3 January 2017

India | Strategy

Strategy 2017

Will the two-year impasse end?

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The Nifty 50 has turned in a negative return over the past two years (Jan'15-Jan'17) after a 30% rally in CY2014, due to recurring disappointment to earnings with the then FY15E EPS now likely fructifying in FY18E. Over the same period, inflows of US$23.5bn, of which domestic inflow of $17bn ensured that the Nifty remained in the less-travelled, higher end of its multiples while the midcap index re-rated from 18.5x to 23.9x TTM EPS. Our analysts have again trimmed their estimates to account for domestic (demonetisation, fiscal, GST) and global (commodity) factors with the extent of cuts by the former moderated by the latter. The Nifty now trades at ~17x NTM EPS (on lower JM estimates) and at 16x (consensus), and the earnings yield differential with risk-free is at a 7-year low. Given that 2HFY17E EPS is likely to decline YoY with further cuts to consensus, and multitude of upcoming events, stock rotation towards value is recommended over aggressive buying or selling. We recommend the following – a) Add to L&T and Titan; trim Hero Motocorp in large caps, b) In midcaps, add United Phosphorous (UPL) and Sobha Developers. Our sector weights emerge from bottom-up stock picking and we are overweight healthcare, IT services (tactical), private financials and for the first time, industrials.

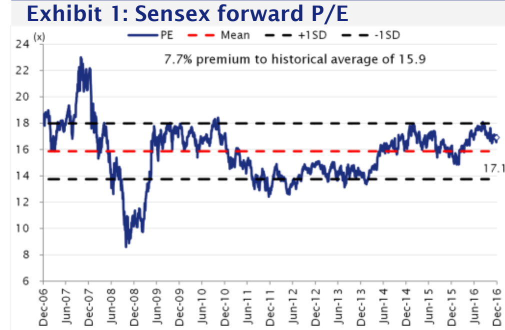
- **Earnings revision:** Considering all the recent developments and making a few assumptions around key events such as the impact of demonetisation (to last beyond 1HFY18 given wealth effect on property and income effect among smaller farmers), GST (2HFY18), budget (pro-rural, existing fiscal constraints), higher oil/commodity prices, we have lowered our Nifty FY17E/18E EPS by 3.1/6.0%. Consequently, the 2HFY17 EPS is estimated to decline 6.1% YoY. Our new FY18E EPS is ₹491 (still a growth of 21.6% over FY17E). Overall, the deepest cuts have been in building materials, cement and real estate, while oil & gas and agri. inputs witnessed the least cuts.

- **Market levels not yet enticing to buy aggressively**: After these changes, the Nifty at 17x based on our estimates and at 16x on consensus. On other valuation metrics, a) the earnings yield differential of Nifty with risk-free is at a 7-year low and the trailing 7-year PE is towards lower end (exhibit 39) and if inflation stays benign, there is an argument to buy the markets into every fall. However, a tough 1QCY17 calendar of events and uncertainty around oil prices makes us believe that slow, selective buying in stocks where risk reward is favourable is the best tactic in near-term.

- **Changes to the portfolio:** **a)** Add to L&T—core business pricing in no growth (company could lower guidance for order inflows in 3Q but priced in), **b)** Titan—22% discount to avg NTM P/E, shift to organised, **c)** UPL -EPS CAGR of 19%, at 12x vs. 16x FY17E for global agrochem, and **d)** Sobha—at below book of historical land prices. We recommend trimming Hero and Indocount. Our biggest recommended weight continues to be the private financials (HDFC Bank, IndusInd Bank, Bajaj group, Mahindra Finance). A new overweight for us is industrials. Our top 10 large cap and midcap picks are in exhibit 2.

- **JM model portfolio:** The JM model portfolio returned 6.7% in CY16 (and outperformed the Nifty by 4.8% excl. execution costs). The two-year return is 12.2% (vs. -2%, as of 23rd Dec, '16). The best performers have been Bajaj Finance and Bajaj Finserv. Some durable and new themes that emerge are: a) rural (Mahindra Finance), b) private financials (Bajaj group, IndusInd), and c) shift towards the organised sector (V-guard, Titan and ABFRL).

Exhibit 1: Sensex forward P/E



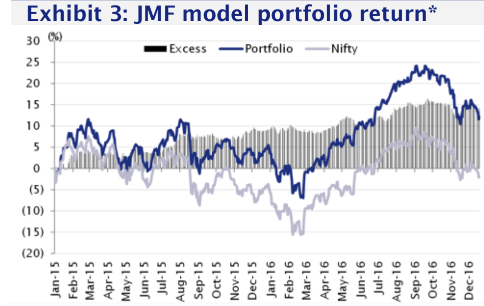
Source: Factset, JM Financial

Exhibit 2: Model Portfolio Major constituents

Large cap	Mid cap
Bajaj Auto	Aditya Birla Fashion
Bajaj Finance	Alembic Pharma
Bajaj Finserv	Bharat Forge
Bharti Airtel	Mahindra Finance
Cipla	NIIT Limited
HDFC Bank	Kirloskar Oil Engines
IndusInd Bank	Suprajit Engineering
Infosys	V-Guard
L&T	SRF
NTPC	United Phosphorous

Source: Bloomberg, JM Financial

Exhibit 3: JMF model portfolio return*



Source: Bloomberg, JM Financial, as on 23rd Dec, 2016 *since inception

JM Financial Research is also available on:
Bloomberg - JMFR <GO>,
Thomson Publisher & Reuters,
S&P Capital IQ and FactSet.

Please see Appendix I at the end of this report for Important Disclosures and Disclaimers and Research Analyst Certification.

Event calendar

Exhibit 4. Event calendar

Calendar 2016-17			
Sep'16	**Oct'16**	**Nov'16**	**Dec'16**
• Raghuram Rajan's term ends • Monsoon retreats • 1st advance Kharif estimates • FCNR deposits mature • FOMC meeting • ECB Monetary Policy meeting	• Buildup to UP elections • Festive Season Dispatches • Q2FY17 Earnings • RBI Monetary Policy • ECB Monetary Policy meeting • Italy Referendum	• MSP hikes (Rabi) • Winter Session of Parliament (Nov-Dec) • FOMC Meeting • US Elections	• RBI Monetary Policy • FOMC Meeting • ECB Monetary Policy meeting
Jan'17	**Feb'17**	**Mar'17**	**Apr'17**
• Q3FY17 Earnings • ECB Monetary Policy meeting • Trump Presidency	• Union Budget • RBI Monetary Policy • FOMC Meeting • Assembly elections, India – 5 states including UP and Punjab	• FOMC meeting • Dutch elections • UK activates Brexit clause • Rabi harvesting	• GST Implementation • Q4FY17 Earnings • 1st round of French Presidential elections • RBI Monetary Policy • 1st IMD monsoon forecast
May'17	**Jun'17**	**Jul'17**	**Aug'17**
• FOMC Meeting • Iran Elections	• Q1FY18 Earnings • FOMC Meeting • ECB Monetary Policy Meeting • RBI Monetary Policy	• FOMC meeting • 2nd & Final round pf French Presidential elections • ECB Monetary Policy Meeting	• RBI Monetary Policy

Source: JM Financial, Bloomberg

JMF model portfolio update

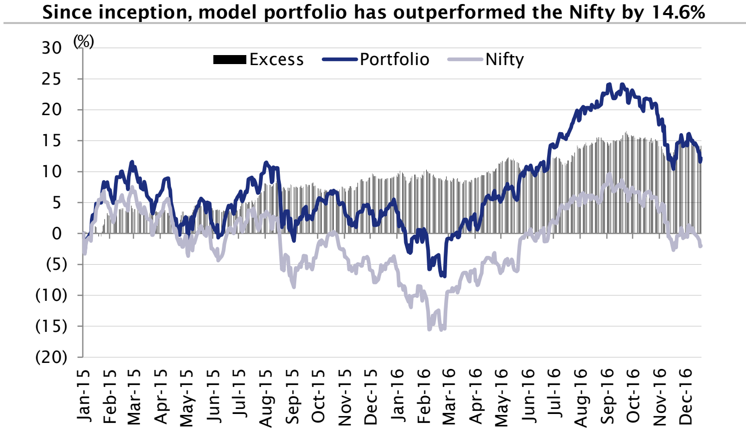
Exhibit 5. Changes to the model portfolio

Action	Rationale
Add Titan (0% to 1%)	Recent measures taken by government like demonetisation and emphasis on implementation of GST is expected to create a level-playing field for compliant companies in the jewellery segment and trigger a shift of market share to organised players. Titan is expected to be a prime beneficiary of the consolidation in the jewellery sector and is eyeing a near-doubling of market share. Even in near-term, Titan would be least impacted within the jewellery industry given high adherence to compliance, good traction in GHS scheme (largely insulated from demonetisation impact), strong wedding season and a weaker base. Stock has corrected 27% from its recent peak levels and is quoting at c.31x 12M forward earnings on our estimates implying a 12%/22% discount to 5/3 year average. It presents an interesting entry opportunity, in our view, especially given the improved prospects under the GST regime.
Add UPL (0% to 1%)	We forecast UPL's earnings to grow at a CAGR of 19% for FY17-19 led by 1) EBITDA CAGR of 14% driven by Brazil and India and 2) savings in finance costs on back of a) lower interest rates (USD 500mn bond issue at 3.25% in FY17) and b) improved debt: equity of 0.5:1 (from 0.6:1) on back of slowdown in acquisitions.
Add L&T (0% to 4%)	L&T is a buy despite the historically lacklustre performance due to the following reasons: Firstly, L&T has delivered -2% Consol. EPS CAGR in FY13-16, despite i) 21% EBITDA CAGR in Infrastructure(Infra) segment which forms 75% of Consol. EBITDA and ii) 23% PAT CAGR in IT&TS which forms 34% of Consol. EBITDA. These were offset by slowdown/ losses/ strikes in other core segments like Heavy Engg(HE)/ Hydrocarbons(HC) with heavy loss (30% of Consol PAT) in Developmental Projects(DP). However, 1H17 results have witnessed revival in HE/HC, while loss making units are in sell off mode. We believe growth to bounce back in FY18-19 for L&T's core segments (Infra, HE & HC), resulting in 16% EPS CAGR in FY16-FY19e vs -2% in last 4 years. Paring of bleeding subsidiaries will be an added bonus. However, its key growth engine - Infra segment (40% of EBITDA) must see continued traction given weaker execution in 1H17. Despite cutting FY17/18 estimates, we find value in base case (₹1600) vs. a limited downside.
Add SOBHA (0% to 0.5%)	We believe Sobha is well placed to benefit from structural reforms in the sector with the introduction of a regulator and demonetisation providing a level playing field for organised developers. Sobha has 6msf of inventory catering to sub Rs10mn ticket size segment which, in our view, provides visibility for 2 years of sales. In addition, at CMP, the market is valuing the land parcel at 0.5x the book value, which is significantly lower than the potential of the land bank. We are attributing the book value to Sobha's land bank to arrive at ₹350/share
Reduce HERO (3% to 0%)	YTD FY17 HMCL's market share in motorcycles stands at c.50.2% down from 52-53% seen earlier. In scooters, facing stiff competition from HMSI, HMCL has been losing ground with current market share at 14.7% (YTD FY17) down from FY16 exit market share of 19-20% (Q4FY16). Although Hero's unmatched rural connect, deep network penetration, strong positioning in the executive motorcycle segment augur well for the business, the recent loss of market share, in a growing 2 wheeler market, in the wake of high competitive intensity raises doubts on sustainability of its leadership position in the medium term. Post demonetisation, HMCL's rural portfolio has been significantly hit leading to a decline of 50% in retail volumes in November and >25% decline in December. We expect the weakness in volumes to prevail in the short-term. Currently trading at 16x FY18EPS on earnings CAGR of 9%FY16-19, stock has increasing downside risks stemming from weak volumes post demonetization, weakening market share in motorcycles and fast growing scooters segment.
Reduce Indocount (1% to 0%)	In our view, the upside in earnings and stock performance is capped by the stagnation of India's cotton sheet market share in the US, reduction in India-China cotton price spread, Yuan depreciation and higher cotton prices domestically. Hence, we recommend trimming exposure to Indocount Industries.
Reduce Somany (0.5% to 0%)	We cut our estimates of Somany Ceramics by 27-37% for FY17-19E to reflect impact of demonetisation and build recovery in sales growth and margins from 2HFY18. While we like the positioning and operating leverage over longer term, we are constrained on account of fair valuation (at Rs485, it trades at 28.5xFY18EPS and 19.8xFY19EPS) and await better price for entry/addition.
Reduce HDFC (6% to 5%)	Most of the triggers contributing to an uptick in business margins have played out. We expect demonetisation other and recent measures related to black money to have an adverse near term impact on real estate sector. This will have negative impact on growth and the stock appears overpriced at 3x FY18E book (ex- value of subs). Hence, we recommend reducing weightage on HDFC limited. More importantly, a combination of a developer (Sobha), contractor (L&T), and financier (HDFC) is more diversified way to capture any value.

