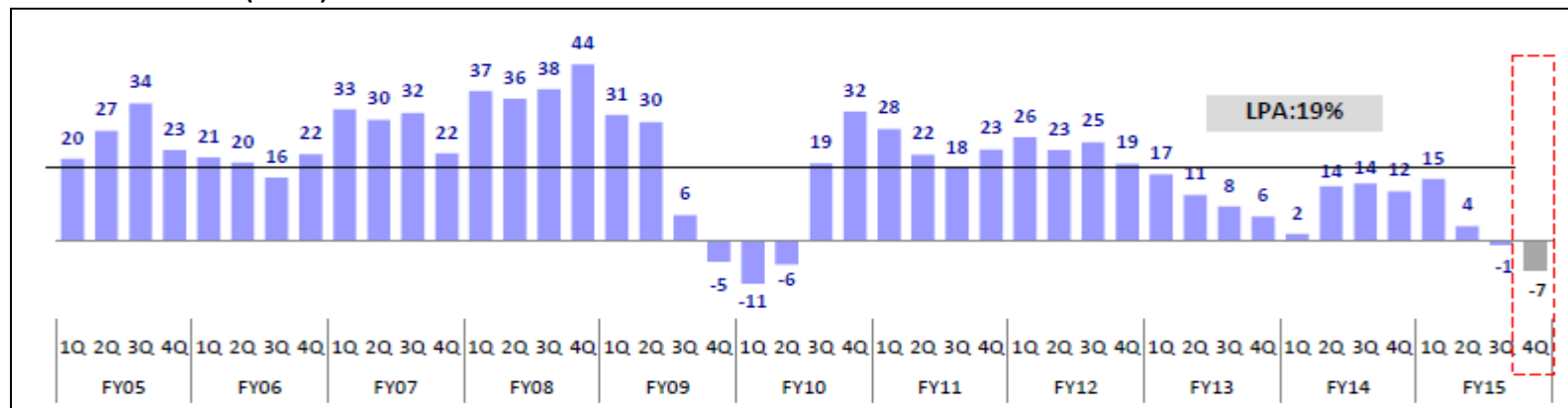
Trends in Kharif Sowing area (mn ha)

	26th June 2015	26th June 2014	YoY%	Total Area sown	
Area Sown	165.62	134.18	23.43%	2014-15	2013-14
Rice	23.28	25.04	-7.03%	380.00	376.41
Pulses	11.04	6.14	79.80%	102.34	109.08
Coarse Cereals	19.28	16.74	15.17%	182.34	196.05
Oilseeds	27.89	5.29	427.22%	178.49	194.91
Sugarcane	41.58	43.92	-5.33%	48.74	50.32
Jute & Mesta	7.69	7.98	-3.63%	8.15	8.34
Cotton	34.87	29.07	19.95%	126.55	114.37

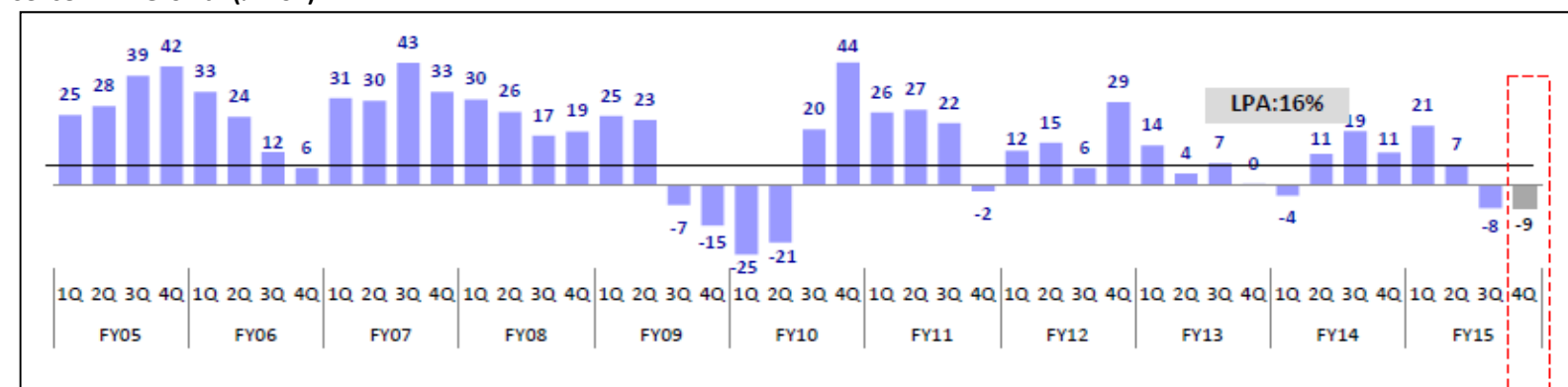
- In contrast to IMD's projection of 12% shortfall in full season rainfall, till date the season has had a strong start with cumulative rainfall being 16% above normal with healthy distribution
- The strong trend got reflected in sowing for Kharif crops as sowing was up 23% YoY in June with sharpest increase in oilseeds and pulses

