28th Jun 2024

What We Are Reading - Volume 2.160

The enclosed 2.160 version includes interesting set of reports starting with Motilal's report on India Strategy – Indian PSUs – Back with a vengeance, Avendus Spark's India Strategy report, Kotak Securities India Strategy report – What will break the market?, ICICI Securities report on Indian Economy, Nomura's report on Indian Banks, Kotak's India Strategy – Where do we go next?, IIFL Securities report on India Telecom and lastly Harding Loevner – Fundamental Thinking - 'Wegovy and the Topsy-Turvy World of Weight-Loss Drugs'.

June 2024

India Strategy

BSE Sensex: 77,338 **Nifty-50: 23,516**

Refer to our strategy note on Corporate profit to GDP – Rebounds to a 15-year high!

Indian PSUs – Back with a vengeance!

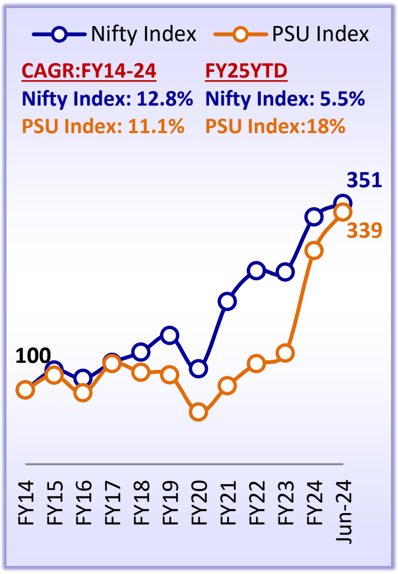
Indian PSUs: Earnings momentum fueling the outperformance!

- **Rebounding in style…:** After a decade of underperformance, the Indian PSUs have made an admirable comeback. They have marked FY24 as the year of clear outperformance. This was evident in the sharp run-up of PSU companies and their index outperformance compared to the Nifty-50 in the previous year.
- **…and galloping ahead:** Since our previous report on PSUs, released on 21st Dec'22, the PSU index has surged 113% to date. Conversely, the market capitalization of the BSE PSU Index has galloped ~2.1x to INR69.1t from INR32.5t between Dec'22 and Jun'24. The BSE PSU Index P/E ratio has expanded to 12.8x from 8.7x during the same period.
- As FY24 came to an end, we are revisiting our findings on Indian PSUs.

Strong business narratives and growing order book driving a rerating

- After a period of weak performance at the start of the past decade, PSUs made a comeback and reported a strong revival in their profits in the previous five years.
- The government's infrastructure and capex push, which had gained momentum post-pandemic, along with cleaner balance sheet, improved governance, margin tailwinds for commodities, and burgeoning order books, have continued to drive the PSU outperformance and their rerating, in our opinion.
- During FY19-24, PSU earnings reported a 33.8% CAGR, outperforming that of the Private Sector, which posted an 18.6% CAGR over the same period. The share of PSUs in the profit pool expanded to 36% in FY24 after hovering in the 17-30% range during the past few years. **Further, the earnings of PSUs during FY24** witnessed a spectacular growth of 45% YoY.
- **Notably, the loss pools of PSUs have reduced consistently over the last five years.** The contribution of loss-making companies (accounting for 1% of profit pool as of FY24 vs. 45% in FY18) has dwindled over the past few years.
- **The RoE of the PSU universe also jumped to 17.6% in FY24 from the lows of 5.2% in FY18.**
- **Sharp underperformance of the past continues to catch up:** The PSU index posted a CAGR of 9.6%, underperforming Nifty-50 (12% CAGR) during Jun'14-Jun'24. Notably, the majority of the gains for PSUs have occurred in the past four years only. The BSE PSU index reported a 9% compounded decline during Jun'14-Jun'20, but clocked an impressive CAGR of 45% during the past four years (Jun'20-Jun'24). During FY24, the PSU index returns of +92.4% significantly outperformed the benchmark (+28.6%). Further, the outperformance continues as of FY25YTD; the PSU index is up by 18% vs. the benchmark (+5.5%).
- **A steep fall and then a laudable rise in the market cap share:** Notably, the market cap share of PSUs in India, which dropped significantly to 10.5% in FY22 from 20.8% in FY14, has since recovered and currently stands at 17.5%. Over a similar period, India's market cap skyrocketed to INR389t in FY24 from INR69t in FY14 and currently it stands at INR440t. During FY14-24, PSUs' market cap surged to INR66t (INR77t as of Jun'24) from INR14t, while the private sector's market cap catapulted to INR323t (INR363t as of Jun'24) from INR55t.

PSU index has outperformed the Nifty in FY25YTD



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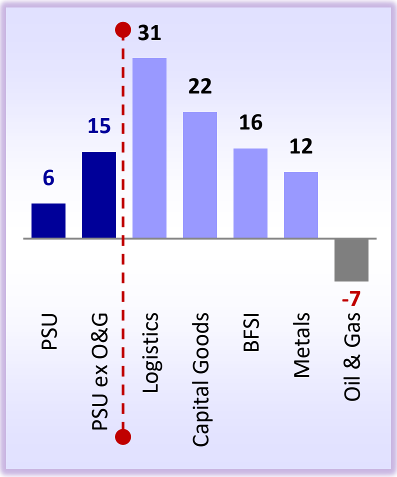
PAT growth expected over FY24-26 (%)



Healthy outlook to continue!

- Fundamentally, India is witnessing its own mini-Goldilocks moment with excellent macros (GDP growth of 8.2% in FY24 on the back of ~7% growth in FY23, inflation at ~5%, both current account and fiscal deficits well within tolerance band, stable currency, etc.), robust corporate earnings (Nifty ended FY24 with 25% earnings growth and FY25/26 earnings are likely to post 14-15% CAGR), focus on manufacturing, capex and infrastructure creation, and valuations at ~20x one-year forward earnings.
- The political stability with Modi 3.0 augurs well for the economy and capital markets as it provides the necessary stability and continuity in policy-making which will likely continue pushing its economic agenda.
- This verdict and the consequent political stability and continuity in policy-making will act like an icing on the cake and keep India as the cynosure of all eyes, in our view.
- For our MOFSL Coverage PSU Universe (~55% of Indian PSU Mcap), we estimate that the FY24-26 PAT CAGR is likely to moderate to 6%, mainly due to conservative margin assumptions for O&G. Conversely, the earnings growth for other sectors continues to remain strong. Ex O&G, we estimate a PAT CAGR of 15% for MOFSL Coverage PSU Universe. For the said Universe, incremental profits would be contributed by BFSI (120%), followed by Metals (22%). O&G is likely to drag the earnings CAGR with an adverse contribution of -47% to overall profitability.
- **The road ahead:** As we look forward, the profitability of PSUs is likely to improve notably across domestic and global cyclicals, with a sharp turnaround in the fortunes of PSU Banks driving the overall trend. Higher commodity prices over the last two years have strengthened the P&L and balance sheets of Metals and O&G PSUs. The government's emphasis on localization, increased capex, and 'Make-in-India' in the defense sector has catalyzed the improvement in the fortunes of Industrial PSUs. Hence, we expect the recovery in PSUs' contribution to earnings and market capitalization to continue.
- **Preferred PSU Ideas:** SBI, Coal India, GAIL, HPCL, and Bank of Baroda.

Exhibit 1: Preferred PSU's valuations

	Mkt Cap	CMP	EPS (INR)			EPS CAGR (%)	PE (x)			PB (x)			ROE (%)		
Company	(USDb)	(INR)	FY24	FY25E	FY26E	FY24-26	FY24	FY25E	FY26E	FY24	FY25E	FY26E	FY24	FY25E	FY26E
State Bank	90.4	845	75.2	89.4	104.7	18.0	10.0	9.4	8.1	1.7	1.6	1.4	18.8	18.8	18.5
Coal India	36.4	489	60.7	55.9	66.0	4.3	7.1	8.7	7.4	3.2	3.0	2.5	45.2	34.6	34.1
Bank of Baroda	17.8	287	34.4	39.4	45.1	14.6	7.7	7.3	6.4	1.3	1.2	1.0	17.9	17.7	17.6
GAIL	17.5	222	13.7	13.1	16.5	9.8	13.2	16.9	13.4	1.8	2.0	1.9	15.0	12.9	15.0
HPCL	9.0	530	112.9	71.9	72.1	-20.1	4.2	7.4	7.4	1.4	1.4	1.2	40.4	20.2	17.6

Source: Company, MOFSL

Note: Exhibit data is sourced from Capitaline, Bloomberg and MOFSL research database. Prices as of 18th June'24 closing.

Insightful trends

Exhibit 2: PSUs witnessing a smart recovery after a dull decade

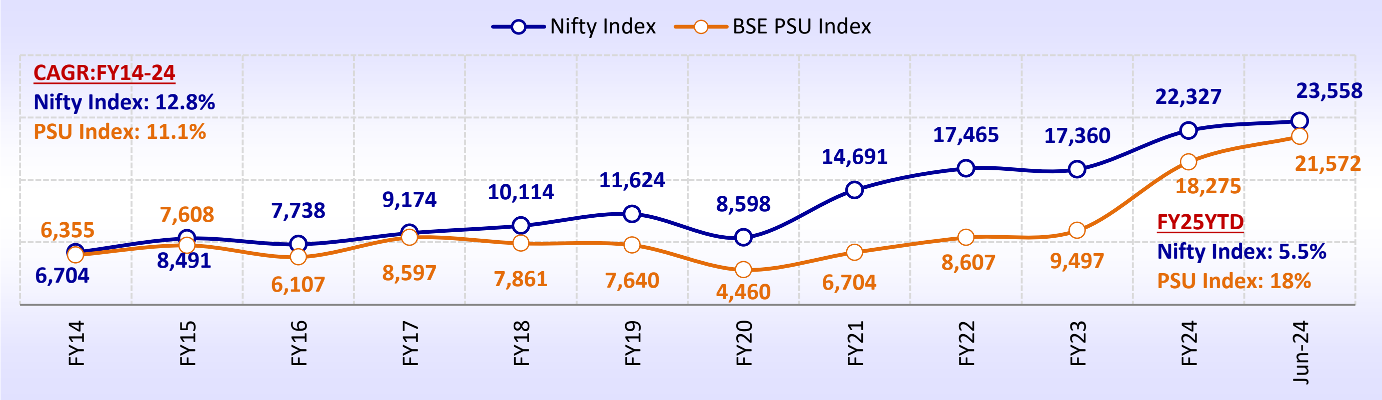


Exhibit 3: BSE PSU's market cap remained nearly flat during FY09-20, while it surged 6.1x in the last four years (since Mar'20)

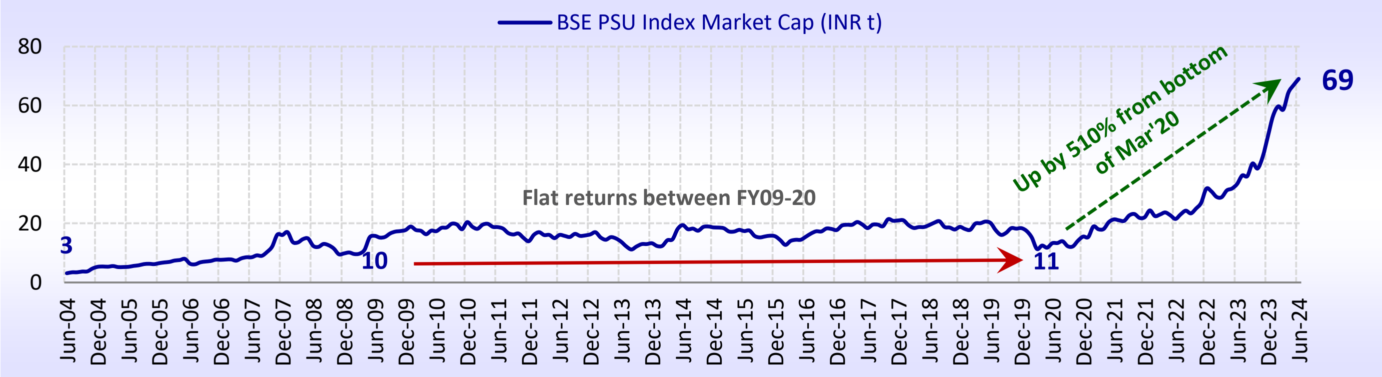


Exhibit 4: PSU's share in the Indian market cap exhibiting an uptick from the FY22 lows

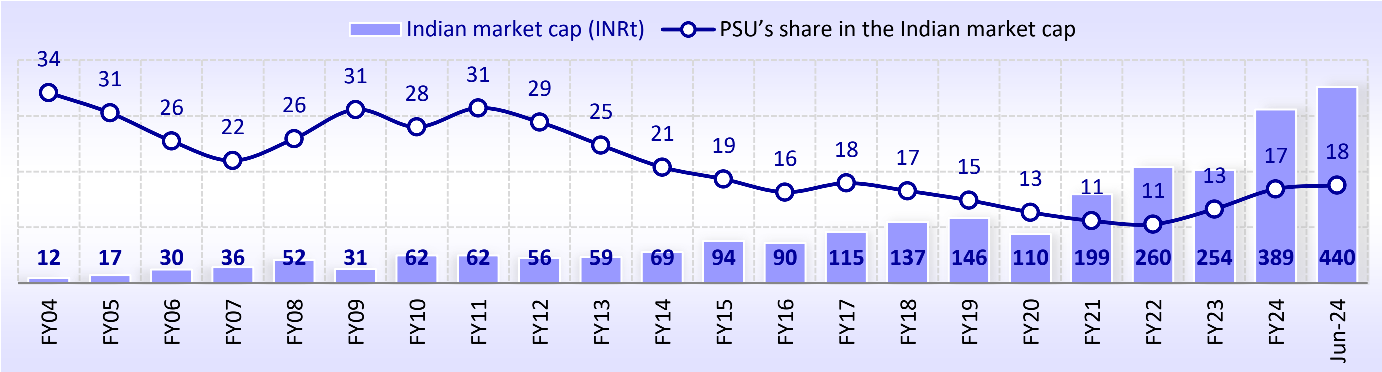


Exhibit 5: PSUs' corporate earnings expanded faster than that of the Private sector in Phase 2

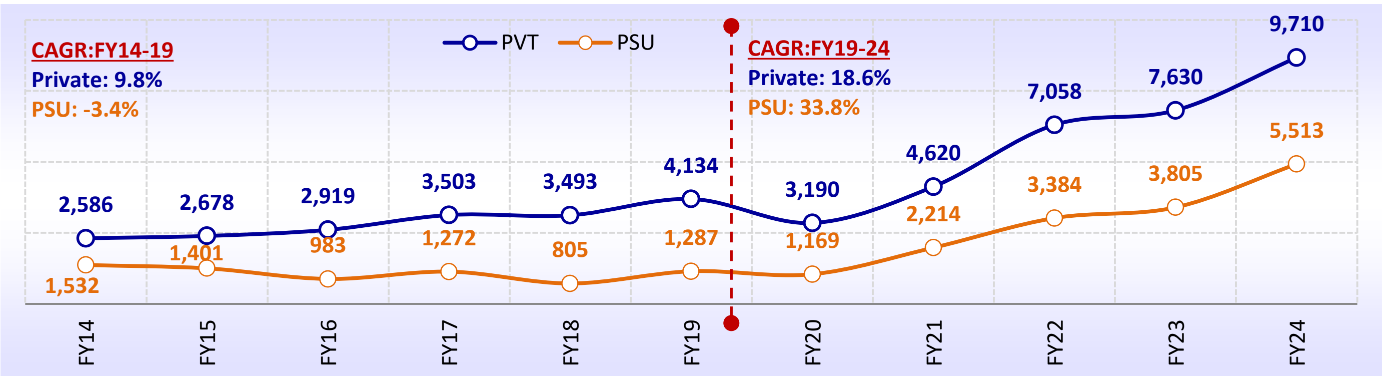


Exhibit 6: PSU's market-cap-to-GDP trend at a 13-year high

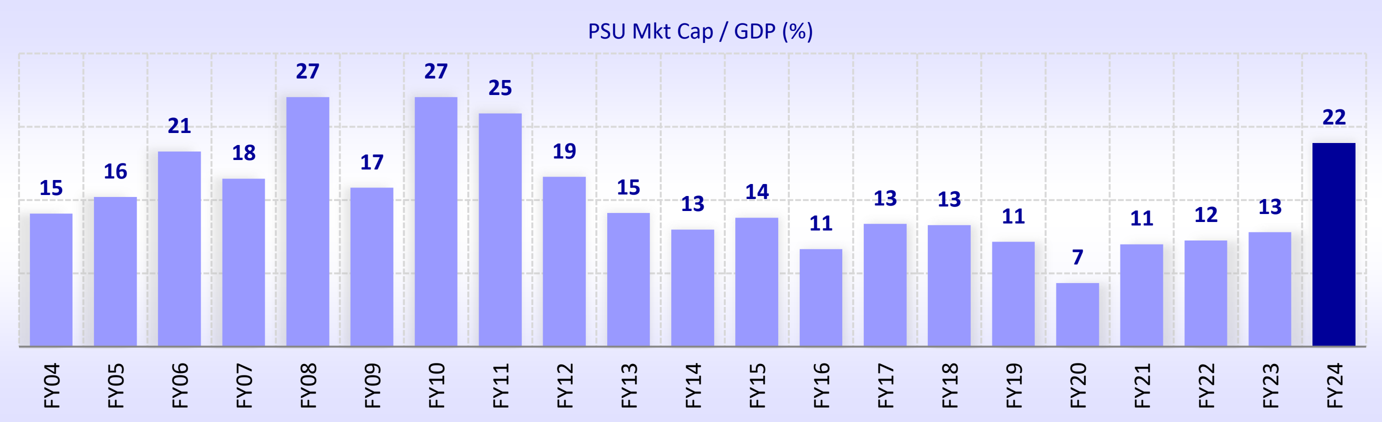


Exhibit 7: Profit mix between Private and Public sectors – PSU's regaining share!

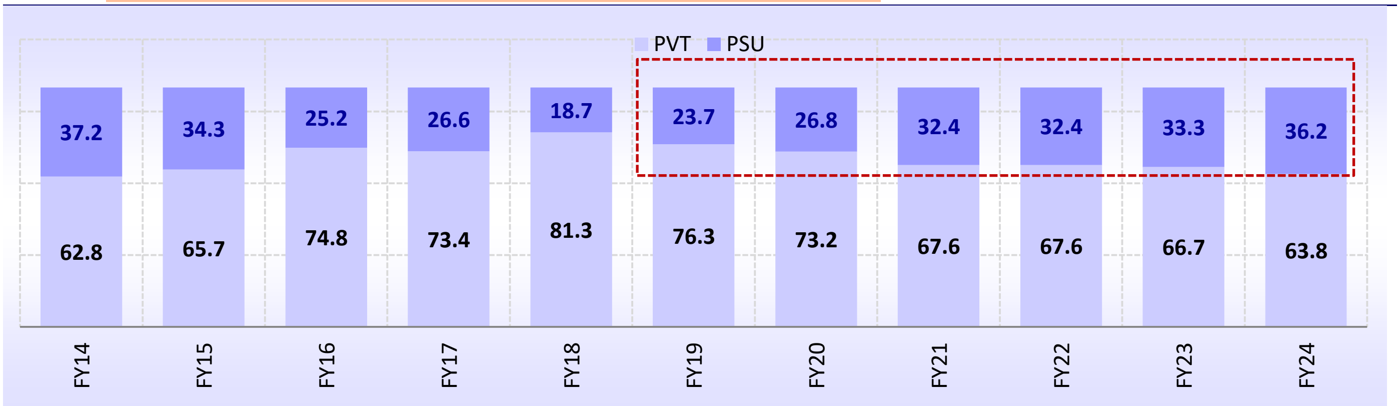


Exhibit 8: Loss pools of PSUs witnessing continuous reduction from the FY18 highs

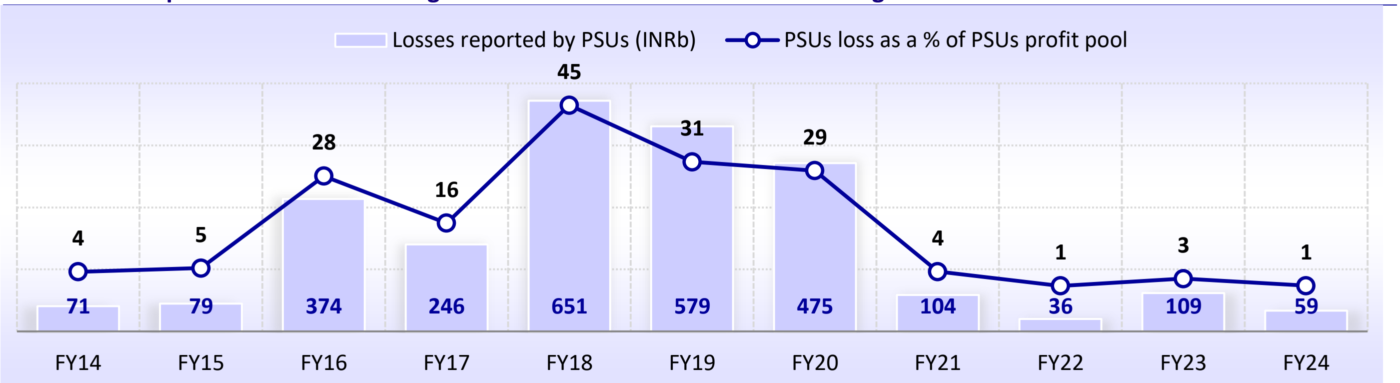
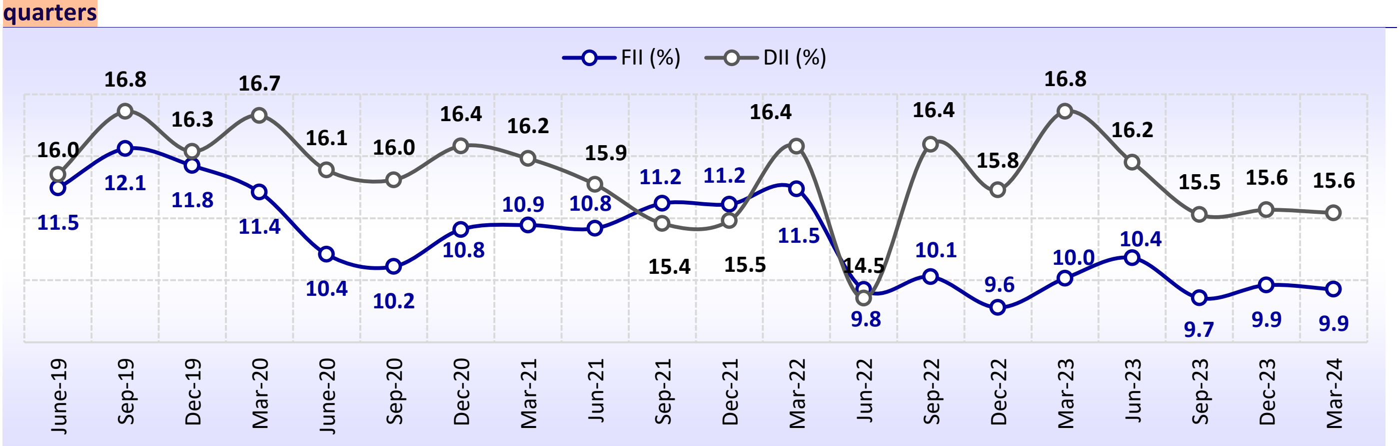
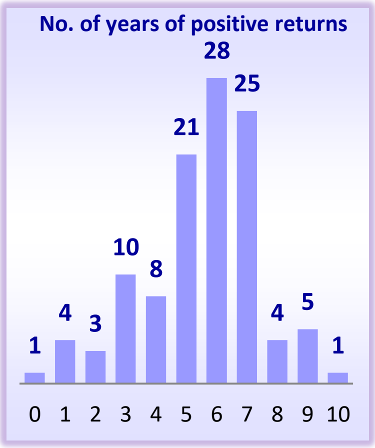


Exhibit 9: PSU companies – FII vs. DII holding trend (%): Institutions' holding in PSUs have remained constant since past few quarters



Two-thirds of the PSU Universe have generated 5-7 years of positive returns



Key insights from the report

- **Decoding Indian PSUs:** In this report, we analyze Indian PSUs' journey over the past decade as well as their future prospects. We have selected all the listed PSUs for analysis purpose. Further, to account for future earnings growth, we have taken our MOFSL PSU Coverage as a proxy, which constitutes 55% of the overall listed PSU Universe.
- **Market cap scorecard:** PSUs' share in India's market cap dropped significantly to 10.5% in FY22 from 20.8% in FY14, but has since recovered and currently stands at 17.5%. Over a similar period, India's market cap skyrocketed to INR389t in FY24 from INR69t in FY14 and currently it stands at INR440t. During FY14-24, PSUs' market cap surged to INR66t (INR77t as of Jun'24) from INR14t, while the private sector's market cap catapulted to INR323t (INR363t as of Jun'24) from INR55t.
- **The tale of "sweet and sour" returns:** Around two-thirds of the listed PSU companies have clocked 5-7 years of positive returns since FY14. The positive breadth improved and stood at 95% in FY24, after a weakened trend during FY18-FY20. Of the top 25 stocks, 13 belong to the BFSI space.
- **Volatilities in PSU banks hurt PSU profits over FY14-24:** Most of the Indian PSUs operate in deep-cyclical industries (e.g., Metals, O&G, and Financials), which inherently results in volatile and cyclical profitability and market capitalization performance. A major part of the FY14-24 decade was spent cleaning up the balance sheets of Financials, which took its toll on the overall PSU profits as PSU Banks formed one-third of the profit pool of Indian PSUs. This, along with many other macro disruptions, kept the PSU profit pool suppressed over FY14-20.
- **PSU banks compensated in the second half:** The second half performance was fueled by a sharp 4.3x surge in PSU profits to reach INR5.5t from INR1.3t over FY19-24. About 68% of these incremental profits came from BFSI alone, while Oil & Gas and Metals contributed 21% and 5%, respectively. Profits of PSU Banks surged to INR1.6t in FY24 vs. a reported loss of INR0.3t in FY19. The ROE of Indian PSUs improved notably to 17.6% in FY24 from a mere 7.7% in FY19.
- **Expect healthy earnings ahead:** For our MOFSL Coverage Universe of PSU stocks (~55% of Indian PSU Mcap), we estimate that the FY24-26 PAT CAGR is likely to moderate to 6%, mainly due to conservative margin assumptions for O&G. Conversely, the earnings growth for other sectors continues to remain strong. Ex O&G, we estimate a PAT CAGR of 15% for MOFSL Coverage PSU Universe. For the said Universe, incremental profits would be contributed by BFSI (120%), followed by Metals (22%). O&G is likely to drag the earnings CAGR with an adverse contribution of -47% to overall profitability.
- **Valuations – Continuous re-rating trends seen across PSUs:** The BSE PSU index experienced continued valuation expansion and is trading at 12.8x 12-month forward P/E and 2x 12-month forward P/B as of Jun'24, up 112% and 187% from the FY20 lows, respectively. Given the continued earnings momentum and guidance, we believe the valuation premiums for PSUs are expected to sustain in the near term.

Market cap witnesses continuous gains with sharp rerating trends

- PSUs' share in India's market cap dropped significantly to 10.5% in FY22 from 20.8% in FY14, but has recovered since then and currently stands at 17.5%. Over a similar period, India's market cap skyrocketed to INR389t in FY24 from INR69t in FY14 and currently stands at INR440t. During FY14-24, PSUs' market cap surged to INR66t (INR77t as of Jun'24) from INR14t, while the private sector's market cap catapulted to INR323t (INR363t as of Jun'24) from INR55t.
- Among the top 20 PSUs by market cap, IOB, Bharat Electronics, Union Bank and PFC were the top 'rank gainers' during the past 10 years, while BPCL, Coal India, GAIL, and ONGC were the top losers.
- In the last one year, REC, IRFC, PFC, and Hindustan Aeronautics were the top rank gainers, while BPCL, SBI Life Insurance, BOB, and Canara Bank were the top losers, among the top 20 PSU stocks by market cap.
- As profitability has improved, valuations of the PSU companies have also experienced steady expansion in the past one year. They have been trading at a five-year high level.

Exhibit 10: PSU's share in the Indian market cap sees continuous gains

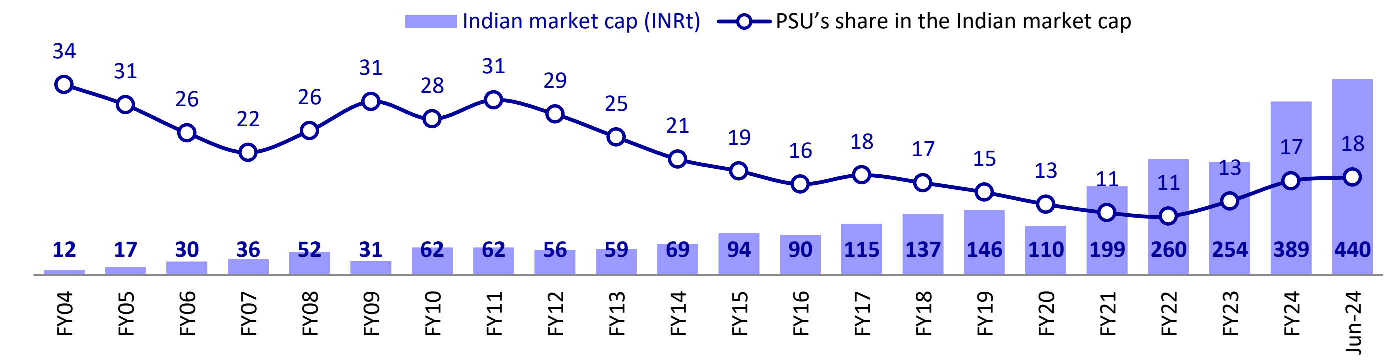


Exhibit 11: Top-20 stock – market cap rank change

	Mkt Cap (INRb)								Rank in PSU Universe							
Company Name	**2014**	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**	**Jun'24**	**2014**	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**	**June'24**
St Bk of India	1,432	2,863	1,758	3,252	4,403	4,674	6,717	7,538	3	1	1	1	1	1	1	1
Life Insurance						3,382	5,785	6,680						2	2	2
Hind. Aeronautics		237	178	333	497	913	2,225	3,701		25	24	21	14	9	8	3
NTPC	989	1,339	833	1,032	1,309	1,699	3,258	3,586	4	5	4	4	4	4	4	4
O N G C	2,727	2,007	859	1,285	2,062	1,900	3,370	3,469	1	2	3	2	2	3	3	5
Power Grid Corpn	550	1,036	832	1,128	1,513	1,574	2,577	3,085	7	6	5	3	3	5	6	6
Coal India	1,818	1,459	863	804	1,128	1,317	2,673	3,013	2	4	2	9	5	6	5	7
I O C L	677	1,532	769	864	1,120	1,101	2,369	2,395	5	3	6	8	7	8	7	8
Bharat Electron	92	227	181	305	514	713	1,473	2,326	27	26	23	23	13	12	11	9
I R F C				300	280	348	1,861	2,296				25	26	25	9	10
Power Fin. Corpn.	255	325	243	300	297	401	1,288	1,675	15	16	16	24	24	22	15	11
Bank of Baroda	310	341	247	383	577	873	1,366	1,485	11	15	14	14	12	10	13	12
SBI Life Insuran		580	641	881	1,121	1,101	1,500	1,476		9	8	6	6	7	10	13
GAIL (India)	477	783	345	602	691	692	1,191	1,461	9	8	10	10	10	14	16	14
Punjab Natl.Bank	269	439	218	384	386	514	1,369	1,415	14	10	17	13	20	16	12	15
REC Ltd	226	302	175	259	243	304	1,187	1,390	16	20	25	28	31	32	17	16
B P C L	333	860	686	928	779	746	1,307	1,369	10	7	7	5	9	11	14	17
I O B	63	132	117	263	344	426	1,134	1,260	36	34	29	27	23	20	19	18
Union Bank (I)	86	168	98	218	265	454	1,171	1,123	29	31	31	33	28	19	18	19
Canara Bank	122	220	93	251	413	516	1,054	1,105	20	28	34	30	17	15	20	20

The tale of "sweet and sour" returns

- Around two-thirds of listed PSU companies have clocked 5-7 years of positive returns since FY14.
- The positive breadth improved and stood at 95% in FY24, after a weakened trend during FY18-FY20.
- Of the top 25 stocks, 13 belong to the BFSI space. Over FY14-24, one stock (IGL) delivered nine years of positive returns. In addition, five stocks (GAIL, Gujarat State Petronet, Petronet LNG, GIC Housing Fin, and Elnet Technologies) delivered eight years of positive returns over the said period.
- About 52% of the listed PSU stocks outperformed the BSE PSU index in FY24, with 55 of 110 listed PSUs more than doubled during the year. Notably, only five stocks reported negative returns in FY24.