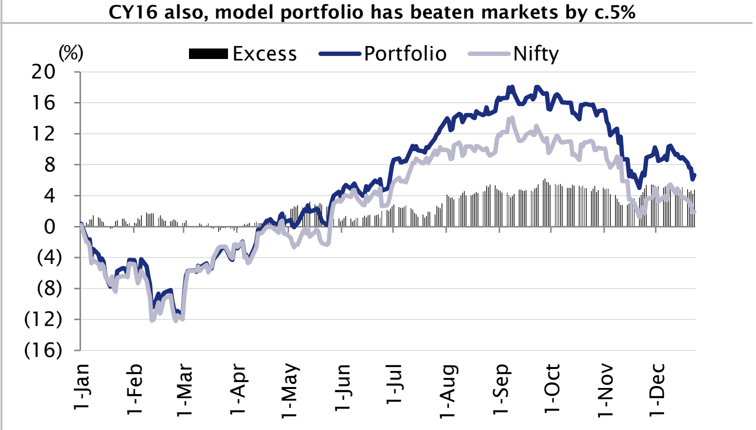
Source: JM Financial

Exhibit 6. JMF model portfolio vs. Nifty (Excl. execution costs)

Since inception, model portfolio has outperformed the Nifty by 14.6%



CY16 also, model portfolio has beaten markets by c.5%



Source: Bloomberg, JM Financial, as on 23Dec'16, inception on 05Jan'15

Exhibit 7. JM financial model portfolio

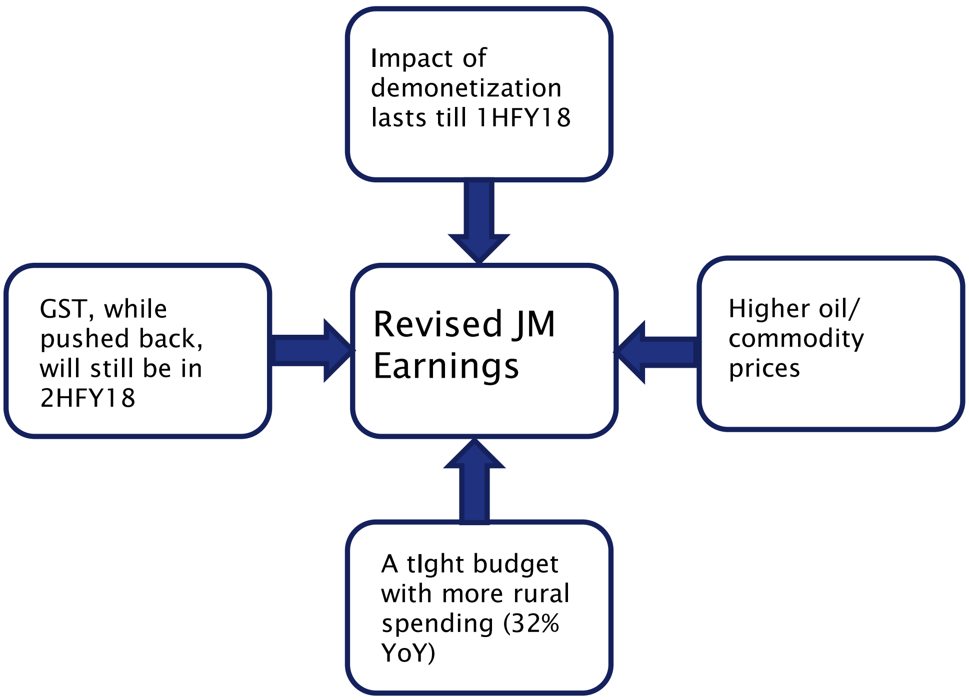
Sector/stock	Nifty Wt.	Portfolio Wt.	Stance	Mkt Cap	CMP	Perf	1 Yr
	(%)	(%)		(` bn)	`/sh	(%)	(%)
Consumer Discretionary	**10.1**	**6.5**	**UW**				
Titan Company		1.0		290	327	(7)	(6)
Bajaj Auto	1.2	2.5		762	2,632	9	4
Aditya Birla Fashion Retail		2.0		106	138	(2)	(40)
Suprajit Engineering		0.5		25	191	51	34
Sobha Ltd		0.5		24	246	-	(21)
Consumer Staples	**8.5**	**5.0**	**UW**				
Bajaj Corp		1.0		55	371	(5)	(12)
Hindustan Unilever	2.0	4.0		1,788	826	(9)	(4)
Financials	**31.5**	**31.5**	**MW**				
HDFC Bank	8.0	8.0		3,079	1,206	26	11
Axis Bank	2.6	2.5		1,076	450	(13)	0
IndusInd Bank	1.8	5.0		662	1,108	35	14
Bajaj Finance		3.0		461	842	145	40
State Bank of India	2.7	2.5		1,942	250	(20)	11
Bajaj Finserv		3.5		461	2,895	130	46
HDFC Ltd	6.6	5.0		2,001	1,263	9	(0)
Mahindra Finance		2.0		154	270	(2)	12
Energy	**8.2**	**5.7**	**UW**				
Reliance Industries	5.4	5.7		3,511	1,082	16	7
Utilities	**5.1**	**3.0**	**UW**				
NTPC	1.3	3.0		1,358	165	24	13
Telecom	**3.2**	**3.0**	**MW**				
Bharti Airtel	1.4	3.0		1,222	306	(10)	(10)
Healthcare	**6.7**	**10.0**	**OW**				
Sun Pharma	2.5	1.0		1,512	630	(14)	(23)
Cipla	1.0	3.5		458	569	(10)	(12)
Lupin	1.2	1.0		671	1,487	4	(19)
Torrent Pharma		3.0		223	1,317	(5)	(8)
Alembic Pharma		1.5		112	595	9	(15)
Industrials	**6.5**	**8.5**	**MW**				
Bharat Forge		1.0		211	907	19	2
Kirloskar Oil Engines		0.5		47	325	(6)	30
Cummins India		2.0		227	819	5	(21)
Larsen & Toubro Ltd.	3.8	4.0		1,258	1,349	-	6
V Guard		1.0		49	162	43	72
Information Technology	**13.9**	**17.0**	**OW**				
Tech Mahindra	1.0	4.0		476	489	(24)	(5)
Infosys	6.4	8.0		2,321	1,011	1	(9)
TCS	4.0	4.0		4,661	2,366	(6)	(3)
NIIT		1.0		13	80	(15)	(19)
Materials	**6.2**	**4.6**	**UW**				
JK Lakshmi		2.0		41	351	(12)	7
Hindalco	0.7	0.6		320	155	(5)	83
UPL Ltd		1.0		328	647	-	48
SRF Ltd		1.0		89	1,546	30	22
Cash		5.2					
Total	**100.0**	**100.0**					

Source: Bloomberg, JM Financial, as on 01Jan'17

Earnings Revision

We reviewed our earnings estimates for all the companies post demonetisation, the recent spike in oil prices, considered the budgetary constraints, the likely timetable for implementation of GST, and have moderated our estimates for most sectors except pharma and IT services.

Exhibit 8. Basic Assumptions



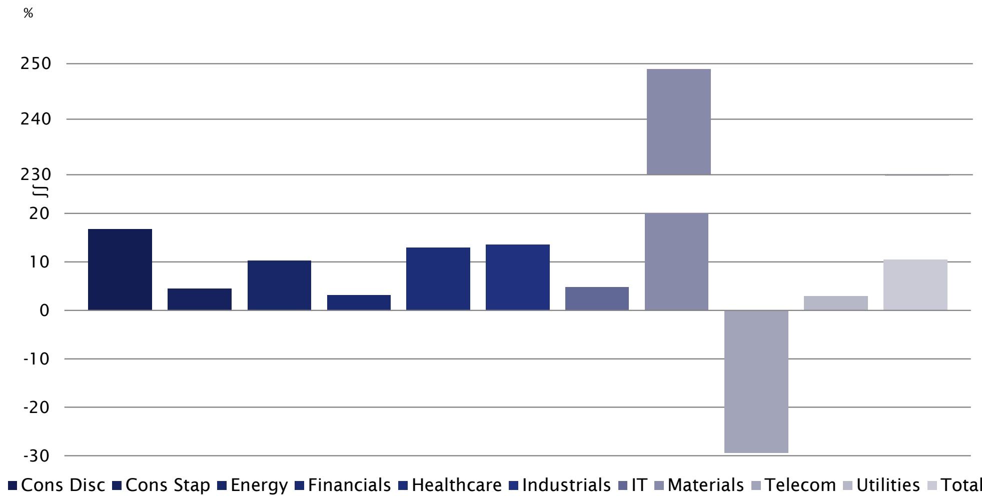
With the revised earnings, the sectors with the highest growth rates in FY18 are banks and industrials while that of telecom and oil & gas are likely to be the lowest. The expected impact of demonetisation on real estate and allied industries is reflected in deep earnings cut. Sectors such as agri. inputs and oil & gas, which are indirectly affected by recent measures, had to bear marginal cuts.

Exhibit 9. Building materials, cement and real estate face deep cut in earnings

Sector	Earnings Revision		FY18 earnings growth projection	
	FY17E	FY18E	Earlier	Now
Agri. Inputs	-0.3%	-0.3%	17.9%	18.0%
Auto	0.2%	2.3%	17.5%	20.0%
Auto Anc.	-7.5%	-6.8%	25.0%	25.9%
Building Materials	-30.8%	-32.7%	20.5%	17.1%
Cement	-14.9%	-23.4%	33.0%	19.7%
Consumer	-5.4%	-4.7%	14.7%	15.6%
Industrials	-11.9%	-8.2%	41.9%	46.3%
Infra	-14.6%	-19.0%	26.8%	20.3%
Media	1.9%	7.1%	17.6%	23.6%
Metals	-1.8%	-1.6%	20.2%	20.5%
Midcaps	-3.1%	-3.8%	22.6%	21.8%
Oil & Gas	-0.2%	-0.1%	11.7%	11.8%
Real Estate	-15.0%	-13.9%	14.8%	16.2%
Telecom	1.3%	-12.7%	(9.1%)	(21.6%)
Utilities	-11.8%	-14.5%	18.3%	14.6%
NBFC	-4.3%	-6.6%	19.3%	16.4%
Banks	-9.2%	-18.4%	70.8%	53.5%
Overall	-4.7%	-7.7%	24.9%	20.9%

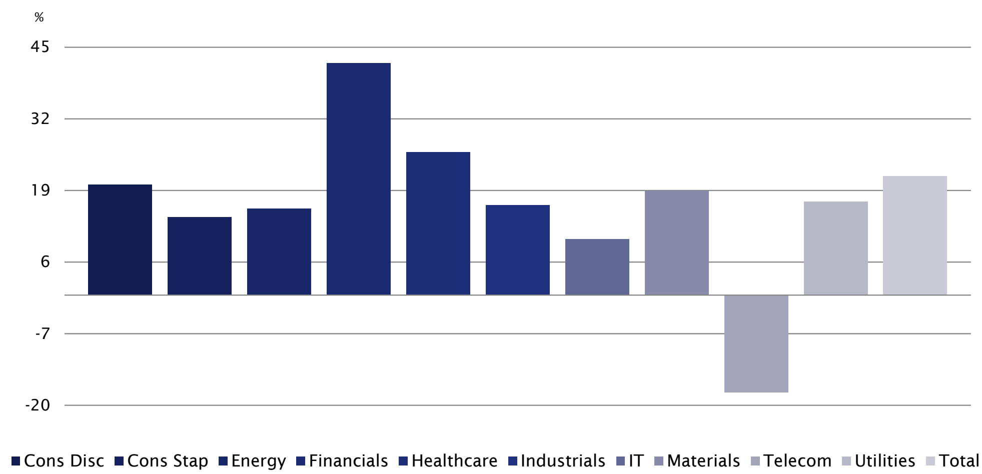
Source: JM Financial

Exhibit 10. Revised FY17 Nifty earnings growth (sector-wise, YoY)



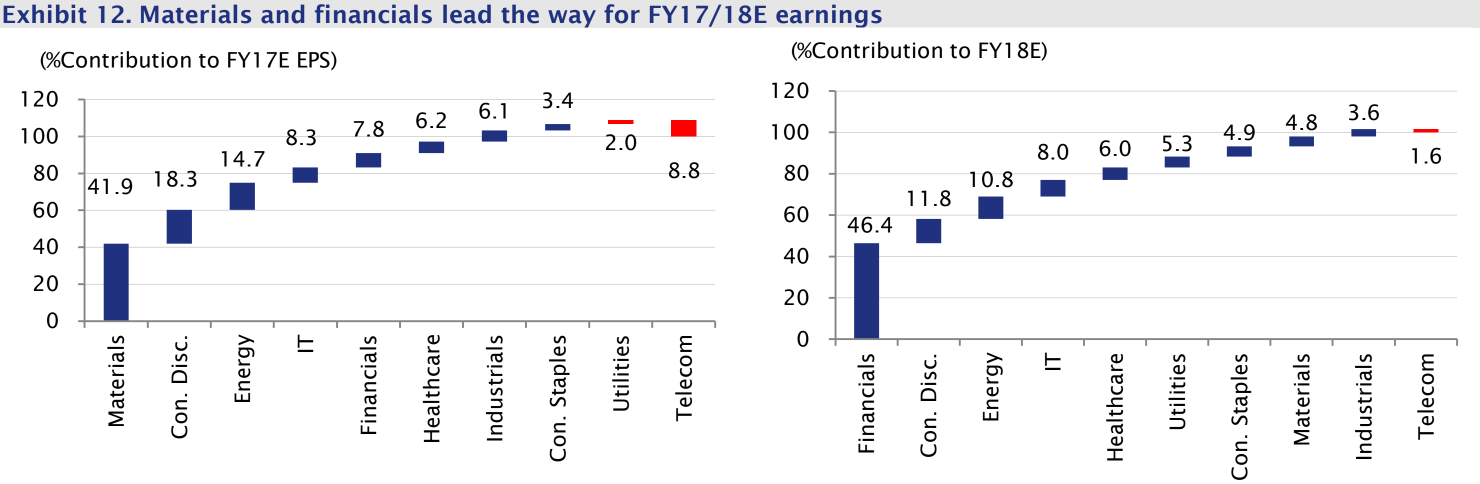
Source: JM Financial

Exhibit 11. Revised FY18 Nifty earnings growth (sector-wise, YoY)



Source: JM Financial

Exhibit 12. Materials and financials lead the way for FY17/18E earnings



Source: JM Financial, based on GICS sector classification

Demonetisation impact

The ban of specified bank notes (SBNs) without commensurate supply of notes in an economy with c.95%/65% (volume/value) of consumer transactions in cash is the main cause for the short-run impact caused due to demonetisation. As per our estimates, 21bn notes (₹15trn) were discarded as legal tender. Despite assuming full capacity utilisation, printing presses have not been able to replace the SBNs with new notes, resulting in a liquidity crunch. We estimate the demand-supply mismatch to persist until mid-March 17, assuming printing began mid-Sept and presses operate in three shifts per day. The diminishing shortage of currency with periodic printing is shown in Exhibit below.

We expect complete remonetisation by end of March 2017

Exhibit 13. Demand-supply mismatch is expected to persist until end-March'17

Time period	Additional notes printed (₹ bn)	Shortfall covered
Mid Sept-10 Nov	2,893	19%
10 Nov-20 Nov	2,564	36%
1 Dec-31 Dec	3,465	59%
1 Jan-31 Jan	2,820	78%

Source: JM Financial

Impact of currency shortages mitigated by digitalisation in medium term

Although the adverse impact of demonetisation originates from the supply side (currency shortage), its impact is likely to be felt after March, when liquidity eases out. A permanent loss in wealth due to high penalty rate on undisclosed income (liable to tax hereon) and hit to real estate demand (more so in the secondary market and hence to prices) are expected to keep consumption levels lower vis-à-vis prior levels. If a populist policy such as a tax cut is enacted, which induces people to perceive themselves as wealthier, consumption may approach pre-demonetisation levels, but may not bring real GDP growth at 7.6%, as investor confidence (crucial for investments) if hurt after demonetisation, can have adverse long-term consequences on the economy.