Earnings Season – Weakness continues

Sensex Sales Growth (% YoY)



Sensex PAT Growth (% YoY)



- Latest quarter sales for Sensex companies declined by 7%, while the net profits declined by 9%, significantly below Long Period Average Growth rates

Earnings Season – Weakness continues

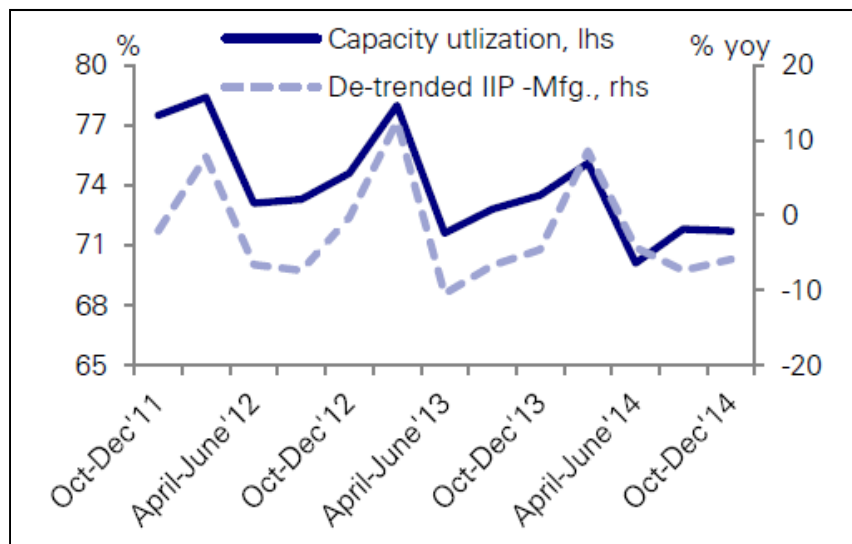
Earnings summary

Based on market cap	Market cap range	Number of Companies Reported	Revenue Growth	EBITDA growth	Net profit Growth	EBITDA margins	Change in Ebitda margins
Mega Caps (ex Oil PSU)	More than US\$5bn	58	-1%	6%	-2%	26%	165
Large Caps (ex Oil PSU)	Between US\$ 2bn and US\$ 5bn	67	-6%	-9%	-8%	21%	(82)
Mid Caps (ex Oil PSU)	Between US\$ 250mn and US\$ 2bn	328	5%	7%	-25%	20%	49
Small Caps (ex Oil PSU)	Between US\$ 50mn and US\$ 250mn	445	-1%	-41%	NM	10%	(685)
Micro Caps (ex Oil PSU)	Between US\$ 25mn and US\$ 50mn	247	-6%	-18%	NM	5%	(72)
Nano Caps (ex Oil PSU)	Less than US\$ 25mn	1868	-10%	NM	-1%	-3%	4
Broad Market		3020	-7%	-3%	-20%	21%	9
Broad Market ex-Oil PSU		3014	-7%	1%	-13%	21%	15
Broad Market ex-Energy		3009	-4%	-2%	-19%	21%	5