Exhibit 12: Two-thirds of the PSU Universe have generated 5-7 years of positive returns

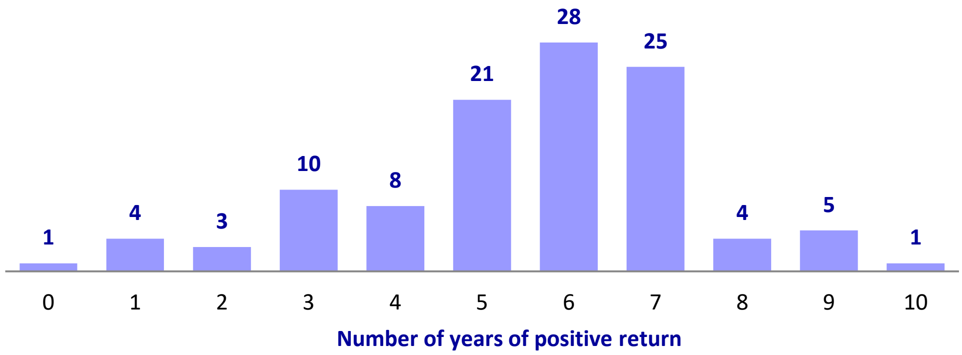


Exhibit 13: % of stocks delivering positive returns

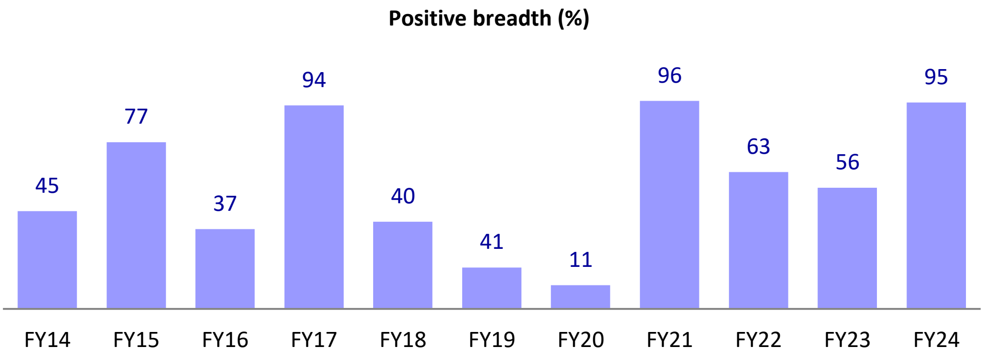
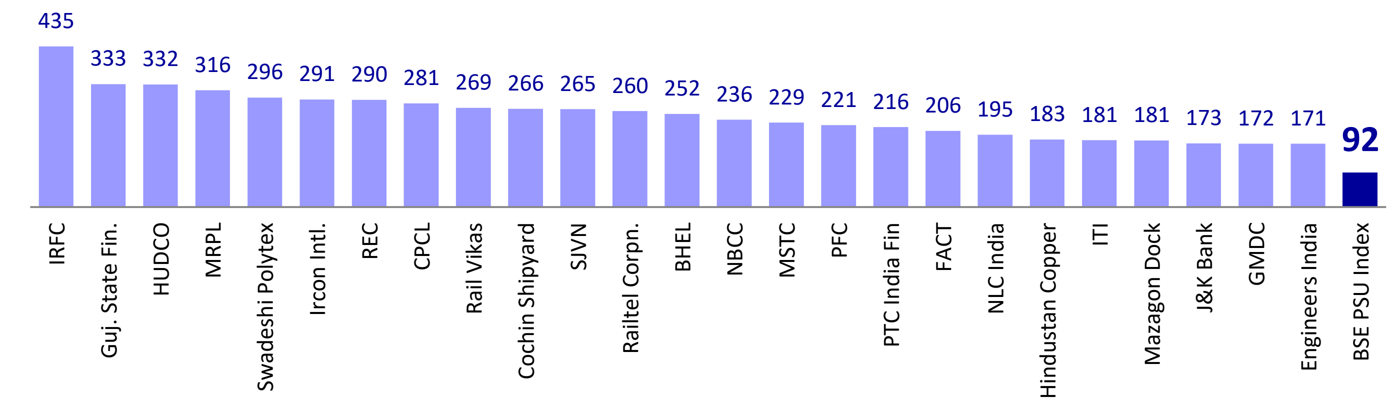


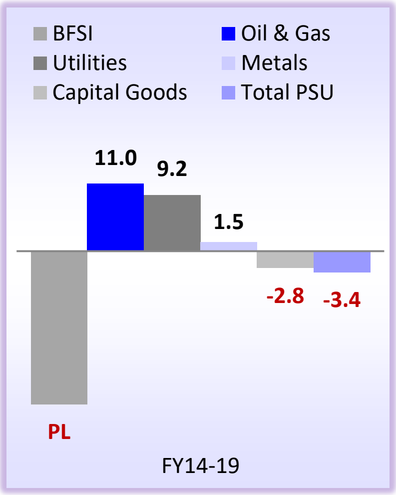
Exhibit 14: Trends in top-25 PSU sectoral performance (%) — 13 of the top 25 stocks belong to the BFSI space

	Price Performance YoY (%)											MCap
Company	**FY14**	**FY15**	**FY16**	**FY17**	**FY18**	**FY19**	**FY20**	**FY21**	**FY22**	**FY23**	**FY24**	**(INR b)**
SBI	-7	39	-27	51	-15	28	-39	85	35	6	44	6,717
LIC of India											71	5,785
ONGC	2	-4	-30	29	-4	-10	-57	50	60	-8	77	3,370
NTPC	-16	23	-13	29	2	-4	-38	26	27	30	92	3,258
Coal India	-7	26	-19	0	-3	-16	-41	-7	40	17	103	2,673
Power Grid Corp.	-1	38	-4	42	-2	2	-20	36	34	4	64	2,577
IOCL	-1	32	7	97	-9	-8	-50	12	30	-2	115	2,369
Hind.Aeronautics						-37	-25	87	49	84	144	2,225
IRFC									-7	24	435	1,861
SBI Life Ins.						-14	11	37	27	-2	36	1,500
Bharat Elect.	0	192	9	28	0	-34	-20	68	69	39	107	1,473
PNB	4	-3	-41	78	-37	0	-66	13	-4	33	166	1,369
BOB	6	13	-10	18	-18	-9	-58	38	51	51	57	1,366
BPCL	22	76	11	44	-1	-7	-20	35	-16	-4	75	1,307
PFC	7	41	-37	70	-41	43	-25	23	-1	35	221	1,288
GAIL	18	3	-8	41	16	6	-56	77	15	1	72	1,191
REC	10	45	-50	118	-31	22	-42	48	-6	25	290	1,187
Union Bk	-37	14	-16	19	-40	1	-70	18	14	72	131	1,171
IOB	-22	-17	-28	-12	-36	-16	-51	126	14	24	166	1,134
Canara Bk	-31	39	-48	64	-13	10	-69	68	49	25	104	1,054
NHPC	-4	4	21	33	-14	-10	-19	23	14	45	123	900
IDBI Bk	-18	9	-2	8	-4	-35	-59	100	11	5	80	870
BHEL	11	19	-52	43	-25	-8	-72	134	1	42	252	861
IRCTC								79	121	-26	62	744
Indian Bk	-34	50	-39	167	7	-7	-85	170	32	87	81	701
BSE PSU Index	**-2**	**20**	**-20**	**41**	**-9**	**-3**	**-42**	**50**	**28**	**10**	**92**	**58,661**
Nifty-50	**18**	**27**	**-9**	**19**	**10**	**15**	**-26**	**71**	**19**	**-1**	**29**	

Exhibit 15: Top-25 PSU stocks – FY24 performance (%)



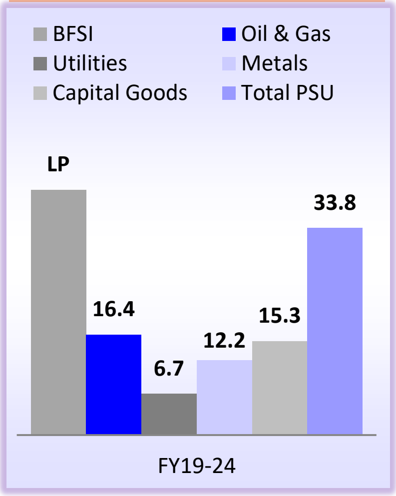
PAT CAGR (%) over FY14-19 Phase



Analyzing PSUs' profit pool during 2014-24

- After a muted performance over FY14-20, when the earnings CAGR of the listed universe stood at 0.9% and absolute profits expanded to INR4.4t in FY20 (vs. INR4.1t in FY14), corporate earnings have accelerated sharply and posted a 37% CAGR over FY20-24 to reach INR15.2t in FY24 from a mere INR4.4t in FY20.
- Notably, the listed PSU Universe reported a 4.4% decline over FY14-20 and its profits contracted to INR1.2t in FY20 from INR1.5t in FY14. However, the PSUs have posted a strong 47% profit CAGR over FY20-24 to reach INR5.5t in FY24 as against Private Sector Universe CAGR of 32% to reach INR9.7t in FY24.
- BFSI's contribution to the PSU profit pool in FY23 was 54%, which moderated to 48% in FY24. The same hovered ~35% over the last few years. However, O&G's contribution jumped sharply to 31% in FY24 from 20% in FY23. Further, Utilities' share dipped to a new low of 8% in FY24.
- We note that there were two distinct phases of growth: a) **Phase 1 (FY14-19),** which clocked a muted PAT CAGR; and **Phase 2 (FY19-24),** which reported a higher PAT CAGR.

PAT CAGR (%) over FY19-24 Phase



A tale of two distinct phases of growth

Phase 1 (2014-19): The period of moderation…

- During this five-year period, corporate profits grew at a slower pace due to multiple macroeconomic headwinds and high interest rates.
- Listed Universe profit registered a 5.7% CAGR during Phase 1, primarily fueled by Technology and O&G sectors.
- PSU Universe profit declined 3.4% during Phase 1 led by BFSI, and Capital Goods sectors. BFSI recorded a loss of INR189b in FY19 vs. a profit of INR527b in FY14 due to asset quality clean-up, and steep reduction in its share in the PSU profit pool to -15% in FY19 from 34% in FY14.
- Further, Capital Goods weakened notably (posting a 2.8% compounded decline).
- Notably, O&G and Utilities' contributions to PSU profit pool surged to 62% and 25% in FY19 from 31% and 13% in FY14, respectively.

Phase 2 (2019-24): …followed by resurgence

- Over this period, corporate profit growth across sectors bounced back smartly, propelled by tax rate cuts, a reduction in banking sector NPAs, and post-Covid tailwinds after a weak two-year base.
- Listed Universe profit posted a stronger 22.9% CAGR in Phase 2 to reach INR15.2t.
- The listed PSU Universe recorded a stronger profit CAGR of 33.8% during Phase 2 to reach INR5.5t in FY24 vs. 18.6% CAGR of the Private sector, reaching INR9.7t in FY24.
- Financials continued to drive PSU profit growth followed by Oil & Gas, and Metals. BFSI continued to witness strong profit growth, contributing 48% to the overall PSU Universe profit in FY24.
- O&G recorded a decent growth, with its earnings recording a 16.4% CAGR over FY19-24, and its share in the profit pool contribution expanding considerably to 31% in FY24 from a low of 20% in FY23.
- During **FY24**, PSUs have continued to report strong earnings growth of 45% YoY, surpassing the Private sector earnings growth of 27%.

PSUs out of the woods | Loss pools melt away

- The BSE PSU index performance remained relatively muted during Phase 1 (FY14-19), reporting a 3.8% CAGR and underperforming Nifty (11.6%) over the same period.
- During Phase 2 (FY19-24), the BSE PSU Index performance was better than Nifty with 19.1% CAGR (vs. 13.9% of Nifty).
- However, PSUs' profits (at 33.8% CAGR) recovered sharply and outperformed those of the Private Sector (at 18.6% CAGR) over the last five years (FY19-24).
- **PSUs' losses that had spiked by FY18 have consistently narrowed over the last four years:** The contribution of loss-making companies (reduced to 1% of profit pool in FY24 as against 45% in FY18).

Exhibit 16: Loss pools of PSUs that spiked during FY15-18, have consistently reduced over the last four years

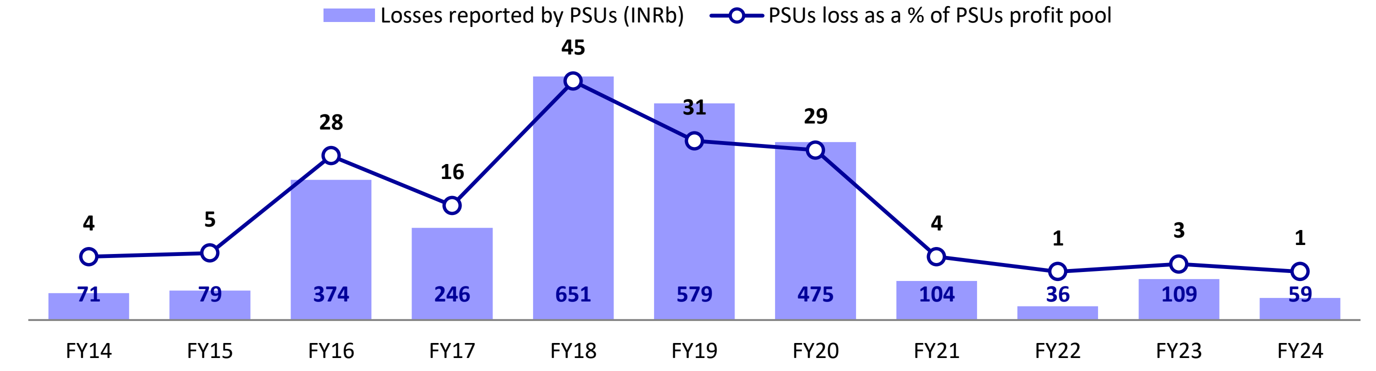


Exhibit 17: PSU's PAT jumped 4.3x vs. 2.4x gain in the PSU index during FY19-24

FY14-24: PAT grew by 14% Vs. 11% gain of PSU Index

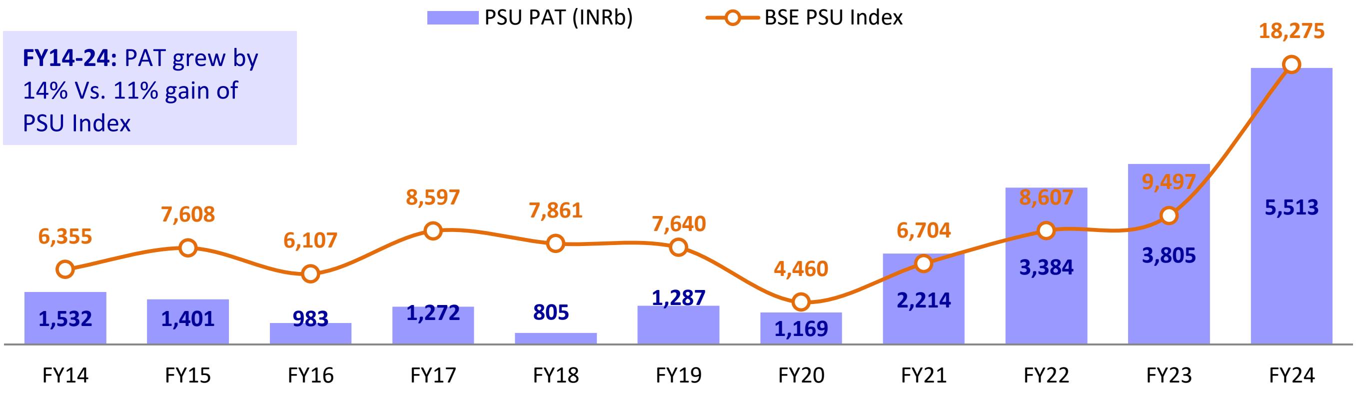


Exhibit 18: PSUs' corporate earnings expanded faster than that of the Private sector in Phase 2

PAT of PSU corporates surged 4.3x over FY19-24, clocking a CAGR of 33.8% vs. Private Sector CAGR of 18.6%

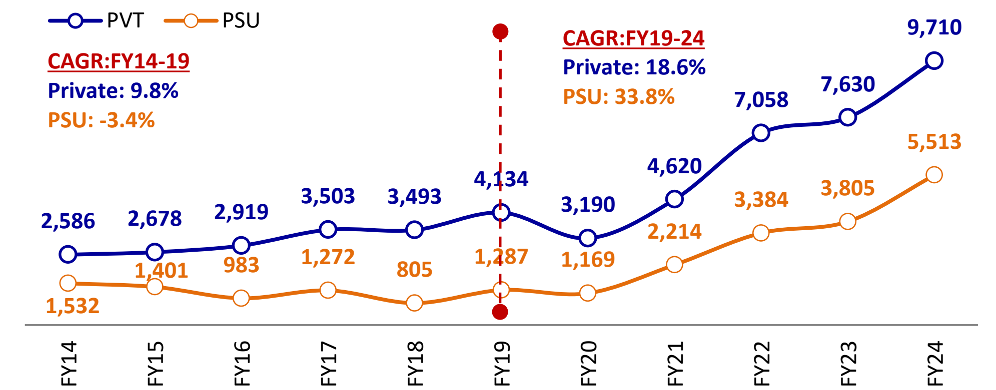


Exhibit 19: PSU Universe profit declined 3.4% during Phase 1 due to BFSI, and Capital Goods sectors

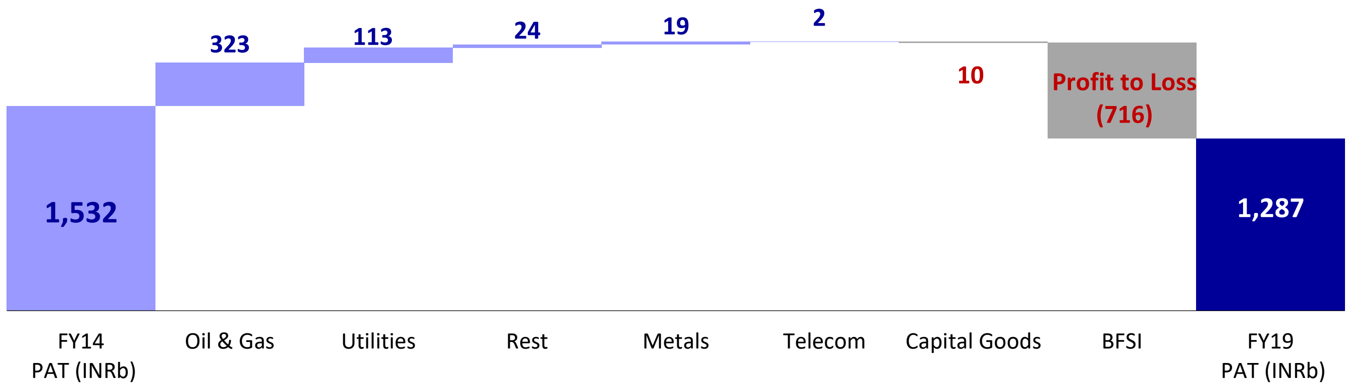


Exhibit 20: PSU Universe reported a stronger growth during Phase 2; BFSI drove profit growth of PSUs followed by Oil & Gas, and Metals

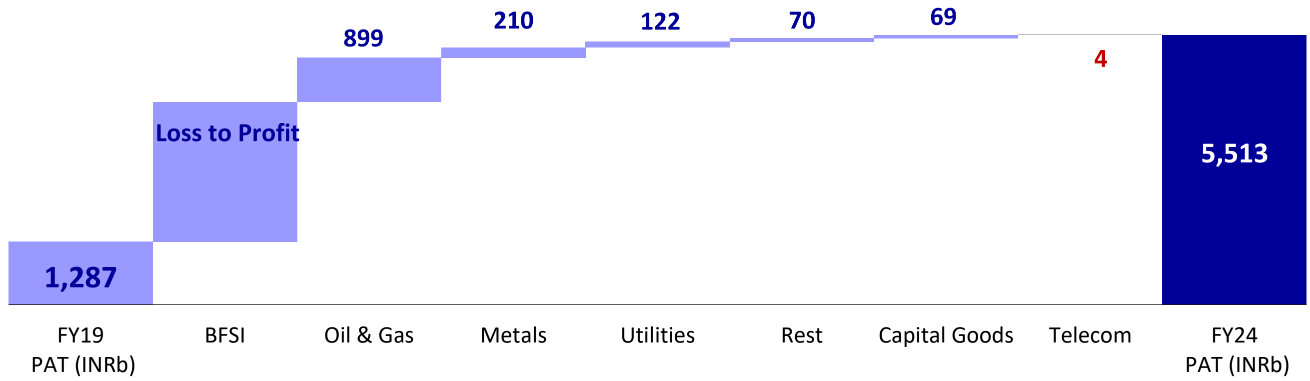


Exhibit 21: PSU Universe profit jumped in FY24 fueled by O&G, BFSI, and Metals sectors

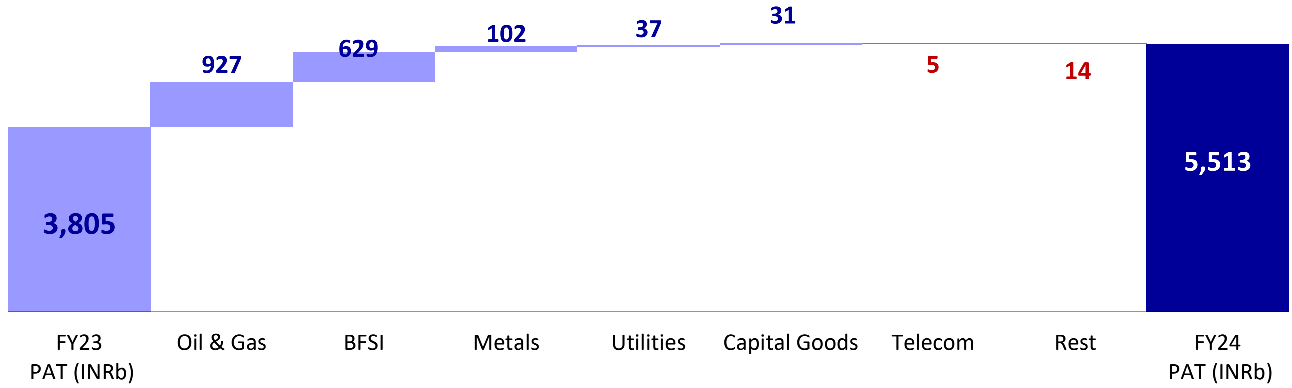


Exhibit 22: Profit mix between Private and Public sectors – PSU's regaining share!

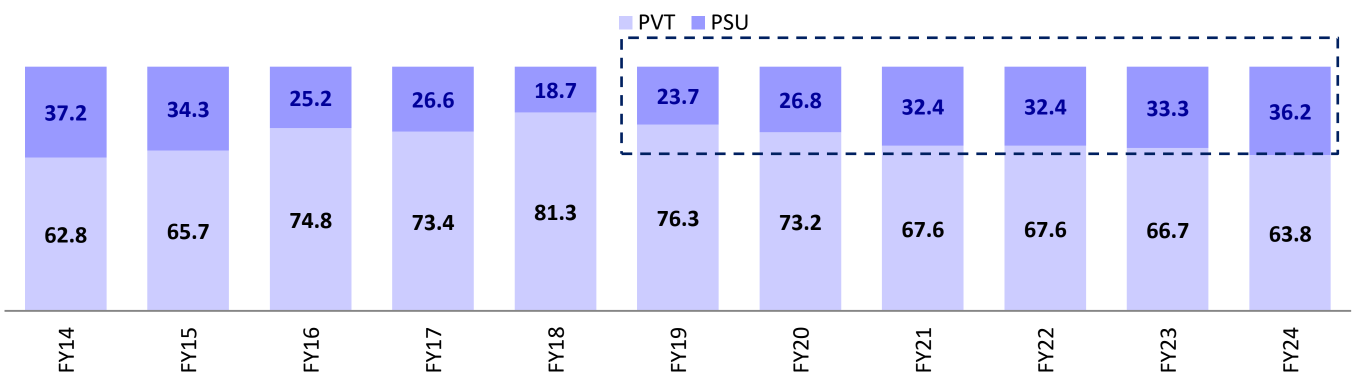


Exhibit 23: Trend in RoE of the PSU Universe (%) – Seeing continuous recovery from the FY18 lows

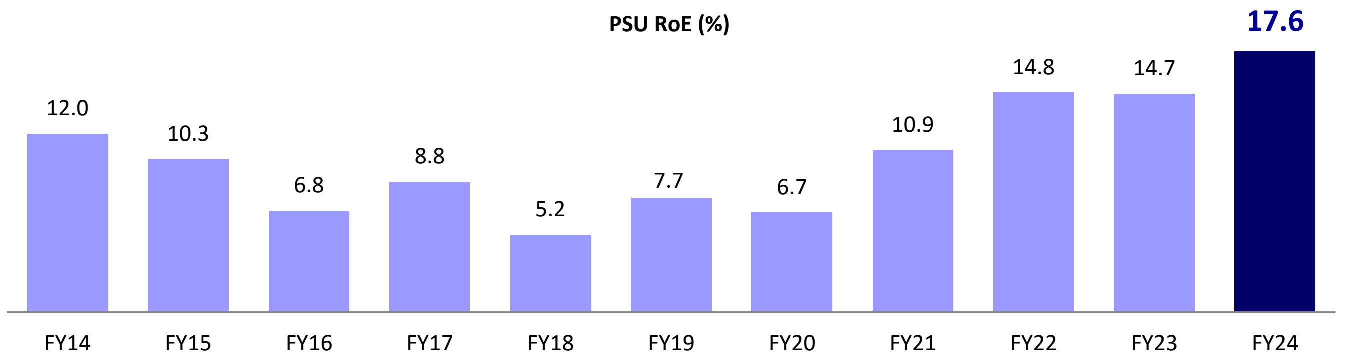


Exhibit 24: BFSI and Oil & Gas' profits expanded at a faster pace in the last five years (INR b)

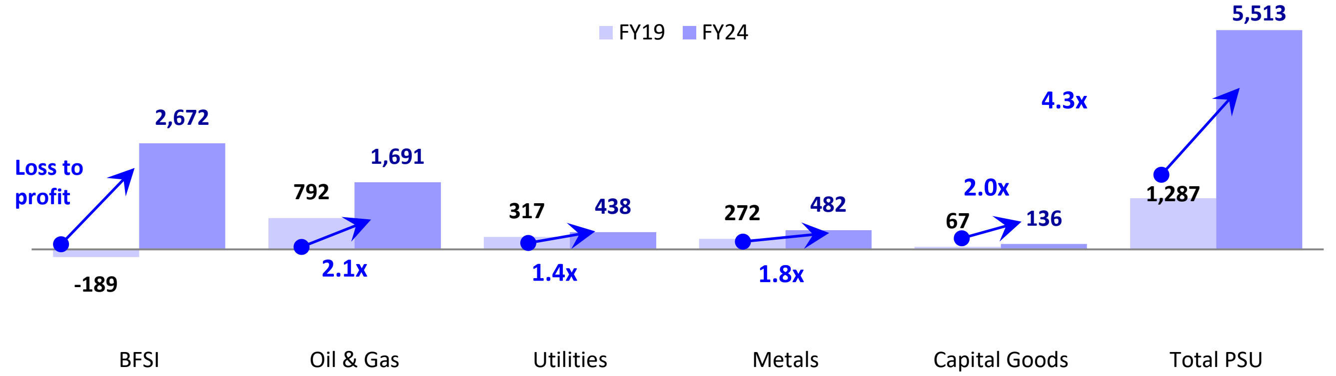


Exhibit 25: BFSI's contribution to PSU profit moderated in FY24, after scaling highs in FY23

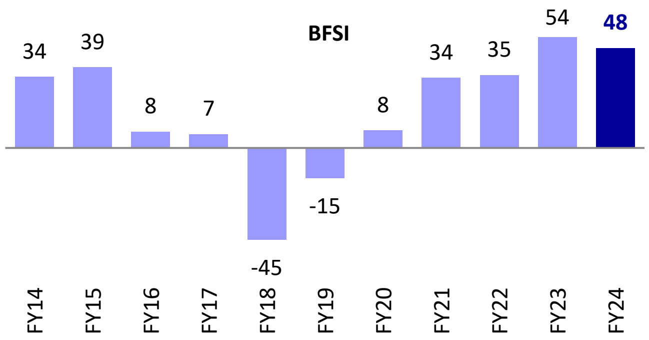


Exhibit 26: O&G's contribution to PSU profit pool recovered in FY24, after hitting lows in FY23

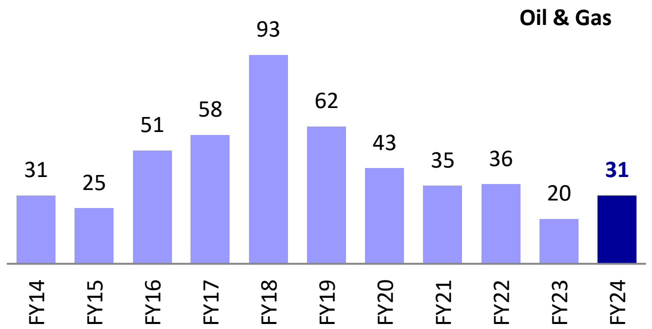


Exhibit 27: Utilities' contribution to PSU profit pool at a new low

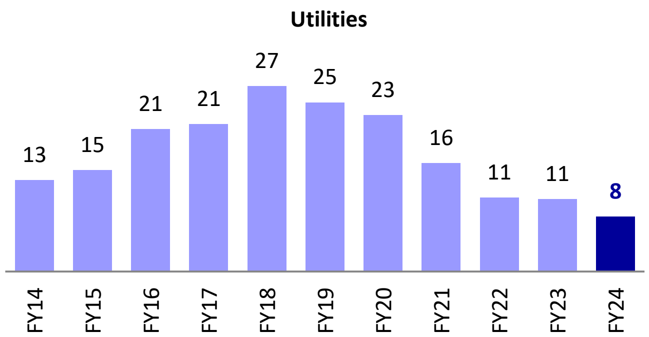


Exhibit 28: Metals' contribution to PSU profit pool at a new low as well

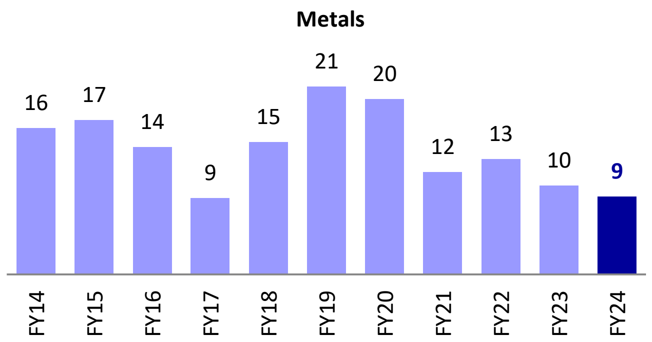


Exhibit 29: Capital Goods' contribution to PSU profit pool continues to be low

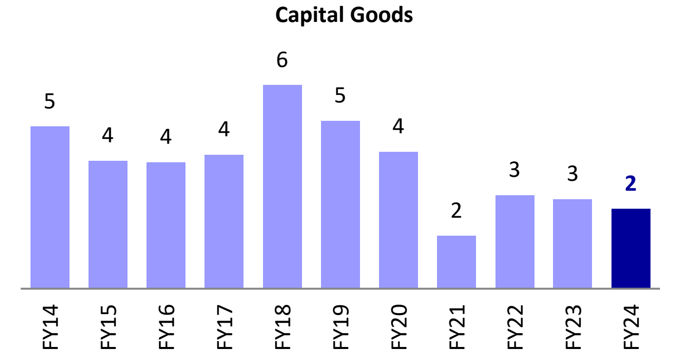


Exhibit 30: Telecom has been a negative contributor to PSU's profit pool

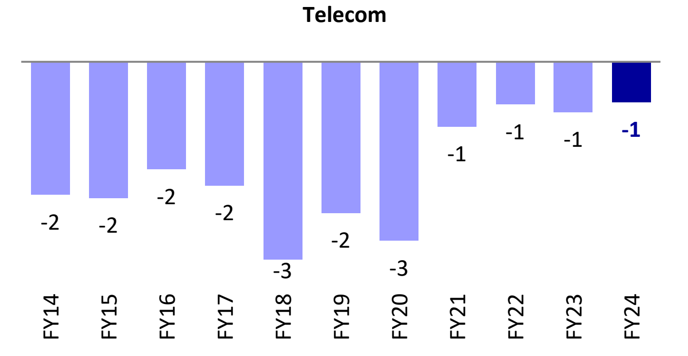


Exhibit 31: Top 25 PSU stocks – PAT CAGR over FY14-19 (%)

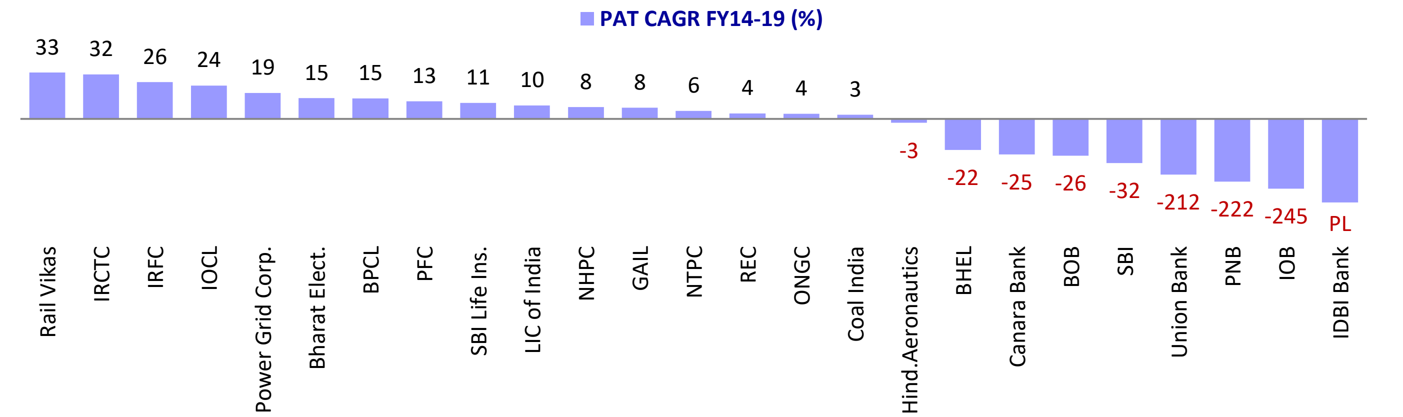
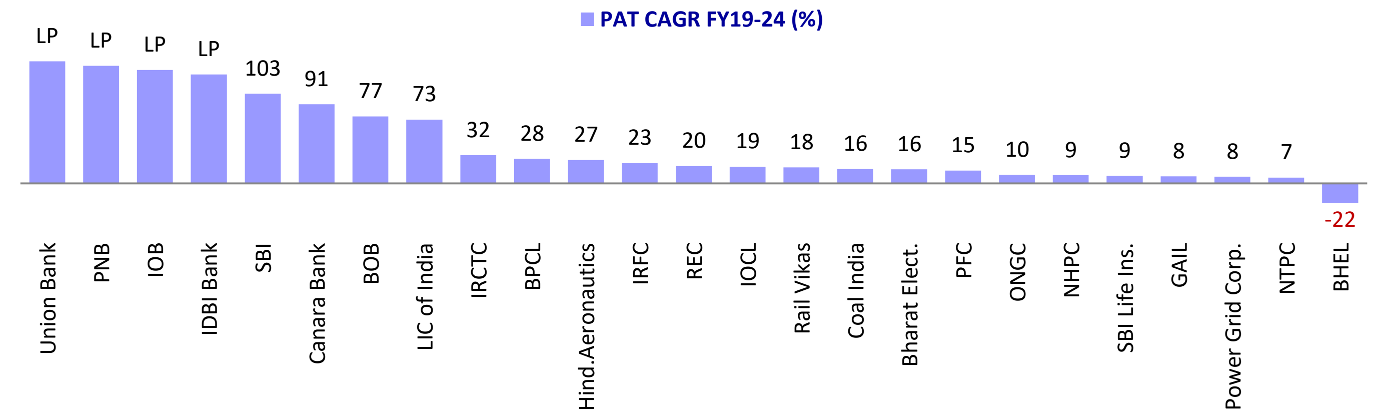


Exhibit 32: Top 25 PSU stocks – PAT CAGR over FY19-24 (%)

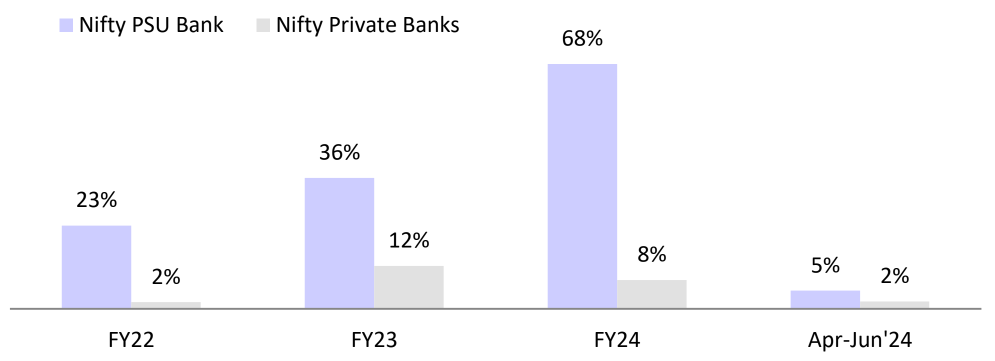


Sharp recovery in PSBs' profitability supports PSU revival from the lows

- PSBs have experienced a remarkable turnaround, from reporting record losses to posting record profits, as their aggregate earnings surpassed the ~INR1.2t mark in FY24. The strong earnings recovery is attributed to steady credit growth, significant improvements in asset quality, and stable to positive margins.
- The steady recovery in PSBs' profitability during the past three years led to a significant rerating of the underlying stocks within the coverage universe and also drove PSU index outperformance.