We assess the impact of demonetisation on GDP through the money market framework. We believe that the immediate short-run impact of demonetisation led to a fall in wealth for all with unaccounted income, translating into lower demand and hence fall in quarterly velocity of money by 6.5%. The simultaneous fall in money supply for December is expected to result in a magnified QoQ GDP loss for Q3. We define medium run as the period when the currency is remonetised completely. We consider two scenarios for the medium term: **a)** without digitalisation and **b)** with digitalisation. In the former case, we assume that people do not adopt digital payments means and hence with complete remonetisation, they revert to holding same levels of cash, and thus quarterly velocity will approach historical Q4 levels of 0.32. In the latter case, we assume that people adopt digitalisation and hence Q4 velocity of money increases permanently from 0.32 to 0.34 say, due to less currency with public. This behavioural change will help recovering QoQ GDP, as per the Quantity Theory of Money.

Digitalisation will help in recovery of quarterly GDP, as it is expected to permanently increase quarterly velocity of money due to less cash held with public

Exhibit 14. Changing quarterly velocity under different scenarios

Time Period	Historical Velocity	New Velocity	% Change
Short Run: End of Q3	0.31	0.29	-6.5%
Medium Run Without Digitalisation: End of Q4	0.29*	0.32	10%
Medium Run With Digitalisation	0.29	0.34	17%

Source: JM Financial, CMIE; *Velocity for Q3 after demonetisation to capture quarterly change

Digitalisation to lower cash required in the economy

Digitalisation is estimated to bring down the value of transactions made in cash from 65% to 50%

We do not expect cash shortage to severely affect transactions after January. Currency in circulation (CIC) not only comprises currency with public, but also cash-in-hand with banks (though only 5% of CIC). On 11Nov'16, CIC stood at ₹17.77trn, but only ₹16.88trn (95%) was held by public. Using transaction's demand for money, as a proxy for the percentage of cash used for transactions, we get ₹14trn as the money kept by people to make transactions. In India, 65% of the transactions are made through cash. This gives total transactions value for the economy as ₹21.56trn. If we were to assume that after demonetisation, the ratio falls to 50% of cash equivalent, ₹10.78trn will be required for cash transactions that run the economy, assuming demand remains the same. It should be noted that this ₹10.78trn includes all denominations. Thus, the currency actually required to eliminate cash shortage for daily cash transactions is less than ₹10.78trn. As per RBI data, ₹5.9trn has already been issued through ATMs or banks, which is 55% of this required cash. Even if 90% of the currency held with public is used for transactions, actual cash requirement after demonetisation is ₹11.7trn; out of which 51% has already been provided for.

Exhibit 15. Cash required in the economy

₹ bn	Case 1: 83% of currency required for transactions	Case 2: 90% of currency required for transactions
Currency in circulation	17,773	17,773
% held with public	95%	95%
Currency with public	16,884	16,884
% of currency held used for daily transactions	83%	90%
Currency used for transactions	14,014	15,196
% of transactions(value) in cash: Pre-demonetisation	65%	65%
Value of transactions	21,560	23,378
% of transactions in cash after demonetisation with digitalisation	50%	50%
Cash required in economy	**10,780**	**11,689**

Source: JM Financial, CMIE

The medium-run adverse impact of demonetisation is not attributable to currency shortage, but is due to the combination of wealth affect (property-related) and income effect (especially for farmers)

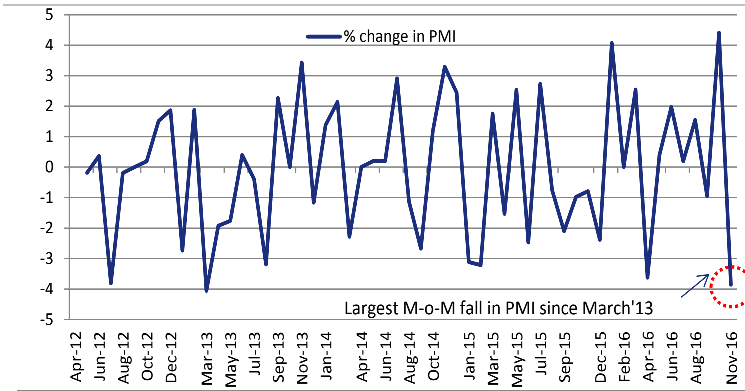
Macroeconomic indicators

Macro indicators for Nov'16 reflect the impact of demonetisation on the economy. On the real economy side, the hit in economic activity is evident from the fall in manufacturing PMI that witnessed the highest MoM fall since Mar'13 (from 54.4 to 52.3). The composite output index witnessed a steeper decline of 11% from 55.4 in Oct'16 to 49.1 in Nov'16. Services PMI fell 3.9 % (from 54.4 to 52.3). Trade data for Nov'16, on the other hand, reveals the worsening of the trade deficit to $13bn, partly due to a rise in gold imports by 23% YoY and 25% MoM.

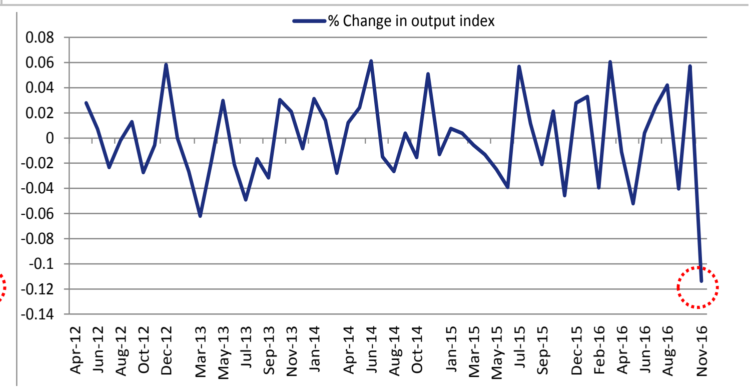
Looking at Nov'16, we accept that this may not present the right and complete picture. Having said that, while digitisation is likely to mitigate the ease of transactions in coming days even further, a combination of wealth effect (property-related primarily) and income effect (especially for the smaller farmers) could mean that the demonetisation-led slowdown could last into 1HFY18. This is even before considering any impact of other upcoming disruptions.

Exhibit 16. Nikkei Markit India Indices show the plight of economic activity in November

After demonetisation, manufacturing PMI fell 3.86% MoM



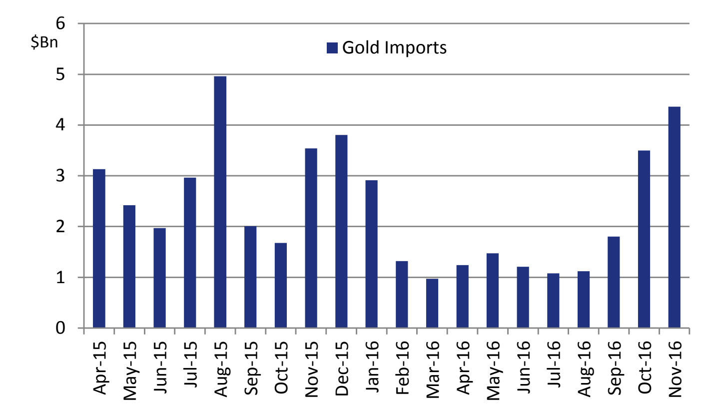
Composite output index witnessed a 11% fall MoM in Nov'16



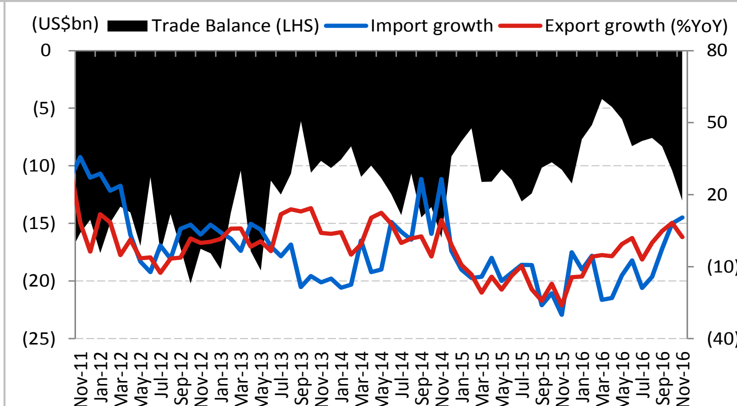
Source: JM Financial, Markit Economics

Exhibit 17. Trade Data for Nov'16 reveals effects of demonetisation

Gold imports reached $4.36bn, as individuals park their black money



Trade deficit worsened to $13bn in Nov'16



Source: JM Financial, Markit Economics

Other developments to watch out for

GST:

The most awaited upcoming disruption is the Goods and Services Tax (GST). Our analysis for GST sector-wise can be accessed at GST Update. The sectors, which benefit or are negatively impacted, are summarised below:

Exhibit 18. Winners and losers among sectors

Sectors	Impact
FMCG	Positive
Consumer Electricals/Kitchen Appliances	Positive
Pharma	Positive
Cement	Positive
Media – Distribution	Positive
Media – Broadcasting	Neutral
Auto	Neutral
Metals	Neutral
Home Textiles	Neutral
Banking & NBFCs	Neutral
Chemicals/Agro-chemicals/Seeds	Neutral to Negative
Oil & Gas	Negative
Telecoms	Negative
Aviation	Negative
Real Estate	Negative

Source: JM Financial

We reckon the following are the major areas to be completed for a smooth rollout of GST in India.

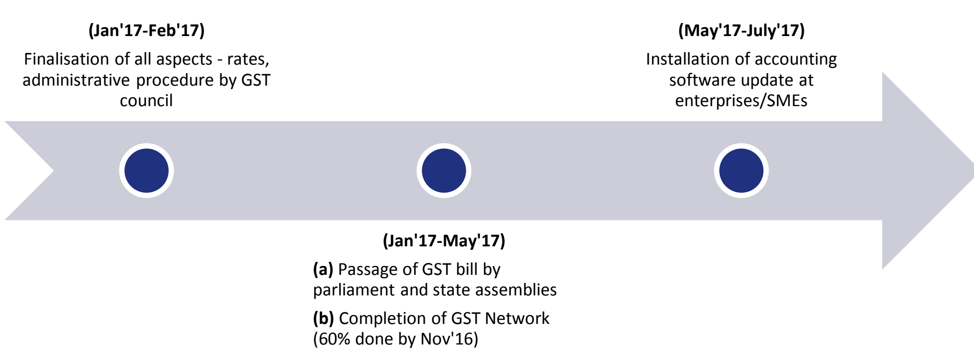
We expect GST to be rolled out by July, 2017, subject to passage of GST bills in the budget session of parliament

Exhibit 19. Key steps for smooth implementation of GST in India

S No.	Details
1	Product-wise rate finalisation
2	Consensus on division of administrative responsibilities between state and centre
3	Migration of entire taxpayer base (along with their supply chain) to GST network
4	Clarity on transitional provisions for claiming input tax credit (paid to manufacturers in pre-GST regime) by traders/dealers
5	Framework for the implementation of anti-profiteering clause
6	Extensive training of the tax administration officials on concept, legislation and procedures

Source: JM Financial

Exhibit 20. GST could be rolled out by end of 2QFY18



Source: JM Financial

After finalisation of all aspects of rules in the GST council, the GST bill would need passage from parliament and also in state assemblies. The bill can pass in the parliament now during the budget session (Jan-Apr'17). Following the passage of the bills, accounting software updates would be needed to be installed across the tax paying base, which could take 2-3 months. **Therefore, we believe the earliest GST could be rolled out is only near end of Q2FY18 (Jul-Sep).**

Benami Transaction Act, Unaccounted Income Declaration Scheme—continued focus on eradication of black money

Government has indicated emphasis on the implementation

The government has announced multiple measures (listed in the exhibit below) in its effort to eradicate corruption, enhance tax base and increase less cash transactions. As part of these efforts, the government has proposed amendments (Appendix I) in income tax rules, which have been passed by the Lok Sabha (29Nov'16). The key change includes a new self-income declaration scheme—**PM Garib Kalyan Yojana**—and increase in fines/surcharges on discovery of unaccounted income/deposits. As the bill could not be passed through both houses of parliament in the recently concluded winter session, the government has brought the PMGKY scheme as an ordinance.

The implementation of the Benami Transaction Act, which has already been passed by the parliament (effective 01Nov'16), is likely to be a priority area in 2017.

Exhibit 21. Further steps taken for identification of unaccounted income/black money

Act/Rules	Date of announcement	Details	Impact
Benami Transaction Act	Effective 01Nov'16	The current bill amends the earlier Benami Transactions Bill (1988) by: (a) expanding the definition of property comprehensively to include not only immovable assets such as land, flat or house, but also movable assets such as gold, stocks, mutual fund holdings and even bank deposits, (b) establishment of implementation procedure, and (c) increase the penalty for entering into benami transactions to up to 7 years. The government has clearly indicated that their focus after demonetisation of ₹1,000 and ₹500 currency notes would be on the eradication of corruption/identification of black money in property deals.	Implementation could adversely impact investments in real estate in the near to medium term
New Income declaration scheme—PM Garib Kalyan Yojana	15Dec'16	The government announced another unaccounted income disclosure scheme—Pradhan Mantri Garib Kalyan Yojana (PMGKY), 2016—effective from 17Dec'16 to 31Mar'17. Those who declare income under this scheme will be levied a charge of 50% (30% tax, 33% surcharge and 10% penalty). In addition to this, 25% of the amount declared will go into the non-interest bearing Pradhan Mantri Garib Kalyan Deposit Scheme, 2016, for four years.	Deposits received under the scheme would benefit fiscal balance and this is also likely to be the last scheme of income declaration by the government
Ordinance to amend the Payment of Wages Act, 1936	21Dec'16	The centre approved the promulgation of an ordinance on 21Dec'16 to enable industries to pay wages by cheque or by direct credit into bank accounts of workers earning up to ₹18,000 a month, **without taking their explicit consent**. The present law states that all payment of wages should be in cash with a provision asking employers to obtain "written permission of the worker" to pay either by cheque, or by crediting the wages to his or her bank account. The centre can make rules regarding payment of wages in relation to railways, air transport services, mines, oil fields and its establishments, while states take a call on all other cases. Media reports suggest that Andhra Pradesh, Uttarakhand, Punjab, Kerala and Haryana have already made provisions for payment of wages through cheque and electronic transfer.	This step will provide a major boost to the promotion of digital or less-cash economy
Identification of potential non-filer of tax returns	22Dec'16	The Income Tax Department had already rolled out a non-filers monitoring system (NMS) for identification of non-filers with potential tax liabilities. On 22Dec'16, the Central Board of Direct Taxes (CBDT) reported about the identification of additional 6.75mn potential non-filers, who have carried out high-value transactions in FY14-15, but have not filed returns of income for the assessment year. The government would continue to monitor high-value transactions through the use of data analytics. The government has also set up an email address—blackmoneyinfo@incometax.gov.in—where people can send information on those having black money and are trying to launder it.	Tax compliance and tax base is likely to increase over medium term, however, it could impact discretionary consumption in the near term

Source: PRS

State assembly elections in 2017

There are likely to be six state elections during 2017 with five state elections—Uttar Pradesh (UP), Punjab, Uttarakhand, Goa and Manipur—expected to be held during early 2017 and Gujarat elections during the latter half of the year. The five states likely to undergo elections in 1HCY17 account for c.18% of parliamentary seats. Among the five states, Punjab and Goa have the BJP-led National Democratic Alliance (NDA) state governments; while UP has Samajwadi Party (SP) Government; Uttarakhand and Manipur have Congress state governments.