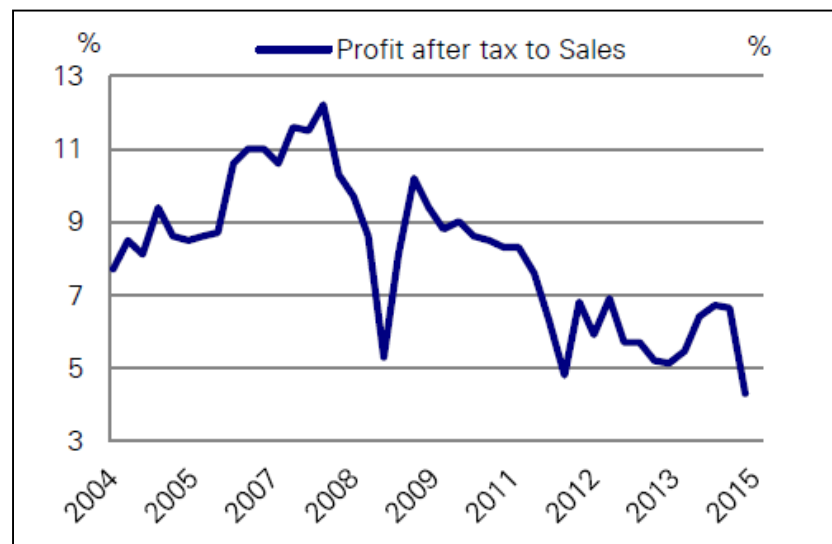
- Even broad market earnings were very weak as aggregate of 3020 companies reported a revenue decline of 7% and PAT decline of 20%
- In the latest reported earnings season ended March 2015, consensus (IBES) has revised down FY15 and FY16 earnings growth forecast by 1.57% and 1.81% respectively