- The aggregate market cap of PSBs has surged in recent years, up ~5x since FY20 at ~INR17t.
- Further, with the sharp revival in PSBs' profitability, the aggregate contribution of BFSI to PSU profits recovered to 54% in FY23 from the lows of -45% in FY18.
- We estimate the earnings momentum to continue and the PSBs to register a CAGR of 18% over FY24-26, thereby reaching INR1.7t by FY26. Please refer to our recent note on PSBs.

Exhibit 33: PSU bank index has generated 68% returns in FY24 (Apr'23- Mar'24) vs. 8% for the Private bank index over the same period



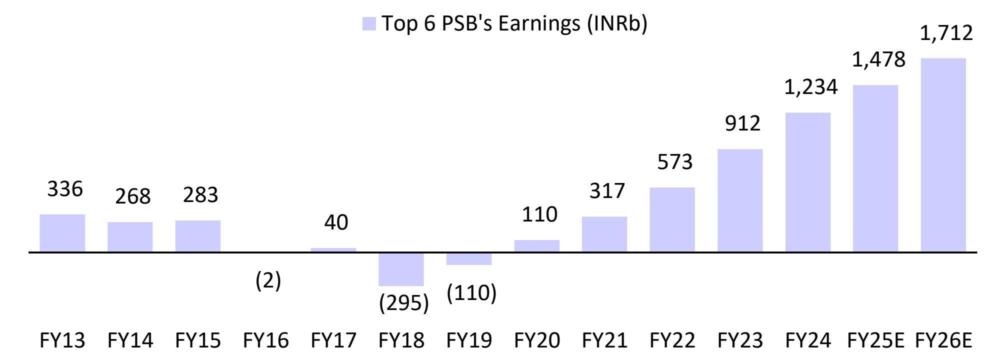
Source: MOFSL, Company

Exhibit 34: PSBs' market cap contribution to the total banking sector has increased to FY14 levels

Market Cap (INR b)	FY13	FY14	FY15	FY16	FY17	FY18	FY19	FY20	FY21	FY22	FY23	FY24
PSBs	2,672	2,671	3,392	2,611	3,996	3,521	4,720	2,918	5,511	7,457	9,227	17,143
Pvt Banks	4,540	5,333	8,029	7,910	10,622	13,581	17,429	12,070	21,354	22,305	24,851	29,847
Total	**7,212**	**8,004**	**11,421**	**10,521**	**14,617**	**17,102**	**22,149**	**14,988**	**26,864**	**29,763**	**34,078**	**46,990**
Share in M. Cap	**FY13**	**FY14**	**FY15**	**FY16**	**FY17**	**FY18**	**FY19**	**FY20**	**FY21**	**FY22**	**FY23**	**FY24**
PSBs	37%	33%	30%	25%	27%	21%	21%	19%	21%	25%	27%	36%
Pvt Banks	63%	67%	70%	75%	73%	79%	79%	81%	79%	75%	73%	64%
Total	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**

Exhibit 35: PSBs to report ~18% earnings CAGR over FY24-26E

Earnings of PSBs improved significantly to INR1.2t in FY24 from INR110b in FY20



Calculated based on six PSBs under our coverage

Source: MOFSL, Company

Earnings outlook continues to remain healthy

- Fundamentally, India is witnessing its own mini-Goldilocks moment with excellent macros (GDP growth of 8.2% in FY24 on the back of ~7% growth in FY23, inflation at ~5%, both current account and fiscal deficits well within tolerance band, stable currency, etc.), robust corporate earnings (Nifty ended FY24 with 25% earnings growth and FY25/26 earnings are likely to post 14-15% CAGR), focus on manufacturing, capex and infrastructure creation, and valuations at ~20x one-year forward earnings.
- The political stability with Modi 3.0 augurs well for the economy and capital markets as it provides the necessary stability and continuity in policy-making which will likely continue pushing its economic agenda.
- This verdict and the consequent political stability and continuity in policy-making will act like an icing on the cake and keep India as the cynosure of all eyes, in our view.
- For our MOFSL Coverage PSU Universe (~55% of Indian PSU Mcap), we estimate that the FY24-26 PAT CAGR is likely to moderate to 6%, mainly due to conservative margin assumptions for O&G. Conversely, the earnings growth for other sectors continues to remain strong. Ex O&G, we estimate a PAT CAGR of 15% for MOFSL Coverage PSU Universe. For the said Universe, incremental profits would be contributed by BFSI (120%), followed by Metals (22%). O&G is likely to drag the earnings CAGR with an adverse contribution of -47% to overall profitability.

Conservative margin assumption for O&G to moderate earnings growth over FY24-26

Exhibit 36: Expect FY24-26 earnings growth to moderate mainly due to O&G, while other sectors to remain strong

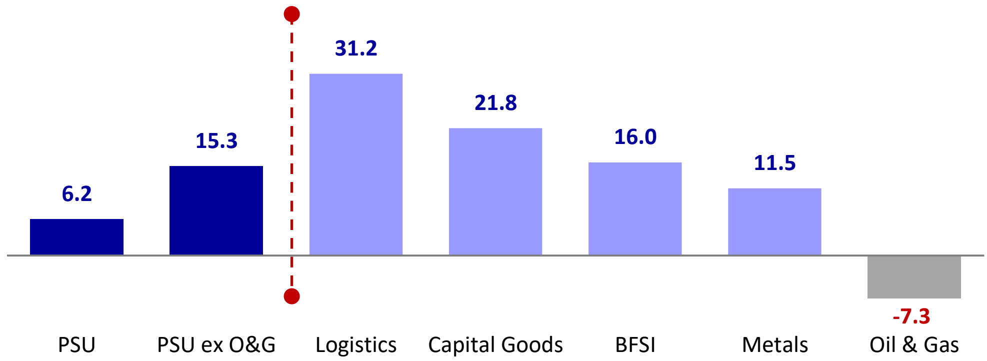


Exhibit 37: MOFSL Coverage PSU stocks – PAT growth for FY24 (%)

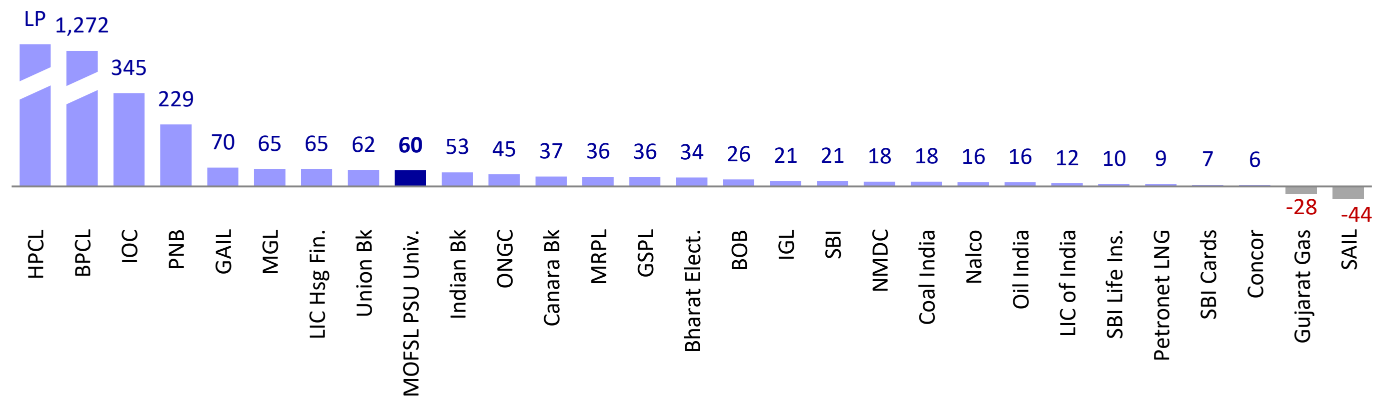
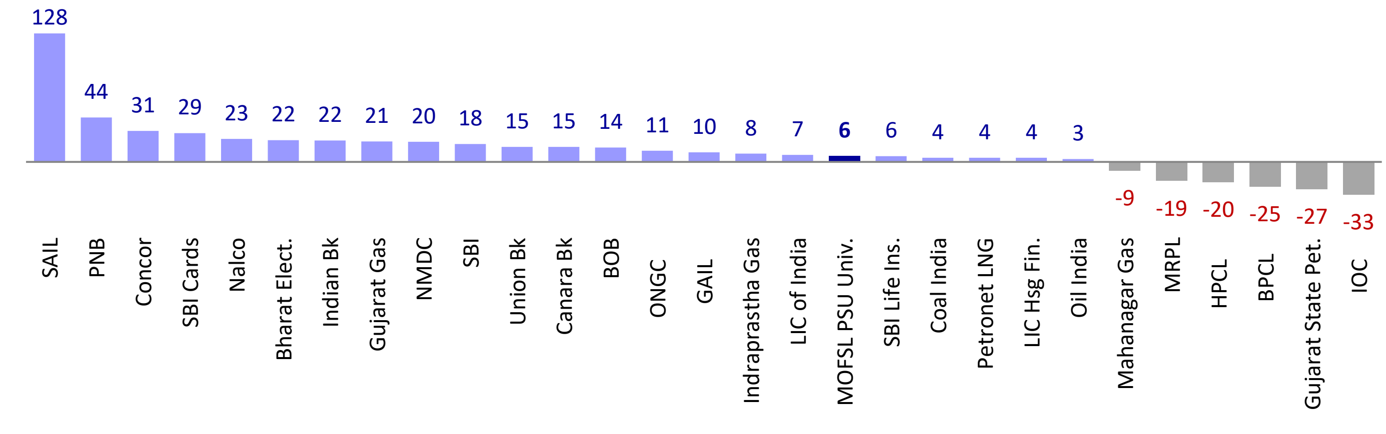


Exhibit 38: MOFSL Coverage PSU stocks – PAT CAGR over FY24-26E (%)



Valuation: Continuous rerating trends seen across PSUs

- Strong earnings pickup with underlying RoE expansion, healthy macros, policy tailwinds and an optimistic management outlook led to the sharp valuation expansion for PSUs over the past few years.
- The BSE PSU index that had seen a sharp de-rating in the first half of the previous decade, has subsequently experienced a sharp re-rating in the past three years.
- The BSE PSU index experienced continued valuation expansion and is trading at 12.8x 12-month forward P/E and 2x 12-month forward P/B as of Jun'24, up 112% and 187% from FY20 lows, respectively.
- Given the continued earnings momentum and guidance, we believe the valuation premiums for PSUs are expected to sustain in the near term. However, due to the multi-year high valuation and sharp run-up in select PSU stocks, earnings guidance vs. delivery would be the key monitorable.

Exhibit 39: 12-month forward P/E (x)

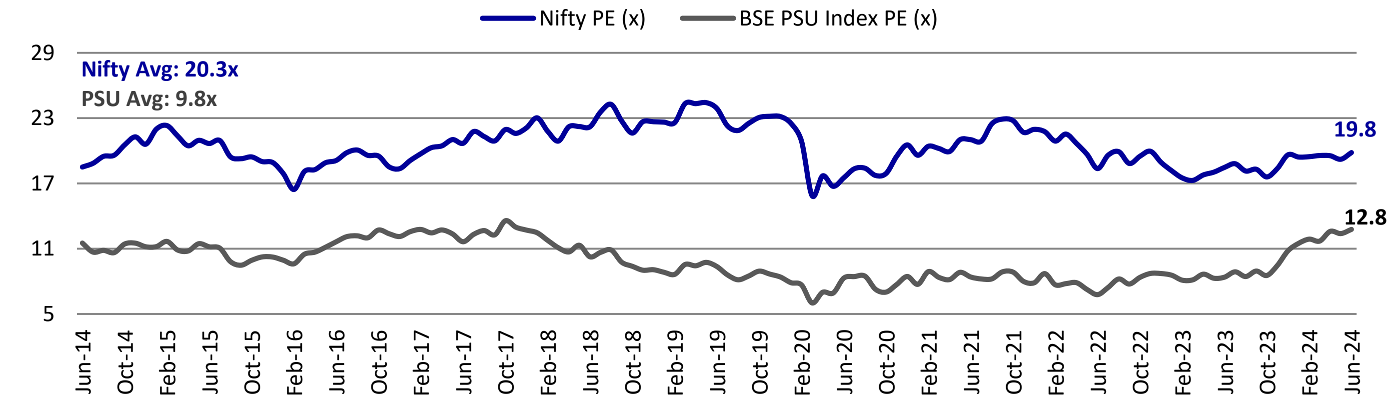


Exhibit 40: Trend in P/E discount to the benchmark (%)

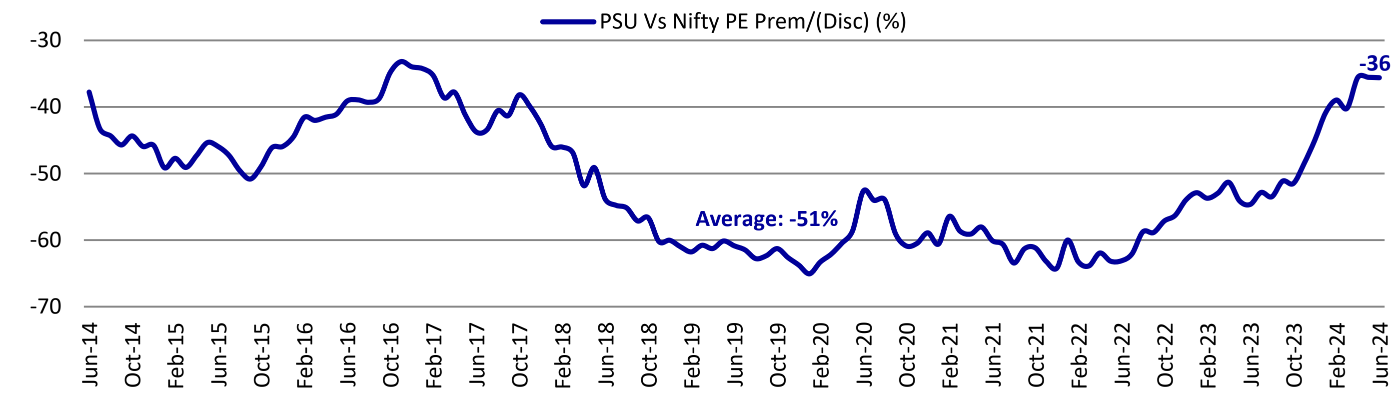


Exhibit 41: 12-month forward P/B (x)

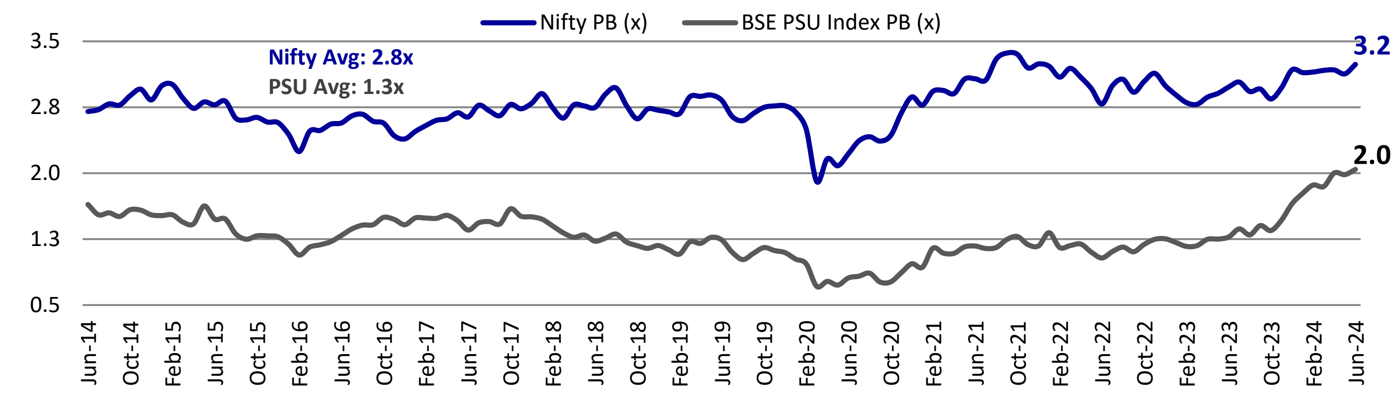
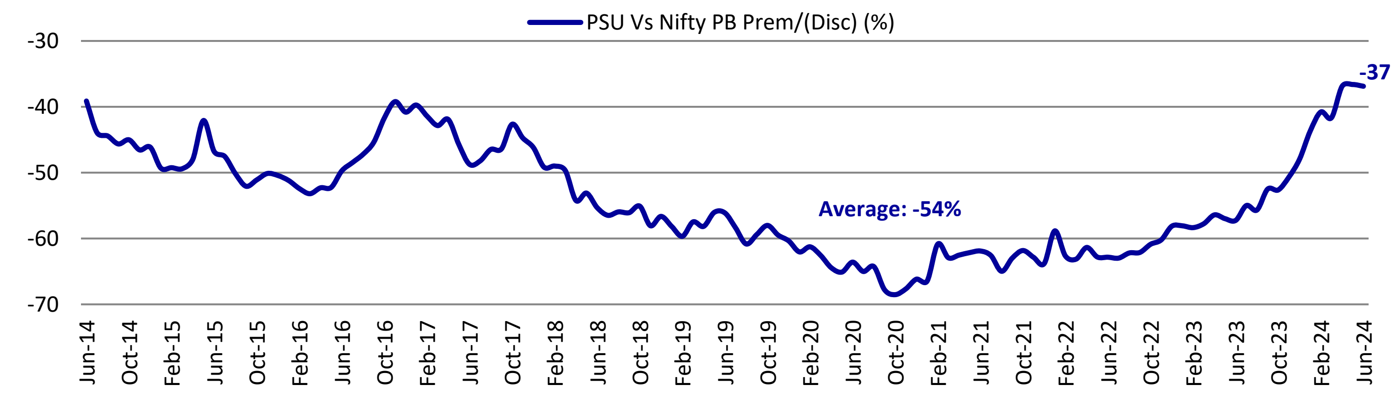


Exhibit 42: Trend in P/B discount to the benchmark (%)



AVENDUS SPARK STRATEGY

Caught between a rock and a hard place (1/2)

To be divided between two seemingly equal options and undecided about which one to ch the government – whether to prioritize welfare or fiscal probity, for policymakers – wheth investors – whether to shift portfolio bias from cyclicals to the consumer sector. We have at

 # 1: Welfare tilt or Fiscal Probity? – The government might opt for a middle path with a bias

Reasons for a middle path: The current coalition mandate, along with multiple state elect spending priorities towards welfare schemes. Interestingly, direct spending on welfare scher capital expenditure has doubled in the same period. Our recent channel checks reveal that de the absence of first-time buyers in rural and semi-urban areas. Therefore, increasing allocatio personal income tax cuts, and GST rate rationalization, especially for food and agricultural inpu

Why fiscal consolidation bias is needed: The government might want to keep a buffer for p salary growth and reduced corporate profitability growth. Profit growth for BSE 500 companie Importantly, the intent for fiscal consolidation offers lasting benefits at a time when foreign sa

 # 2: Can Consumption revive or slow down further? – Can be a false start. More Pain before

Reasons for further slowdown: Our concerns regarding consumption demand, particularly in highlighted, have not fully materialized. The lagging effects of moderated retail credit growth, growth, household indebtedness, and the secondary and tertiary impacts of a slowdown in recovery. We expect further moderation in volume growth, particularly in categories reliant or

What if the welfare tilt plays out? We acknowledge that the emphasis on welfare sch consumption, thereby correcting the infamous K-shaped recovery in the economy. Deleverag remains to be seen whether these measures can lead to sustainable growth in the medium te

Premiumization theme, traditionally a core pillar for consumption sector growth, has been sig towards new categories. Aggregate spending on smartphones, wearables, hearables, OTT sul ~Rs. 6.2tn (USD 75bn), which is twice the size of the passenger car market and six times th premiumization within these categories, along with changes in spending patterns, remain key

oose? This is the current dilemma for all stakeholders: For
ner to focus on inflation or the interest rate cycle, and for
tempted to answer these questions in this note.

towards fiscal consolidation.

tions in the second half of FY25, should compel a shift in mes has remained stagnant over the last four years, while emand for entry-level products continues to struggle due to n towards a combination of direct rural spending schemes, ut products, are likely options.

potential challenges in direct tax collections, given slowing es is projected at 14-15% in FY25E, down from 30% in FY24. vings ($ flows) and stable interest rates are crucial.

gain.

n urban and semi-urban areas, which we have consistently limited addition to the IT sector workforce, stagnant salary unsecured personal loans continue to hinder consumption n leverage.

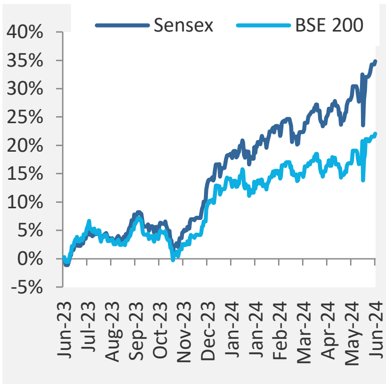
emes and state government dole-outs could boost rural ging may still be a priority for rural households. However, it rm, which depends on changes in consumption patterns.

gnificantly displaced and disrupted by a shift in wallet share bscriptions, real-money gaming, and mobile data stands at ne size of the two-wheeler market. Therefore, growth and areas to monitor in this cycle.

[Contd...]

STRATEGY
19 June 2024

BSE Sensex	77,301
NSE Nifty	23,558



Performance (%)

	1m	3m	12m
Sensex	4.5%	7.3%	22.4%
BSE200	5.3%	12.2%	35.3%

RESEARCH ANALYSTS

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AVENDUS SPARK STRATEGY

Caught between a rock and a hard place (2/2)

 # 3: Capex Cycle momentum? Expect heavy lifting from Private and PSU sectors.

Large sector capex matters from here: Private sector capex experienced a slowdown in deleveraged balance sheets among Public Sector Undertakings (PSUs) in the Energy and approximately Rs. 14tn (USD 170bn) worth of capex announcements are likely in the Power years.

 # 4: Real Estate Cycle? Some more steam is left.

Changing factors: We expect supply to exceed demand for the first time since FY15. Addition increased proportion of investor demand over the last 6-9 months, and reduced affordabilit buying are favouring demand. For longevity of the cycle, we need stronger end-user demand a

 # 5: Key Conclusions and Top picks changes:

- ~90% of the coverage universe is trading in neutral to unattractive valuation territory, offer
- Consumer stocks still offer lesser earnings comfort in totality; any rural recovery could be o
- Cyclicals, especially private sector capex beneficiaries and property capex beneficiaries, co

Above-mentioned reasons and our low confidence in the consumer balance sheet still warr

- Stocks with time-tested high-quality managements that can deliver strong performance reg
- Stocks with strong tailwinds for earnings growth in industrials and home improvement.
- High proportion of cash, at 10%, stays to use if better opportunities present themselves.

Top Picks changes: Stocks In: Credit Access Grameen & PVR Inox; Stocks Out: Federal Bank &

Our bottom-up exercise of slicing and dicing 250 stocks revealed some interesting takeaway growth estimated for FY25E. **2)** ~45% of the companies still have market share gain potent further RM cost tailwinds. **4)** Operating leverage upside is restricted to ~33% of our coverage, except for a few large-cap private banks and potential turnaround companies. **6)** 68% of our c the second half of FY24 due to elections. However, strong free cash flow generation and Metals sectors should help rebuild momentum. Our bottom-up calculations suggest that value chain, Semiconductors, Refining (Petrochemicals), and Steel sectors over the next three

ally, we observe a narrowing spread between tax-adjusted rental yield and mortgage yield, an ty due to higher property prices. Factors such as wealth effects across asset classes and NRI and favorable changes in tax laws.

ing no margin of safety.

ffset by urban slowdown.

ntinue to offer more earnings comfort.

ant a portfolio construct with a barbell structure.

gardless of the macro outlook.

& Bharti Airtel

ys: **1)** Nearly 65% of our coverage companies are dependent on the macro to meet the volume tial due to favourable industry/sub-sector dynamics. **3)** At best, ~4% of the companies have , which again depends on macro-led volume growth. **5)** Valuation comfort barely exists at 10% overage companies trade at top quartile valuations.

Summary of our macro views

Our cautious stance stays!

	Factors		Current View	
1	Govt. Revenue		Neutral	▪ Higher RBI dividend, a shock ab
2	Government Capex Outlook		Neutral	▪ Tilt towards rural schemes thro
3	Rural Govt. Spend Allocation		Positive	▪ Focus on the bottom-end of the
4	Rural Consumption		Positive	▪ Balance sheet repair; Select cas
5	Urban Consumption		Negative	▪ Knock-on effects to continue du
6	Property Capex (Real estate)		Neutral	▪ Supply picking up; Higher invest
7	Liquidity & BOP		Neutral	▪ Liquidity situation is likely to im ▪ Capital a/c outlook is still uncer
8	Credit Growth		Moderation	▪ Credit growth should moderate
9	Inflation & Interest Rate		No Rate Cuts	▪ CPI inflation needs to stabilize
10	Currency		Stable	▪ CAD remains under control; RBI
11	Private Capex		Positive	▪ Large sector capex to revive in F
12	PSU Capex		Positive	▪ Refining, Pet-chem, Power and
13	Exports	Goods	Neutral	▪ Electronics and Pharma are the
		Services	Neutral	▪ GCCs and other business service
14	Wealth Effect		Neutral	▪ Top-up loans due to higher prop

Reasons	Earlier View
sorber for a possible lower tax collections in 2HFY25.	Neutral
ugh higher RBI dividend; Fiscal consolidation, a priority	Neutral
e pyramid	Neutral
h-based consumption should recover; Wallet share shift is a key	Neutral
ue to slowdown in retail credit	Negative
tment buying seen in certain markets vs end-user	Positive
nprove due to higher RBI dividend and unspent Govt cash balances. rtain. Global demand uncertainty and higher domestic valuations	Negative
e to 13-14%; It should grow in line with deposit growth	Moderation
at 4% or growth needs to falter for rate cuts	No Rate Cuts
l intervention due to healthy forex reserves	Stable
Power, Semi-conductors, Steel and Energy transition sectors	Positive
Metals	Neutral
bright spots	Negative
es growth is sustaining, offset slowdown in IT services	Neutral
perty and gold prices remains a key monitorable	Positive

Fiscal Outlook: Welfare or Growth?

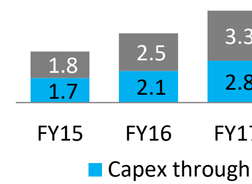
Fiscal consolidation would still be a priority; Possible tilt towards direct rural s

	Absolute values (Rs. bn)		Growth (%, yoy)	
	FY24	FY25E	FY24	FY25E
Net tax revenue (i)	**23,266**	**26,016**	**10.9%**	**11.8%**
Non-tax revenue (ii)	**4,019**	**5,097**	**40.8%**	**26.8%**
Non debt capital receipts (iii)	604	590	-16.0%	-2.3%
Disinvestment of PSUs	331	300	-28.1%	-9.4%
TOTAL REVENUES (i+ii+iii) = A	**27,884**	**31,703**	**13.6%**	**13.7%**
Revenue expenditure (a)	**34,940**	**37,447**	**1.2%**	**7.2%**
Major Subsidies	4,135	4,012	-22.1%	-3.0%
Rural & Agri spend	3,519	4,147	4.0%	17.8%
Capex excluding loan to states*	8,778	9,527	21.6%	8.5%
TOTAL EXPENDITURE (a+b) = B	**44,425**	**48,558**	**5.9%**	**9.3%**
Fiscal deficit (B-A)	**16,541**	**16,855**	**-4.8%**	**1.9%**
Fiscal deficit (% of GDP)	**5.6%**	**5.1%**	**…**	**…**
Net market borrowings	11,805	11,752	6.5%	-0.4%

Source: GoI, Avendus Spark Research

Govt. Capex is unli

(Rs. tn)



Note: Budgeted Capex exclud

Govt. focus would s

Strategic Divestment C

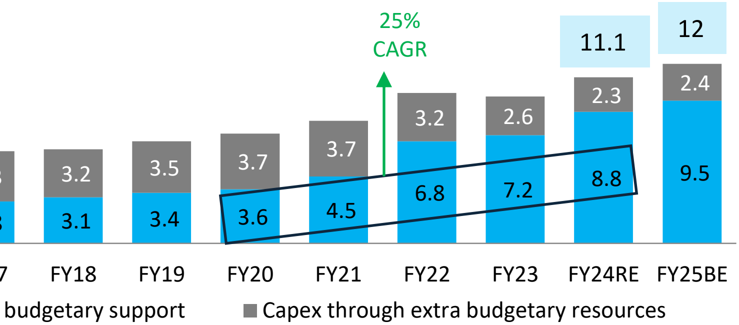
Other candidates: H
Pharmaceutical Corp a

Can profit slowdow

Corporate tax collecti
BSE 500 PAT growth
BSE 500 contribution t

chemes from higher RBI dividend; Tax revenues might be under pressure

ikely to continue with the same pace as seen in last 4 years



e 50year interest free loan to States

hift to disinvestment to garner extra revenues

Candidates: Cochin Shipyard, CONCOR, BEML, Shipping Corp, IDBI

LL Lifecare, Projects & Development India, Indian Medicines nd Ferro Scrap Nigam also in the pipeline for divestment in FY25.

yn in BSE 500 lead to lower corporate tax collections?

	FY23	FY24RE	FY25BE
ons growth	16.0%	11.7%	13.0%
	5%	30%	14-15%
to Corporate taxes	40.0%	42.3%	-

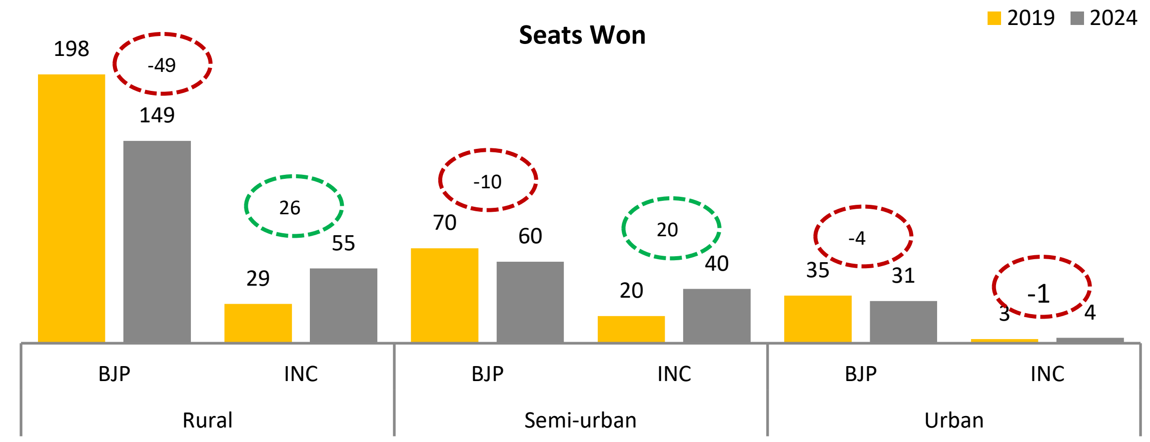
Fiscal Outlook FY25

- Rs. 1.1tn extra dividend from RBI might allow the Govt. to increase allocation towards rural and social welfare schemes without cutting Govt. Capex (Rs. 11.1tn).
- **This buffer should help in cutting personal income tax and GST rate rationalisation.**
- India's inclusion in the Global Bond Index would add pressure to bring the fiscal deficit under control.
- Govt. fiscal situation is not under stress in 1HFY25 given Rs. 5.1tn cash balance. However, in 2HFY25, if there is fiscal pressure due to lower-than-budgeted tax collections led by moderation in corporate earnings growth, Govt. might have to trim Capex to keep the fiscal deficit under control.