Exhibit 22. Current strength of state assemblies and results from previous state election (2012)

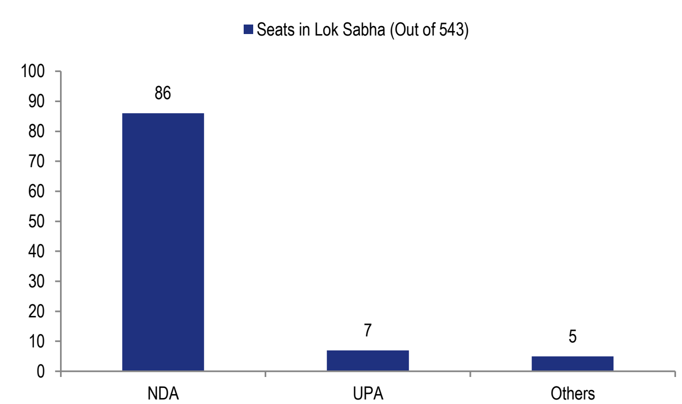
	BJP	INC	SP	BSP	SAD	Others	Total
UP	SP has formed the government in UP since 2012						
Seats (No.)	47	28	224	80	-	24	**403**
Vote share (%)	15.0%	11.7%	29.1%	25.9%	-	-	100%
Punjab	SAD + BJP alliance is the ruling government in the state						
Seats (No.)	12	46	-	-	56	3	**117**
Vote share (%)	7.2%	40.1%	-	4.3%	34.7%	-	100%
Uttarakhand	Congress has been in power in the state with slender majority						
Seats (No.)	31	32	0	3	-	4	70
Vote share (%)	33.1%	33.8%	-	12.2%	-	-	100%
Goa	BJP has formed the government along with regional partner						
Seats (No.)	21	9	-	-	-	10	40
Vote share (%)	34.7%	30.8%	-	-	-	-	100%
Manipur	Congress has formed the government in Manipur						
Seats (No.)	0	42	-	-	-	18	60
Vote share (%)	2.1%	42.4%	-	-	-	-	100%

Source: Election Commission, Note: BJP - Bharatiya Janata Party INC - Indian National Congress, SP - Samajwadi Party, BSP - Bahujan Samaj Party, SAD - Shiromani Akali Dal

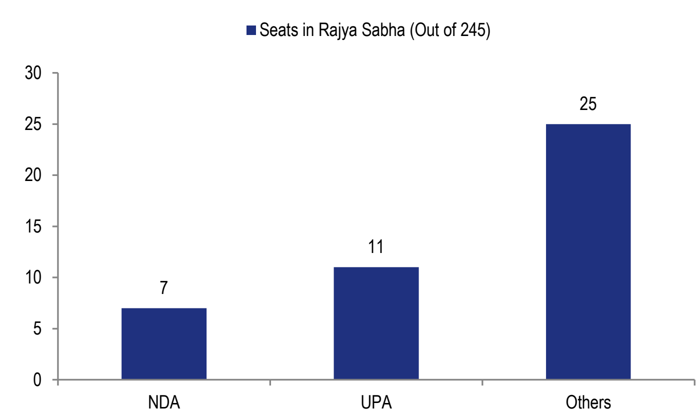
Due to the strong performance of NDA in UP during the 2014 Lok Sabha (LS) elections (73 seats won out of total 80 elections), NDA has 88% of seats in the LS in the five states undergoing elections. However, given that the number of seats in assembly for NDA has been low in these states, at present NDA has only 16% of seats in the upper house or Rajya Sabha (RS) from these states. This is because representatives from state assemblies elect RS members and the outcome is largely proportional to the strength of the political party in state assemblies.

Exhibit 23. The five states going for assembly elections during 1HCY17 account for 18% of parliamentary seats

NDA dominates the LS seats in the states undergoing elections, given strong win in UP (73 out of 80 seats)



NDA needs a good performance in the assembly elections in these states to improve its seats in upper house or Rajya Sabha



Source: Election Commission

Exhibit 24. How key political parties fared in the 2014 LS elections in states undergoing election

State	Key Political Parties – Number of seats won and vote-share (%)						
	BJP	INC	SP	BSP	SAD	Apna Dal	Total
UP							
Seats (No.)	71	2	5	0	0	2	80
Vote share (%)	42.6%	7.5%	22.4%	19.8%		1.0%	100%
Punjab							
Seats (No.)	2	3	-	-	4	-	9
Vote share (%)	8.8%	33.2%	-	-	26.4%	-	100%
Uttarakhand							
Seats (No.)	5	0	-	0	-	-	5
Vote share (%)	55.9%	34.4%	-	4.8%	-	-	100%
Goa							
Seats (No.)	2	0	-	-	-	-	2
Vote share (%)	54.1%	37.0%	-	-	-	-	100%
Manipur							
Seats (No.)	0	2	-	-	-	-	2
Vote share (%)	12.0%	41.9%	-	-	-	-	100%

Source: Election Commission, Note: BJP - Bharatiya Janata Party, INC - Indian National Congress, SP - Samajwadi Party, BSP - Bahujan Samaj Party, SAD - Shiromani Akali Dal

A good performance by the ruling NDA in the state assembly elections, particularly in UP and Punjab, would aid the NDA to increase its strength in the upper house or Rajya Sabha.

Improvement in performance of NDA in the upcoming assembly elections, would drive positive market sentiments

In addition, the state elections could also reflect the popular mood after the demonetisation exercise if there are large vote share shifts from previous elections. We believe, the outcome of these elections would be closely watched by markets and good performance by NDA would drive positive sentiments.

Budget Expectations

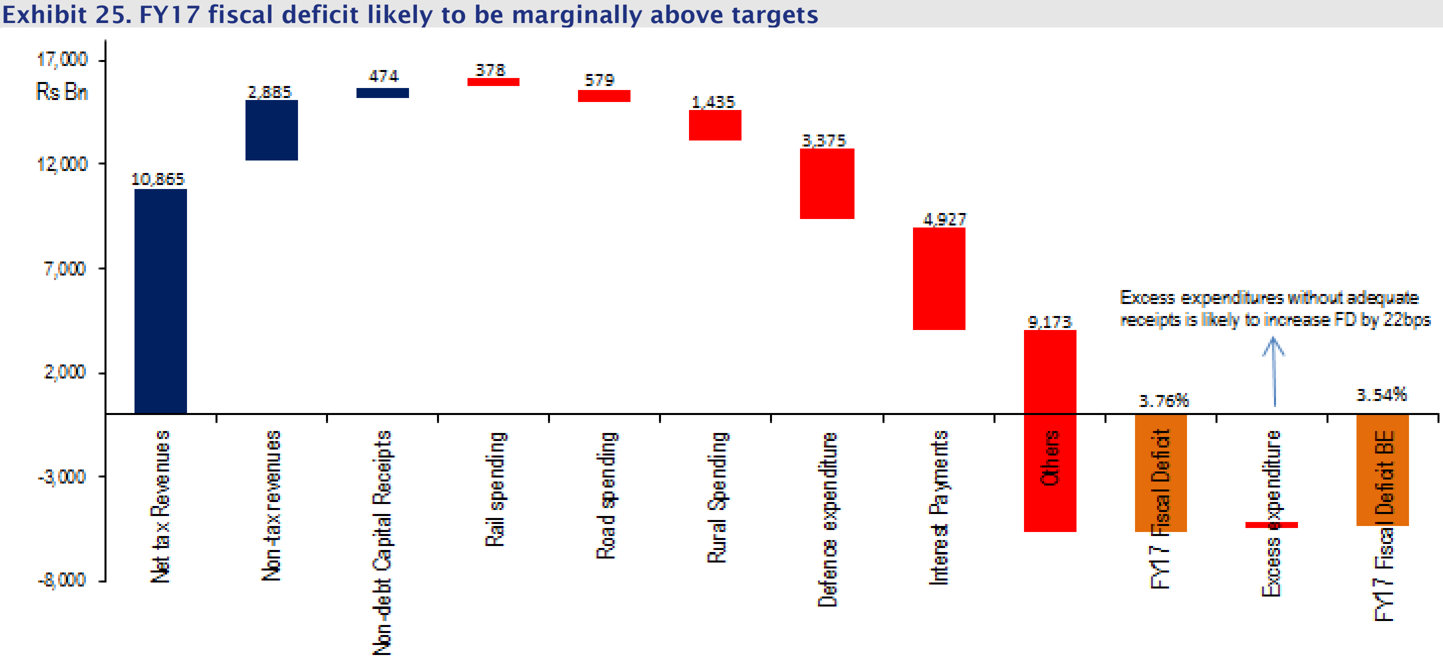
There is always a lot to be done and expected out of a Union budget but instead of coming up with a laundry list as is the wont, we have focussed on analysing the fiscal numbers given pulls and demands post demonetisation while also adhering to the FRBM target of 3% for fiscal deficit by Mar'18. Given the uncertainty in the nominal GDP growth following demonetisation, we estimate fiscal deficit for FY17 and FY18 under two scenarios each—**(a)** nominal GDP growth at 10.5% and **(b)** nominal GDP growth at 11%.

Shortfall of revenues from spectrum auctions and divestments, along with increased spending could worsen the fiscal deficit vis-à-vis the budget estimate

Fiscal deficit for FY17 can be managed with some finesse

- The shortfall: **(a) Spectrum auction** receipts by Rs332bn (20bps of GDP) along with **(b)** Divestment receipts to Rs367bn (again 22bps of GDP or 65% of stated target Rs565bn) due to current market volatility
- Despite higher excise collections due to oil price hike and windfall gains from the Income Declaration Scheme (IDS -1) of c.₹124bn (accruing to FY17 out of a total of ₹247.5bn;45% of ₹550bn), **the overall receipts for the centre could fall short of the budget target by 170--130bps YoY.**
- On the expenditure side, **we estimate expenditure to exceed budget target by 30-40 bps** owing to higher rural (at 31% vs. BE of 29%) and road spending (at 24% vs. BE of 23%).
- Hike in expenditures also captures higher revenue expenditure due to unaccounted cost of the 7th Central Pay Commission (CPC); latent in ministry-wise data. While we expect food and fertiliser subsidy to remain as per budget estimates, fuel subsidy is estimated at ₹217bn (vs. BE of ₹269bn) following a crude price hike and depreciation of currency towards the end of FY17.
- Based on above calculations, we conclude that the fiscal deficit for FY17 is likely to digress from the stated budget target of 3.5% of GDP marginally by 18–22bps, unless infrastructure and rural spending is cut for H2FY17.

Exhibit 25. FY17 fiscal deficit likely to be marginally above targets



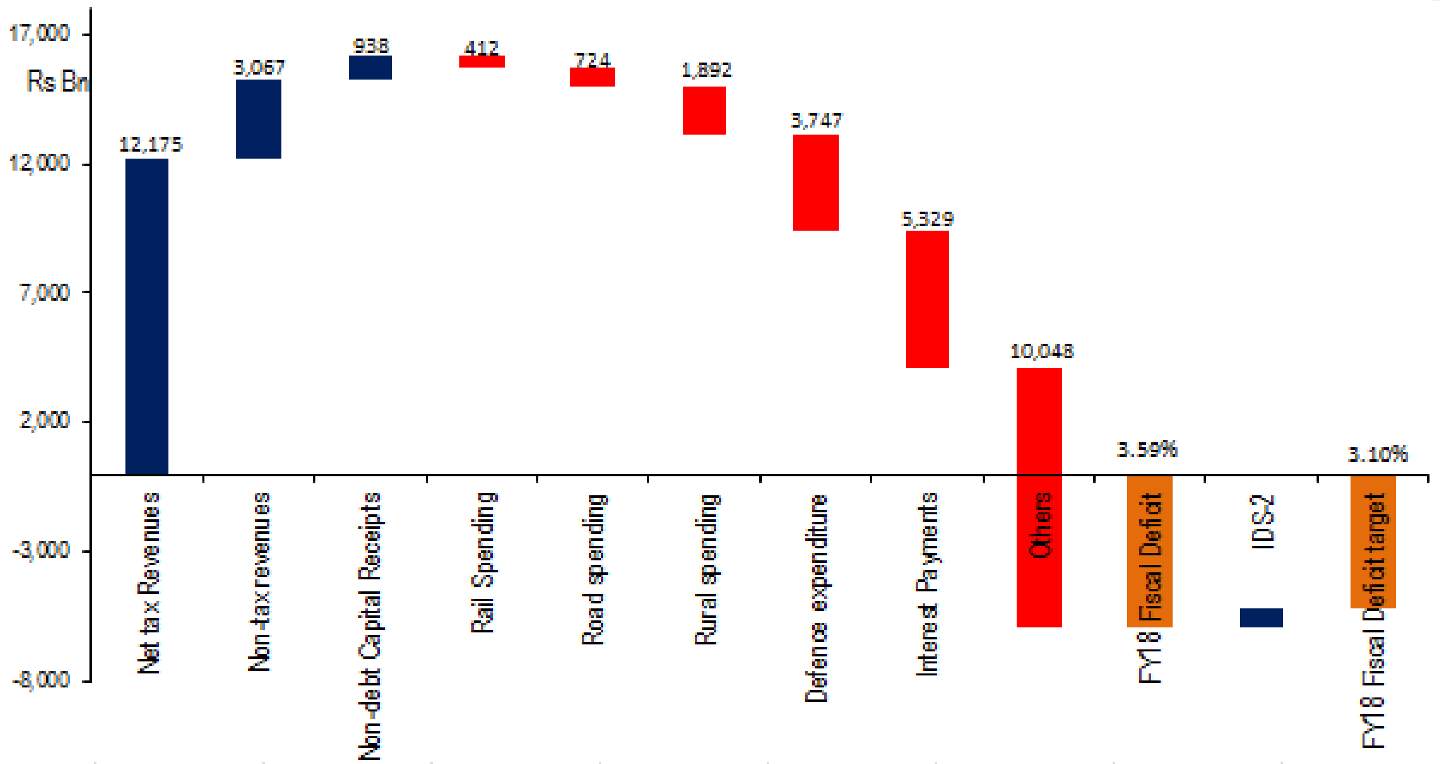
Source: JM Financial, Budget 2016-17, CMIE