Earnings – Levers for Recovery

Capacity Utilisation trends

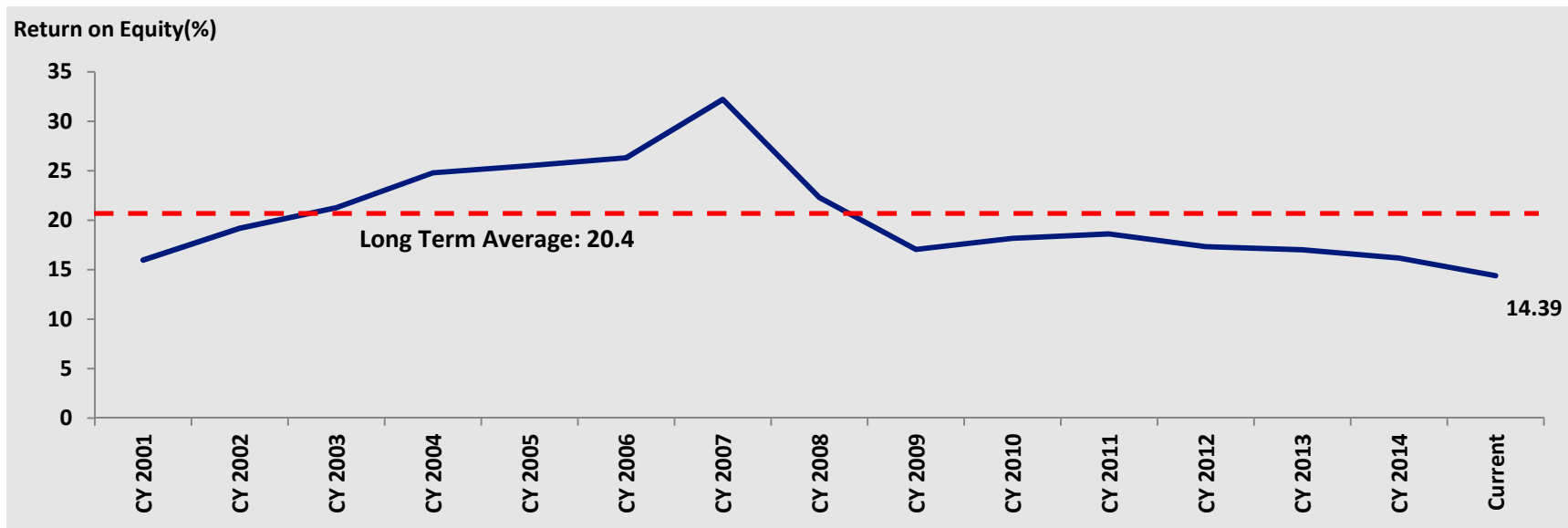


PAT to sales ratio



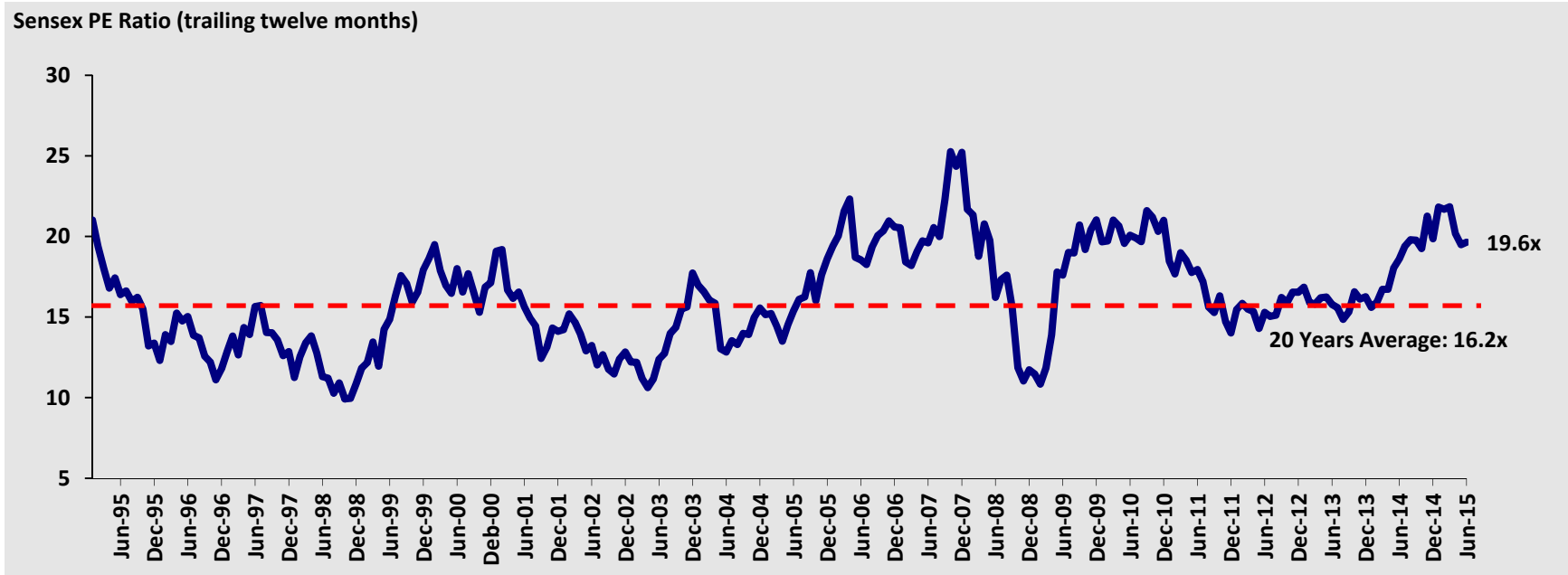
- While current earning cycle is weak, there are levers to earnings recovery
- Current capacity utilisation of Indian Companies is quite low implying significant operating leverage
- Profit to Sales ratio is also at a decade low and can mean revert in a cyclical upturn