Fiscal Outlook: Why Direct Rural Schemes might see more a

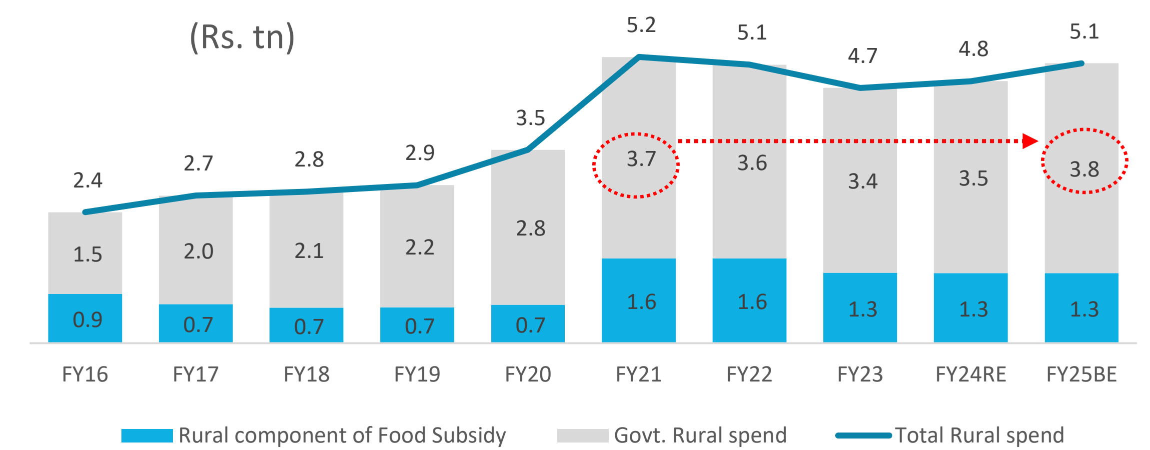
Flattish Govt. rural spending and weak economic conditions among lower-inco

#1: In General Elections 2024, the BJP witnessed a massive seat share loss in Rural India…



Source: ECI, News Articles, Avendus Spark Research

#3: Govt. spend on Rural and Agri has been flat at ~Rs. 3.8tn in the last five years while Capex jumped from Rs. 3.6tn to Rs. 8.8tn during the same time



Source: GoI, Avendus Spark Research (Note: Rural food subsidy is assumed at 65% of the total food subsidy)

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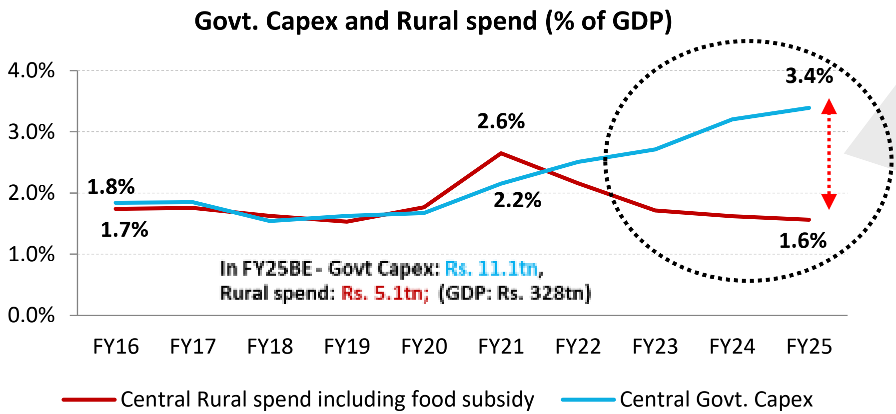
ome groups

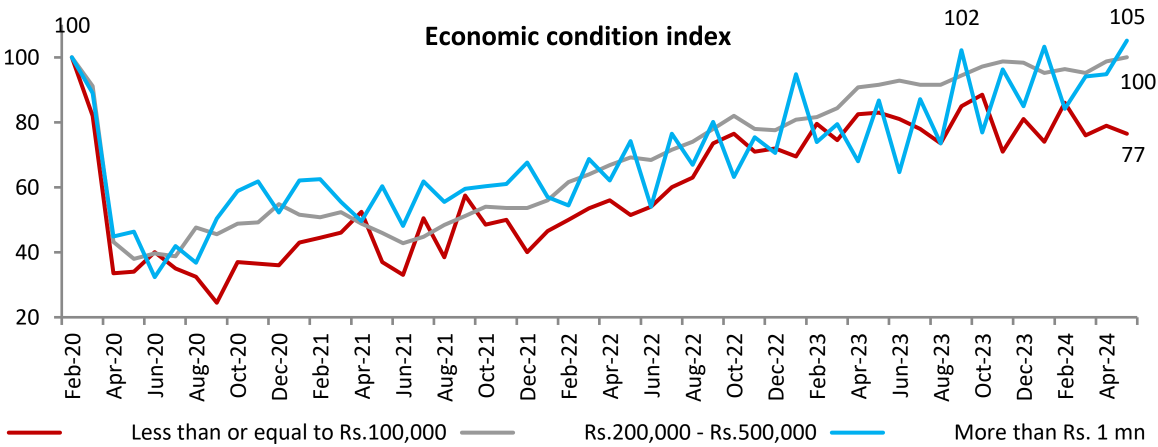
#2: Govt. direct rural spend took a back seat post Covid'19 while Capex went up sharply



This seems to be the reason for the BJP not doing well in rural areas. Govt. might focus on correcting this divergence as many key states are coming for elections in next 6 months.

Source: GoI, Avendus Spark Research

#4: The current economic condition index indicates that the lower per capita income strata are yet to come to the pre-Covid levels in terms of their economic conditions



Source: CMIE, Avendus Spark Research

Rural India Channel Checks: Key takeaways from rural road tr

Key Highlights (link to the note)

#6: F&O Trading in Market is in a bubble zone:

- We observed that shopkeepers, dealers, SME players, students, blue collar workers, among others actively trading in the F&O segments daily without realizing the size of positions.
- F&O trading seems to have become a pastime activity for a lot of young people who got introduced to it post Covid'19.
- A lot of so-called "market experts" with over 1 million followers on social media have emerged in the last 6-12 months, who are advising their followers on F&O trading.

#5: Milk production impacted by wide-spread disease in milch cattle

- In dairy, a widespread animal disease called foot-and-mouth disease has affected milk production.
- Farmers' non-farm income has also been impacted negatively
- It's positive for companies providing vaccine and treatment for the disease.

#4: Wealth effect is strong, pushing up large-ticket consumption

- Residential real estate has witnessed a massive jump in activities across all regions we visited.
- Huge demand for high-end flats (Rs. 60mn+), and it's investment-led (mainly in Delhi NCR).
- It's rare to spot a Maruti Alto on the road, as people have moved to larger cars(even if they have to purchase a used SUV).
- Huge demand for Two-wheelers and ACs from rural areas

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#1: Rabi harvest is good after three years of lower output

- **The combination of improved yield, higher Agri commodity prices and lower farm input cost has led to higher cashflow to farmers in this Rabi season.**
- **North and Central India are showing uptick in rural demand while South and West India are still weak due to water shortage.**
- **Labour availability is a major issue for farmers/ industry; Everyone was complaining about labour shortage during our conversations.**

#2: What explains the K-shaped recovery if rural demand is not a problem?

- **Poor & Lower Middle-Class Households: EMI pressure/inflation is forcing them to downgrade/postpone expenses. As a result, the first-time buyers (FTBs) are missing from the market, leading to weak demand for entry-level products.**
- **Middle & Upper Middle-Class HH: This category has shifted to premium products led by high-income growth and social media influence.**
- **Richest Households: This category has shifted to luxury cars/ houses, holidays driven by a massive positive wealth effect.**

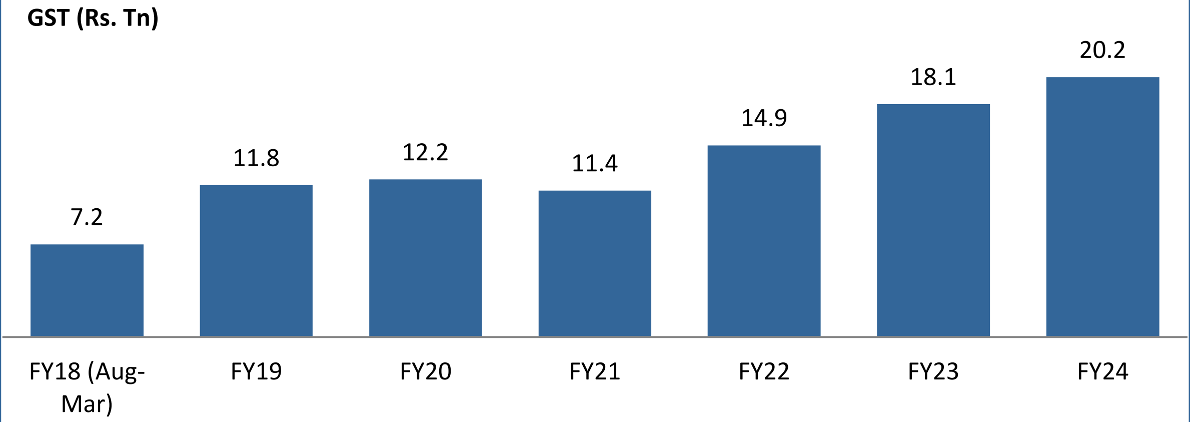
#3: Rise of regional players impacting large/listed players across sectors

- **QSR space:** Several players are emerging in this space, eating into the market share of large players.
- **PizzaWings (**Punjab, Haryana, UP, NCR and Goa) and **Rominus Pizza (**Rajasthan, UP, NCR). **The Burger Company** (100 stores).
- **SendMe** a Food delivery app in Vapi (Gujarat), having a market share higher than Zomato and Swiggy.
- **Ethnic wear/footwear:** Huge competition from regional players and more flexible in offering latest & trendy designs.

Can GST rationalisation be considered?

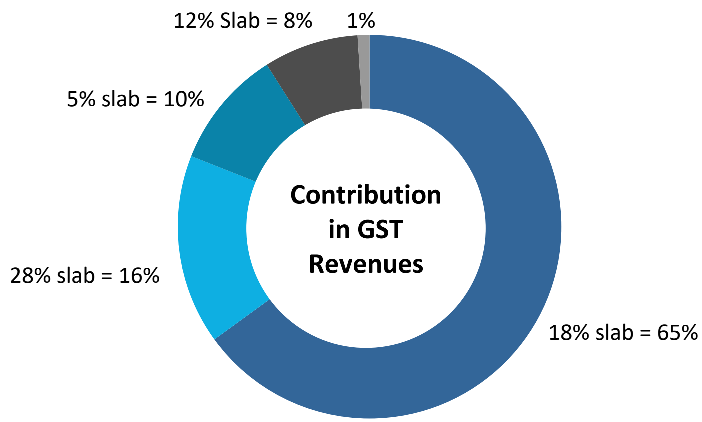
Higher GST rates on many food/non-food items of daily use are impacting mas

#1: GST collection stood at Rs. 20.2tn, surged ~2x vs the pre-covid level of 2019…



Source: GSTN Avendus Spark Research

#2: GST revenue split across rate slabs



Source: Articles, Avendus Spark Research

ss customers, including food & agri inputs

#3: Many food/Non-food of daily use items which are impacting the customer pockets which might be rationalize

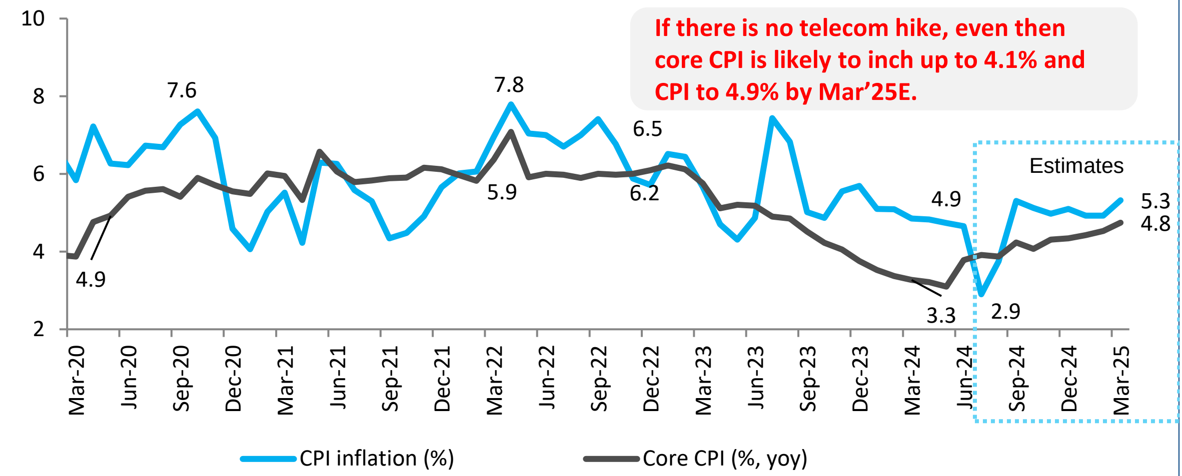
5%	12%	18%	28%
▪ Food and Beverages in Cinema Halls ▪ Uncooked, Unfried, and Extruded Snack Palettes ▪ Imitation Zari Thread or Yarn ▪ Fish Soluble Paste ▪ LD Slag ▪ Natural gums ▪ Mehendi paste in cones ▪ Edible Oil ▪ Cocoa Beans ▪ Pizza bread ▪ Namkeens, bhujia and mixture ▪ Tobacco leaves ▪ Natural graphite ▪ Building stone ▪ Fly ash, Biogas ▪ Natural rubber ▪ Silk yarn ▪ Cotton sewing thread ▪ Coir mats ▪ Carriages for disabled persons ▪ Fishing vessels ▪ Aircraft MRO services ▪ Insecticidal, frozen seeds	▪ Condensed milk ▪ Dried Nuts ▪ Wool grease ▪ Roasted chicory ▪ Soya milk drinks ▪ Granite blocks ▪ Surgical rubber gloves ▪ Idols of wood ▪ Bamboo flooring ▪ Household articles of aluminium ▪ Nozzles for drip irrigation equipment ▪ Bicycles ▪ Contact lenses,Spectacle lenses and Frames ▪ Umbrellas ▪ Butter ▪ Ghee ▪ Almonds ▪ Coconut water ▪ Preprations of vegetables	▪ TV upto 27 inches ▪ Mobile phones ▪ Washing Machine ▪ Refrigerator ▪ Geyser, Cooler and Fan ▪ Electric Appliances ▪ LPG Stoves ▪ Vacuum Vessels and Flasks ▪ Static Converters ▪ Vegetable waxes ▪ Cocoa butter, fat and oil ▪ Chocolates and other food preparations ▪ cakes, biscuits and bakers' wares ▪ Ice cream and other edible ice ▪ Non-alcoholic beverage ▪ Education, Health Services ▪ Tar distilled from coal ▪ Beauty or make-up preparations ▪ Shaving Preparations, soaps & deodorants ▪ Polishes and creams ▪ Toilet paper and similar paper ▪ Cigarette Filter rods ▪ Electronic Toys ▪ Hair Oil, Toothpaste	▪ Online Gaming ▪ Molasses ▪ Caffeinated Beverages ▪ Carbonated Beverages ▪ Cigars, cheroots, and cigarillos ▪ Pumps for dispensing fuel ▪ Air-conditioning machines ▪ Aircrafts for personal use ▪ Smoking pipes ▪ Road tractors for semi-trailers ▪ Luxury items such as small cars, ▪ Premium Cars ▪ High end Motorcycle

Source: CBIC-GST, Avendus Spark Research

Inflation & Interest rate outlook: RBI is unlikely to cut repo

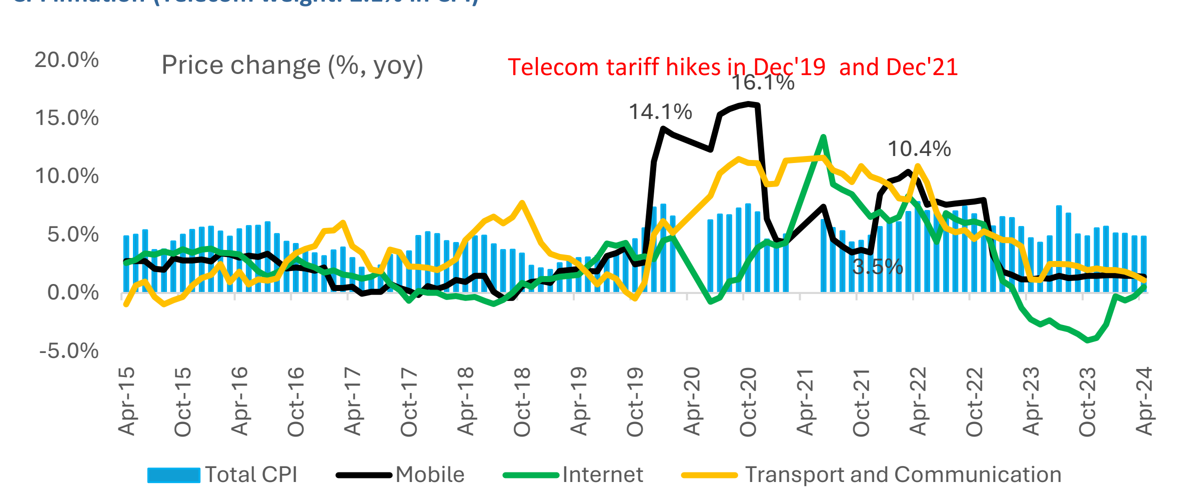
We see upside risks to service inflation mainly led by Telecom, Electricity and I

#1: Core CPI has bottomed out in May'24, likely to inch up to 4.8% and CPI inflation to be 5.3% by Mar'25E (assuming a telecom tariff hike of 20% in Jun-Jul'24)



Source: GoI, Avendus Spark Research

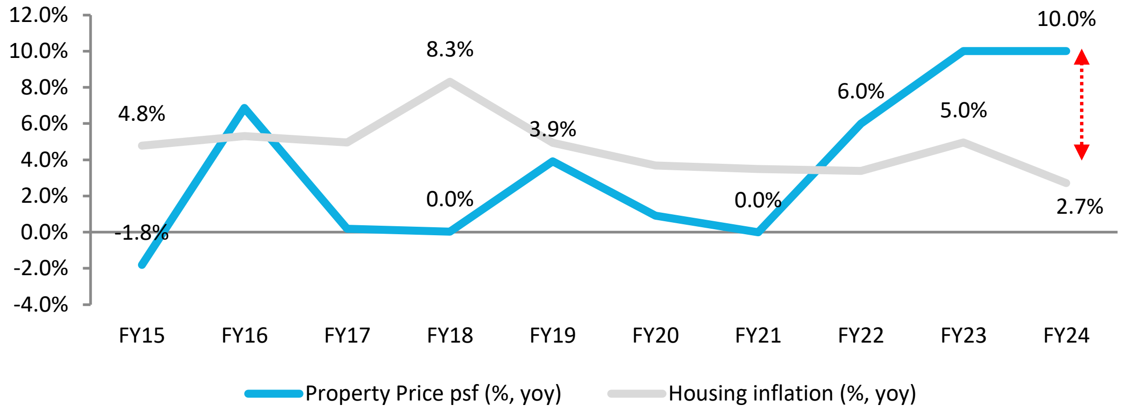
#3: Telecom tariff hike and impact on CPI inflation: Telecom tariff hike of 20% can lead to 40bps rise to CPI inflation (Telecom weight: 2.1% in CPI)



Source: GoI, Avendus Spark Research

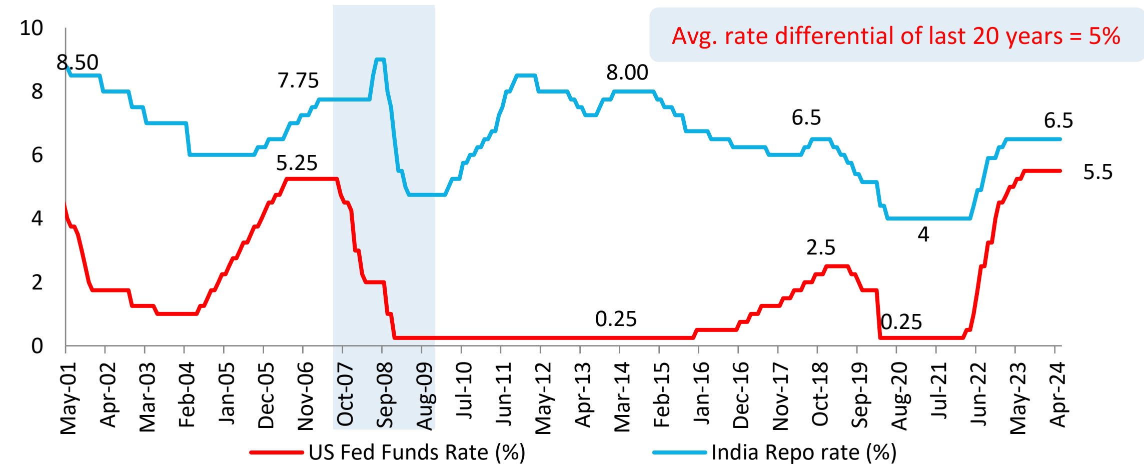
House Rent

#2: Property prices in India have risen in the last 2-years while house rental inflation in CPI is yet to reflect. It has 10% weight in CPI and can take the CPI higher



Source: GoI, Avendus Spark Research

#4: Indian monetary policy action remain de-coupled from the Fed policy rate in 2000, 2005, 2007 and 2015-16 rate cycles; Fed cutting rate does not guarantee that RBI would also cut the repo rate

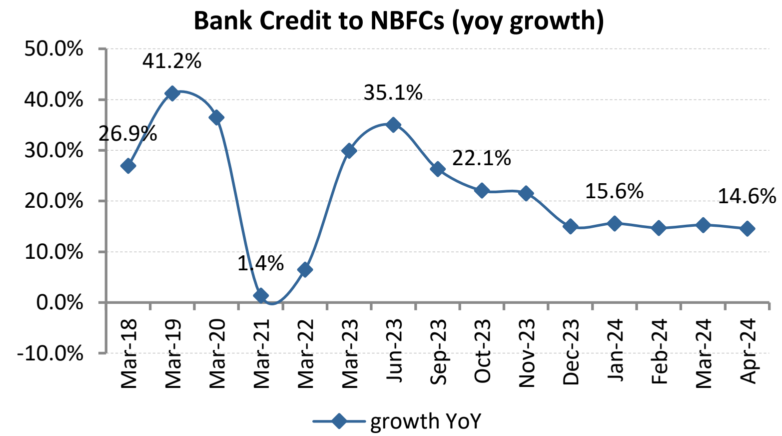


Source: RBI, GoI, Avendus Spark Research

Discretionary Consumption to remain under pressure led by

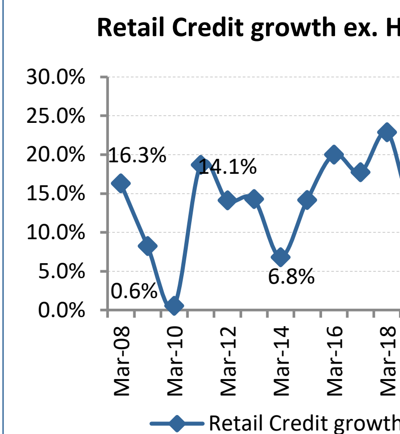
…retail credit slowdown, weak job market (IT sector hiring, subdued salary hik

#1: Bank lending to NBFCs slows down



Source: RBI, Avendus Spark Research

#2: Precipitous slowdown in Ret



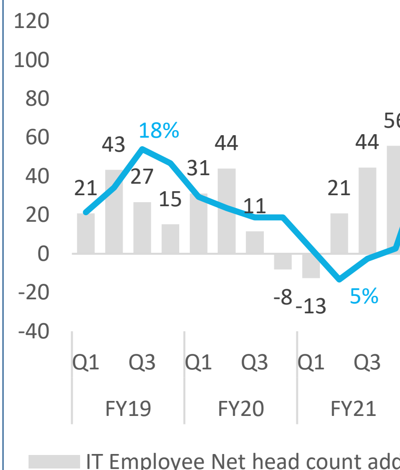
Source: RBI,, Avendus Spark Research

#4: NBFCs' other non-food credit had witnessed a sharp jump since Covid'19 – What was getting funded?

Mix (%)	FY19	FY23	FY19 - FY23 CAGR	Incremental Credit share % FY19 - FY23
NBFC Credit (Rs.tn)	**22.9**	**34.3**	10.5%	**100.0%**
Agri & Allied	2.7%	1.8%	5.4%	-0.20%
Industry	40.5%	37.3%	2.6%	30.6%
Services	17.9%	13.9%	8.2%	5.8%
Retail Loans	26.1%	30.8%	24.0%	40.3%
Other Non-food Credit	12.7%	16.3%	36.9%	23.50%

Source: RBI, Avendus Spark Research

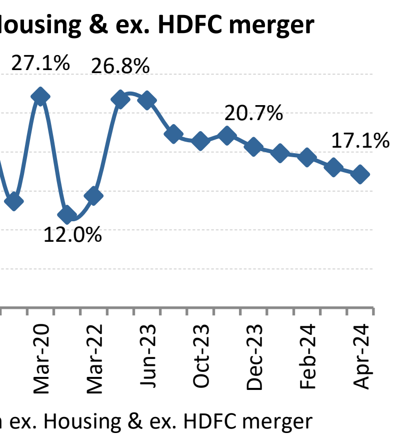
#5: IT sector is not adding net jo



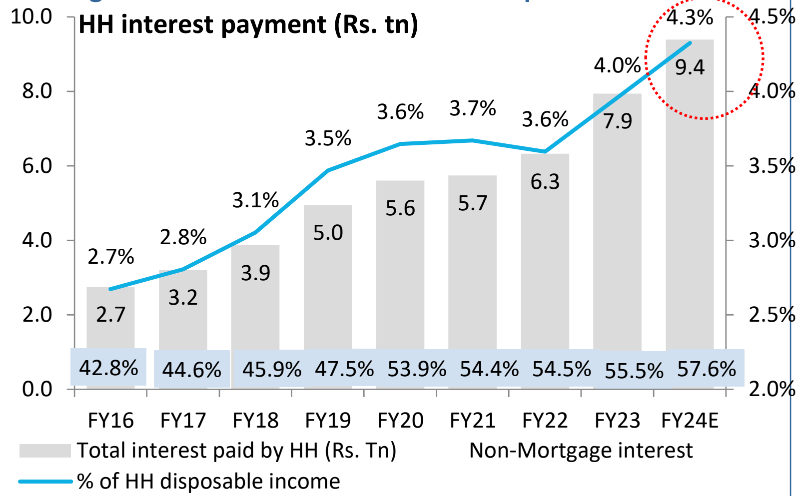
Source: IT companies, Avendus Spark Researc

kes) and leveraged household balance sheets

ail credit

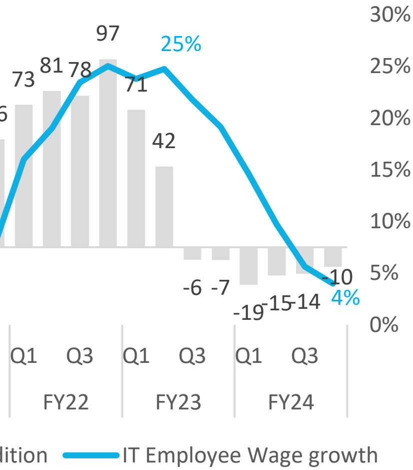


3: Higher interest burden on HH consumption



Source: RBI, Avendus Spark Research

bs and salary growth is low..



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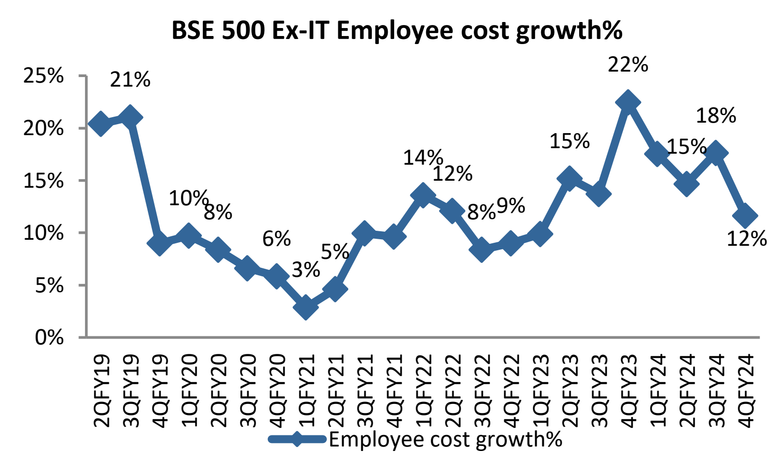
#6: …BSE 500 companies (ex. IT) employee cost growth has fallen to a 2-year low of 12% in 4QFY24



Source: Bloomberg, Avendus Spark Research

High Frequency Indicators - Are we Resilient or Complacent?

Some of the key indicators are showing weak trends on a 3M moving average b

Positive macro data points…

- **E-way bill generation continue to clock strong double-digit growth at 14.5% in Apr’24.**
- **Electricity Consumption up 13% y-o-y in YTD FY25**
- **Double-digit steel consumption growth in YTD FY25**
- **2W registrations growth in double digits since Jan’23**
- **Strong double-digit growth in durables sales in YTD FY25**
- **Services exports in mid-teens in YTD FY25**

basis – Election factor or slowdown?

…but aren't we complacent?

- **Toll traffic moderated to 5.5% in YTDFY25 v/s 13.7% in YTD FY24;**
- **Daily average freight index carried by trains is flat on a YTD basis**
- **Diesel consumption at ~1.6% in YTDY25 v/s 10.6% in YTD FY24**

Passenger vehicle inventory levels have surged to 60-days, which is close to the 2018-19 levels. PV registration growth is subdued.

No growth in imports of Engineering goods in YTDFY25

Domestic Air passenger traffic moderated to ~3.4 % in YTD FY25 v/s ~18% in YTD FY24

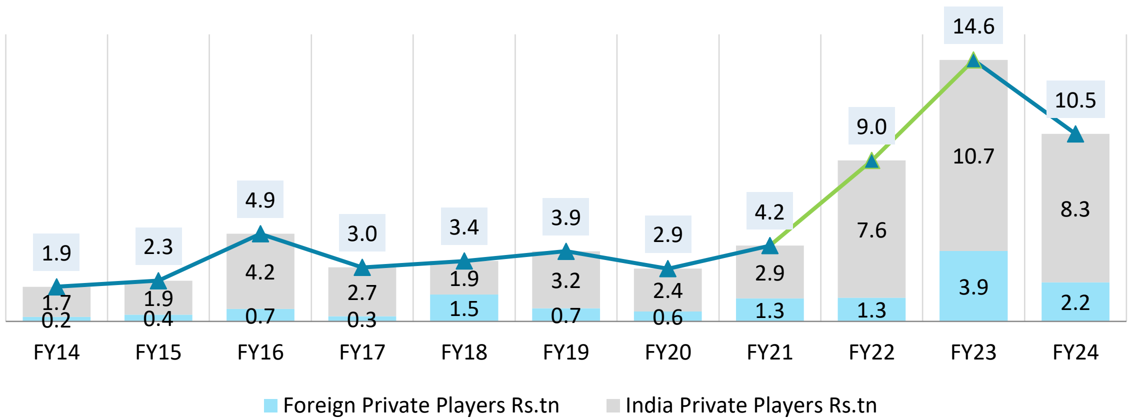
% of Nifty 50 stocks currently trading at their 52-week highs has surpassed the levels observed during the 2007 cycle

25% of promoters in BSE 500 companies have sold their stake in the past eight months.

Corporate Capex: Election uncertainty is behind; Capex mor

PSU capex should improve materially due to strong FCF generation; Large ticke

#1: Project announcements may have slowed down due to elections in FY24 after Foreign private players have seen ~3x jump in Project Announcements in Manufacturing Sector in FY23



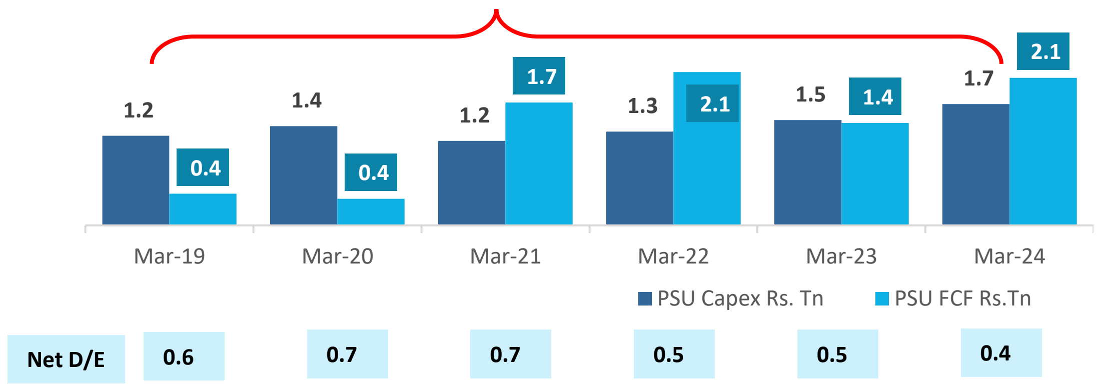
#3: Free cash flow of BSE 500 companies is up 50% in FY24; Cash accumulation at all-time high

	OCF				Capex				FCF		
In Rs. Tn	FY19	FY23	FY24		FY19	FY23	FY24		FY19	FY23	FY24
BSE 500 Ex Financial Ex IT	5.4	10.1	13.0	−	4.5	6.4	7.7	=	0.9	3.7	5.3
PSU	1.7	2.9	3.8		1.2	1.5	1.7		0.4	1.4	2.1
BSE 500 Ex Fin, IT and PSU	3.7	7.2	9.3		3.2	5.0	6.0		0.4	2.2	3.3

Source: Bloomberg, Companies, Avendus Spark Research mentum should rebuild

t-size capex announcements should firm up

#2: PSU capex has been flat in the past 5 years even as FCF jumped 5x during the same period and Net Debt/Equity has reduced from 0.6 to 0.4



#4: Potential large ticket-size capex during FY25-27E

Rs.mn	Thermal	FGD	Solar	Wind	Pump Storage	Transmission (State+Central)	Total (Rs.bn)
Power (GW)	30	100	70	20	10		
Cost Per GW (mn)	100	5	50	70	75		
Total	3,000	500	3,500	1,400	750	1,500	10,650
Steel							1,250
Refining (Pet chem)							890
Semiconductors							1,510
Total							**14,290**

Real Estate - Favourable factors relating to the property cyc

Affordability factors, interest rates, and spread between home loan vs rental y

#1: Higher interest rate led to surge in EMI cost for home buyers

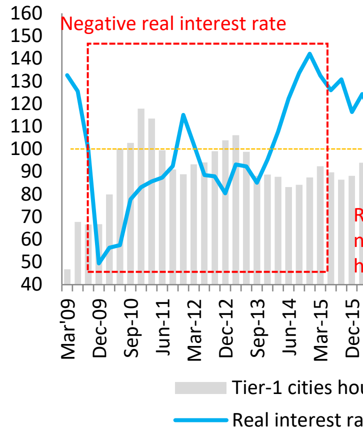
Loan interest rate (%, Loan Tenure: 15 years)

	2.5 years ago, home loan rate	Current home loan rate for new customers	Current home loan rate for existing customers
Int. rate	**6.50%**	**8.50%**	**9.30%**
Loan amount: 10mn	87,111	98,474	103,219
		11,363	16,108

For existing customer, the total EMI jump is Rs. 16,108 per month for Rs. 10mn loan of 15 years tenure, which is substantial.