Budget expectations for FY18

We estimate rural spending to grow by 32%, while rail and road grow by 9% and 25%, respectively

- Based on estimations on net tax collections under the two above mentioned scenarios (nominal GDP growth of (a) 10.5% (b) 11% in FY18), we expect net tax collections to grow at 11.6% YoY and 12.1% YoY, respectively.
- Given recent suggestions in the pre-budget meet, we estimate a divestment target of 0.5% of GDP, of which actual realisation rate is assumed at 60%. This could yield revenues of ₹500bn if we assume nominal GDP growth at 11%. Revenues from telecom sector are estimated to be at ₹573bn (₹40bn as upfront revenues from auctions of unsold spectrum (2,100 & 2,500 bands) and 900MHz spectrum in the Tamil Nadu circle).
- **On the expenditure side**, we estimate: **(a)** the rural sector to remain under the focus with spending at ₹1,892bn (32% YoY growth), and **(b)** infrastructural spending is expected to grow at 9% for rail (to ₹412bn) and 25% for road (to ₹724bn). We estimate interest payments at 3.2% of GDP, while defence expenditure remains at 2.25% of GDP (inclusive of pension payments). Fuel subsidy is estimated at ₹248bn, 14.3% YoY due to increased burden from crude oil price hike.
- These receipts and expenditures give way to an estimated fiscal deficit of 3.61% and 3.59% of GDP, respectively, under the two scenarios. Receipts from IDS-2, hence, form a crucial source of revenue for FY18 to help bridge the gap. The magnitude of fiscal deficit change with IDS-2 receipts is shown in Exhibit 26.

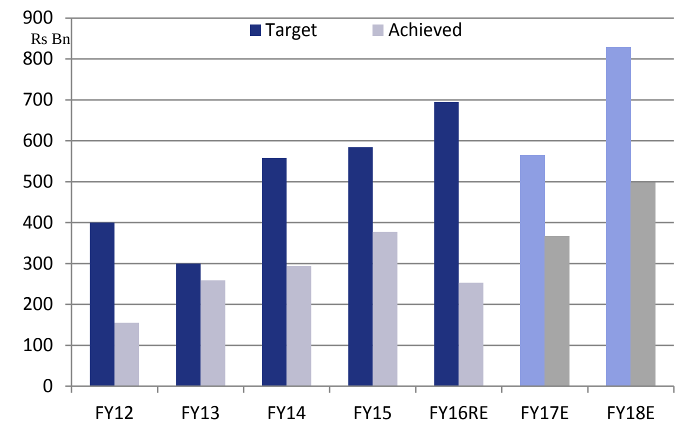
Exhibit 26. Revenues from IDS-2 are crucial for curbing deficit closer to FRBM target of 3% of GDP



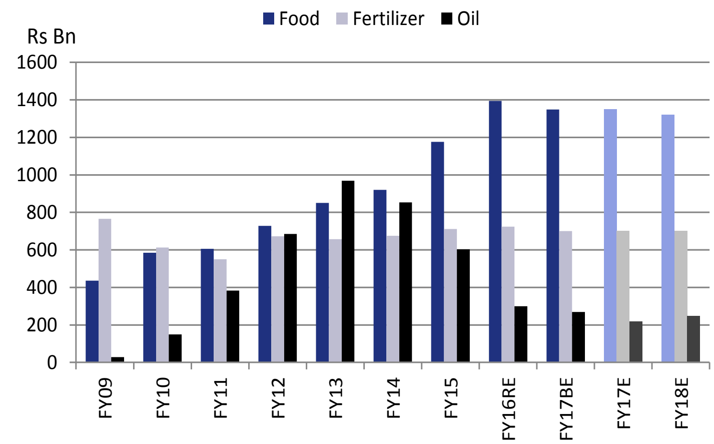
Source: JM Financial, Budget 2016-17, CMIE

Exhibit 27. Receipts from divestment and expenditure on subsidies

We expect revenues up to 60% of divestment target of 0.5% GDP in FY18



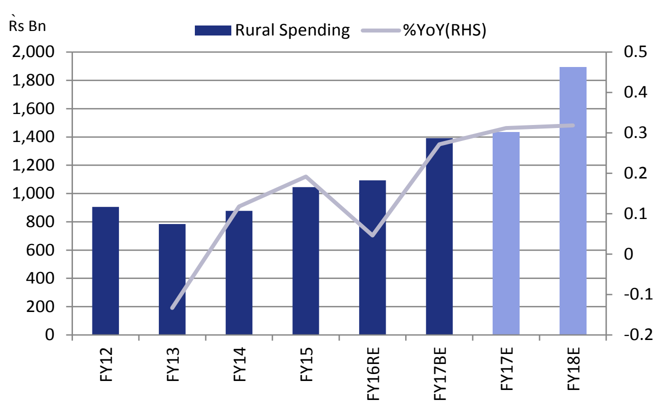
Oil subsidy is expected to rise given crude price hike



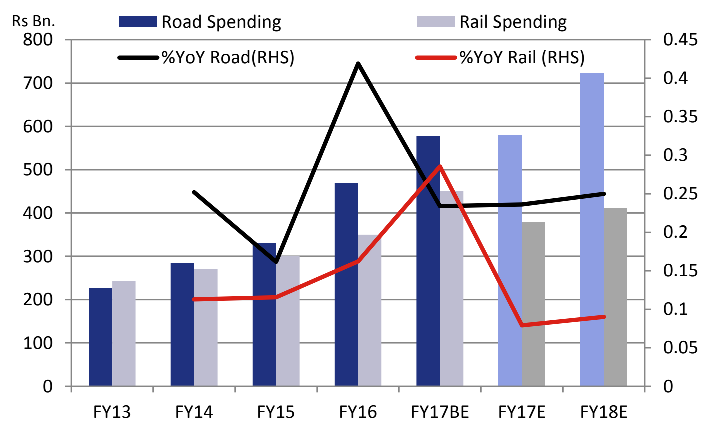
Source: JM Financial, DIPAM, Budget 2016-17

Exhibit 28. High expectations for rural and infrastructure spending in FY18

Rural Spending is expected to grow at 32%YoY in FY18



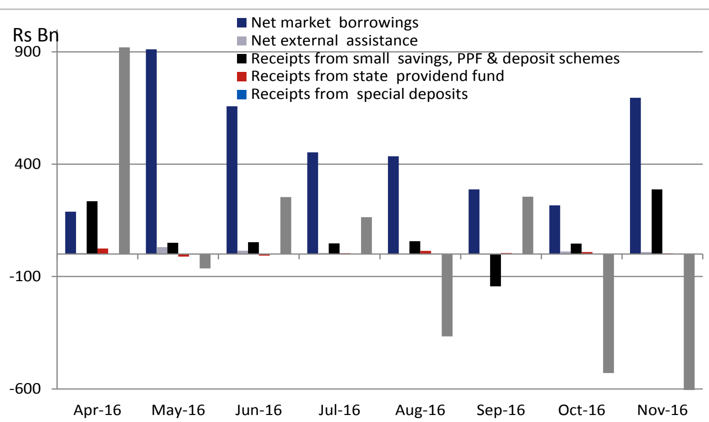
Road and rail spending is expected to grow at 25% and 9% respectively



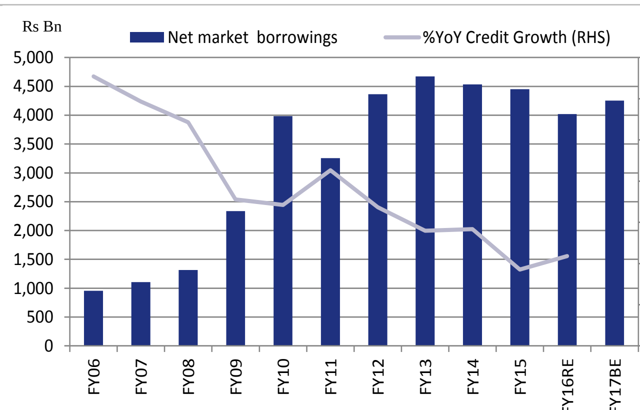
Source: JM Financial, CMIE, Budget 2016-17

Exhibit 29. Government borrowings to finance spending

Sources of Financing Deficit FYTD17



Movement of Credit Growth and Net Market Borrowings



Source: JM Financial, CMIE, Budget 2016-17

Rural India: Leverage increases

As part of our regular effort to understand the rural economy and its demand drivers, we visited seven states (with c.40% of rural population) during early December (**Rural India - Dec 2016)**. Our key findings from the survey are: **(a)** the Kharif produce has been unequivocally better YoY at most places we visited, however, liquidity challenges after 08Nov'16 has impacted realisations adversely, particularly for small farmers, **(b)** Rabi sowing overall has been good (now is up 7% YoY by 30Dec'16), despite select down-trading in seeds/fertilisers, and **(c)** discretionary consumption has taken a hit and will likely revive with the normalisation of cash levels.

We forecast total income growth of 6%/13% YoY for a small/large farmers in FY17 (down from 12%/17% earlier), along with the worsening of credit profile for the small farmer

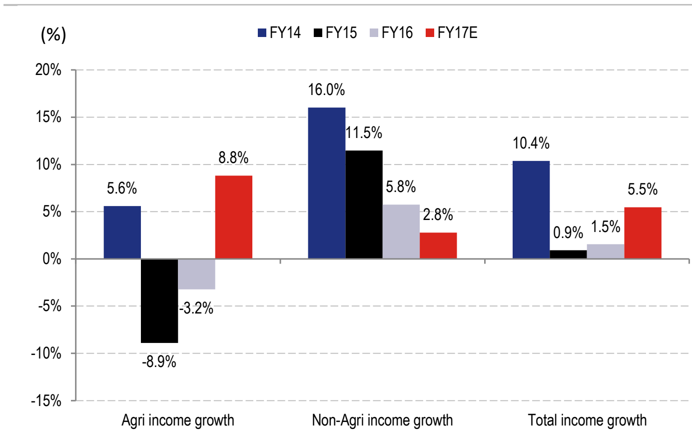
Small farmers take higher income hit, increase in leverage: We revisited our estimates for farmer income and now forecast total income growth of 6%/13% YoY for a small/large farmer in FY17 (down from 12%/17% earlier), along with the worsening of credit profile for the small farmer.

We reckon, a small farmer has received lower realisations (particularly in vegetables and fruits, which form c.15% of the net sown area), and hence we apply a higher discount in low teens to the small farmer's income against a mid-single digit discount to a large farmer's Kharif income as liquidity adjustment. Our estimates have assumed normalisation of cash flow in the rural ecosystem for the Rabi season produce (Mar/Apr).

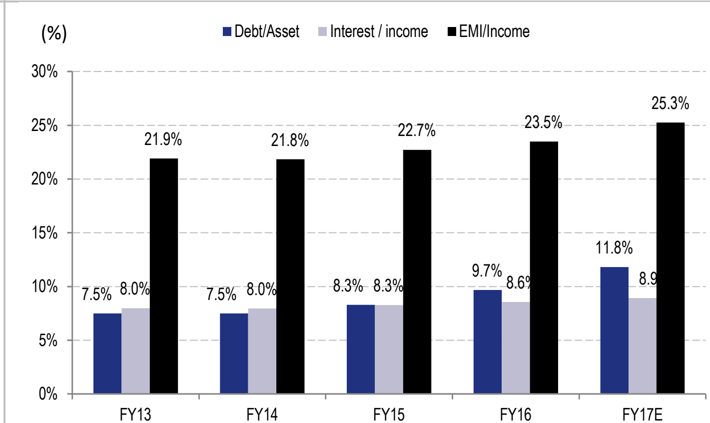
Reduced cash flow after the Kharif season has clearly increased the current debt levels and that too from informal channels (money lenders and agri. traders). Overall, 44% of rural credit is through informal channels and 25% by co-operative societies. Due to liquidity-related challenges and issues with co-operative banks after demonetisation, dependence on money lenders has increased for the small farmer in the interim.