Valuations – RoE subdued



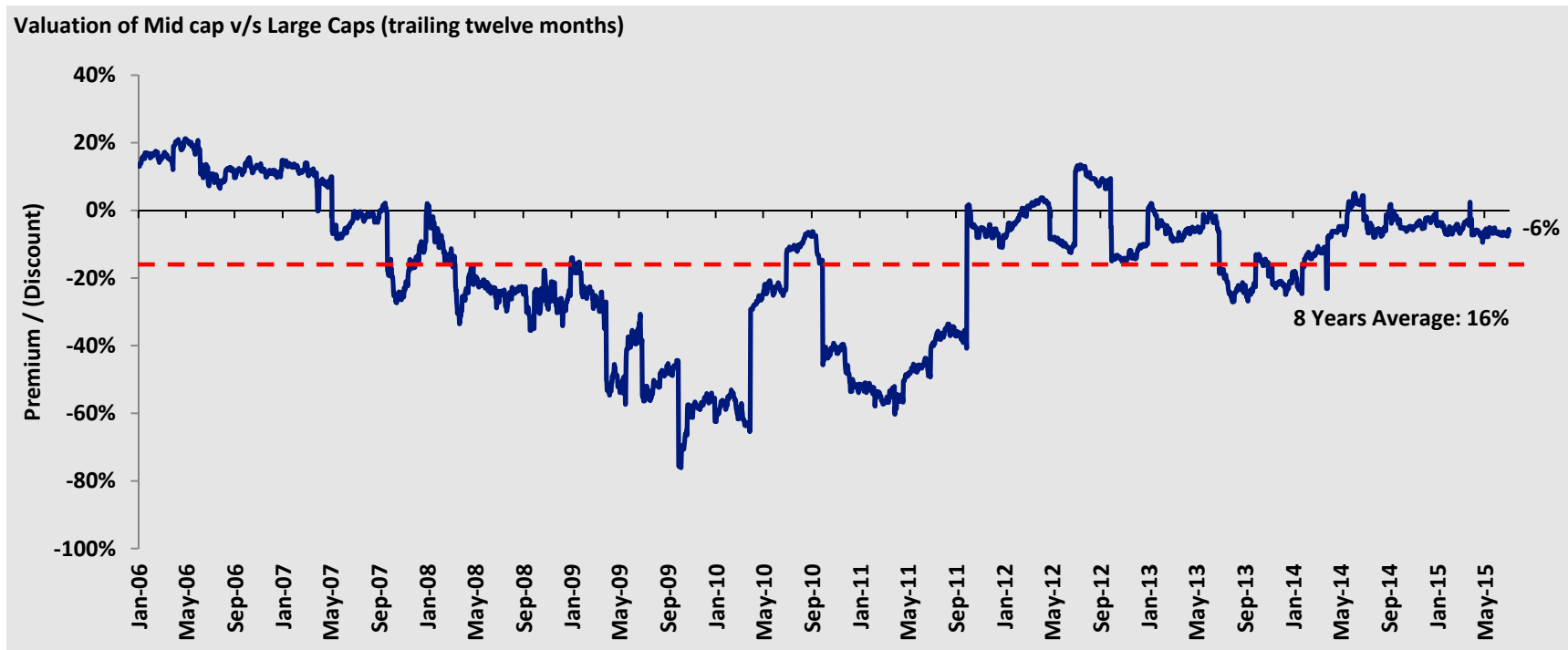
- While markets are trading at significant premium to its long term average, the underlying Return on Equity (RoE) is below its long term average
- This is a reflection of the poor PAT to sales ratio on slide 11

Valuations - Premium to Long term Average



- Recent price correction has not resulted into meaningful valuation correction due to weak earnings
- The large cap benchmark Sensex index continues to trade at 21% premium to its long term trailing 12 months average P/E multiple as compared to 22% premium in March 2015

Valuations – Relative valuations of Midcaps vs Largecaps Higher than Long Period Avg



- Midcap Index valuation is currently at a 6% discount to its large cap peer (Nifty), as compared to a long period average of 16% discount

- Falling commodity prices and weak demand has led to concerns on global growth
- In India macro economic parameters like current account deficit , fiscal deficit and high inflation have shown significant improvement
- However economic activity outcomes are mixed – demand conditions remain weak but investment cycle is in a slow and intermittent recovery
- Valuations now at 21% premium to long term average. From here the baton passes to earnings growth rather than P/E expansion
- Earnings growth still remains weak but has levers to improve in FY16
- Sectors such as financials, consumer discretionary and industrials will benefit from cyclical recovery in growth. Based on valuations we prefer the financials and consumer discretionary over Industrials
- Earnings growth for Mid cap companies will likely improve with a recovery in domestic growth and a more benign monetary environment
- Though there is a preference for pro cyclical stance, portfolio strategy is more balanced given the valuations changes over past year

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