Source: PropEquity, Avendus Spark Research

#2: Positive real interest rates



Source: PropEquity, Avendus Spark Research

#4: Affordability factor has increased in the last three years due to higher property prices

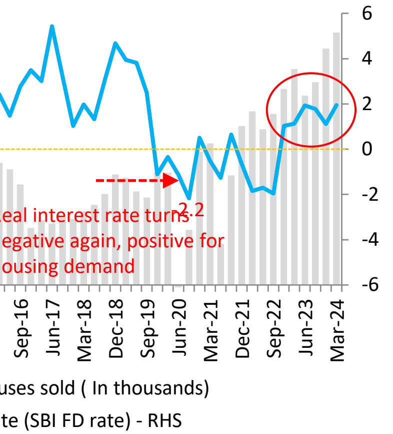
Mumbai- Suburbs	2003	2007	2012	2017	2020	2024
Price/sq-ft - Built up (Rs.)	4,000	7,000	9,500	13,000	13,500	17,000
% CAGR		15%	6%	6%	1.3%	3.9%
Size of house - Built up (sq.ft)	900	900	900	900	900	900
Cost of house (Rs.mn)	3.6	6.3	8.5	11.7	12.15	15.3
Loan eligibility (70% of house cost)	2.52	4.41	5.98	8.19	8.50	10.71
Interest rate %	7.8%	10.0%	11.0%	9.5%	7.5%	9.3%
EMI (Rs.) per month for 20 years	20,688	42,557	61,776	76,342	68,516	98,437
Annual income (Rs.mn)	0.5	1.0	1.4	2.1	2.8	2.90
Increase in income %		19%	7%	8%	10%	6%
Property price to income ratio (x)	**7.2**	**6.3**	**6.1**	**5.6**	**4.3**	**5.3**

Source: PropEquity, Avendus Spark Research

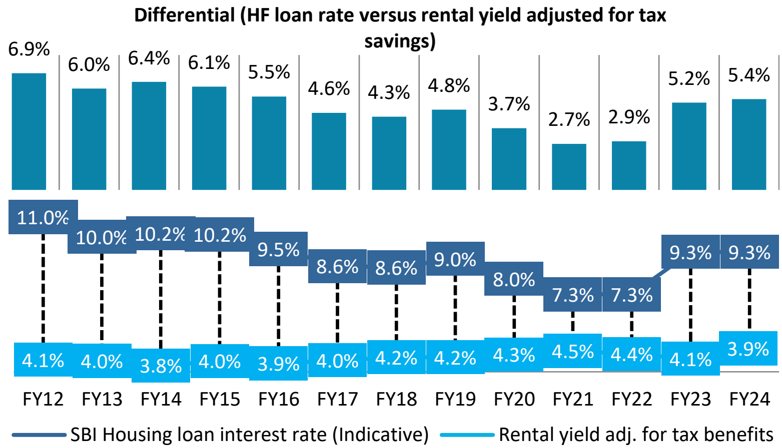
le have started reversing

Avendus SPARK

ield are showing trend reversal

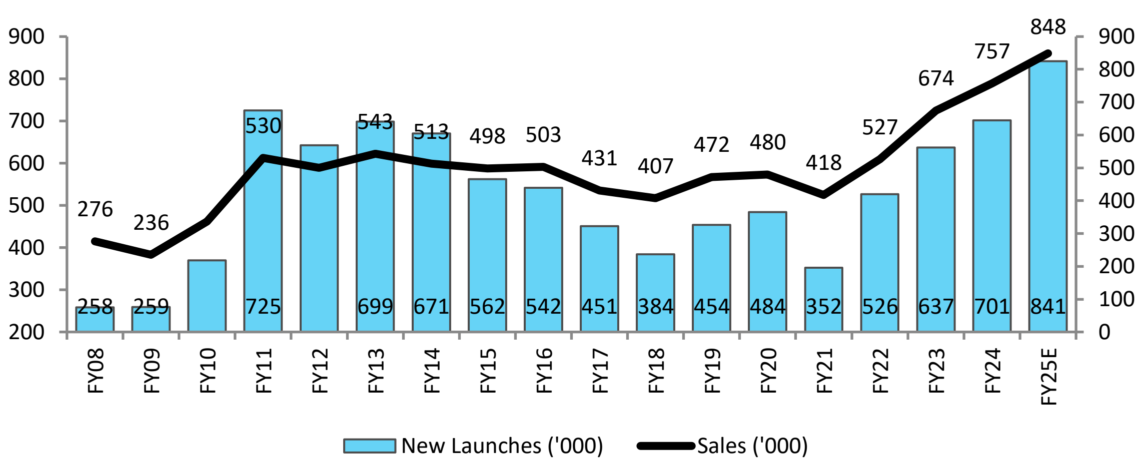


#3: Diff. b/w tax-adjusted home loan rate and rental yield has increased



Source: PropEquity, Avendus Spark Research

#5: Housing supply is expected to surpass demand in FY25E, for the first time since FY15



Source: PropEquity, Avendus Spark Research

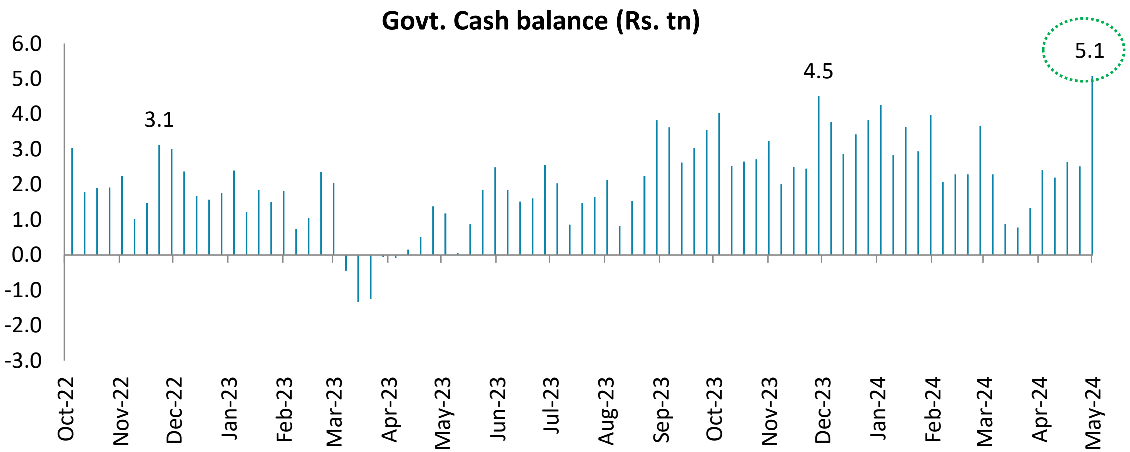
BoP outlook: CAD under control; High Govt. cash balances p

Moderate FDI inflows; Bond flows key for FY25E

#1: CAD is likely to be under control at 0.7% of GDP while Capital account challenges still exists

		Bear Case	Base Case	Bull Case
Crude oil assumption ($/bbl)	$83/bbl	$70/bbl	$80/bbl	$90/bbl
CAD (US$ bn)	**FY24**	**FY25E**	**FY25E**	**FY25E**
Total imports (a)	**675**	**659**	**704**	**747**
Total Exports (b)	**437**	**410**	**456**	**477**
Trade balance (b-a) = i	**-238**	**-249**	**-247**	**-270**
Invisibles (ii)	**216**	**202**	**220**	**225**
- Software exports	141	136	144	146
- Business Services	31	29	32	34
- Other Services	45	36	45	46
CAD (i+ii+iii) = a	**-26**	**-50**	**-29**	**-47**
CAD (% of GDP)	**-0.7**	**-1.2**	**-0.7**	**-1.2**
Capital account				
Foreign Direct Investment	**11**	**12**	**15**	**24**
Portfolio Investment	**34**	**-5**	**20**	**30**
Others	31	15	31	44
Capital account (b)	**76**	**22**	**66**	**98**
Balance of Payment (a+b)	**49**	**-28**	**37**	**51**

#3: Govt. Cash Balance has increased and stood at Rs. 5.1tn



Source: RBI, Avendus Spark Research

#2: FDI net investment in FY24 declined 66% y-o-y to $10.6bn, the lowest in over a decade

Indicators	FY21	FY22	FY23	FY24
▪ FDI-Equity (I)	61.1	59.7	47.6	45.9
▪ FDI-Reinvested Earnings (II)	16.9	19.3	19.1	19.5
▪ FDI-Other Capital (iii)	3.9	5.8	4.7	5.6
FDI Gross Investment - RHS	**82.0**	**84.8**	**71.4**	**71.0**
▪ FDI-Repatriation/Disinvestment	27.0	28.6	29.3	44.4
▪ FDI-By India	11.0	17.6	14.0	16.0
FDI Net Investment	**44.0**	**38.6**	**28.0**	**10.6**

Source: RBI, *Avendus Spark Research*

#4: Expect credit and deposit growth gap to narrow between 13-14% in FY25E; YTD incremental deposits > incremental credit

Banking system credit (Rs. tn, incl. HDFC)	Mar-23	Mar-24	May-24	Incremental (Rs. tn)
Non-food credit	136.6	164.1	165.7	1.6
YoY credit growth	15.4%	20.2%	19.6%	-
Deposit	180.4	204.8	208.1	3.3
YoY deposit growth	9.6%	13.5%	13.3%	-

Banking system credit (Rs. tn, excl HDFC)	Mar-23	Mar-24	May-24	
Non-food credit	136.6	158.8	160.5	1.7
YoY credit growth	15.4%	16.3%	15.8%	
Deposit	180.4	203.7	207.1	3.4
YoY deposit growth	9.6%	12.9%	12.7%	

Source: RBI, Avendus Spark Research

Avendus Spark Coverage Universe: Operating Cashflows way

Valuation multiples tend to expand when cashflow growth > earnings growth

Cashflow Vs Earnings (Avendus Spark Universe)	Absolute numbers in Rs.bn	
Overall coverage (#242 cos.)	**FY23**	**FY24**
OCF (pre-tax)/PPOP for financials	9,898	12,841
EBITDA/ PPOP	14,629	17,540
Earnings	7,664	9,916
OCF(post-tax/post interest)/PPOP for financials	7,004	9,374
Overall coverage Ex-Financials (#215 cos.)		
Revenue	73,360	75,252
EBITDA	10,706	12,919
Earnings	5,460	6,973
Operating cash flows (Post tax / post interest)	7,004	9,374
Capex	5,316	5,685
Free cash flows (Post interest)	2,163	4,059
Invested capital	41,487	45,117
Cash return on invested capital (CROCI=OCF/Invested capital)	**17%**	**21%**
Overall coverage Ex-Financials, IT, Pharma, O&G, Metals and Telecom (#169 cos.)		
Revenue	24,907	27,108
EBITDA	4,320	4,954
Earnings	2,455	2,953
Operating cash flows (Post tax / post interest)	2,778	3,488
Capex	1,691	1,722
Free cash flows (Post interest)	1,217	1,897
Invested capital	16,928	18,616
Cash return on invested capital (CROCI=OCF/Invested capital)	**16%**	**19%**

- **Across the board, OCF > earnings growth for FY24; The current CROCI is the best since FY19**
- **Subdued capex growth due to elections related uncertainty, in-turn leading to robust free cash generatio**

ahead of earnings growth in FY24

Avendus SPARK

y-o-y growth %	
FY23	FY24
-1%	30%
7%	20%
3%	29%
-5%	34%
25%	3%
3%	21%
-7%	28%
-5%	34%
31%	7%
-39%	88%
6%	9%
27%	9%
21%	15%
26%	20%
12%	26%
31%	2%
-4%	56%
9%	10%

n

Net Debt Rs. Bn (Avendus Spark Universe)					
	Spark Ex-IT/RIL/PSU	IT	Reliance	PSU	Total
FY23	3,471	-1,471	2,896	4,786	9,681
FY24	2,925	-1,628	2,893	4,054	8,243
Difference	-546	-157	-3	-732	-1,438

OCF post interest Rs. Bn (Avendus Spark Universe)					
	Spark Ex-IT/RIL/PSU	IT	Reliance	PSU	Total
FY23	3,133	1,083	955	1,860	7,004
FY24	3,915	1,274	1,357	2,852	9,374
Total	7,048	2,357	2,311	4,711	16,378

FCF Post Interest Rs. Bn (Avendus Spark Universe)					
	Spark Ex-IT/RIL/PSU	IT	Reliance	PSU	Total
FY23	935	974	-188	456	2,163
FY24	1,408	1,189	72	1,295	4,059
Total	2,343	2,163	-117	1,751	6,222

FY25E & FY26E Cumulative OCF post tax/interest (Ex IT/RIL/PSU) estimated at Rs. 10.1tn and FCF at Rs. 5.1tn

Robust cashflow generation and high CROCI should lead to acceleration in capacity annoucements across the board

Avendus Spark Coverage Universe: No Margin of Safety what

No margin of safety in majority of the sectors

	Sector	ROE		
		FY25	FY26	FY
Domestic Cyclicals	EMS/Outsourced Manufacturing	15%	17%	72
	Capital Goods	17%	17%	67
	Consumer Discretionary	20%	20%	65
	Electrical/Consumer durables	20%	21%	58
	Building material	19%	21%	54
	Realty	11%	13%	52
	Auto ancs	16%	17%	41
	Cement	10%	12%	34
	General Insurance	16%	16%	34
	Market Intermediaries	24%	24%	32
	Auto OEM	19%	19%	30
	Infra	16%	17%	28
	NBFC	16%	16%	19
	Banks	15%	15%	14
Domestic Defensives	Healthcare	14%	15%	54
	Telecom	15%	16%	49
	Consumer Staples	28%	29%	39
	Utilities & Mining	20%	19%	15
	Gas Utilities	17%	16%	19
	Pharma	14%	14%	30
	IT	29%	30%	25
	Life insurance	5%	6%	20
Global Cyclicals	Speciality Chemicals	14%	15%	39
	Textiles	11%	12%	27
	Metals	10%	11%	19
	Oil and Gas	12%	11%	10
	Reliance	10%	10%	23
	Avendus Spark Universe	14%	14%	24
	Avendus Spark Universe (Ex - Financial)	15%	16%	28

soever!

PE(x)		PB(x)		EV EBITDA(x)	
Y25	FY26	FY25	FY26	FY25	FY26
2.0	56.0	11.1	9.4	39.4	31.4
7.3	59.7	11.8	10.0	45.7	40.6
5.7	56.2	13.1	11.4	39.3	33.9
8.6	48.3	11.7	10.2	39.7	32.8
4.5	42.0	10.2	8.9	34.5	27.0
2.5	39.0	5.6	5.0	39.5	30.1
1.6	34.1	6.6	5.7	23.1	19.5
4.6	26.2	3.6	3.3	16.1	13.0
4.2	29.2	5.5	4.8		
2.4	27.3	7.7	6.7		
0.3	26.5	5.9	5.1	19.5	16.8
8.6	24.5	4.5	4.1	18.8	16.4
9.6	16.8	3.2	2.8		
4.6	13.1	2.2	1.9		
4.4	43.3	7.6	6.4	28.0	23.2
9.1	38.6	7.4	6.1	9.8	8.5
9.4	36.2	11.0	10.5	27.7	25.5
5.7	14.6	3.1	2.8	9.3	8.6
9.1	18.5	3.2	2.9	10.8	9.9
0.4	26.2	4.3	3.7	18.4	15.8
5.2	22.2	7.3	6.7	16.5	14.6
0.3	16.8	1.0	1.0		
9.7	30.8	5.4	4.7	23.3	18.7
7.6	22.4	3.1	2.8	16.4	13.7
9.3	15.9	1.9	1.7	6.5	5.6
0.5	11.1	1.3	1.2	5.3	5.2
3.2	20.2	2.3	2.0	11.3	9.9
4.5	21.5	3.4	3.1	10.8	9.5
8.5	25.1	4.3	3.9	15.0	13.3

Strategy

June 20, 2024

What will break the market?

The number of queries we have received on this topic makes us wonder if investors (1) expect a big correction or (2) want a big correction. We discuss potential risks but do not see any imminent risks. The market is largely driven by irrational exuberance among non-institutional (and certain institutional) investors. It is impossible to model the behavior or psychology of a crowd.

All about (irrational) expectations of retail investors

In our view, the high valuations across sectors in general and frothy valuations in specific sectors largely reflect the extremely bullish sentiment among non-institutional investors and even among certain institutional investors. Thus, it is hard to get a good handle on the captioned issue. It is virtually impossible to model the behavior of a mob; it can stay irrational for an extended period of time. There is limited point in (1) searching for clues in past cycles, (2) trying to guess peak valuations of stocks; they can be anything and (3) modeling flows of households into equity markets, which is technically incorrect incidentally.

Flows do not matter, expectations do

We would argue for the umpteenth time that institutional investors should stop trying to derive any clues from domestic flows. We have heard some incredible arguments about "excessive" liquidity, "too much" money, household savings "moving to" equities from bank deposits, etc. These are economically unsound explanations. Investors may note that (1) there is never any money in the secondary market (somebody will buy, somebody will sell); this is valid at all times and all price points, (2) overall household savings cannot and do not 'move' between bank deposits and equities (keeping aside foreign in/outflows; they are anyway irrelevant now) and (3) the number of outstanding shares of companies does not change with the mere act of buying and selling shares. As a corollary, even the sector 'rotation' argument is a bogus one.

High past returns have emboldened and numbed investors

The bullish investment sentiment among non-institutional investors reflects their conviction that they will make (1) excellent returns in the market, (2) excellent returns at all price points and (3) excellent returns in mid-cap. and small-cap. stocks, in particular. This conviction stems from high returns of the recent past (see Exhibit 1). Institutional investors may want to introspect on their own roles in perpetuating the conviction of non-institutional investors.

High returns of the past have been assumed as high returns for the future too

The ebullient mood of non-institutional investors and the cautious view of institutional investors may be best understood by the different ways the two sets of investors approach the market and stocks. For any rational (institutional perhaps) investor, the expected rate of return from the market or a stock will come down as stock prices go up assuming the fair value of the stock does not change much. For an irrational investor, the expected rate of return from the market or a stock goes up as stock prices go up.

Key estimates summary

	2024	2025E	2026E
Nifty estimates			
Earnings growth (%)	20.0	9.9	14.1
Nifty EPS (Rs)	989	1,093	1,249
Nifty P/E (X)	23.8	21.6	18.9
Macro data			
Real GDP (%)	8.2	6.9	6.5
Avg CPI inflation (%)	5.4	4.4	4.2

Source: Company data, Kotak Institutional Equities estimates

Quick Numbers

Nifty-50 Index is trading at 21.6X FY2025E 'EPS' and 18.9X FY2026E 'EPS'

We expect net profits of the Nifty-50 Index to grow 10% in FY2025 and 14% in FY2026

CYTD24 inflows of US$28 bn from DIIs into the equity market reflect bullish view of retail investors

Full sector coverage on KINSITE

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Potential risks, not that anything is imminent or material

We would note that big market corrections typically stem from four areas—(1) macroeconomic challenges (inflation spike, BoP crisis); the most obvious ones are the Asian currency crisis in 1995-96 and taper tantrum in EMs in 2013, (2) leverage issues with banks, companies, government, households; the most obvious ones are the US household mortgage crisis of 2007-08 and the Euro crisis of 2010-11, (3) political or social instability; recurring bouts in many EMs and (4) natural or man-made disasters such as pandemic, war, etc.; the Covid-19 pandemic was the latest one.

However, we do not see any issues on the first three points as imminent sources of risk for the Indian market and the fourth is impossible to forecast anyway. (1) India's macroeconomic position is in good shape (see Exhibit 2 for key macroeconomic parameters), (2) Indian banks, companies and households are in financially sound health; government debt may be on the higher side (see Exhibit 3) but almost all of public debt is domestic debt and (3) India's political and social situation is quite stable despite the shock results in the 2024 general elections.

We examine a few sources of risks below but would stress that these may not break the faith of non-institutional investors. The faith in the market is at epic levels and may require something equally epic to break the faith (irresistible force meets immovable object perhaps?). Lastly, high or even bubble valuations are irrelevant for non-institutional investors.

- **Any major change in government policies or priorities.** The market could be at some risk from any change in government taxation policies on equities, specifically higher capital gains tax on equities. We note that the capital gains taxation structure is quite different for various asset classes (see Exhibit 4) and various press articles in the past have speculated about a common capital gains taxation structure across asset classes. We are not sure if the government would want to do the same in the forthcoming budget (July 2024).

  Investment-related sectors may be at maximum risk from any change in government priorities, especially given their extremely high multiples (see Exhibits 5-6). For now, we expect the central government to broadly continue with its economic agenda of the past 6-7 years. The government has sufficient fiscal flexibility (see Exhibit 7) to manage (1) fiscal consolidation, (2) increase capital expenditure and (3) allocate more funds for revenue expenditure (if required) in FY2025. However, we would note that (1) its weaker-than-expected performance in recent Lok Sabha polls, especially in certain poll-bound states (see Exhibits 8-9) and (2) any further setbacks in forthcoming state elections, particularly Haryana and Maharashtra, may increase the possibility of the government focusing more on populist measures to revive consumption (see Exhibit 10).

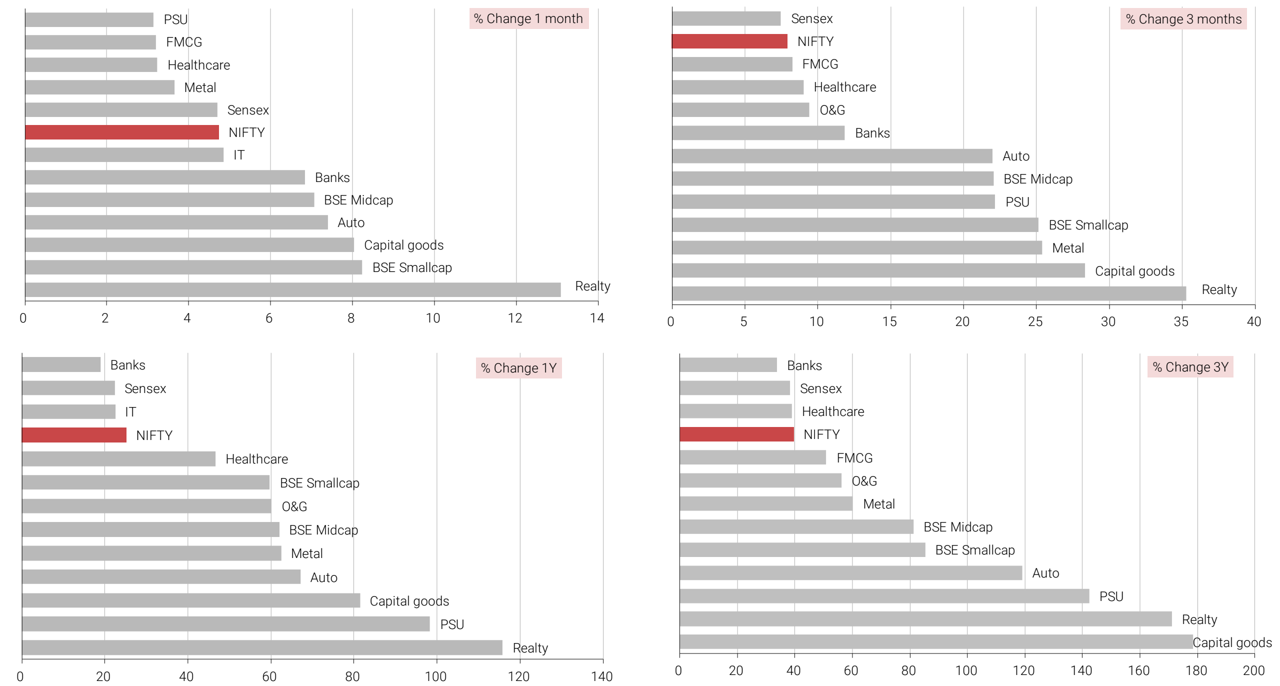
- **Increase in regulatory oversight in capital markets.** The capital markets' regulator (SEBI) may want to ensure a more 'orderly' market but we are not sure how it can do so. It appeared to have concerns about high valuations in the mid-cap. and small-cap. space in March 2024, based on the number of measures it had unveiled to protect the interests of domestic retail investors (see Exhibit 11). Valuations have become higher since then, especially in several low-quality and low-liquidity stocks. We expect the regulator to continue to monitor the risks arising from (1) sharp increase in stock price in low-float stocks and (2) sharp increase in retail activity in options market (see Exhibits 12-15).

- **Government stake sale in PSU stocks.** Any large divestment in PSUs, especially those trading at unfathomable valuations, may reveal the true value of PSU stocks. In our view, most of the PSUs are extremely overvalued and their current stock prices do not reflect their fundamentals. The government has targeted Rs500 bn of divestment for FY2025. It remains to be seen if the government (1) will achieve the same; the government has missed its targets for the past several years (see Exhibit 16) or (2) may want to take advantage of the euphoria surrounding PSU stocks and increase stake sale, through a mix of OFS and ETFs (see Exhibit 17).

- **Earnings disappointment.** The current multiples of most consumption and investment stocks bake in strong growth in revenues/volumes and elevated margins/profitability for an extended period of time. We are reasonably sanguine about our revenue and volume growth assumptions but it is possible that margins may disappoint; elevated margins (see Exhibits 18-20) leave limited room for disappointment in several sectors. However, it may take a number of quarters of consistent disappointment for investors to question the extant narratives, given the strong conviction of the market participants about robust earnings and growth prospects.

Indian equity markets have generated strong returns over the past 1-3 years

Exhibit 1: Performance of various sectors (%)



Source: Bloomberg, Kotak Institutional Equities

India's macro is in good shape at present

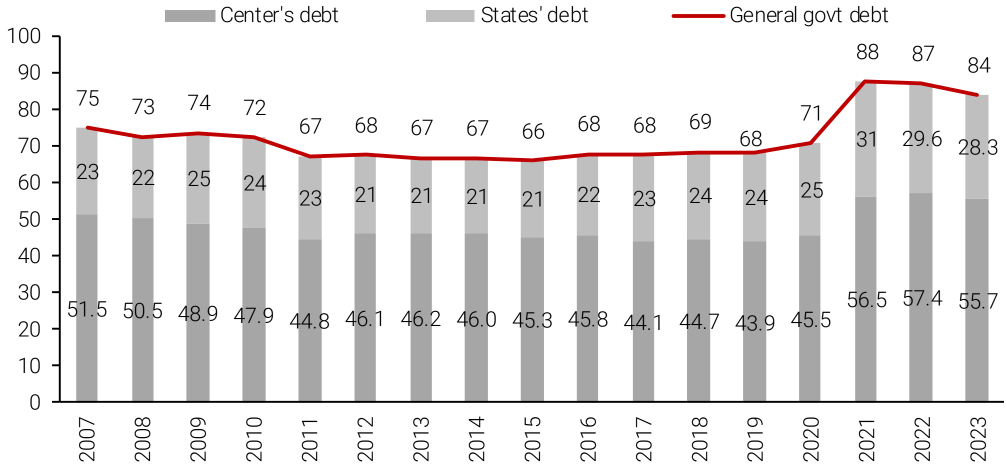
Exhibit 2: Summary of key macro metrics for India

	2016	2017	2018	2019	2020	2021	2022	2023	2024E	2025E	2026E
Real economy											
Real GDP growth (% yoy)	8.0	8.3	6.8	6.5	3.9	(5.8)	9.7	7.0	8.2	6.9	6.7
Nominal GDP growth (% yoy)	10.5	11.8	11.0	10.6	6.4	(1.2)	18.9	14.2	9.6	10.8	11.0
CPI Inflation (% yoy, average)	4.9	4.5	3.6	3.4	4.8	6.2	5.5	6.7	5.4	4.4	4.2
Public Finance											
Consolidated Fiscal Deficit (% of GDP)	7.0	7.0	5.9	5.8	7.3	13.2	9.5	9.1	8.6	7.8	7.2
- Centre	3.9	3.5	3.5	3.4	4.6	9.2	6.8	6.4	5.8	5.0	4.5
- States	3.1	3.5	2.4	2.4	2.6	4.1	2.8	2.7	2.8	2.8	2.7
Monetary Policy											
Repo Rate (%, EOP)	6.75	6.25	6.00	6.25	4.40	4.00	4.00	6.50	6.50	6.00	5.50
Reverse Repo/SDF Rate (%, EOP)	5.75	5.75	5.75	6.00	4.00	3.35	3.35	6.25	6.25	5.75	5.25
CRR (%)	4.0	4.0	4.0	4.0	3.0	3.5	4.0	4.5	4.5	4.5	4.5
SLR (%)	21.5	20.5	19.5	19.3	18.3	18.0	18.0	18.0	18.0	18.0	18.0
3-month T-bill (%, EOP)	7.13	5.78	6.09	6.14	4.24	3.27	3.77	6.88	6.95	6.05	5.25
10-year G-Sec (%, EOP)	7.47	6.68	7.40	7.35	6.14	6.17	6.84	7.31	7.05	6.70	6.25
External sector											
Current Account Balance (US$ bn)	(22.2)	(14.4)	(48.7)	(57.3)	(24.7)	23.9	(38.8)	(67.1)	(26.6)	(41.9)	(45.3)
Current Account Balance (% of GDP)	(1.1)	(0.6)	(1.8)	(2.1)	(0.9)	0.9	(1.2)	(2.0)	(0.8)	(1.1)	(1.0)
- Trade deficit (US$ bn)	(130)	(112)	(160)	(180)	(158)	(102)	(189)	(265)	(248)	(267)	(274)
- Trade deficit (% of GDP)	(6.2)	(4.9)	(6.0)	(6.7)	(5.6)	(3.8)	(6.0)	(7.8)	(7.0)	(6.8)	(6.3)
Balance of Payments (US$ bn)	18	22	44	(3)	59	87	48	(9)	53	35	15
Crude Oil (USD/bbl, average)	47	49	58	70	61	45	80	95	83	83	84
INR/USD (average)	65	67	64	70	71	74	74	80	83	85	80

Source: CEIC, Bloomberg, Kotak Institutional Equities estimates

India's public debt is currently on the higher side, relative to history

Exhibit 3: Trend in debt of center, state and general government, March fiscal year-ends (% of GDP)



Notes:

(a) Center's liabilities have been adjusted for loans to states and state liabilities have been adjusted for investment in center's T-bills.

Source: CEIC, Kotak Institutional Equities

Equities attract significantly lower capital gains tax compared to other asset classes

Exhibit 4: Capital gains tax for various asset classes in India, May 2024 (%)

Asset	Holding period (months)	Tax rates (%) Short-term	Long-term
Equity shares/preference shares (listed)	12	15	10
Equity shares/preference shares (unlisted)	24	Marginal	10
Immovable property	24	Marginal	20
Listed securities (bonds, derivatives, etc.)	12	Marginal	20
Units of UTI	12	Marginal	20
Units of equity-oriented mutual funds	12	15	10
Units of debt-oriented mutual funds	36	Marginal	20
Bank deposit	NA	Marginal	Marginal
Gold	24	Marginal	20

Notes:

(a) Indexation benefit is available for immovable property.