Exhibit 30. Demonetisation-led liquidity squeeze leads to partial disruption in agri. supply chain and thereby impacting income, particularly for the small farmer

Healthy Rabi crop to still enable high single-digit growth in agri. income for small farmers in FY17



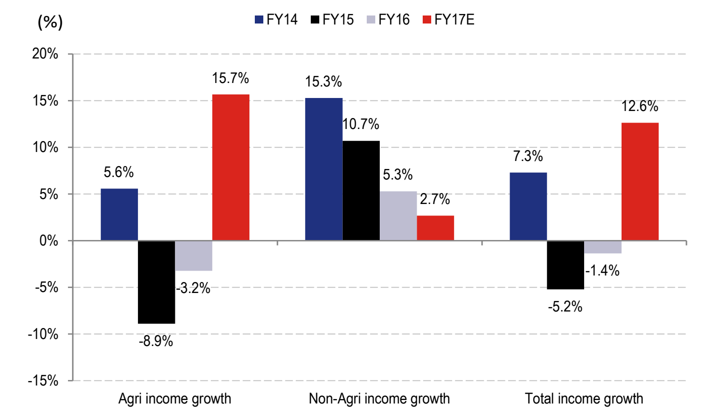
Increase in debt, largely from informal channels leads to deterioration in credit metrics for small farmers



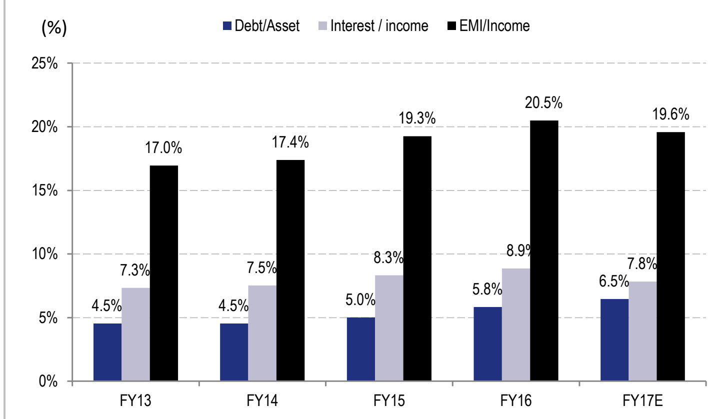
Source: JM Financial

Exhibit 31. A large farmer has been able to manage Kharif sale at good prices aided by the use of banking channels and ability to time the sale; strong credit profile additionally aids large former to obtain quality inputs for Rabi sowing

Large farmers to still record income growth in high teens during FY17



Credit metrics are impacted, but still remain better than the average farmer

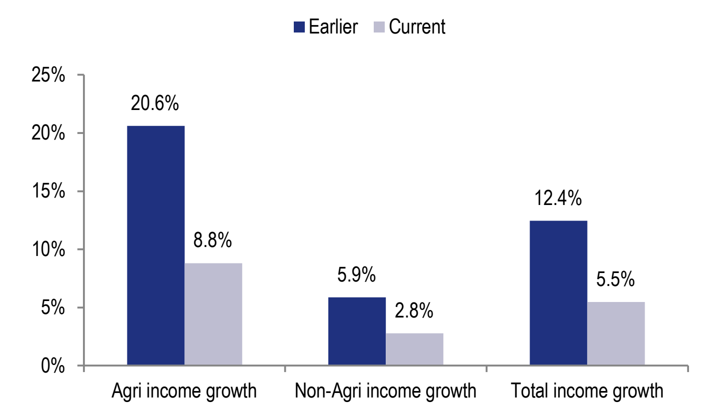


Source: NSSO, JM Financial

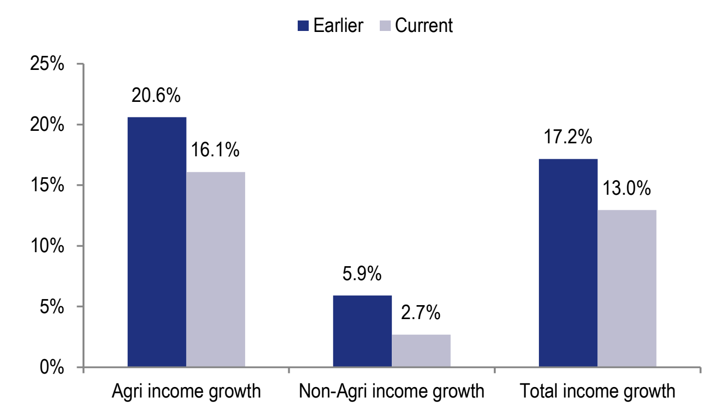
It is to be noted that even after a decrease in income from earlier expectations; overall farmer income would still increase at the highest pace during FY17 over the past three years due to healthy crop output driven by good monsoons.

Exhibit 32. How have growth estimates been revised due to liquidity constraints?

Small farmer to see sharper downward revision in agri. income growth after demonetisation—income growth (FY17E)



Large farmer to see modest decline in agri. income growth and since agri. income share is higher in income, overall income growth is also in teens—(FY17E)



Source: JM Financial

Normalisation of cash essential to revival of growth and consumption in rural India

Interestingly, despite a delay in cash flow, **(a)** informal lending**, (b)** scaling down of discretionary consumption, and **(c)** social/community help have reduced the adverse impact on small/marginal farmers.

We found 'demonetisation' has healthy approval, but has also raised expectations of a change in policy execution (e.g., less corruption) and immediate benefits to the poor. We are encouraged by the acceptance of digital payment modes in smaller towns/cities, but also realise the enormity of spreading financial/digital literacy across 0.64mn villages (c.69% of population).

Equity market performance

Major emerging markets in the red

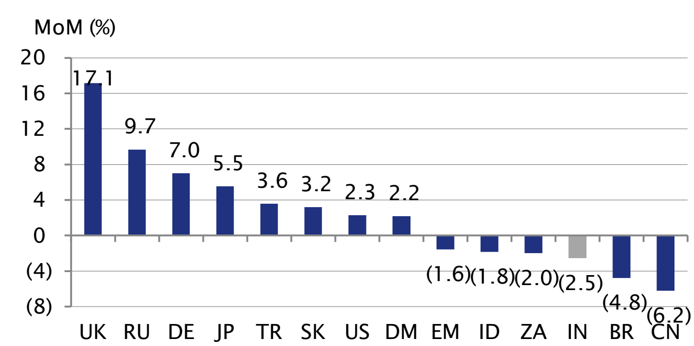
Exhibit 33. Utilities and consumer discretionary outperform, while healthcare and materials underperform (MoM)

	US	EU	GB	DE	JP	AU	ES	CN	BR	IN	RU	ZA	MX	ID	MY
Index	2.1	5.2	3.3	6.8	5.0	2.6	9.1	(6.0)	(1.1)	(3.4)	9.7	(2.0)	(0.2)	(2.1)	(1.1)
Consumer Discretionary	(0.3)	6.2	6.0	8.8	4.9	1.3	(0.6)	(7.7)	1.5	0.8	-	(4.1)	1.6	(1.7)	(3.9)
Consumer Staples	2.1	3.0	2.3	5.2	4.4	0.2	4.3	(7.1)	(2.1)	(3.0)	0.5	(5.1)	(3.3)	(6.0)	(1.6)
Energy	5.3	10.7	10.2		11.6	1.3	13.2	(1.2)	(1.3)	0.7	10.4	(10.4)	-	(5.8)	5.9
Financials	5.3	7.0	3.2	6.4	7.9	5.7	14.0	(6.9)	(0.5)	(5.6)	12.7	0.6	4.4	1.4	(0.1)
Healthcare	0.2	4.2	0.8	9.4	2.5	(1.9)	1.6	(6.6)	10.0	(10.7)	-	(5.2)	-	2.1	(1.1)
Industrials	0.7	4.4	1.9	6.7	3.5	1.2	5.9	(6.8)	1.3	(2.1)	-	11.0	(1.2)	(6.0)	(1.4)
Information Technology	1.6	4.5	(2.3)	1.7	2.8	6.2	1.6	(5.8)	(2.7)	(0.3)	-	-	-	-	-
Materials	1.7	1.8	(4.4)	7.0	7.1	(3.9)	-	(8.4)	(5.5)	(8.6)	5.4	(3.9)	(4.2)	6.1	(0.0)
Telecom	6.7	5.6	1.7	9.3	7.6	(4.2)	12.2	(3.2)	1.4	(4.5)	15.2	1.3	7.0	(3.9)	0.9
Utilities	3.7	5.6	4.8	3.5	12.7	9.3	6.6	(5.6)	(0.2)	1.0	9.8	-	(3.4)	(3.4)	(2.7)

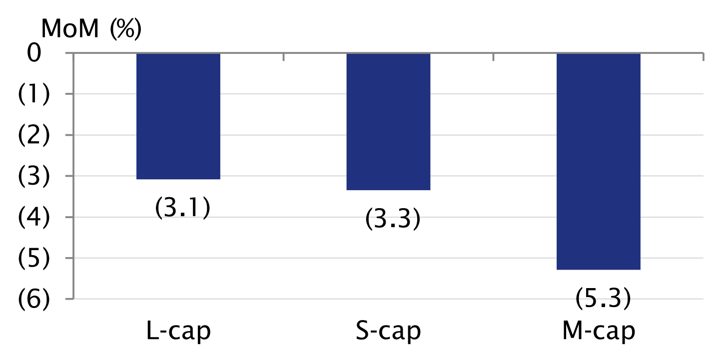
Source: Bloomberg, JM Financial - Based on MSCI Indices (as on 26Dec'16)

Exhibit 34. Compared to major economies, India's performance was only better than China and Brazil (MoM)

Indian markets put up poor show vis-à-vis globally



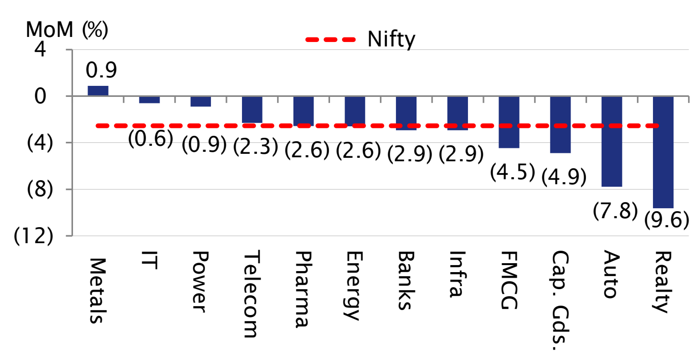
Mid-caps were the worst affected



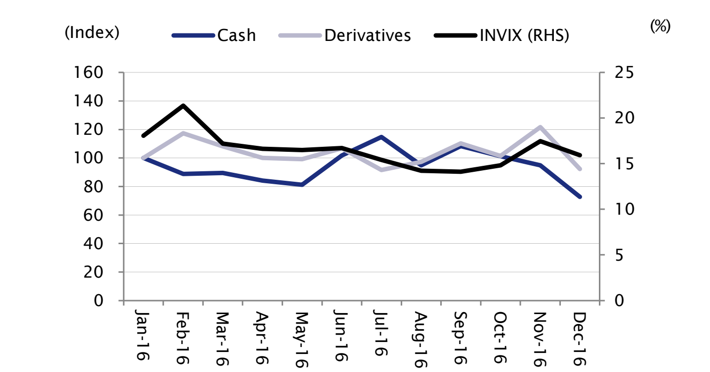
Source: Bloomberg, JM Financial – L-cap: BSE100 index, M-cap: BSE Mid-cap index and S-cap: BSE Small-cap index (as on Dec 26th,'16)

Exhibit 35. Realty, auto, cap goods and FMCG were the main draggers in an overall negative market

Except metals, every sector ended in the negative



Cash volumes were at the lowest level for the year



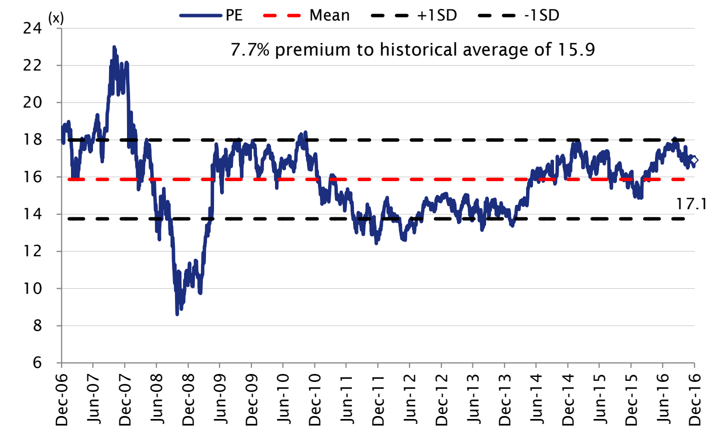
Source: Bloomberg, JM Financial

Valuations -Sensex at 17.1x NTM P/E

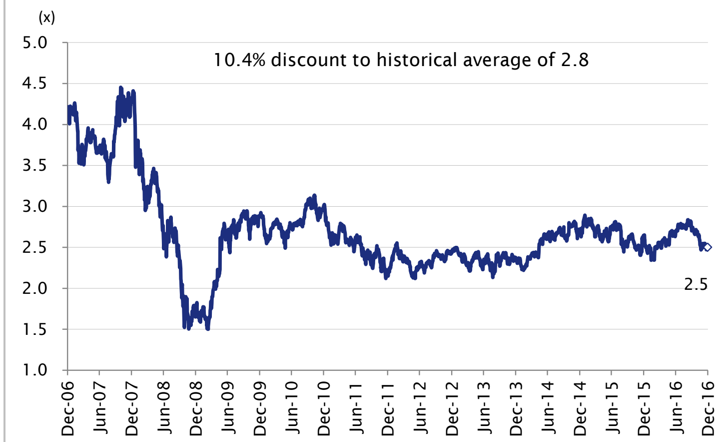
Markets trading at a premium to historical average; RoE fails to pick up

Exhibit 36. Sensex trading at a premium to historical average P/E

Sensex NTM P/E



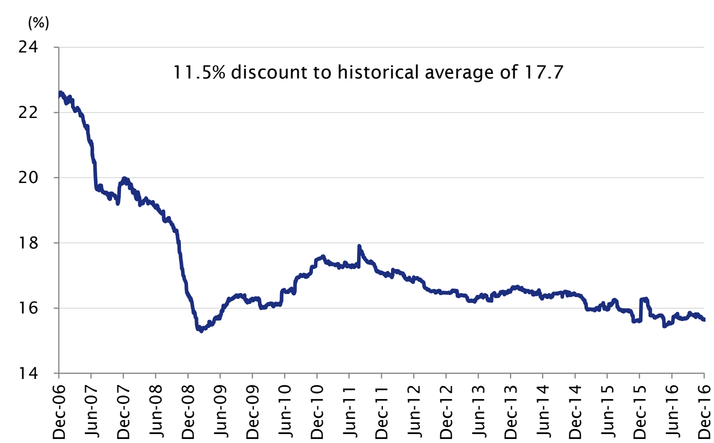
Sensex NTM P/B



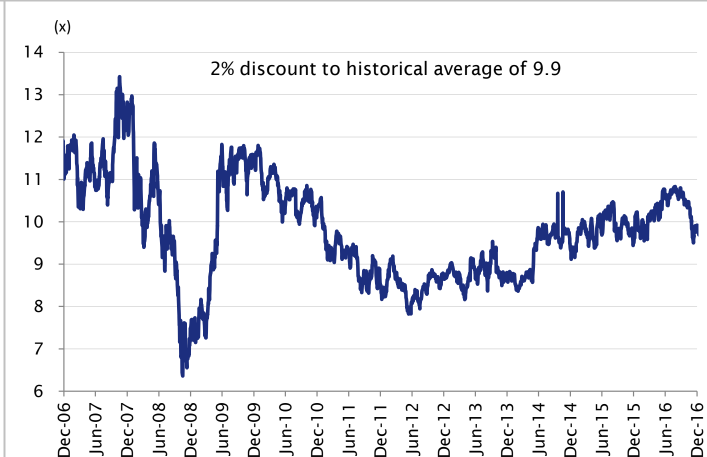
Source: Factset (p/e adjusted for earnings revision), JM Financial, As of 31Dec'16

Exhibit 37.. RoE remains closer to FY09-10 bottom

Sensex NTM RoE



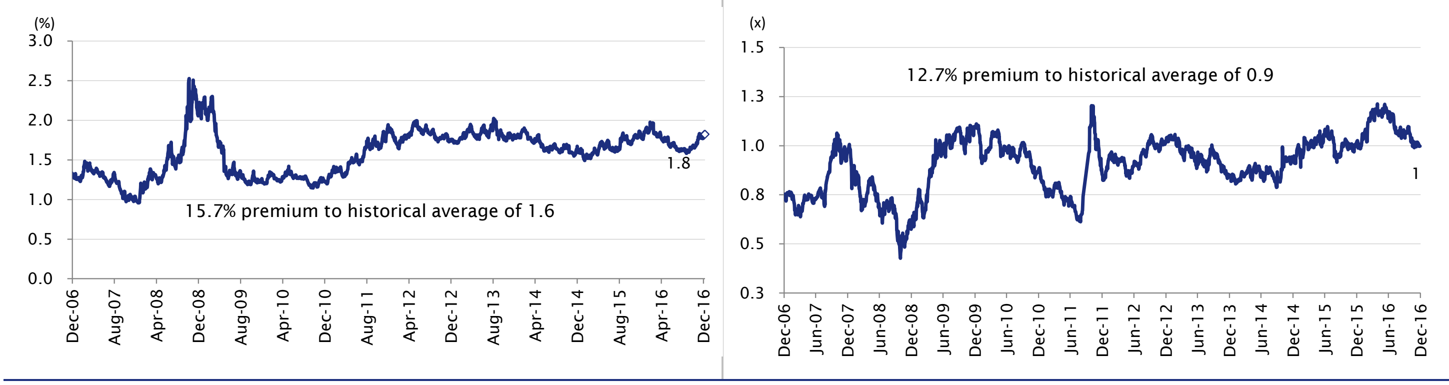
Sensex NTM EV/EBITDA



Source: Factset, JM Financial, as of Dec 31st, '16

Exhibit 38. Premium of PEG to historical averages is substantial

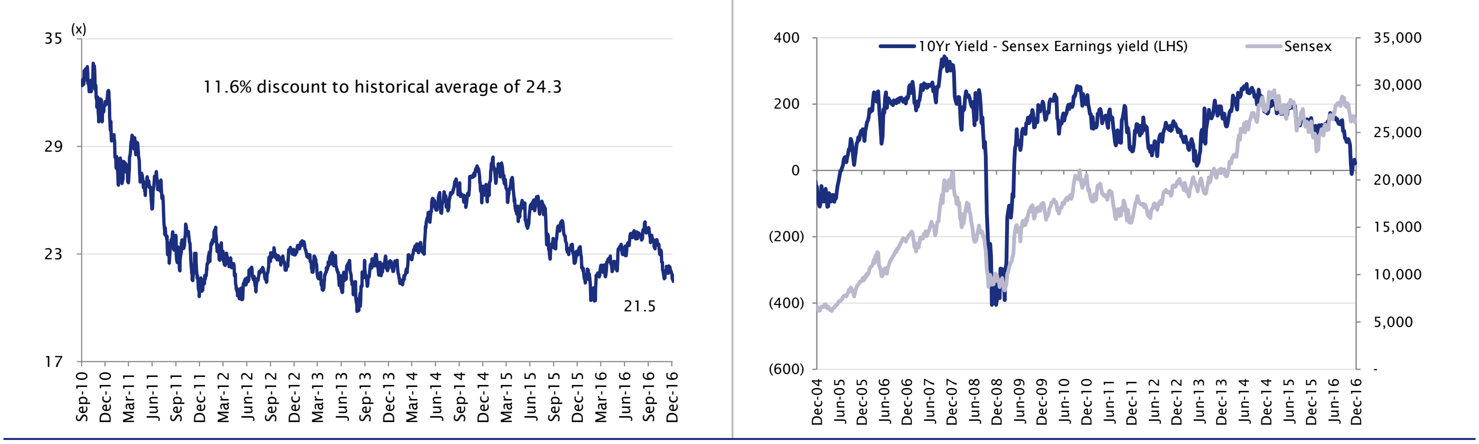
Sensex NTM dividend yield | **Sensex NTM PEG**



Source: Factset, JM Financial, as of 31Dec'16

Exhibit 39. G-sec and market yield differential at 7-yr low (22bps)

7-yr trailing P/E | **Sensex NTM earnings yield vs. G-sec yield**



Source: Bloomberg, Factset, JM Financial, as of 31Dec'16

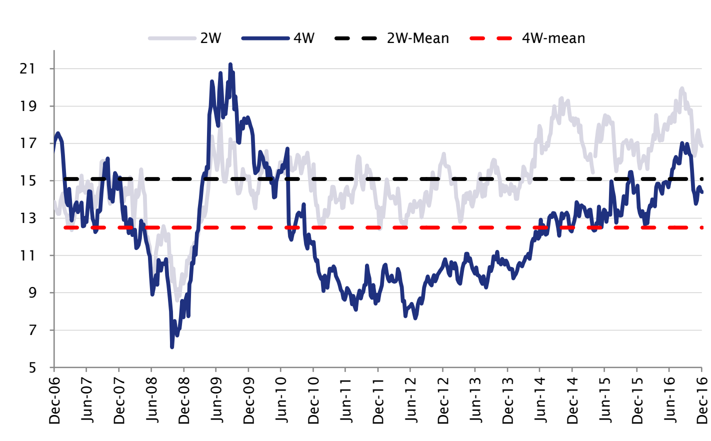
Exhibit 40. Global valuations

	Now				Long-term averages				Premium/discount			
Country	NTM EPS growth	NTM P/E	NTM P/B	NTM RoE	NTM EPS growth	NTM P/E	NTM P/B	NTM RoE	NTM EPS growth	NTM P/E	NTM P/B	NTM RoE
India	16.8	16	2.5	15.6	15.6	15.9	2.8	17.1	8.1	(0.1)	(10.4)	(8.8)
US	11.8	17.2	2.8	16.1	10.8	14.1	2.3	16.0	8.6	21.8	22.8	0.8
Japan	12.4	17.8	1.7	9.3	24.6	17.7	1.4	7.8	(49.5)	0.4	20.5	20.0
Brazil	28.9	11.9	1.2	10.4	23.2	9.1	1.4	15.6	24.5	31.2	(12.6)	(33.4)
South Africa	15.2	12.8	1.7	13.6	17.4	12.1	2.1	17.6	(12.6)	5.1	(18.9)	(22.8)
Russia	16.5	6.6	0.8	11.6	16.5	22.5	0.6	2.8	(0.1)	(70.5)	20.8	310.0
China	29.9	22.7	2.7	12.1	27.1	20.3	2.8	13.6	10.4	11.8	(0.4)	(10.9)
Indonesia	20.2	15.3	2.2	14.5	15.4	13.9	2.6	19.0	31.2	9.7	(16.2)	(23.7)
Mexico	22.4	16.8	2.2	13.3	18.6	16.1	2.5	15.2	20.3	3.9	(8.9)	(12.3)
Taiwan	9.6	13.2	1.6	12.0	15.2	13.9	1.7	12.2	(36.8)	(5.1)	(6.3)	(1.3)
Thailand	9.6	14.6	1.8	12.4	14.0	11.9	1.7	14.7	(31.2)	23.1	4.1	(15.4)

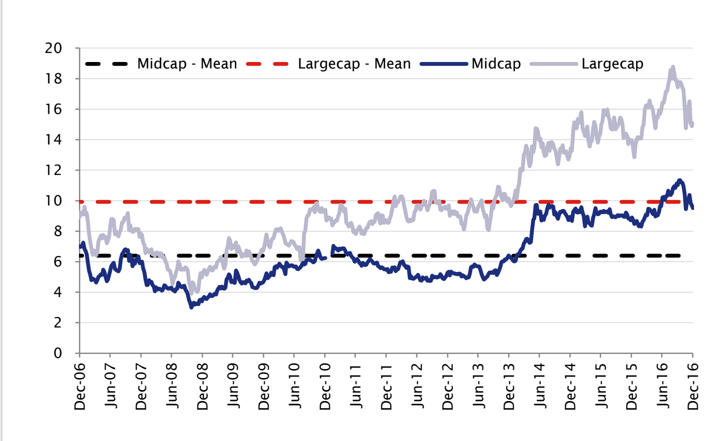
Source: Factset (unadjusted), consensus numbers, JM Financial

Exhibit 41. Mean reversion witnessed in healthcare and IT; cement and consumer still appears pricey

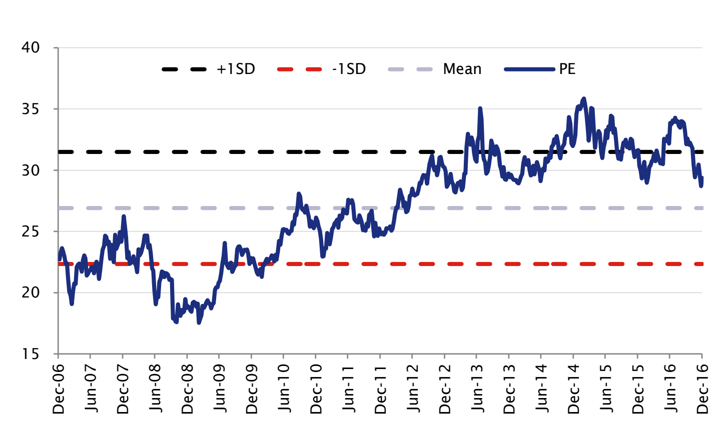
Auto



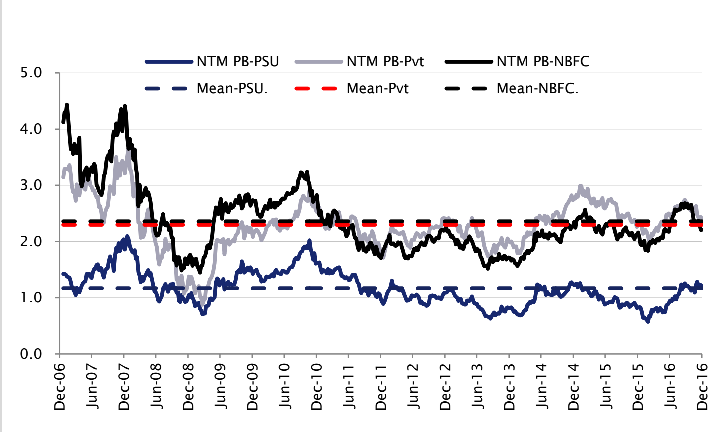
Cement EV/EBITDA



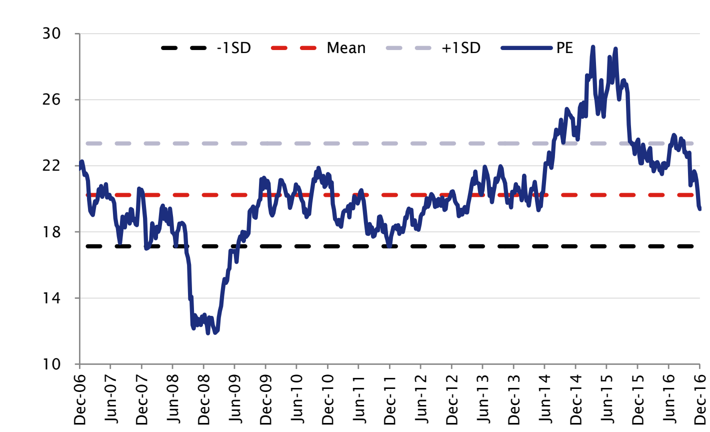
Consumer



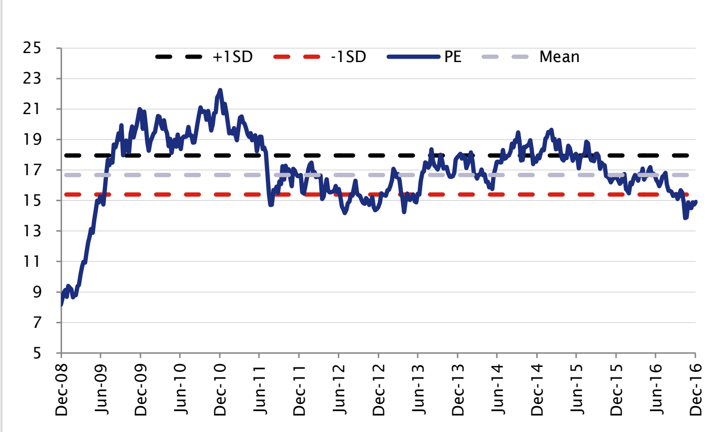
Financials



Healthcare



Large cap IT



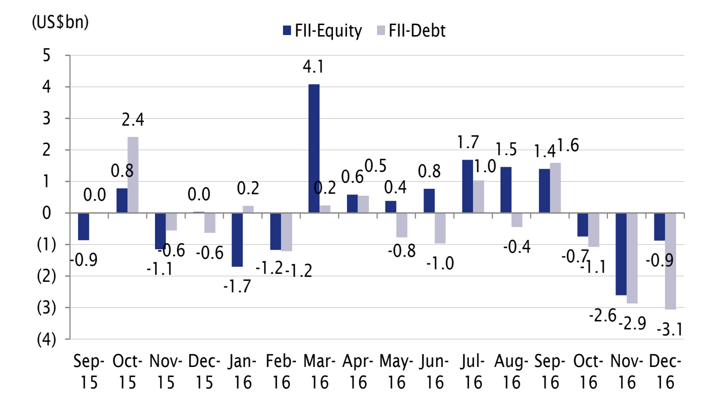
Source: Factset, JM Financial

Flows put forward a mixed picture

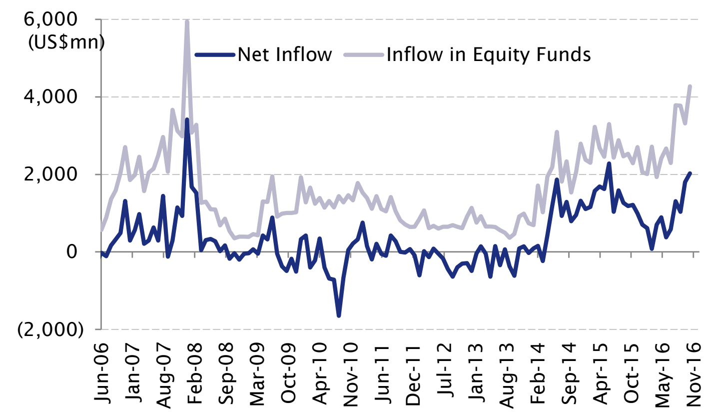
FIIs sold US$0.86bn in equities, DMF flows on the rise

Exhibit 42. FII flow remains at negative levels as DMF flows keep steady

Both FII equity and debt outflow heightened in Nov'16, with little improvement in Dec'16



DMF equity inflows



Source: Bloomberg, AMFI, JM Financial (as on Dec 26th, 2016)

In Dec'16 markets saw net outflow of US$0.86bn from equities while FIIs withdrew US$3.1bn from debt. In Nov'16, domestic mutual funds (DMFs) have garnered funds of US$4.3bn of equity inflows. With the gap between earnings yield and risk-free rates falling to 7 year lows, the flows from domestics could continue if the earnings growth revives in FY18 and inflation outlook remains benign.