Source: Ministry of Finance, Kotak Institutional Equities

Most investment stocks are trading at very expensive valuations

Exhibit 5: 12-m forward P/E multiple of investment stocks in KIE universe, March fiscal year-ends, 2011-25E

		12-m forward P/E multiple (X)														
Company	Sector	Mar-11	Mar-12	Mar-13	Mar-14	Mar-15	Mar-16	Mar-17	Mar-18	Mar-19	Mar-20	Mar-21	Mar-22	Mar-23	Mar-24	Current
ABB	Capital Goods	41	48	32	60	67	60	51	43	53	42	64	69	73	87	97
Bharat Electronics	Capital Goods	14	12	10	11	22	20	21	18	13	10	15	19	21	35	48
BHEL	Capital Goods	15	10	8	16	21	27	26	20	17	7	28	28	28	78	69
Carborundum Universal	Capital Goods	13	13	13	17	21	18	23	24	25	13	30	32	37	42	57
Cochin Shipyard	Capital Goods	NA	NA	NA	NA	NA	NA	NA	16	11	5	NA	6	14	37	82
Cummins India	Capital Goods	18	21	18	25	29	26	28	23	24	13	35	32	36	50	56
IRB Infrastructure	Capital Goods	13	12	7	7	13	12	11	8	6	4	8	26	17	32	36
Kalpataru Projects	Capital Goods	9	8	6	7	15	15	16	19	16	5	10	10	12	20	21
KEC International	Capital Goods	8	8	7	9	13	12	15	19	13	7	15	13	18	23	28
L&T	Capital Goods	21	16	15	22	28	21	23	23	19	11	19	21	22	31	30
Siemens	Capital Goods	28	28	29	53	75	50	50	37	37	30	52	52	59	76	90
Thermax	Capital Goods	16	15	18	24	33	28	36	35	27	23	43	48	43	65	75
Amber Enterprises	Electronic Manufacturing Services	NA	NA	NA	NA	NA	NA	NA	31	19	19	51	43	29	48	47
Avalon Technologies	Electronic Manufacturing Services	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	36	44
Cyient DLM	Electronic Manufacturing Services	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	49	43
Dixon Technologies	Electronic Manufacturing Services	NA	NA	NA	NA	NA	NA	NA	37	27	25	64	63	40	70	92
Kaynes Technology	Electronic Manufacturing Services	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	75	79
Syrma SGS Technology	Electronic Manufacturing Services	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	25	42	46

Source: Companies, Factset, Kotak Institutional Equities

Many 'narrative' stocks are overvalued relative to the fundamental value of the businesses; their valuations bake in optimistic profitability and volume assumptions

Exhibit 6: Valuation summary of 'narrative' and high-valuation stocks under KIE coverage, March fiscal year-ends, 2024-26E

			Price (Rs)	Fair Value	Upside	Mkt cap.		EPS (Rs)			P/E (X)			P/B (X)			EV/EBITDA (X)			RoE (%)		
Company	Sector	Rating	20-Jun-24	(Rs)	(%)	(Rs bn)	(US$ bn)	2024	2025E	2026E	2024	2025E	2026E	2024	2025E	2026E	2024	2025E	2026E	2024	2025E	2026E
Capital goods																						
ABB	Capital Goods	SELL	8,539	6,000	(30)	1,810	21.6	59	87	99	145	99	87	30	24	19	118	79	69	23	27	24
Bharat Electronics	Capital Goods	SELL	312	170	(45)	2,280	27.3	5	6	7	57	51	43	14	12	10	43	38	32	26	25	26
BHEL	Capital Goods	SELL	293	75	(74)	1,022	12.2	1	(2)	1	393	NM	364	4	4	4	171	(8,852.3)	83	1	NM	1
CG Power & Industrial	Capital Goods	SELL	680	365	(46)	1,039	12.4	6	7	8	122	99	83	34	24	17	92	72	63	28	24	21
Cochin Shipyard	Capital Goods	SELL	2,232	740	(67)	587	7.0	30	28	30	75	79	75	12	11	10	63	64	56	17	14	14
Siemens	Capital Goods	SELL	7,525	4,900	(35)	2,680	32.1	79	90	107	95	83	70	18	15	13	78	66	56	20	20	20
Thermax	Capital Goods	REDUCE	5,140	4,350	(15)	612	7.3	51	71	84	102	72	61	13	11	10	77	56	45	14	17	17
Construction Materials																						
ACC	Construction Materials	REDUCE	2,623	2,300	(12)	493	5.9	112	117	137	23	22	19	3.0	2.7	2.4	15	12	10	14	13	13
Ambuja Cements	Construction Materials	SELL	659	445	(32)	1,624	19.4	15	19	21	45	35	31	3.6	3.0	2.8	24	16	14	9	10	9
Shree Cement	Construction Materials	SELL	27,698	19,000	(31)	999	12.0	684	727	824	40	38	34	4.9	4.4	4.0	22	20	17	13	12	12
UltraTech Cement	Construction Materials	SELL	10,903	7,200	(34)	3,148	37.6	244	318	359	45	34	30	5.2	4.7	4.3	24	20	18	12	14	15
Electric Utilities																						
JSW Energy	Electric Utilities	SELL	707	275	(61)	1,236	14.8	10	15	20	67	46	36	5.6	4.4	3.9	27	19	17	9	11	12
NHPC	Electric Utilities	SELL	100	64	(36)	1,007	12.0	4	4	6	28	24	18	2.6	2.4	2.3	27	22	11	10	10	13
NTPC	Electric Utilities	SELL	358	275	(23)	3,468	41.5	21	23	25	17	16	14	2.1	2.0	1.8	11	10	9	13	13	13
Power Grid	Electric Utilities	SELL	325	245	(25)	3,019	36.1	17	18	19	19	18	17	3.5	3.2	3.0	11	10	9	18	18	18
Tata Power	Electric Utilities	SELL	444	265	(40)	1,418	17.0	11	12	15	41	38	30	4.4	3.9	3.5	17	15	14	11	11	12
Electronic Manufacturing Services																						
Cyient DLM	Electronic Manufacturing Services	SELL	746	570	(24)	59	0.7	8	16	20	97	48	38	6.5	5.7	5.0	50	34	25	7	12	13
Dixon Technologies	Electronic Manufacturing Services	SELL	11,485	6,000	(48)	687	8.2	63	117	150	183	98	77	41	28	20	98	54	42	25	34	31
Gas Utilities																						
GAIL (India)	Gas Utilities	SELL	219	150	(31)	1,437	17.2	13	14	14	16	16	16	2.2	2.1	1.9	12	11	11	15	14	13
Petronet LNG	Gas Utilities	SELL	314	230	(27)	471	5.6	22	25	24	14	13	13	2.8	2.4	2.1	9	8	9	21	21	17
Oil, Gas & Consumable Fuels																						
BPCL	Oil, Gas & Consumable Fuels	SELL	626	510	(19)	1,358	16.2	132	47	56	5	13	11	1.8	1.6	1.5	3	7	7	44	13	14
HPCL	Oil, Gas & Consumable Fuels	SELL	524	285	(46)	743	8.9	104	43	52	5	12	10	1.8	1.6	1.5	6	10	9	43	14	15
IOCL	Oil, Gas & Consumable Fuels	SELL	169	105	(38)	2,386	28.5	28	14	15	6	12	11	1.4	1.3	1.2	4	7	6	25	11	11
Oil India	Oil, Gas & Consumable Fuels	SELL	685	500	(27)	743	8.9	69	64	68	10	11	10	1.7	1.5	1.4	9	8	7	19	15	14
Transportation																						
Container Corp.	Transportation	SELL	1,096	740	(32)	668	8.0	20	24	29	54	46	38	5.7	5.3	5.0	33	29	24	11	12	14
GMR Airports	Transportation	SELL	97	69	(29)	585	7.0	(1)	(1)	1	NM	NM	84	165	(136)	217	30	22	14	NM	2,132	NM
JSW Infrastructure	Transportation	SELL	303	205	(32)	636	7.6	6	7	9	53	43	35	8.0	7.0	6.1	33	29	25	20	17	19

Source: Companies, Kotak Institutional Equities estimates

Government had budgeted FY2025 GFD/GDP at 5.1%

Exhibit 7: Major central government budgetary items, March fiscal year-ends, 2019-25E (Rs bn)

									Growth yoy (%)				
	2019	2020	2021	2022	2023	2024P	2025BE	2025E	2022/ 2021	2023/ 2022	2024P/ 2023	2025BE/ 2024P	2025E/ 2024P
Receipts													
1. Revenue receipts (2d + 3)	**15,529**	**16,841**	**16,339**	**21,699**	**23,832**	**27,284**	**30,013**	**31,317**	**33**	**10**	**14**	**10**	**15**
2. Gross tax revenues (a + b)	**20,805**	**20,101**	**20,271**	**27,093**	**30,542**	**34,648**	**38,308**	**38,308**	**34**	**13**	**13**	**11**	**11**
2.a. Direct taxes	11,431	10,554	9,523	14,158	16,723	19,689	22,130	22,130	49	18	18	12	12
2.a.1. Corporation tax	6,636	5,569	4,577	7,120	8,258	9,111	10,428	10,428	56	16	10	14	14
2.a.2. Income tax (incl. other taxes)	4,796	4,985	4,946	7,038	8,464	10,579	11,701	11,701	42	20	25	11	11
2.b. Indirect taxes	9,373	9,547	10,748	12,935	13,819	14,959	16,178	16,178	20	7	8	8	8
2.b.1. Goods and Services Tax	5,816	5,988	5,488	6,981	8,491	9,570	10,677	10,677	27	22	13	12	12
2.b.1.1. CGST	4,575	4,941	4,563	5,912	7,185	8,206	9,177	9,177	30	22	14	12	12
2.b.1.2. IGST	289	91	73	21	47	(50)	—	—	(71)	124			
2.b.1.3. Compensation cess	951	956	852	1,048	1,259	1,414	1,500	1,500	23	20	12	6	6
2.b.2. Customs duty	1,178	1,093	1,348	1,997	2,134	2,331	2,313	2,313	48	7	9	(1)	(1)
2.b.2.1. Basic duties	1,048	906	1,065	1,460	1,676	1,779	1,820	1,820	37	15	6	2	2
2.b.2.2. Others	130	187	282	537	457	551	493	493	90	(15)	21	(11)	(11)
2.b.3. Excise duty	2,310	2,406	3,897	3,946	3,190	3,053	3,188	3,188	1	(19)	(5)	4	4
2.b.4. Service tax	69	60	16	10	4	4	1	1	(37)	(57)	(2)	(76)	(76)
2.c Transfers to states, UTs, etc.	7,633	6,532	6,008	9,045	9,564	11,383	12,292	12,292	51	6	19	8	8
2.d Net tax revenues (2 - 2.c)	**13,172**	**13,569**	**14,263**	**18,048**	**20,978**	**23,265**	**26,016**	**26,016**	**27**	**16**	**11**	**12**	**12**
3. Non-tax revenues	**2,357**	**3,272**	**2,076**	**3,651**	**2,854**	**4,019**	**3,997**	**5,301**	**76**	**(22)**	**41**	**(1)**	**32**
3.a. RBI's transfer of surplus	680	1,476	600	991	303	874	800	2,104	65	(69)	188	(8)	141
3.b. Telecommunications	408	698	455	858	648	935	1,203	1,203	89	(24)	44	29	29
3.c. Others	1,269	1,097	1,021	1,802	1,903	2,209	1,994	1,994	76	6	16	(10)	(10)
4. Non-debt capital receipts (a + b)	**1,128**	**686**	**576**	**394**	**722**	**605**	**790**	**790**	**(32)**	**83**	**(16)**	**31**	**31**
4.a Recovery of loans	181	183	197	247	262	273	290	290	25	6	4	6	6
4.b Other receipts (incl. disinvestments)	**947**	**503**	**379**	**146**	**460**	**331**	**500**	**500**	**(61)**	**214**	**(28)**	**51**	**51**
5. Total receipts (1 + 4)	**16,657**	**17,527**	**16,915**	**22,093**	**24,554**	**27,889**	**30,803**	**32,107**	**31**	**11**	**14**	**10**	**15**
Expenditure													
6. Revenue expenditure	**20,074**	**23,506**	**30,835**	**32,009**	**34,531**	**34,940**	**36,547**	**36,547**	**4**	**8**	**1**	**5**	**5**
6.a. Interest payments	5,826	6,121	6,799	8,055	9,285	10,639	11,904	11,904	18	15	15	12	12
6.b. Subsidies	1,968	2,283	7,077	4,461	5,310	4,135	3,812	3,812	(37)	19	(22)	(8)	(8)
6.b.1. Food	1,013	1,087	5,413	2,890	2,728	2,118	2,053	2,053	(47)	(6)	(22)	(3)	(3)
6.b.2. Fertilizer	706	811	1,279	1,538	2,513	1,895	1,640	1,640	20	63	(25)	(13)	(13)
6.b.3. Oil	248	385	385	34	68	122	119	119	(91)	99	80	(3)	(3)
6.c. Pay, allowances and pensions	4,957	5,366	6,711	5,899	6,564	6,876	7,111	7,111	(12)	11	5	3	3
6.c.1.a. Pay and allowances	3,291	3,526	4,626	3,910	4,148	4,495	4,714	4,714	(15)	6	8	5	5
6.c.1.b. Pensions	1,666	1,840	2,085	1,989	2,416	2,380	2,396	2,396	(5)	21	(1)	1	1
6.d. Agriculture and farmers' welfare	461	942	1,083	1,145	999	1,083	1,174	1,174	6	(13)	8	8	8
6.e. Education	781	873	840	803	972	1,234	1,206	1,206	(4)	21	27	(2)	(2)
6.f. Health and family welfare	506	607	740	787	703	783	833	833	6	(11)	11	6	6
6.g. Rural development	1,118	1,221	1,964	1,604	1,768	1,619	1,776	1,776	(18)	10	(8)	10	10
6.h. Others	4,457	6,092	5,622	9,255	8,931	8,572	8,731	8,731	65	(3)	(4)	2	2
7. Capital expenditure	**3,077**	**3,357**	**4,263**	**5,929**	**7,400**	**9,485**	**11,111**	**11,991**	**39**	**25**	**28**	**17**	**26**
7. a. Defence	998	1,160	1,399	1,448	1,509	1,646	1,822	1,822	3	4	9	11	11
7. b. Railways	528	678	1,093	1,173	1,593	2,426	2,520	2,873	7	36	52	4	18
7. c. Roads and highways	676	684	892	1,133	2,060	2,639	2,722	3,049	27	82	28	3	16
7. d. Loans for capex to states	—	—	118	142	812	1,129	1,300	1,500	20	472	39	15	33
7. e. Housing and urban affairs	158	193	103	259	269	264	286	286	151	4	(2)	8	8
7. f. Others	717	642	657	1,774	1,158	1,381	2,460	2,460	170	(35)	19	78	78
8. Total expenditure (6 + 7)	**23,151**	**26,863**	**35,098**	**37,938**	**41,932**	**44,425**	**47,658**	**48,537**	**8**	**11**	**6**	**7**	**9**
Deficit													
Primary deficit (PD)	668	3,216	11,384	7,790	8,092	5,898	4,951	4,526	(32)	4	(27)	(16)	(23)
Revenue deficit (RD)	4,545	6,665	14,496	10,310	10,699	7,656	6,534	5,230	(29)	4	(28)	(15)	(32)
Gross fiscal deficit (GFD)	**6,494**	**9,337**	**18,183**	**15,845**	**17,378**	**16,537**	**16,855**	**16,430**	**(13)**	**10**	**(5)**	**2**	**(1)**
Gross market borrowing (dated securities)	5,715	7,041	12,601	9,684	14,210	15,430	14,130	14,130	(23)	47	9	(8)	(8)
Net market borrowing (dated securities)	4,233	4,681	10,329	7,041	11,083	12,193	11,752	11,752	(32)	57	10	(4)	(4)
Short-term borrowing (T-bills)	69	1,560	2,032	774	661	483	500	400					
Nominal GDP	**188,997**	**201,036**	**198,541**	**235,974**	**269,496**	**295,357**	**327,718**	**328,681**	**18.9**	**14.2**	**9.6**	**11.0**	**11.3**
PD/GDP (%)	**0.4**	**1.6**	**5.7**	**3.3**	**3.0**	**2.0**	**1.5**	**1.4**					
RD/GDP (%)	**2.4**	**3.3**	**7.3**	**4.4**	**4.0**	**2.6**	**2.0**	**1.6**					
GFD/GDP (%)	**3.4**	**4.6**	**9.2**	**6.7**	**6.4**	**5.6**	**5.1**	**5.0**					

Notes:
(a) 'Gross tax revenues' means revenues post refunds and 'net tax revenues' means gross tax revenues minus devolution to states.
(b) RBI's transfer of surplus for FY2024BE and FY2024E are our estimate.
(c) Pay and allowances include pay and allowances from Ministry of Railways.

Source: Ministry of Finance, Kotak Institutional Equities estimates

Sharp decline in vote share in Haryana resulted in loss of five seats for the BJP

Exhibit 8: Vote-share of BJP in Lok Sabha constituency of Haryana, calendar year-ends, 2019-24 (%)

	2019		2024		Difference
	Winner	BJP share (%)	Winner	BJP share (%)	(pps)
Ambala	BJP	57	INC	46	(11)
Bhiwani-Mahendragarh	BJP	63	BJP	50	(14)
Faridabad	BJP	69	BJP	54	(15)
Gurgaon	BJP	61	BJP	50	(10)
Hisar	BJP	51	INC	43	(8)
Karnal	BJP	70	BJP	55	(15)
Kurukshetra	BJP	56	BJP	45	(11)
Rohtak	BJP	47	INC	35	(12)
Sirsa	BJP	52	INC	34	(18)
Sonipat	BJP	52	INC	47	(5)

Source: Election Commission of India, Kotak Institutional Equities

BJP lost vote share in all the seats that it had won in 2019 in Maharashtra

Exhibit 9: Vote-share of BJP in Lok Sabha constituency of Maharashtra, calendar year-ends, 2019-24 (%)

	2019		2024		Difference
	Winner	BJP share (%)	Winner	BJP share (%)	(pps)
Ahmednagar	BJP	59	NCP(SP)	45	(14)
Akola	BJP	50	BJP	39	(11)
Amravati	IND	NA	INC	43	NA
Aurangabad	AIMIM	NA	SS	NA	NA
Baramati	NCP	41	NCP(SP)	NA	NA
Beed	BJP	50	NCP(SP)	45	(6)
Bhandara-Gondiya	BJP	52	INC	45	(8)
Bhiwandi	BJP	52	NCP(SP)	35	(18)
Buldhana	SS	NA	SS	NA	NA
Chandrapur	INC	42	INC	41	(1)
Dhule	BJP	57	INC	42	(14)
Dindori	BJP	50	NCP(SP)	37	(12)
Gadchiroli-Chimur	BJP	46	INC	41	(5)
Hatkanangle	SS	NA	SS	NA	NA
Hingoli	SS	NA	SS(UBT)	NA	NA
Jalgaon	BJP	66	BJP	58	(8)
Jalna	JD(S)	58	INC	37	(21)
Kalyan	SS	NA	SS	NA	NA
Kolhapur	SS	NA	INC	NA	NA
Latur	BJP	56	INC	44	(12)
Madha	BJP	48	NCP(SP)	39	(9)
Maval	SS	NA	SS	NA	NA
Mumbai North	BJP	71	BJP	66	(6)
Mumbai North Central	BJP	54	INC	47	(7)
Mumbai North East	BJP	57	SS(UBT)	45	(11)
Mumbai North West	SS	NA	SS	NA	NA
Mumbai South	SS	NA	SS(UBT)	NA	NA
Mumbai South Central	SS	NA	SS(UBT)	NA	NA
Nagpur	BJP	56	BJP	54	(2)
Nanded	BJP	43	INC	42	(1)
Nandurbar	BJP	50	INC	42	(8)
Nashik	SS	NA	SS(UBT)	NA	NA
Osmanabad	SS	NA	SS(UBT)	NA	NA
Palghar	SS	NA	BJP	44	NA
Parbhani	SS	NA	SS(UBT)	NA	NA
Pune	BJP	61	BJP	53	(8)
Raigad	NCP	NA	NCP	NA	NA
Ramtek	SS	NA	INC	NA	NA
Ratnagiri-Sindhudurg	SS	NA	BJP	49	NA
Raver	INC	60	BJP	54	(6)
Sangli	BJP	43	Independent	40	(2)
Satara	NCP	NA	BJP	48	NA
Shirdi	SS	NA	SS(UBT)	NA	NA
Shirur	NCP	NA	NCP(SP)	NA	NA
Solapur	BJP	48	INC	45	(3)
Thane	SS	NA	SS	NA	NA
Wardha	BJP	54	NCP(SP)	41	(13)
Yavatmal-Washim	SS	NA	SS(UBT)	NA	NA

Source: Election Commission of India, Kotak Institutional Equities

GDP growth over FY2019-24 was driven by investments

Exhibit 10: Real GDP and components growth, March fiscal year-ends, 2014-24 (%)

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	5-year 2014-19	CAGR (%) 2019-24
Real GDP	**6.4**	**7.4**	**8.0**	**8.3**	**6.8**	**6.5**	**3.9**	**(5.8)**	**9.7**	**7.0**	**8.2**	**7.4**	**4.4**
Private consumption	7.3	6.4	7.9	8.1	6.2	7.1	5.2	(5.3)	11.7	6.8	4.0	7.2	4.3
Government consumption	0.6	7.6	7.5	**6.1**	**11.9**	**6.7**	**3.9**	**(0.8)**	**0.0**	**9.0**	**2.5**	**7.9**	**2.9**
Gross fixed capital formation	**1.6**	**2.6**	**6.5**	**8.5**	**7.8**	**11.2**	**1.1**	**(7.1)**	**17.5**	**6.6**	**9.0**	**7.3**	**5.1**
Inventory	(35.6)	111.7	(12.8)	(48.8)	68	27	(59)	(76)	(525)	(14.5)	(5.9)	15.2	(5.9)
Valuables	(42.7)	26.2	(1.0)	(18.6)	40	(9.7)	(14.2)	30	33	(19.1)	21.2	5.2	7.7
Exports	7.8	1.8	(5.6)	5.0	4.6	11.9	(3.4)	(7.0)	30	13.4	2.6	3.4	6.3
Imports	(8.1)	0.9	(5.9)	4.4	17.4	8.8	(0.8)	(12.6)	22	10.6	10.9	4.8	5.4

Source: CEIC, Kotak Institutional Equities estimates

SEBI had introduced a number of measures in March 2024, to curb excessive speculation in Indian equities

Exhibit 11: Key measures announced by SEBI to curb speculation in equities, calendar year-end, 2024

Measure
Warned AMFI of froth in mid-and-small cap. stocks and nudging it to moderate flows
Asked mutual funds to periodically undertake stress tests, to determine the liquidity of MF portfolio
Directed brokers to gradually raise upfront margin collection from clients to 100%
Introduced additional surveillance mechanism and graded surveillance mechanism
Reduced timeline for listing of IPO from T+6 to T+3

Source: SEBI, Media articles, Kotak Institutional Equities

Top performing PSUs have seen trailing 6-month delivery volumes exceeding their free float market caps

Exhibit 12: Delivery value/free float market cap. of top- and bottom-performing mid-cap. stocks, May 2024 (%)

	Delivery value/free float market cap. (%)									
Company Name	**Sep-23**	**Oct-23**	**Nov-23**	**Dec-23**	**Jan-24**	**Feb-24**	**Mar-24**	**Apr-24**	**May-24**	**6M Total**
Top-20 stocks on the basis of 6M performance										
BSE	14	10	11	6	7	5	5	5	5	33
Suzlon Energy	14	8	3	1	7	7	7	7	7	35
Mazagon Dock	43	15	17	32	30	22	17	38	38	176
SJVN	55	33	34	30	53	52	52	52	52	290
BHEL	21	9	19	16	23	23	14	11	13	100
Kalyan Jewellers	16	17	15	12	15	27	27	27	27	133
Prestige Estates	3	8	7	9	10	9	8	7	8	52
Rail Vikas	57	18	17	30	54	25	15	17	25	165
Bharat Dynamics	17	9	16	27	13	20	11	19	21	111
Macrotech Developers	8	5	17	4	4	7	8	5	5	32
Dixon Technologies	7	9	5	10	8	6	5	7	6	42
NMDC	15	12	12	10	13	24	13	11	9	80
Torrent Power	3	2	2	3	3	8	6	4	5	29
Oil India	6	7	7	14	11	15	9	10	8	67
Indus Towers	17	9	6	12	22	84	24	26	12	180
JSW Energy	11	12	7	8	9	8	6	9	9	50
NHPC	17	6	6	11	37	44	17	16	25	150
FACT	15	11	7	12	10	6	3	4	3	38
Cummins India	6	4	5	5	4	6	4	4	4	27
Union Bank (I)	23	12	10	13	13	24	9	9	9	77
Average	**18**	**11**	**11**	**13**	**17**	**21**	**13**	**14**	**15**	**93**
Bottom-20 stocks on the basis of 6M performance										
Bandhan Bank	14	9	11	15	23	17	14	23	13	105
AU Small Finance	3	3	4	3	8	6	5	9	4	36
Zee Entertainment	7	4	10	23	46	33	25	13	14	154
Page Industries	6	4	3	6	6	4	5	7	4	31
Dalmia Bharat	6	4	6	5	6	6	6	8	4	37
Syngene International	6	7	4	9	8	5	6	6	5	38
MMFSL	6	6	4	9	10	5	5	7	7	42
Indraprastha Gas	3	8	9	8	9	6	6	9	6	44
Jubilant Food.	8	7	6	6	9	11	8	10	6	50
Tata Elxsi	3	4	4	3	4	4	4	5	3	22
Piramal Enterprises	10	4	6	14	9	10	10	10	9	62
Tata Chemicals	4	3	3	8	5	6	16	9	4	48
Deepak Nitrite	5	4	3	6	3	3	2	6	3	23
Delhivery	3	3	9	6	10	13	9	8	7	53
Gujarat Gas	10	9	3	11	13	7	4	6	4	44
IDFC First Bank	17	8	7	13	13	8	12	11	9	64
Sona BLW	3	3	3	5	5	5	5	4	5	29
Coforge	6	7	3	6	7	5	7	6	17	47
Average	**7**	**5**	**6**	**9**	**11**	**8**	**8**	**9**	**7**	**52**

Source: Companies, Kotak Institutional Equities

Top performing PSUs have seen trailing 6-month delivery volumes exceeding their free float market caps

Exhibit 13: Delivery value/free float market cap. of top- and bottom-performing small-cap. stocks, May 2024 (%)

	Delivery value/free float market cap. (%)									
Company Name	**Sep-23**	**Oct-23**	**Nov-23**	**Dec-23**	**Jan-24**	**Feb-24**	**Mar-24**	**Apr-24**	**May-24**	**6M Total**
Top-15 stocks on the basis of 6M performance										
Cochin Shipyard	50	22	37	46	48	16	16	16	16	157
HUDCO	23	25	18	51	39	34	34	34	34	226
NBCC	32	38	23	29	56	39	39	39	39	241
Hindustan Copper	20	12	20	43	27	16	16	16	16	132
National Aluminium	10	8	8	33	34	26	26	26	26	172
Century Textiles	6	9	2	3	9	3	3	3	3	24
IRB Infra	27	21	19	19	28	15	15	15	15	109
MRPL	27	37	24	17	25	28	28	28	28	156
IOB	49	26	11	25	27	46	46	46	46	237
Exide Industries	5	4	5	6	9	4	4	4	4	32
Rites	25	12	9	15	40	30	30	30	30	175
NMDC Steel	10	8	5	9	15	12	12	12	12	73
JBM Auto	1	1	0	8	14	10	10	10	10	63
HFCL	15	7	4	23	34	28	28	28	28	168
Data Pattern	14	4	6	6	8	35	35	35	35	155
Average	**21**	**16**	**13**	**22**	**28**	**23**	**23**	**23**	**23**	**141**
Bottom-15 stocks on the basis of 6M performance										
IIFL Finance	4	3	2	24	8	3	3	3	3	42
Sonata Software	3	4	4	4	3	2	2	2	2	17
PVR Inox	9	8	4	10	14	8	8	8	8	54
Shree Renuka Sugar	25	9	9	15	10	18	18	18	18	96
CreditAccess Gramin	6	9	6	5	6	5	5	5	5	30
Angel One	9	13	11	10	11	5	5	5	5	39
Praj Industries	13	7	8	14	7	8	8	8	8	51
Tata Tele	17	6	7	10	13	16	16	16	16	86
Cyient	6	5	5	6	6	5	5	5	5	30
GNFC	13	13	13	9	11	7	7	7	7	46
KRBL	7	3	7	7	5	3	3	3	3	25
PVR Inox	9	8	4	10	14	8	8	8	8	54
Campus Activewe.	17	15	19	14	10	14	14	14	14	81
VIP Industries	15	10	9	16	15	10	10	10	10	72
Medplus Healthcare	7	3	2	4	4	10	10	10	10	50
Jyothy Labs	8	5	7	6	8	6	6	6	6	38
Happiest Minds	12	5	4	10	8	4	4	4	4	36
Tanla Platforms	6	6	5	11	12	3	3	3	3	37
Can Fin Homes	6	7	4	10	10	7	7	7	7	47
IDFC	8	7	4	5	5	4	4	4	4	26
Average	**10**	**7**	**7**	**10**	**9**	**7**	**7**	**7**	**7**	**48**

Source: Companies, Kotak Institutional Equities

Sharp increase in options premium traded per retail client, compared to growth in cash turnover per retail investor

Exhibit 14: Key growth metrics for cash and options, March fiscal year-ends, 2016-24

	2016	2017	2018	2019	2020	2021	2022	2023	2024	2016-24 CAGR (%)
Index options										
Premium turnover (Rs bn)	2,085	3,500	4,607	6,541	10,825	26,294	58,423	109,556	138,196	69
Share of retail (%)	22	25	25	27	29	32	34	35	35	6
Retail options premium (Rs bn)	459	875	1,152	1,766	3,118	8,283	19,689	38,454	48,368	79
Active F&O traders (# mn)	0.57	0.6	0.8	1.3	1.4	2.0	4.5	8.5	9.7	42
Premium traded per client (Rs)	800,399	1,409,140	1,372,995	1,391,406	2,205,901	4,069,099	4,421,358	4,507,865	5,002,248	26
Cash equities										
Cash turnover (Rs bn)	42,370	50,559	72,348	79,490	89,988	153,979	165,662	133,051	201,034	21
Share of retail (%)	33	36	39	39	39	45	41	37	36	1
Retail cash turnover (Rs bn)	13,982	18,201	28,216	31,001	34,915	69,291	67,425	48,564	71,367	23
Active cash traders (# mn)	4.56	4.9	6.3	7.3	8.4	12.8	23.0	25.5	26.7	25
Cash turnover per client (Rs)	3,067,676	3,684,734	4,491,695	4,266,169	4,168,695	5,409,424	2,930,058	1,907,747	2,674,941	(2)

Notes:

(a) Above calculations consider aggregate trading volume and active traders for both individual and non-individual traders.

Source: NSE, Kotak Institutional Equities

We estimate sharp increase in losses experienced by retail option traders

Exhibit 15: Estimation of retail losses in index options trading, March fiscal year-ends, 2019-24

			2024E			
	2019	2022	Scenario-1 *(2022 loss rate)*	Scenario-2 *(2019 loss rate)*	Scenario-3 *(50% of 2022)*	Scenario-4 *(50% of 2019)*
Active retail traders (# mn)	0.6	4.0	7.9	7.9	7.9	7.9
Retail premium turnover at NSE (Rs bn)	1,766	19,689	48,368	48,368	48,368	48,368
Average P&L of retail investor in the year (Rs)	(53,830)	(64,136)	(78,814)	(114,438)	(39,407)	(57,219)
Aggregate profit/(losses) of retail investors (Rs bn)	(33)	(255)	(626)	(910)	(313)	(455)
Aggregate P&L (% of premium turnover)	*(1.9)*	*(1.3)*	*(1.3)*	*(1.9)*	*(0.6)*	*(0.9)*
Transaction cost (assumed @20% of P&L) (Rs bn)	(7)	(51)	(125)	(182)	(63)	(91)
Overall P&L estimate (Rs bn)	**(40)**	**(306)**	**(752)**	**(1,092)**	**(376)**	**(546)**

Notes:

(a) 'Overall P&L' mentioned above is purely an estimate; actual numbers may vary significantly.

(b) Individual investor excludes proprietary traders, institutions, partnership firms etc.

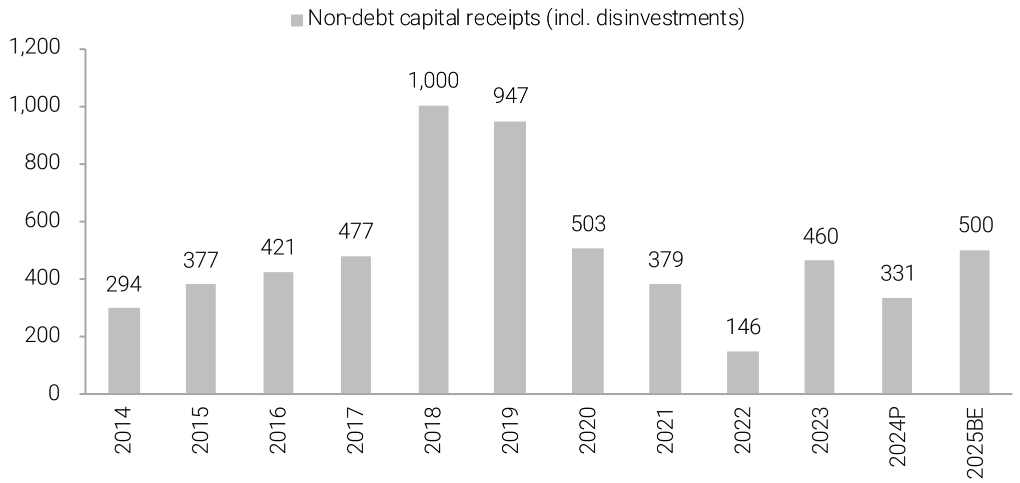
(c) Active traders are individual traders who traded in equity F&O segment more than five times during a year.

(d) We extrapolate active traders for 2024 on pro-rata basis using monthly active F&O traders data from NSE.

Source: SEBI, NSE, Kotak Institutional Equities estimates

Monetization of assets by the government has been quite slow over FY2019-24

Exhibit 16: Non-debt capital receipts (including disinvestments), March fiscal year-ends, 2014-25BE (Rs bn)



Source: Union Budget, Kotak Institutional Equities

Government can raise around Rs23 tn if it was to sell its entire holding in non-financial PSUs

Exhibit 17: List of PSUs with more than 51% government holding (sorted on market cap.)

	Market Cap.		Govt holding	Stake sale	
Company	**(Rs bn)**	**(US$ bn)**	**(%)**	**Entire**	**up to 51%**
Non-financial PSUs					
NTPC	3,468	42	51.1	1,772	3
Hindustan Aeronautics	3,537	42	71.6	2,534	730
ONGC	3,420	41	58.9	2,014	270
Coal India	2,978	36	63.1	1,880	361
Power Grid Corp.	3,019	36	51.3	1,550	10
IOCL	2,386	29	51.5	1,229	12
Bharat Electronics	2,280	27	51.1	1,166	3
GAIL (India)	1,437	17	51.5	741	7
BPCL	1,358	16	53.0	720	27
BHEL	1,022	12	63.2	645	124
NHPC	1,007	12	67.4	679	165
IRCTC	812	10	62.4	507	93
Rail Vikas Nigam	808	10	72.8	588	176
NMDC	801	10	60.8	487	78
Mazagon Dock	803	10	84.8	681	272
Oil India	743	9	56.7	421	42
Container Corp.	668	8	54.8	366	25
SAIL	636	8	65.0	414	89
Bharat Dynamics	575	7	74.9	431	138
Cochin Shipyard	587	7	72.9	428	128
SJVN	520	6	81.9	425	160
Fertilizers & Chemicals Travancore	706	8	90.0	635	275
National Aluminium Co.	351	4	51.3	180	1
Hindustan Copper	323	4	66.1	214	49
NLC India	321	4	72.2	232	68
ITI	295	4	90.0	265	115
NBCC	294	4	61.8	182	32
KIOCL	283	3	99.0	280	136
IRCON International	251	3	65.2	164	36
Total	**37,961**	**455**		**23,381**	**4,021**
Financial PSUs					
State Bank of India	7,530	90	56.9	4,286	446
LIC	6,498	78	96.5	6,271	2,957
IRFC	2,252	27	86.4	1,945	796
PFC	1,589	19	56.0	889	79
Bank of Baroda	1,475	18	64.0	943	191
Punjab National Bank	1,415	17	73.2	1,035	313
Indian Overseas Bank	1,265	15	96.4	1,220	574
Union Bank	1,114	13	74.8	833	265
Canara Bank	1,099	13	62.9	692	131
Indian Bank	734	9	73.8	542	168
GIC	680	8	85.8	584	237
UCO Bank	687	8	95.4	655	305
Bank of India	560	7	73.4	411	125
Central Bank of India	567	7	93.1	528	239
HUDCO	565	7	75.0	424	136
IREDA	477	6	75.0	358	114
Bank of Maharashtra	469	6	86.5	406	166
Punjab & Sind Bank	418	5	98.3	410	197
New India Assurance	414	5	85.4	354	143
Total	**30,126**	**361**		**22,993**	**7,629**
Total (financial + non-financial)	**68,087**	**816**		**46,374**	**11,650**

Source: Capitaline, Kotak Institutional Equities

We assume stable gross and EBITDA margins over FY2025-26E after a sharp jump in FY2024 for automobile and component companies

Exhibit 18: Gross margin and EBITDA margin of auto companies, March fiscal year-ends, 2017-26E (%)

	Gross margin (%)										EBITDA margin (%)									
	2017	2018	2019	2020	2021	2022	2023	2024	2025E	2026E	2017	2018	2019	2020	2021	2022	2023	2024	2025E	2026E
Amara Raja Batteries	34.4	32.1	31.6	35.0	33.6	29.6	28.3	33.1	34.4	34.2	16.0	14.6	14.0	16.1	15.6	11.8	11.8	14.4	15.2	15.5
Apollo Tyres	47.7	43.4	42.2	44.5	46.0	40.9	40.4	46.2	44.1	43.3	14.0	11.1	11.2	11.9	16.1	12.3	13.5	17.5	16.0	15.7
Ashok Leyland	30.6	30.1	28.8	29.2	25.5	22.7	22.9	27.3	26.5	25.3	10.9	11.2	10.8	6.7	3.5	4.6	8.1	12.0	11.7	10.7
Bajaj Auto	31.0	29.5	26.9	28.3	28.1	25.4	27.2	27.7	27.2	26.7	20.3	19.2	17.1	17.0	17.8	15.9	18.0	19.7	19.4	19.3
Balkrishna Industries	58.3	54.1	53.9	56.6	59.9	55.3	51.0	52.5	53.5	53.3	32.0	28.9	26.8	28.5	31.8	26.2	20.2	25.1	25.3	26.1
Bharat Forge	46.9	46.1	44.0	41.4	42.9	45.4	39.6	40.2	41.1	42.7	19.6	20.6	20.3	13.8	13.6	19.3	13.7	16.3	17.9	19.5
CEAT	41.0	39.4	40.1	42.2	43.9	35.6	34.7	42.0	40.6	40.0	11.4	9.8	9.2	10.7	12.9	7.6	8.6	13.8	12.4	12.1
CIE Automotive	59.7	56.2	54.8	51.8	53.7	52.2	45.4	47.1	47.7	47.6	10.0	12.7	13.1	12.4	8.3	12.1	13.4	15.3	15.9	16.3
Eicher Motors	47.3	48.2	48.4	45.4	41.4	42.2	43.1	45.7	46.2	46.2	30.9	31.3	29.6	23.8	20.4	21.1	23.8	26.2	26.7	26.8
Endurance Technologies	42.3	42.4	42.1	46.0	45.5	41.4	39.5	40.9	40.8	40.5	13.6	14.6	15.0	16.3	15.9	12.8	11.8	13.0	13.3	13.7
Escorts	31.8	32.6	31.6	33.7	33.7	31.0	27.3	31.2	31.3	31.3	7.9	11.2	11.8	11.7	16.3	13.3	9.4	13.3	13.5	13.7
Exide Industries	37.8	34.6	34.2	36.4	34.5	30.7	30.1	30.9	32.4	25.0	14.3	13.5	13.3	13.8	13.5	11.3	10.7	11.7	12.8	13.3
Hero Motocorp	32.1	31.1	29.5	30.4	28.3	27.6	28.4	31.1	31.5	30.8	16.3	16.4	14.7	13.7	13.0	11.5	11.8	14.0	14.5	14.3
Mahindra & Mahindra	32.3	33.5	31.9	33.4	32.4	26.3	24.0	25.1	25.0	25.0	13.1	14.8	14.2	14.2	15.6	12.3	12.3	13.1	13.3	13.7
Maruti Suzuki	31.3	31.1	30.8	29.7	27.7	25.2	26.6	28.6	28.7	28.6	15.2	15.1	12.8	9.7	7.6	6.5	9.4	11.6	11.7	12.0
MRF	44.1	39.1	39.6	40.8	42.3	34.9	32.9	40.1	38.4	37.9	19.6	15.3	14.4	14.6	18.2	10.6	10.4	16.9	14.8	14.6
Samvardhana Motherson	–	–	–	–	43.2	42.2	42.5	44.9	43.7	43.4	–	–	–	–	7.6	7.0	8.0	9.4	9.6	10.0
Schaeffler India	39.6	39.4	37.0	36.9	38.0	37.7	38.1	37.9	38.0	38.3	16.5	17.3	16.2	14.5	14.3	17.5	18.8	18.2	18.1	18.7
SKF	38.2	41.6	41.5	37.0	41.5	38.8	40.4	39.2	41.0	40.7	12.8	15.8	16.0	12.3	15.7	15.2	17.4	15.7	17.8	18.1
Sona BLW Precision	–	61.4	59.5	57.9	58.8	55.6	54.4	56.9	55.8	55.1	–	28.2	28.9	26.7	28.2	26.2	26.0	28.8	28.9	28.8
Tata Motors	38.5	36.3	35.0	36.0	36.6	35.0	34.5	37.7	38.3	36.5	12.4	10.4	8.5	7.6	12.2	8.9	9.2	13.6	14.6	14.8
Timken	40.9	41.0	44.2	46.8	44.3	45.8	40.9	41.0	41.7	41.3	15.0	13.2	17.3	22.4	17.9	23.2	20.0	19.7	21.6	22.0
TVS Motor	27.0	26.6	24.0	26.1	24.0	24.0	24.2	26.3	26.4	26.3	7.1	7.7	7.9	8.2	8.5	9.4	10.1	11.1	11.5	11.6
Uno Minda	37.5	38.2	38.7	38.8	38.5	36.6	35.7	35.4	34.9	34.3	11.0	11.9	12.3	10.8	11.4	10.7	11.1	11.3	11.5	11.7
Varroc Engineering	35.1	37.9	37.1	37.2	33.5	34.1	35.7	37.3	36.9	37.0	6.3	8.6	8.8	7.4	3.5	6.1	8.3	10.2	10.4	10.8

Source: Companies, Kotak Institutional Equities estimates

We assume stable gross and EBITDA margins over FY2025-26E after a sharp jump in FY2024 for capital goods companies

Exhibit 19: EBITDA margins of capital goods companies, March fiscal year-ends, 2015-26E (%)

	EBITDA margin (%)											
	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025E	2026E
ABB	7.2	8.8	8.0	6.8	6.8	7.3	4.7	8.0	11.2	14.3	16.6	15.8
Bharat Electronics	16.6	18.9	20.6	19.6	23.9	21.2	22.8	21.7	23.0	24.9	24.5	24.7
BHEL	7.0	(5.4)	3.7	6.7	7.1	(1.1)	(18.1)	3.5	4.1	2.6	(0.0)	3.5
Carborundum Universal	11.4	15.5	15.8	16.8	16.3	15.3	17.7	16.1	14.0	15.7	16.4	17.3
CG Power & Industrial	4.6	7.0	7.7	7.2	4.5	1.4	3.6	11.5	14.2	13.9	14.3	13.2
Cochin Shipyard	5.7	19.7	18.7	19.7	19.3	20.7	25.5	19.8	11.2	22.7	17.7	17.7
Cummins India	16.7	16.5	15.8	14.4	15.3	11.4	13.4	14.4	16.0	19.7	19.9	20.3
G R Infraprojects	10.1	11.8	17.1	18.5	20.4	20.6	18.1	16.2	16.1	14.6	13.6	15.5
IRB Infrastructure	57.5	51.9	52.1	47.1	44.5	43.4	47.4	48.2	50.4	45.0	46.2	47.0
Kalpataru Projects	9.8	11.0	11.5	11.7	12.4	11.7	11.7	8.7	8.4	8.3	8.9	9.2
KEC International	6.0	8.1	9.5	10.0	10.5	10.3	8.7	6.6	4.8	6.1	7.5	8.7
L&T	11.0	10.3	10.1	11.3	11.6	11.2	11.5	11.6	11.3	10.6	10.5	11.0
Siemens	9.3	9.4	9.5	10.3	11.6	10.0	11.1	10.9	12.7	14.3	14.3	14.3
Thermax	8.6	8.3	9.7	9.0	7.7	7.1	7.4	6.9	7.4	8.6	10.3	11.3

Source: Companies, Kotak Institutional Equities estimates

We assume stable gross and EBITDA margins over FY2025-26E after a sharp jump in FY2024 for consumer companies

Exhibit 20: Gross and EBITDA margins of consumer companies, March fiscal year-ends, 2017-26E (%)

	Gross margin (%)										EBITDA margin (%)									
	2017	2018	2019	2020	2021	2022	2023	2024	2025E	2026E	2017	2018	2019	2020	2021	2022	2023	2024	2025E	2026E
Asian Paints	44.7	42.9	41.4	43.7	44.3	37.1	38.7	43.4	42.3	41.2	19.8	19.6	18.2	20.6	22.4	16.5	18.2	21.4	20.0	19.0
Berger Paints	43.1	41.7	39.0	41.5	43.3	38.0	36.3	40.7	39.8	38.9	15.8	15.6	14.5	16.7	17.4	15.2	14.1	16.6	15.6	14.8
Britannia Industries	38.3	38.4	40.6	40.3	41.9	38.0	41.2	43.4	44.1	44.3	14.1	15.1	15.7	15.9	19.1	15.6	17.4	18.9	19.3	19.5
Colgate-Palmolive (India)	62.9	64.4	65.1	65.2	68.0	67.3	65.7	69.7	69.9	70.2	23.7	26.6	27.7	26.6	31.2	30.7	29.6	33.5	33.9	34.4
Dabur India	50.1	50.4	49.5	49.9	50.1	48.2	45.6	48.0	48.3	48.3	19.6	20.9	20.4	20.6	21.1	20.7	18.8	19.4	20.0	20.1
Godrej Consumer Products	55.4	56.6	55.8	57.0	55.3	50.5	49.7	55.2	56.5	56.9	20.5	21.0	20.5	21.6	21.7	19.5	18.3	20.9	23.1	23.7
Hindustan Unilever	50.8	53.0	53.0	54.1	52.9	50.9	47.3	51.5	52.4	52.8	19.0	21.1	22.6	24.8	24.6	24.4	23.0	23.5	23.7	24.2
ITC	60.1	61.1	61.5	62.2	56.1	53.4	56.3	58.8	59.0	59.2	36.4	38.3	38.5	39.2	34.1	33.6	36.3	37.4	36.9	37.3
Jubilant Foodworks	75.6	74.6	75.1	75.0	78.1	77.5	75.9	76.4	76.4	76.5	9.3	14.6	16.8	22.3	23.3	25.5	22.7	20.5	20.9	22.1
Jyothy Laboratories	46.9	47.7	46.5	47.4	47.1	41.6	42.3	49.1	49.3	49.0	15.3	15.4	15.5	14.7	16.5	11.3	12.7	17.4	17.1	17.1
Kansai Nerolac	41.4	39.5	36.2	38.1	37.9	30.0	30.0	35.7	34.7	33.9	18.3	17.2	14.3	15.8	17.8	10.5	11.2	14.2	13.4	12.9
Marico	52.2	47.0	45.2	48.8	46.9	42.9	45.2	50.8	50.8	50.9	19.6	18.0	17.5	20.1	19.8	17.7	18.5	21.0	21.0	21.2
Nestle India	57.2	56.5	59.1	57.5	57.3	56.7	53.8	55.9	56.5	56.9	21.7	21.7	23.7	22.9	23.7	23.6	21.7	23.6	23.8	24.2
Page Industries	59.5	57.4	58.0	55.5	55.4	56.0	55.8	54.5	55.7	56.5	19.4	21.2	21.7	18.1	18.6	20.2	18.3	19.0	19.6	20.5
Pidilite Industries	53.0	52.5	49.3	53.4	53.7	45.1	42.7	51.6	51.9	52.0	22.4	22.1	19.3	21.6	23.0	18.6	16.8	21.9	23.1	23.7
Tata Consumer Products	47.5	45.7	44.7	43.9	40.5	43.0	41.9	43.7	43.9	44.1	11.7	12.3	10.8	13.4	13.3	13.8	13.5	15.0	16.3	17.0
Titan Company	28.3	27.5	27.2	28.0	24.2	24.9	25.2	22.8	24.0	24.2	8.7	10.2	10.8	11.7	8.0	11.6	12.0	10.4	11.3	11.5
United Breweries	53.9	53.2	53.6	51.6	52.2	49.9	43.1	42.7	45.5	48.5	13.6	16.1	17.6	13.5	9.0	11.9	8.2	8.6	11.9	15.5
United Spirits	42.9	47.5	48.8	44.8	43.4	43.9	41.5	43.4	43.6	43.9	11.4	12.5	14.3	16.6	12.5	16.0	13.7	16.0	16.6	17.1
Varun Beverages	55.0	54.8	56.0	54.8	57.1	54.3	52.5	53.8	54.2	54.5	20.6	20.9	19.7	20.3	18.6	18.8	21.2	22.5	23.2	23.5

Source: Companies, Kotak Institutional Equities estimates

Economy

Quarterly CA surplus in Q4FY24; merchandise and services improvement to enable small surplus in FY25 too

India's balance of payments (BoP) current account swung to a surplus of USD 5.7bn (0.6% of quarterly GDP) in Q4FY24 (in line with our forecast), from a deficit of USD 1.3bn (0.2% of GDP) in Q4FY23. The merchandise deficit shrank as exports rebounded by 5% YoY, slightly outpacing imports, but the services and incomes surpluses also expanded YoY. The quarterly surplus helped cut the current account deficit (CAD) to 0.7% of GDP in FY24. The rebound in global trade in CY24 should bolster India's merchandise exports, which grew 9.1% YoY in May'24 and are set to accelerate. Subdued commodity-import prices should also contribute to reining-in the merchandise deficit, while a modestly larger services surplus contributes to a current account surplus of 0.5% of GDP in FY25.

Net FPI the big contributor to large overall BoP surplus

On the financial account, massive net portfolio investment inflows (of USD 11.8bn in Q4FY24 and USD 44bn in FY24) compensated for a sharp reduction in net FDI inflows (just USD 9.8bn), resulting both from lower FDI inflows (USD 26.5bn in FY24, vs USD 42bn in FY23) and larger FDI outflows by Indian corporate investing abroad (USD 16.7bn in FY24 vs USD 14bn in FY23). With contributions from net accretion of NRI deposits and other loans to India (including ECBs), the overall BoP surplus was USD30.8bn in Q4FY24 and USD 63.7bn in FY24.

INR needs to depreciate, so FX reserves are likely to surge

In FY25, net FDI inflows are likely to be modestly stronger as the election-linked uncertainties recede. Net foreign portfolio inflows will remain robust, particularly into bonds, aided by India's impending inclusion in the benchmark emerging market bond index. Despite the strong overall BoP position, however, we expect INR to depreciate to compensate for its 4.25% YoY real effective appreciation in the year to May'24. We expect the rupee to reach INR85.5/USD by Mar'25, thereby restoring competitiveness relative to Asian currencies (CNY, JPY, MYR, THB, IDR, TWD) that have depreciated far more than INR in the past year. With a current account surplus and net financial inflows, India's foreign exchange reserves are likely to reach USD 750bn by Mar'25 in order to bring about that depreciation of INR.

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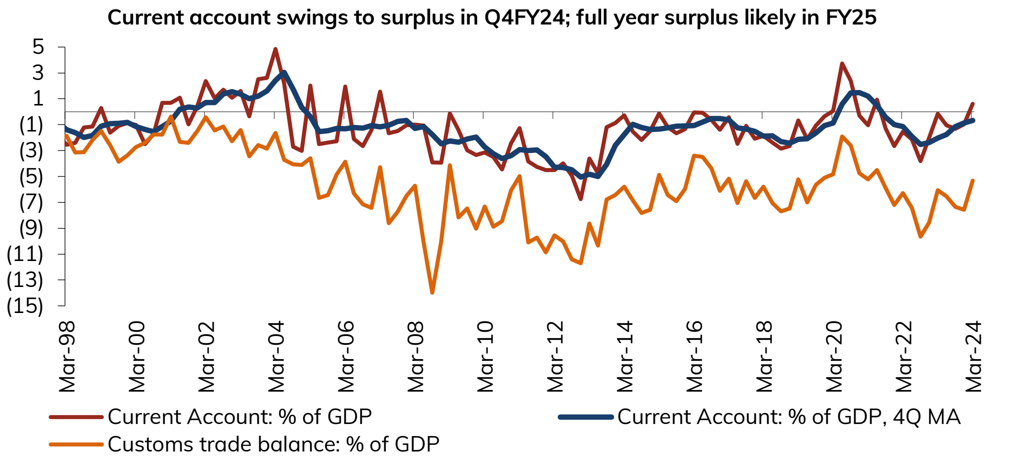
Current account surplus of 0.6% of GDP in Q4FY24, as merchandise, services and income balances all improve

India's BoP current account swung to a surplus of USD 5.7bn (0.6% of GDP) in Q4FY24 (from a deficit of 0.2% of GDP in Q4FY23), in line with our expectations. In Q4FY24, the merchandise deficit shrank to USD 50.3bn (5.3% of GDP) from USD52.6bn (6.1% of GDP) in QQ4FY23, while the services surplus widened to USD 42.7bn (from USD 39.1bn a year earlier) and the net incomes surplus widened to USD 13.9bn in Q4FY24 (from USD 12.2bn in Q4FY23). The services surplus has widened sharply over the past two years, with services exports strongly outpacing services imports as some services that were imported in the past are substituted by domestic provision. The income balance remains relatively stable, with a primary income deficit (reflecting outflows of investment income – profits, royalties, etc. – of MNCs with a presence in India) widening YoY to USD 14.8bn (from USD 12.6bn) a year ago, more than offset by a secondary income surplus (mainly remittances from Indians working abroad) of USD 32.9bn in Q4FY24 (up 11. 9% YoY).

The big turnaround in the quarterly current account balance enabled the FY24 CAD to shrink to USD 23.2bn, or 0.67% of GDP (from USD 67bn, or 2% of GDP, in FY23). There is pronounced seasonality in India's current account, with the Jan-Mar quarter (Q4 of each fiscal year) being by far the strongest, and the Apr-Sep period being relatively weak. We consequently track the 4qma (4-quarter moving average) of the current account, as it smooths out seasonality. The steady improvement in the 4qma of the CAD over the past six quarters should persist into FY25.

Exhibit 1: Q4FY24 surplus cuts FY24 CAD to 0.67% of GDP



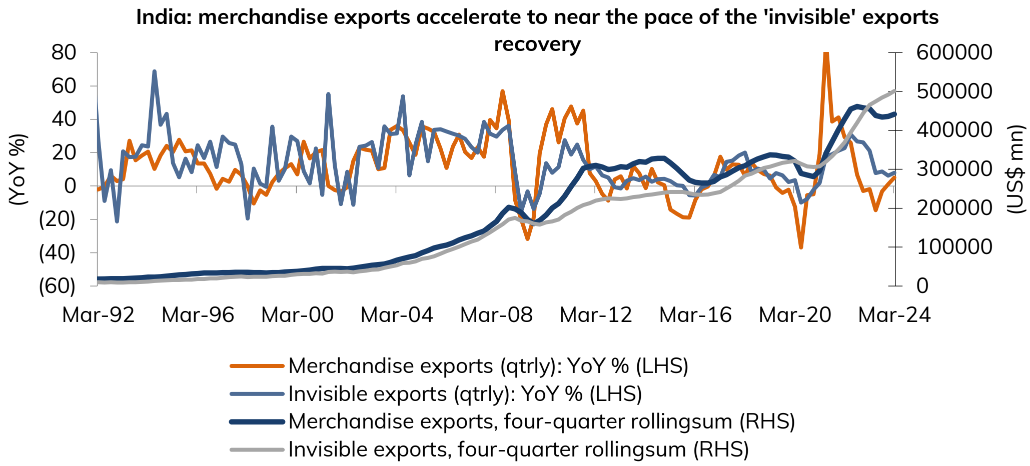
Source: I-Sec, based on data from RBI and CEIC

With both goods and invisible export engines firing, India's economy will receive a fillip

Exhibit 2 illustrates the structural transformation of India's external sector over the past 33 years. Like all emerging or industrializing economies (starting with Britain in the 1760s), India's economic dynamism since 1991 owes primarily to its ability to tap the global market – i.e., to export goods and services. Given that the global economy is much bigger than any domestic economy, rapid export growth imparts dynamism to an emerging economy that it cannot acquire purely from its domestic market. India's exports of goods and 'invisibles' rose from USD 25.94bn in FY1991 (the year before the economic reforms) to USD 942.9bn in FY24 – a 36.3-fold increase over 33 years. India's invisible exports have grown most spectacularly – to USD 501bn in FY24 from USD 7.46bn in FY1991 (a 67-fold increase in 33 years). But the growth in merchandise exports has been impressive as well – from USD 18.48bn in FY1991 to USD 441.5bn in FY2024 (a 23.8-fold jump over 33 years).

The global trade recession in CY23 caused India's merchandise exports to decline over the four quarters ending in Sep'23, but H2FY24 saw the advent of a merchandise export recovery – 1% YoY growth in Q3FY24 and 5% YoY growth in Q4FY24. Invisible exports grew at strong double-digit growth rates (18-31% YoY) for eight consecutive quarters ending in Mar'23, decelerating to a still-impressive 8% YoY growth pace in FY24. India is blessed with not one but two export engines (goods and invisibles). They don't both fire at the same time, but when they do (as currently), they impart substantial dynamism to India's economy.

Exhibit 2: 'Invisible' exports up 67-fold, merchandise nearly 24-fold in the last 33 years



Source: I-Sec, based on data from RBI and CEIC

Further reduction in merchandise deficit and widening of services surplus likely in FY25

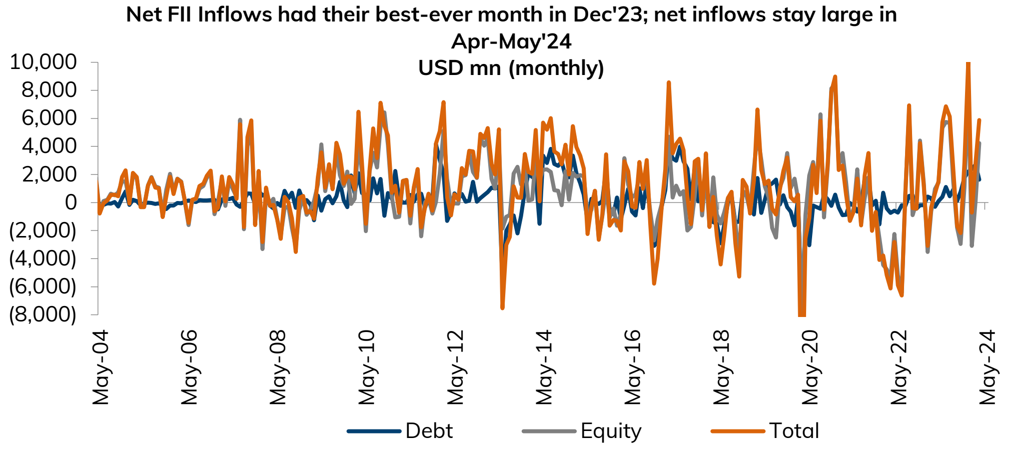
CY23 was a 'global trade recession' year. Since 1945, global trade volume has usually grown at least 1.5x as fast as global real GDP (except in recession years). Although there was no global recession in CY23, global trade volume grew just 0.4% -- much slower than the 3.1% pace of global real GDP growth. This year, global trade volume is recovering strongly from last year's 'trade recession', and the WTO expects global trade volume to grow over 4% this year. The OECD composite leading indicator for the G20 rose to a 2.5-year high in May'24, suggesting a faster acceleration in global trade this year. We expect India's merchandise exports (which grew 9.1% YoY in May'24) to steadily accelerate. Subdued prices of key commodity imports (crude oil, edible oil, coal, fertilisers, etc.) should contribute to a further improvement in the merchandise deficit this year. And the services surplus is likely to widen further (about 5-10% this year, slower than the 15-20% YoY widening in that surplus in each of the past two years). But those factors should suffice to ensure a current account surplus of 0.5% of GDP in FY25.

Overall BoP surplus of USD 31bn in Q4FY24 and USD 63.7bn in FY24

Net FDI inflows were a modest USD 1.96bn in Q4FY24, as inflows of FDI into India of USD 7.72bn were offset by Direct Investment overseas by Indian corporates of USD 5.76bn. Net foreign portfolio inflows, however, soared to USD 11.8bn in Q4FY24 (vs a net outflow of USD 1.7bn in Q4FY23). External commercial borrowings (ECBs) stayed modest (just USD 2.6bn), while the net inflow of NRI deposits rose 50% YoY to USD 5.4bn. With a current account surplus and net inflows on all heads of the financial account, India's overall BoP surplus was a healthy USD 30.8bn in Q4FY24. For all of FY24, the small CAD of USD 23.2bn (0.67% of GDP) was amply funded by net portfolio inflows of USD 44.1bn (a turnaround from the net outflow of USD 5.2bn in FY23), and net FDI inflow of USD 9.8bn (down from USD 28bn in FY23). With ECBs and other loans to India adding USD 32bn, there was an overall BoP surplus of USD 63.7bn in FY24.

With election-related uncertainty removed, net FDI should improve in FY25, and net foreign portfolio inflows are likely to remain large with India's impending inclusion in the benchmark emerging market bond index.

Exhibit 3: Net portfolio inflows were a big plus in FY24

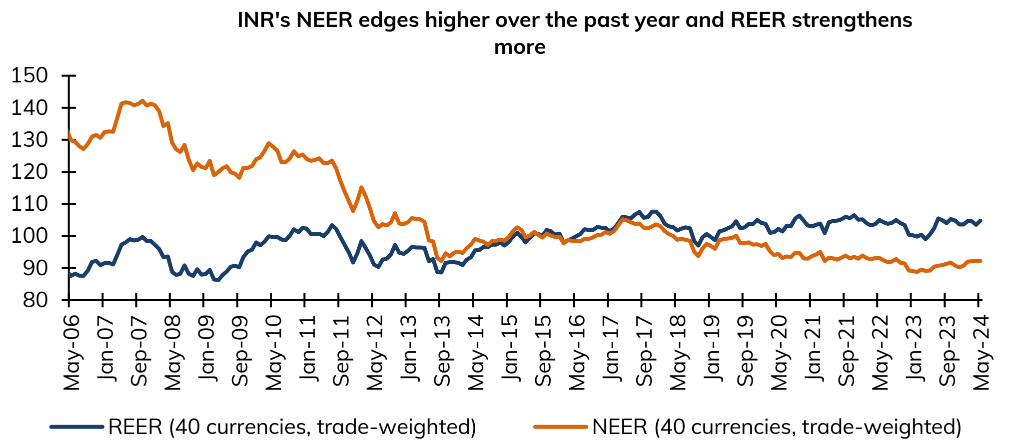


Source: I-Sec, based on data from NSDL and CEIC

FX reserves to reach USD 750bn by Mar'25 in order to enable INR depreciation

Despite the strong overall BoP position, we think INR is likely to depreciate against the USD over the next few months to compensate for the big depreciations of several competitor currencies in Asia over the past year. As of end-May'24, JPY had depreciated 13.7% YoY, China's RMB 3.5%, MYR 4.5%, THB 7.1% YoY against the USD – while INR had only depreciated 1.3%. Consequently, INR's nominal effective exchange rate (NEER) had appreciated 3.37% YoY. And given that India's inflation was slightly higher than the average of its trading partners, INR's REER had appreciated 4.25% YoY as of May'24. To compensate, we expect INR to depreciate slightly less than 3% against USD by Mar'25 to INR 85.5/USD, while the moderation in India's inflation rate also contributes to a real effective depreciation. To bring this about in the face of an overall balance of payments surplus, India's foreign exchange reserves are likely to rise by about USD 100bn during FY25, reaching USD 750bn by Mar'25.

Exhibit 4: INR has appreciated 3.4% YoY in nominal terms, 4.3% YoY in real terms



Source: I-Sec, based on data from RBI and CEIC

India Banks

Global Markets Research
24 June 2024

EQUITY: BANKS

Diagnosing lagging system deposit growth

LCR and LDR to remain system loan growth constraints in FY25F, in our view

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We take a deep dive into the Reserve Bank of India (RBI)'s money supply data to discern the reasons for 'lagging' deposit growth for the banking system over the past two years. As against 14% and 16% y-y growth in bank commercial credit (i.e., including corporate bonds) over FY23 and FY24, system deposit growth has lagged at 9% y-y and 12% y-y respectively, putting pressure on system liquidity. Credit creates deposits and over a longer-term timeframe, both deposit growth and credit growth tend to be roughly equal; hence, this persistent divergence has been concerning. Our analysis (*Fig. 3*) suggests that the key drag on deposit creation in FY24 arose from: a) lower net credit to the government from the banking system, and b) higher net non-monetary liabilities of banks.

Going into FY25F, we argue that deposit positives due to flows from the JP Morgan bond index inclusion can be offset by a 'normal' pick-up in currency in circulation in the system (which was not seen in FY24 due to the INR 2,000 note withdrawal by the RBI). Any sustainable pick-up in deposit growth (above our base case of 13% y-y for FY25F) will, hence, require substantial increase in bank credit to the government or forex assets purchases by the RBI. In the absence of these, we think liquidity coverage ratio (LCR) and loan-to-deposit ratio (LDR) should continue to be system loan growth constraints. We continue to have a 'value'-focused approach amid the broader convergence in RoEs across the sector, with a preference for more liquid banks. We rejig our **top picks list to now include Kotak Bank (KMB, Buy) and exclude Axis Bank (**AXSB, Buy**).** Our top picks now are **ICICIBC, SBIN, KMB among large banks** and **FB among mid-sized banks, all rated Buy.**

Deposit creation in FY23 and FY24 affected by lower bank credit to government and higher non-monetary liabilities of banks/ RBI

All deposits are created through: a) credit, and b) RBI's forex interventions (where RBI purchases forex assets by creating rupees). On the credit front, while the widely-tracked incremental commercial credit formation has been strong (14%/16% y-y in FY23/24), it is the **banking system credit to the government that has lagged** over the past two years (*Fig. 3*), creating a drag on system deposits. This is understandable given the path of fiscal consolidation followed by the government since FY22. The other key drag on deposit creation has been the **higher incremental non-monetary liabilities of banks and the RBI** over the past two years. For banks, this is mainly arising out of higher equity capital formation (amid rising RoE) and slight pick-up in borrowings (*Fig. 5*). For RBI, this is predominantly arising out of higher interest income (leading to higher capital buffers) in a higher interest rate regime (*Fig. 4*). Both these drivers for higher non-monetary liabilities should persist over the near-to-medium term, in our view.

FY25F: Deposit positive from JP Morgan index flows can be offset by an increase in cash in circulation

Media reports indicate that India may see US$ 25-30bn of FPI inflows arising out of the JP Morgan bond index inclusion. If this is offset by a similar increase in FX reserves by the RBI, it could create INR 2-3trn of fresh deposits for the system. However, the positive impact here can be almost completely negated by a 'normal' pick-up in cash in circulation. Cash in circulation (*Fig. 6*) increased by only INR1.3trn in FY24 (vs INR 3trn on an average seen annually post-FY17, aided by the RBI's INR2,000 note withdrawal). In the absence of any such triggers in FY25, cash in circulation should continue to increase at a similar pace of ~INR 3 trn in FY25, offsetting the positive impact on system deposits due to the bond index inclusion.

Flows into capital markets have no effect on system deposits

There is a misplaced narrative among many investors that money moving into capital

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markets (stocks and mutual funds) is affecting system deposit growth. This is incorrect, as flows into capital markets stay with the banking system (money flows from the buyer's deposit account to the seller). In fact, money in capital markets finds no mention in RBI's broad money statistics – as this is already accounted for in system deposit data.

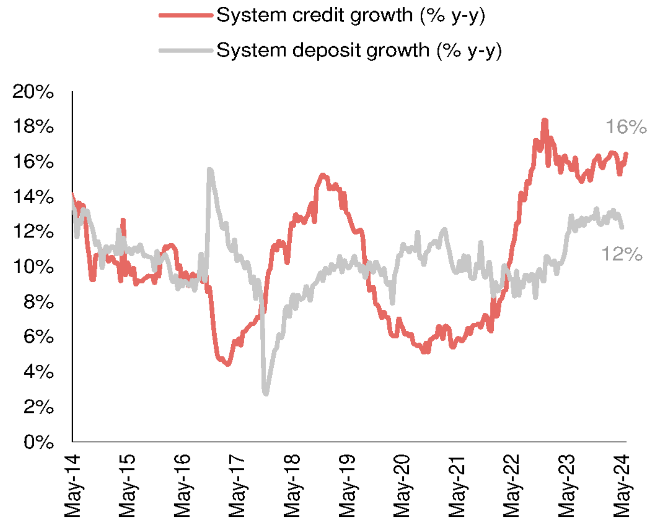
Any sustainable pick-up in deposit growth will require substantial increase in credit to the government or forex assets purchased by the RBI

As highlighted previously, we expect commercial system credit to grow at ~14% in FY25F. With this assumption in place, it would require significant increase in credit to government or forex assets purchases by the RBI, for deposits growth to pick up to 14% in FY25F. Otherwise, our base case still builds in 13% y-y deposit growth for the system. This will still result in a gap between system credit and deposit growth; and hence LDR/LCR constraints for some large private banks could persist, in our view.

LCR and LDR can remain system loan growth constraints

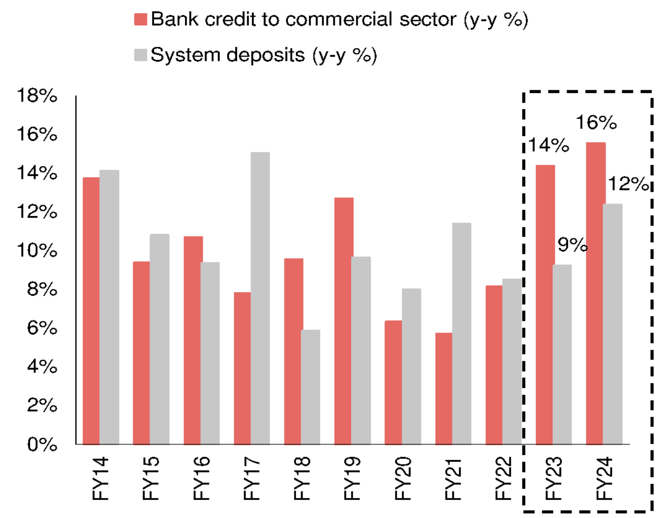
While banks can create deposits by extending commercial credit, this is incrementally LCR-negative, given commercial credit does not qualify as a high quality liquid asset (HQLA). Hence, for banks with lower LCR (and generally higher LDRs), this does create a constraint on loan growth. As shown in *Fig. 8* - *10* , PSU banks still have higher LCRs vs private banks, although this has come down significantly over the past two quarters. We believe some of the large private banks with higher LDRs (e.g. HDFCB, AXSB and IIB) may see a moderation in loan growth (*Fig. 11*), and we reduce our loan growth estimates for these over the past two quarters.