Exhibit 43. DMFs continue to attract equity inflows

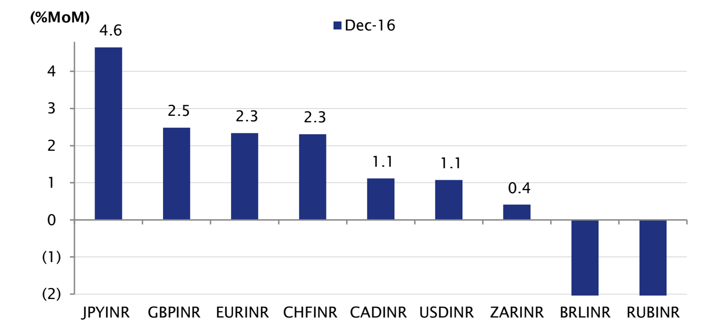
(US$ bn)	2012	2013	2014	2015	YTD-2016
FII	31.4	11.3	42.4	10.8	(3.5)
Equity	24.5	19.8	16.2	3.3	3.3
Debt	6.9	(8.5)	26.3	7.6	(6.7)
DMF equity	(3.0)	(1.9)	8.8	16.7	10.1*

Source: Bloomberg, AMFI, JM Financial, * Jan–Nov for DMF Equity flows (as on 26Dec'16)

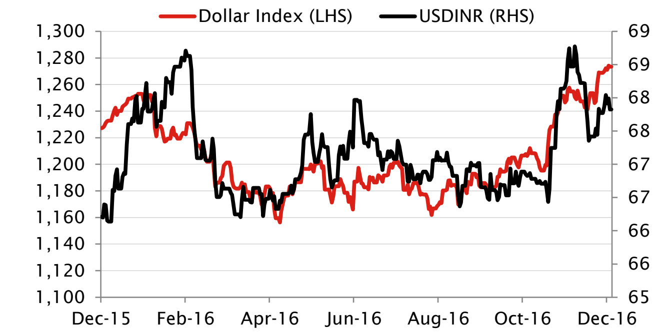
INR remains a stable currency

Exhibit 44. Rupee has appreciated against developed market currencies in Dec, '16

MoM change in INR exchange rate



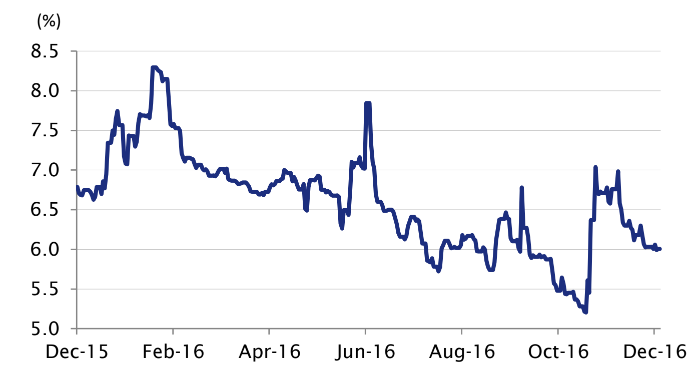
INR stable against a strengthening USD



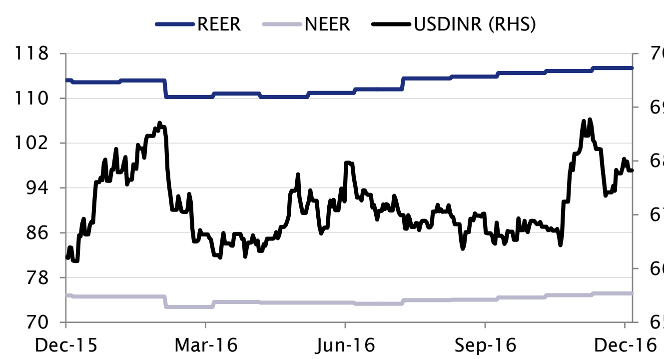
Source: Bloomberg, JM Financial (as on 26Dec'16)

Exhibit 45. REER and NEER valuation remains stable, INR continues to be overvalued

Volatility in INR falling steadily since Nov'16

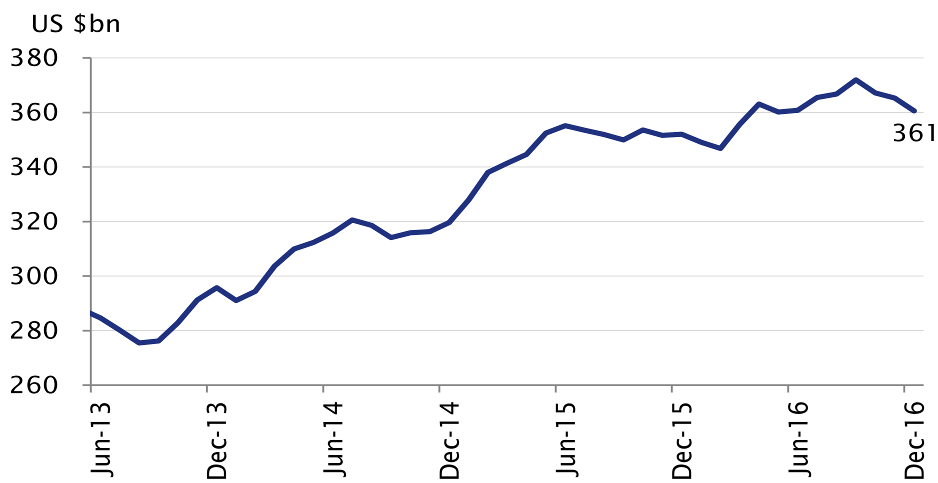


REER and NEER suggestive of an over-valued INR



Source: Bloomberg, JM Financial (as on 26Dec'16)

Exhibit 46. Forex reserves with RBI witness slight dip from highs of Sept '16



Source: Bloomberg, JM Financial

APPENDIX 01: The Taxation Laws (Second Amendment) Bill, 2016—Passed by LS (29Nov'16)

The government has proposed through the amendment a new income disclosure scheme (PMGKY 2016) and also modifications in tax and surcharges on tax evasion. The declarations of undisclosed income made under the Yojana will not be used as evidence under provisions of any other law, except certain laws including: (i) the Prohibition of Benami Property Transactions Act, 1988, (ii) the Prevention of Money Laundering Act, 2002, (iii) the Unlawful Activities (Prevention) Act, 1967, (iv) the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015, and (v) the Special Court (Trial of Offences Relating to Transactions in Securities) Act, 1992.

Exhibit 47. Changes proposed in "The Taxation Laws (Second amendment) Bill, 2016 – Passed by Lok Sabha on 29Nov'16

(A) Levies on undisclosed income as proposed by the bill (PM Garib Kalyan Yojana) – Self declaration scheme		
Levy	**Rate**	Remarks
Tax	30% of undisclosed income	
Cess	33% of the tax levied	
Penalty	10% of undisclosed income	Effective tax of 50%
Deposit in a 4-year non-interest deposit scheme	25% of undisclosed income	25% of undisclosed income is unusable for four years
(B) Change in taxes on unexplained income		
	Current	**Proposed**
Tax	30%	60% of unexplained income
Surcharge	2-15% on tax payable	25% on tax payable
Penalty	-	10% of tax if the assessing authority finds the unexplained income
(C) Income found during search of taxpayer's assets:		
	Current	**Proposed**
Penalty if taxpayer admits holding undisclosed income	10% of undisclosed income	30%
Penalty if taxpayer does not admit holding undisclosed income	20% of undisclosed income	60%

Source: PRS

Other changes in the bill are proposed to increase the penalties and charges and to plug any loopholes in the existing taxation system.

There is an anticipation that some of the people depositing cash in their bank accounts after demonetisation could also try to pass that as income of the current financial year (FY16-17) illegally and pay tax on the normal applicable slab rate (30% + surcharges) and 3% cess.

This bill proposes that with effect from 01Apr'16, in case of unexplained cash/assets/investments etc., a 60% tax + 25% surcharge (on tax payable) or totalling 75% tax would be payable. In addition, 10% of this tax would be levied as penalty, if undisclosed income is not offered in return by the tax payer and detected by tax authorities subsequently (effective: 82% tax on total income).

Tax and penalty provisions for search and seizure have also been made stricter. In case, unexplained assets/cash is found during a search and seizure then apart from the tax and surcharge as proposed earlier, penalty will also be levied, which could be 30% (10% at present), if the taxpayer admits holding undisclosed income and 60% (30%), if the taxpayer does not admit holding undisclosed income.

Appendix II: Benami Transactions in property—likely to be focus area in 2017

The PM has clearly indicated in his speeches about taking continued action on eradication of corruption and detecting/punishment of illegal wealth invested in property would be high in the agenda. In this context, the parliament has already passed a bill—The Benami Transactions Amendment Bill ("Benami") in Aug'16 (effective 01Nov'16). The current bill amends the earlier Benami Transactions Bill of 1988 by enhancing the definition, establishment of implementation procedure and the penalty for entering into benami transactions. A benami property is essentially any property whose legal owner is not its actual owner, is just a front. The key highlights of the Benami Bill are:

(A) Definition of 'Benami' expanded

Under the Benami Act, the term **'property'** has now been defined comprehensively to include not only immovable assets such as land, flat or house, but also movable assets such as gold, stocks, mutual fund holdings and even bank deposits. If the property is sold off, then the proceeds from it too are considered benami.

The exceptions would be property bought in name of spouse/children from known sources of income. A property can also be bought for brother, sister, a lineal ascendant or a lineal descendant, but that must be held jointly with the relative to be excluded under the act. Apart from that, property held by the 'karta' or a member of the Hindu Undivided Family (HUF), the payment for which has been made by known sources of income of the HUF, too will not be treated as benami.

(B) Extension of the legal framework

The current act provides for the implementation machinery to enforce the act, while rules for implementation were not framed earlier. The act gives the initiating officer (Assistant or Deputy Commissioner of Income Tax) the power to enquire into any person, place, documents or property in the course of investigation into any matter related to a benami property transaction. It also mandates officers from different government organisations such as the customs and central excise departments, the narcotics department, RBI, and SEBI to assist the authorities tasked with investigation. If the initiating officer is convinced that one holds a benami property, the person will be issued a notice, and, if required, the property will also be provisionally attached.

(C) Penalties on entering in benami transactions

If the available evidence confirms it, the adjudicating authority (appointed by the centre) will order confiscation of property by the government. Apart from awarding imprisonment of up to seven years to the beneficial owner and the benamidar, a fine of up to a $1/4^{th}$ of the market value of the property can be imposed on all parties who are involved in the deal.

Those providing false information or documents to the authorities may be imprisoned for up to five years and face a fine of up to 10% of the market value of the property involved. Appeals can however, be made against the decision. The act provides for an Appellate Authority, appointed by the central government, for this purpose. Further appeals lie with the relevant High Court, but have to be made within 60 days from the decision of the Appellate Tribunal.

We believe real estate transactions could remain soft till clarity emerges on the rules.

APPENDIX III: Promotion of digital transactions

The government has announced multiple schemes/plans to incentivise small businesses and users for increasing the adoption of digital transactions. One of the measure is to reduce taxes on digital turnover for businesses with a turn-over lower than ₹20mn annually (₹1.6mn/month).

The taxable income for small businesses under presumptive scheme is calculated as 8% of the annual turnover and then tax is paid after the standard deductions. The government has reduced the taxable income rate to 6% for digital transactions. So, a merchant with ₹20mn annual turnover has a tax obligation of ₹267K, if all transactions are done in cash, while it reduces by 46% to ₹144K, if the transactions are done through digital mode. So, any turnover reported through digital mode would result in lower tax incidence to the small businesses.

The government has also launched new schemes to incentivise customers/merchants to use digital channel through schemes such as Lucky Grahak Yojana and DigiDhan Vyapar Yojana.

Exhibit 48. Multiple schemes to promote increase of digital transactions

Scheme	Details	Applicability	Target
Lucky Grahak Yojana	Every day 15,000 people would get ₹1,000 in their account, winners are chosen by a lucky draw. The transactions (of ₹50-3,000) need to be done through the Rupay card, UPI apps, USSD and AEPS to be eligible for the lucky draw. Payments done through digital wallets (Paytm, FreeCharge etc.) are not eligible for lucky draw. Apart from daily prices, weekly prizes of ₹0.1mn, ₹10K and ₹5K will be given. Mega prizes of ₹2.5/5/10mn on 14Apr'17 would be given to three winners.	This is applicable for transactions between 8Nov'16 to 13Apr'17	To improve digital transactions in lower classes.
DigiDhan Vyapar Yojana	Similar criteria as earlier on transactions. A total of 7,000 merchants per week could get rewards of ₹2,500/5,000/50,000 from 25Dec'16 to 14Apr'17. A mega draw on 14Apr'17 will provide rewards worth ₹0.5/2.5/5mn.	This is applicable for transactions between 8Nov'16 to 13Apr'17	To improve digital transactions among merchants.

Source: Company, JM Financial, Note: UPI - United Payments Interface, AEPS - Aadhaar Enabled Payment System, USSD - Unstructured Supplementary Service Data

APPENDIX I

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Rating	**Meaning**
Buy	Total expected returns of more than 15%. Total expected return includes dividend yields.
Hold	Price expected to move in the range of 10% downside to 15% upside from the current market price.
Sell	Price expected to move downwards by more than 10%

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