Fig. 1: Banking system loan growth remained strong at 16% y-y (as of 31 May-24), deposit growth continues to lag with 12% y-y growth



Source: RBI data, Nomura research

Fig. 2: System deposits growth has been lower over the past two years with 9%/12% growth in FY23/FY24 (vs commercial credit growth of 14%/16% in FY23/FY24)*



Source: RBI data, Nomura research; *commercial credit here includes corporate bonds

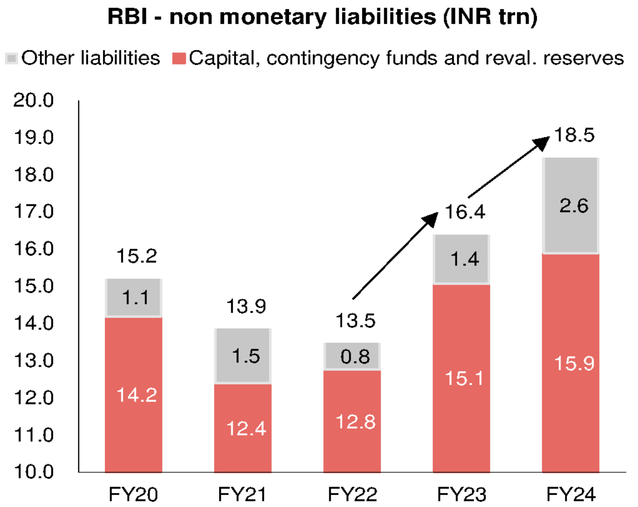
Fig. 3: Analysing incremental deposit formation via RBI data on broad money supply: Lower net credit to the government and higher net non-monetary liabilities of banks and RBI have constrained incremental deposit formation in FY23 and FY24

	Deposit positives (INR trn) -- (A)				Deposit negatives (INR trn) -- (B)				
Year	Increase in bank credit to commercial sector	Increase in bank credit to Govt	Increase in RBI credit to Govt	Increase in net forex assets	Increase in net non monetary liabilities of banks	Increase in net non monetary liabilities of RBI	Increase in currency in circulation	Increase in deposits (INR trn) = Sum of A - Sum of B	% increase in deposits
FY02	0.8	0.8	-0.0	0.6	0.1	0.2	0.3	1.5	14%
FY03	1.4	1.2	-0.3	0.8	0.6	0.3	0.3	1.9	15%
FY04	1.2	1.4	-0.8	1.3	0.5	-0.2	0.4	2.4	17%
FY05	2.6	0.7	-0.6	1.2	1.4	0.1	0.4	2.0	12%
FY06	4.1	-0.2	0.2	0.8	0.2	0.0	0.6	4.2	22%
FY07	4.4	0.7	-0.0	1.9	0.5	0.5	0.7	5.2	23%
FY08	4.5	1.9	-1.2	3.8	1.6	0.3	0.9	6.2	22%
FY09	4.4	2.0	1.7	0.6	-0.8	1.8	1.0	6.8	20%
FY10	4.8	2.4	1.5	-0.7	0.8	-0.9	1.0	7.0	17%
FY11	7.5	1.3	1.8	1.1	2.1	0.7	1.4	7.6	16%
FY12	7.6	2.5	1.4	1.5	1.8	2.4	1.1	7.7	14%
FY13	6.8	2.8	0.5	0.9	0.1	0.9	1.2	8.9	14%
FY14	7.8	2.3	1.1	2.9	1.2	1.5	1.0	10.2	14%
FY15	6.0	3.0	-3.3	3.3	-0.8	-0.6	1.4	8.9	11%
FY16	7.5	1.7	0.6	2.8	0.3	1.7	2.1	8.5	9%
FY17	6.1	4.2	2.0	0.2	2.0	-1.2	-3.3	15.0	15%
FY18	8.0	2.9	-1.4	3.6	0.7	0.7	5.0	6.7	6%
FY19	11.7	0.6	3.3	1.5	0.8	1.5	2.9	11.8	10%
FY20	6.6	3.8	1.9	7.3	2.7	3.2	3.0	10.7	8%
FY21	6.3	7.8	1.1	7.8	2.8	-0.2	4.0	16.4	11%
FY22	9.5	2.8	3.5	2.8	2.5	-0.5	2.8	13.6	8%
FY23	18.1	6.9	0.0	0.6	4.3	2.8	2.4	16.1	9%
FY24	22.4	6.0	-2.6	6.3	5.3	2.0	1.3	23.5	12%
FY25F - Bull case	23.3	7.0	1.5	9.0	5.0	2.0	3.0	30.8	14.4%
FY25F - Base case	23.3	6.5	1.0	8.0	5.0	2.5	3.0	28.3	13.2%
FY25F - Bear case	23.3	6.0	-	6.0	5.0	2.5	3.0	24.8	11.6%

Note: FY24 data has been adjusted for the HDFC merger
Source: RBI data, Nomura research

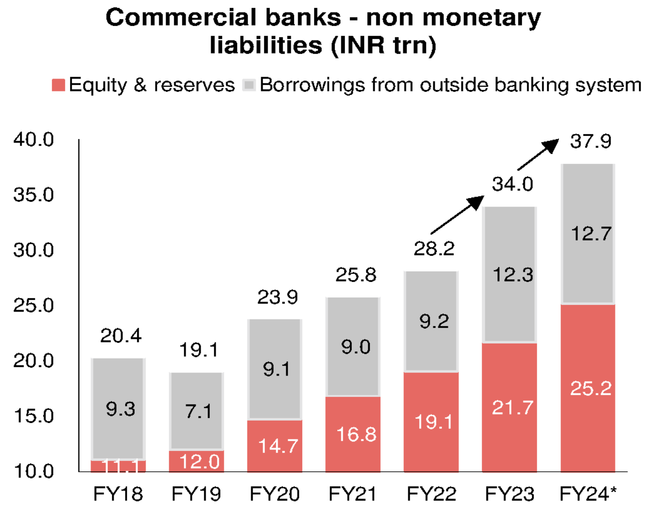
Why have non-monetary liabilities of banks and RBI increased?

Fig. 4: For RBI, higher non-monetary liabilities over the past 2 years is arising out of higher interest income (amid higher rates), leading to higher capital buffers



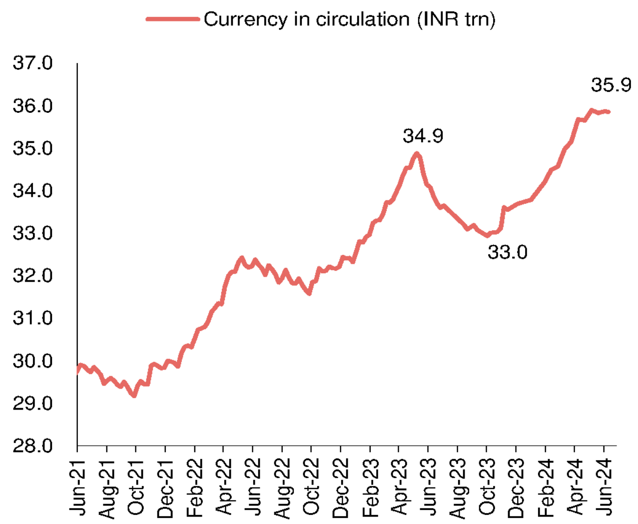
Source: RBI, Nomura research

Fig. 5: For banks, higher non-monetary liabilities is arising out of higher equity capital formation (amid rising RoE) and slight pick-up in borrowings



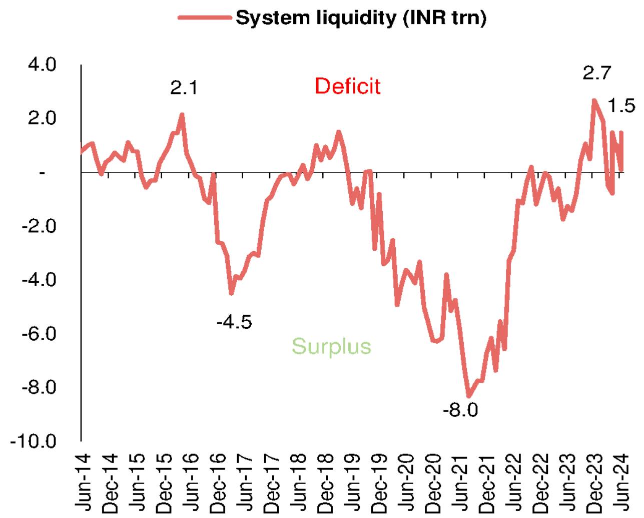
Note: FY24 data has been adjusted for the HDFC merger
Source: RBI, Nomura research

Fig. 6: Cash in circulation picked up only by INR 1.3trn in FY24 (vs annual average of ~INR 3 trn since FY17), aided by RBI's INR 2,000 note withdrawal



Source: RBI, Nomura research

Fig. 7: System liquidity remains in a deficit of INR1.5tn (as of 20 June 2024)



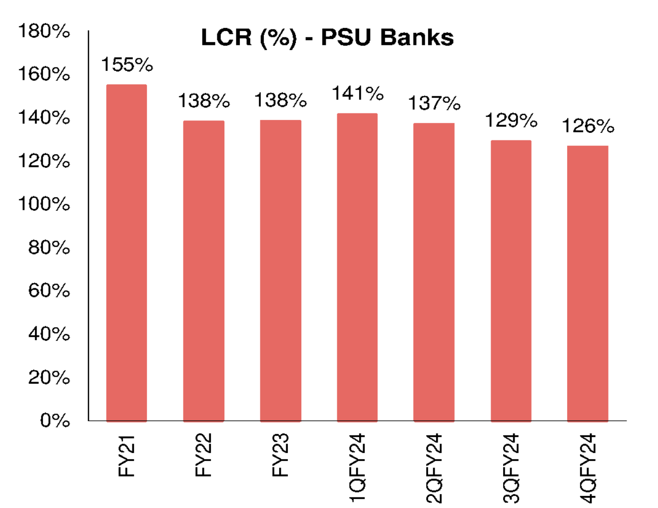
Source: RBI, Nomura research

Fig. 8: Liquidity coverage ratio (LCR) comparison across large banks

	LCR (%)						
	FY21	FY22	FY23	1QFY24	2QFY24	3QFY24	4QFY24
SBI	159%	138%	147%	147%	145%	138%	129%
BOB	161%	152%	146%	152%	147%	136%	125%
CBK	129%	119%	122%	129%	132%	136%	129%
PNB	191%	184%	162%	160%	149%	137%	142%
UNBK	181%	175%	167%	166%	145%	126%	132%
HDFCB	138%	112%	116%	126%	120%	110%	115%
ICICI	135%	127%	122%	122%	120%	118%	121%
AXSB	116%	116%	129%	123%	118%	118%	120%
KMB	178%	130%	124%	122%	127%	127%	133%
IIB	145%	126%	123%	132%	117%	122%	118%
YES	114%	115%	119%	127%	121%	118%	116%
FB	242%	180%	128%	125%	125%	120%	128%

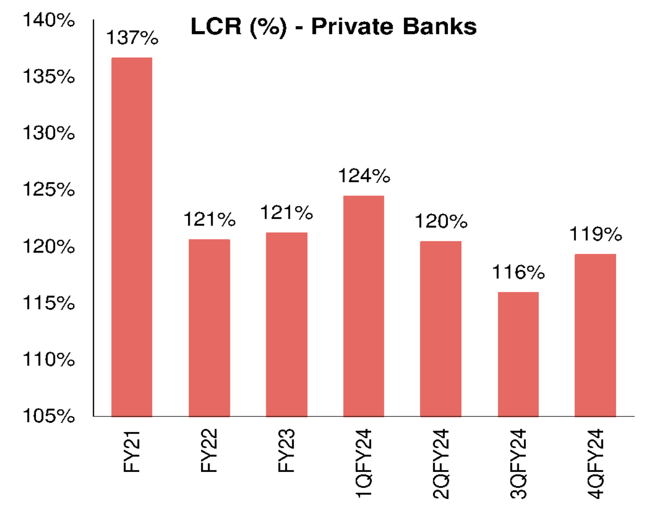
Source: Company data, Nomura research

Fig. 9: Liquidity coverage ratio of PSU banks has moderated over the past 2 quarters...



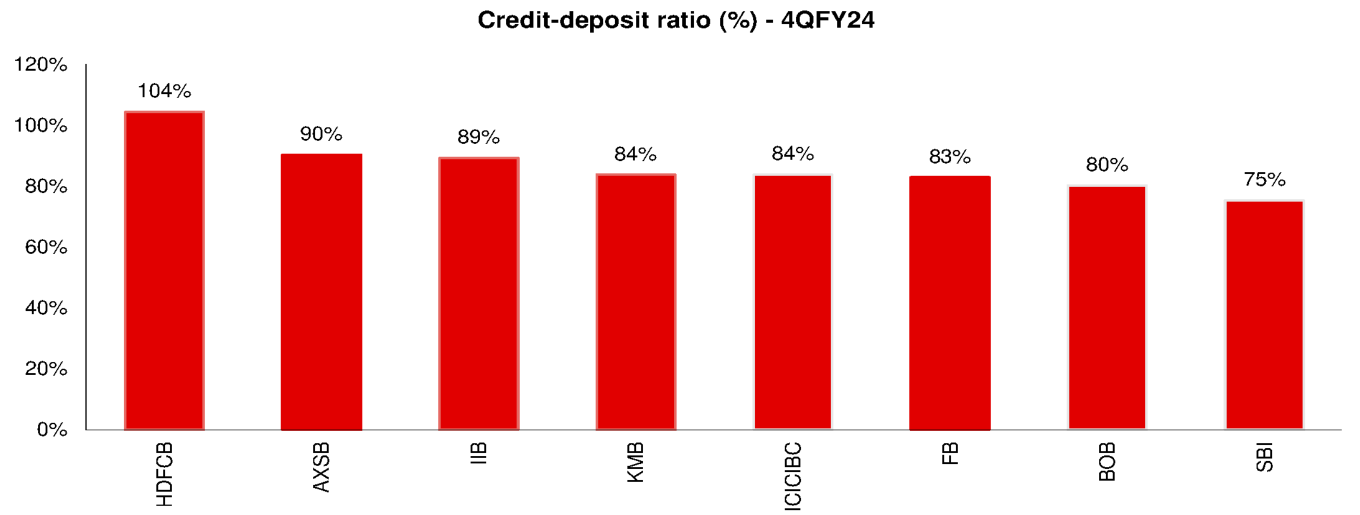
Source: Company data, Nomura research

Fig. 10: ......but still remains higher than private banks



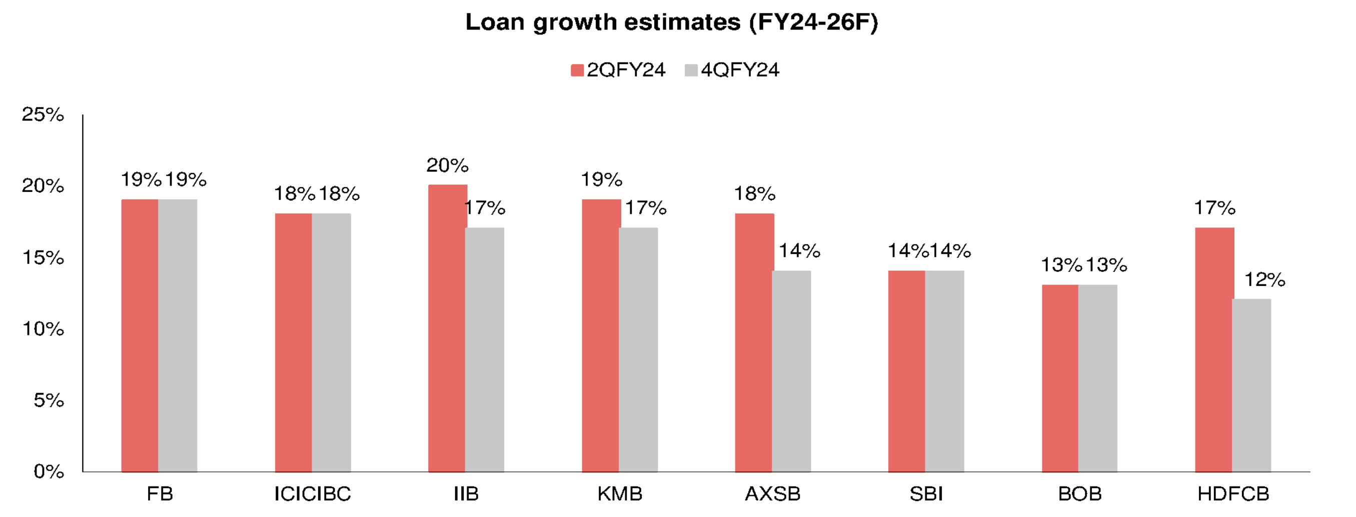
Source: Company data, Nomura research

Fig. 11: SBI and BOB have lowest LDR among all the large banks under our coverage universe



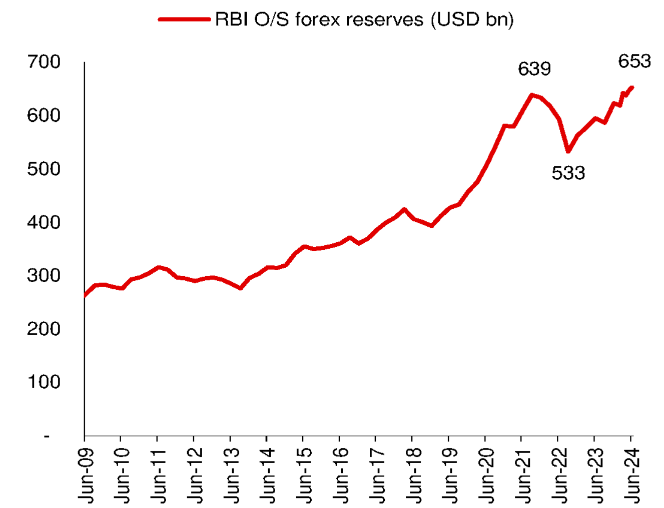
Source: Company data, Nomura research

Fig. 12: We have cut our loan growth estimates over the past two quarters for banks with higher credit-deposit ratio



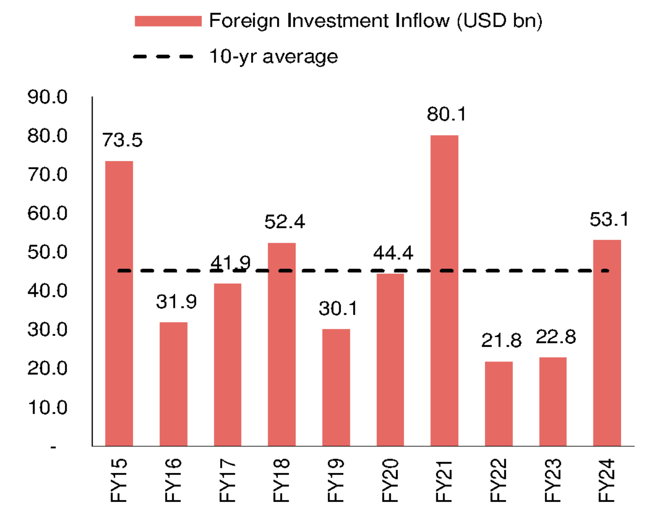
Source: Company data, Nomura estimates

Fig. 13: RBI's outstanding forex reserves increased to USD 653bn in Jun-24 (vs USD 638bn in Apr-24)



Source: RBI, CMIE, Nomura research

Fig. 14: Foreign investment inflows (FII and FPI inflows) were at USD 53.1bn in FY24 (vs 10-yr average of USD 45.3bn)



Source: RBI, Nomura research

Fig. 15: India banks – Valuations and outlook

Bank	CMP (INR)	Subs value (INR)	RoA			RoE			P/B (core)		P/E (core)		EPS CAGR (FY24-26F)	Loan CAGR (FY24-26F)	Reco	TP (INR)
			FY24F	FY25F	FY26F	FY24F	FY25F	FY26F	FY25F	FY26F	FY25F	FY26F				
Pvt. Banks																
HDFCB	1,662	211	1.8%	1.7%	1.8%	14.5%	14.0%	14.5%	2.2	2.0	16.9	14.6	11%	12%	Neutral	1,660
ICICIBC	1,158	157	2.4%	2.3%	2.3%	19.0%	18.1%	18.0%	2.6	2.2	15.4	13.4	13%	18%	Buy	1,335
AXSB	1,232	67	1.8%	1.7%	1.8%	18.1%	16.7%	16.4%	2.0	1.7	13.2	11.5	12%	14%	Buy	1,250
KMB	1,770	672	2.5%	2.2%	2.2%	15.3%	13.7%	13.8%	2.0	1.7	15.3	13.3	9%	17%	Buy	2,000
IIB	1,525	-	1.9%	1.8%	1.7%	15.4%	14.5%	14.5%	1.7	1.5	12.2	10.8	10%	17%	Neutral	1,650
FB	177	7	1.3%	1.2%	1.2%	14.7%	12.9%	13.6%	1.3	1.1	10.4	8.7	13%	19%	Buy	195
BANDHAN	209	-	1.3%	1.8%	1.9%	10.8%	15.3%	16.3%	1.4	1.2	9.5	7.8	39%	16%	Reduce	170
PSU Banks																
SBIN	834	201	1.0%	1.0%	1.0%	18.8%	18.0%	16.8%	1.4	1.2	8.3	7.8	9%	14%	Buy	1,000
BOB	280	-	1.2%	1.1%	1.1%	17.8%	16.5%	15.6%	1.2	1.1	7.6	7.1	7%	13%	Buy	320
SFBs																
AUBANK	666	-	1.5%	1.5%	1.5%	13.1%	13.4%	14.0%	2.9	2.6	23.3	19.6	22%	22%	Neutral	625

Note: CMP as on 21 June 2024
Source: Bloomberg Finance L.P., company data, Nomura estimates

Strategy

June 26, 2024

Where do we go next?

The mind-boggling market caps of many 'narrative' stocks relative to their fundamentals raise the mind-numbing issue about the future of the stocks and investors (and other stakeholders). It is obvious that somebody will still be holding the shares, if and when such stocks were to trade at 'fair' valuations, based on their fundamentals. PSU stocks may be a test case.

How did we get here? That's clear; Where do we go next? Mind-numbing

In our view, irrational expectations (high market return at all price points) among non-institutional investors have been the key driver of the market; see our June 20 report titled *What will break the market?*. The next stage will be even more interesting, as the large disconnect between the market caps of 'narrative' stocks and their fair values based on reasonable volume and profitability assumptions raises the prospect of the large gap (1) narrowing painfully or (2) staying at high levels for a long time with earnings growing into prices. However, we find so many stocks to be so egregiously overvalued that earnings growth alone may not be sufficient to bridge the gap in a reasonable period of time, which raises the worrisome prospect of the former playing out.

PSU stocks have delivered massive returns over the past 15 months

The already-strong rally in PSU stocks has strengthened further in the past few months, with these stocks significantly outperforming the market (see Exhibit 1). We note that the rally has been quite broad-based, with almost every PSU stock delivering superlative returns over the past 12-15 months and outperforming their private peers (see Exhibit 2). However, contrary to narratives, most PSU stocks have not seen a proportional improvement in their fundamentals relative to the increase in the stock prices (see Exhibit 3).

A number of PSU stocks are trading at unfathomable valuations

Exhibit 4 shows the trailing valuation multiples of a section of PSU stocks over the past few months. As discussed in our March 9, 2024 report titled *PSUs: Myth versus reality*, the extant elevated multiples of a large number of PSU stocks seem to stem from bullish assumptions and incorrect valuation methodologies (see Exhibit 5). In fact, stock price of (1) BHEL is implying 23-35 GW of annual BTG sales, (2) COCHIN is implying the company delivering 6-9 new aircraft carriers and (3) FCT is implying absolutely improbable revenues and profits relative to its current scale of operations (see Exhibits 6-8).

Low public shareholding possibly accentuating returns (and subsequent risks)

Our analysis shows that a number of PSU stocks have low public shareholding, despite large market caps (see Exhibit 9). As such, a number of top-performing PSUs in the mid-cap. and small-cap. universes have some of the highest delivery/free-float ratios (above 100%) in the past six months (see Exhibits 10-11), suggesting disproportionately high churn in investor portfolios.

Key estimates summary

	2024	2025E	2026E
Nifty estimates			
Earnings growth (%)	20.0	9.9	14.1
Nifty EPS (Rs)	989	1,093	1,249
Nifty P/E (X)	24.1	21.8	19.1
Macro data			
Real GDP (%)	8.2	6.9	6.5
Avg CPI inflation (%)	5.4	4.4	4.2

Source: Company data, Kotak Institutional Equities estimates

Quick Numbers

BSE PSU Index is up 121%, Nifty-50 Index is up 37% since March 31, 2023

20 PSUs with market cap. above Rs100 bn have delivered >250% returns, 28 PSUs have delivered 100-250% returns and 14 PSUs have delivered 50-100% returns since March 2023

Government could raise around Rs11.5 tn at current prices by selling stakes in PSUs (up to 51%)

Related Research

→Strategy: What will break the market?
→Strategy: PSUs: Myth versus reality

Full sector coverage on KINSITE

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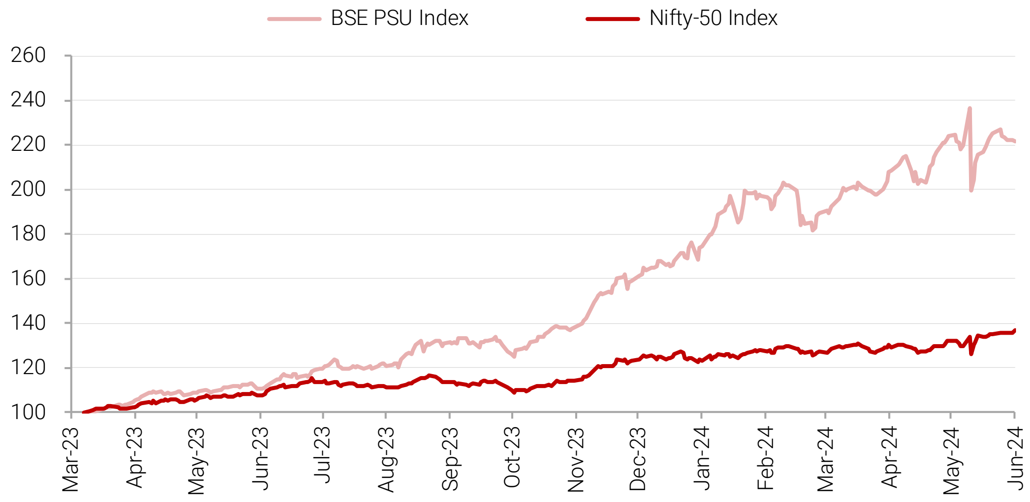
Stake sale in PSU stocks can improve liquidity, while boosting government revenues

We note that the government had exempted public sector entities from minimum public shareholding norms, mandating 25% free-float for listed entities in 2022, given the prevailing low interest in those stocks back then. However, the consequent turnaround in the appeal of PSU stocks in the market should allow the government to gradually monetize its stake in these stocks (see Exhibit 12). In our view, this will also result in improving the liquidity as well as reducing the risk of price manipulation in these stocks.

BSE PSU Index has given 121% return since March 2023 compared to 37% return of the Nifty-50 Index

Exhibit 1: Performance of BSE PSU versus Nifty (Base=100)



Source: Bloomberg, Kotak Institutional Equities

A large number of PSU stocks have delivered more than 100% return in the past 15 months

Exhibit 2: Performance of select PSU stocks (sorted on return) (%)

Company	Market cap. (Rs bn)	Performance (%) 1M	3M	6M	12M	From Mar-23
BSE PSU Index		**(1)**	**16**	**37**	**100**	**121**
Nifty Index		**4**	**8**	**11**	**28**	**37**
Cochin Shipyard	581	16	147	222	654	829
Mazagon Dock	823	28	117	78	225	515
Rail Vikas Nigam	853	10	57	129	232	496
Fertilizers & Chemicals Travancore	654	41	58	26	141	392
IRCON International	254	(1)	20	58	225	383
Railtel Corp.	150	9	29	57	266	364
Garden Reach Shipbuilders & Engineers	239	43	164	139	254	358
NBCC	285	8	38	102	298	346
BHEL	1,031	(3)	23	62	253	323
MRPL	383	(0)	(2)	69	184	316
CPCL	142	(2)	8	39	149	300
SJVN	509	(11)	7	41	208	289
Hindustan Aeronautics	3,535	2	60	87	186	287
BEML	189	(1)	46	57	188	260
MOIL	104	2	84	67	214	260
ITI	296	—	22	2	184	242
Engineers India	139	(8)	20	53	115	233
Hindustan Copper	312	(13)	14	38	178	228
GMDC	128	(2)	14	(2)	143	217
Bharat Electronics	2,243	3	54	69	153	215
Neyveli Lignite Corp.	335	4	12	(3)	146	213
MMTC	122	10	26	36	155	192
Oil India	761	6	15	84	190	179
Shipping Corp.	119	(3)	33	54	151	173
KIOCL	279	1	16	21	144	173
NHPC	998	(3)	16	54	118	147
National Aluminium Co.	343	(3)	23	62	127	138
NMDC	730	(7)	23	23	138	123
Coal India	2,892	(6)	8	28	109	120
IOCL	2,320	(3)	(2)	28	83	111
NTPC	3,540	(3)	11	18	97	108
GAIL (India)	1,403	4	18	39	104	103
Rashtriya Chemicals & Fertilizers	105	22	50	22	76	101
RITES	167	(6)	5	36	81	95
Power Grid Corp.	3,039	2	21	40	75	93
NMDC Steel	169	(11)	2	15	35	85
Container Corp.	638	(5)	21	24	61	80
ONGC	3,368	(5)	1	29	71	77
SAIL	595	(15)	10	27	70	74
IRCTC	792	(11)	7	14	57	73
Bharat Dynamics	583	4	84	88	191	61
HPCL	710	(8)	6	30	85	41
Gujarat Gas	427	12	13	38	33	35
Gujarat State Petronet	168	1	(15)	—	(0)	12
BPCL	1,295	(9)	(1)	32	67	(13)
BFSI						
HUDCO	571	10	55	170	393	559
IRFC	2,289	(5)	20	80	442	559
IFCI	164	5	62	123	439	541
REC	1,358	(7)	12	23	230	347
PFC	1,584	(2)	22	22	200	295
GIC	677	5	18	24	114	189
Indian Overseas Bank	1,213	(4)	10	50	170	186
Punjab National Bank	1,370	(2)	—	41	147	167
Central Bank of India	546	(4)	8	29	127	161
Bank of Maharashtra	458	(5)	10	43	139	161
New India Assurance	396	—	6	13	106	147
J&K Bank	129	(10)	(9)	(7)	111	138
Punjab & Sind Bank	403	(4)	3	36	100	132
UCO Bank	658	(3)	9	40	107	127
Union Bank	1,072	(10)	(6)	20	105	111
IDBI Bank	909	(3)	5	29	58	88
LIC	6,331	(3)	12	28	63	87
Indian Bank	728	(5)	6	32	92	87
Bank of Baroda	1,453	4	7	25	47	66
Bank of India	564	(5)	(7)	13	75	66
State Bank of India	7,544	2	14	32	52	61
Canara Bank	1,077	1	4	40	102	(58)
IREDA	523	5	38	91	NA	NA

Source: Bloomberg, Kotak Institutional Equities

Only a handful PSUs have seen profit growth comparable to their 5-year returns

Exhibit 3: 5-year CAGR of revenues, EBITDA and PAT versus 5-year CAGR price return of select non-financial PSU companies, March fiscal year-ends, 2019-24 (Rs bn)

	Revenues (Rs bn)						5-year	EBITDA (Rs bn)						5-year	Adjusted PAT (Rs bn)						5-year	5-year price
Company	2019	2020	2021	2022	2023	2024	CAGR (%)	2019	2020	2021	2022	2023	2024	CAGR (%)	2019	2020	2021	2022	2023	2024	CAGR (%)	CAGR (%)
Non-financial PSUs																						
Bharat Dynamics	28	30	18	27	25	24	(4)	6	8	3	7	4	5	(3)	4	5	3	5	4	6	8	25
Bharat Electronics	119	126	138	151	177	203	11	29	28	32	33	41	50	12	19	18	21	24	30	40	16	20
BHEL	294	205	163	202	221	229	(5)	19	(2)	(31)	7	10	6	(21)	10	(15)	(27)	4	7	3	(22)	42
Cochin Shipyard	30	34	28	32	24	38	5	6	7	7	6	3	9	9	5	6	6	6	3	8	10	31
Container Corp.	70	65	64	77	82	87	4	18	8	10	17	19	20	2	12	7	6	11	12	13	1	10
Fertilizers & Chemicals Travancore	20	28	33	44	62	51	21	0	3	6	5	8	1	65	2	0	4	4	6	4	19	34
Hindustan Aeronautics	200	214	229	246	269	304	9	45	49	53	54	67	97	16	23	28	32	51	58	76	27	32
Hindustan Copper	18	8	18	18	17	17	(1)	5	(2)	4	5	5	5	2	1	(6)	1	4	3	3	15	28
IRCTC	19	23	8	19	35	43	18	4	7	2	9	13	14	30	3	5	2	7	10	12	32	26
ITI	17	21	24	19	14	13	(5)	(1)	1	1	1	(2)	(3)	26	1	1	0	1	(4)	(6)	(244)	7
KIOCL	19	19	24	30	15	19	(0)	1	(0)	4	4	(2)	(1)	(198)	1	0	3	3	(1)	(1)	(194)	85
Mazagon Dock	NA	49	40	57	78	95	NA	NA	2	1	4	8	14	NA	NA	5	6	6	11	19	NA	25
NBCC	98	80	69	76	88	103	1	4	1	1	1	2	3	(2)	4	1	2	3	4	5	7	22
NHPC	90	100	96	91	106	96	1	50	49	52	40	62	49	(1)	26	29	34	35	39	36	7	28
NLC India	99	103	98	119	162	130	6	23	34	27	42	37	35	9	15	14	13	9	14	19	4	92
SAIL	670	617	691	1,035	1,044	1,054	9	94	94	127	210	80	103	2	26	26	41	125	20	37	7	13
SJVN	26	27	25	24	29	26	(0)	20	20	15	17	22	18	(2)	14	16	19	10	14	9	(10)	28

Source: Factset, Capitaline, Kotak Institutional Equities

Sharp rerating in a large number of PSU stocks has resulted in their valuations reaching astronomical levels

Exhibit 4: Trailing P/E or P/B of select PSU stocks, March fiscal year-ends, 2015-25E (X)

Company	Sector	Mar-15	Mar-16	Mar-17	Mar-18	Mar-19	Mar-20	Mar-21	Mar-22	Mar-23	Mar-24	Current
Non-financial PSUs							Trailing P/E (X)					
Hindustan Aeronautics	Capital goods	NA	NA	NA	20	10	6	10	10	16	29	47
Bharat Electronics	Capital goods	22	219	23	24	12	10	15	21	24	37	57
BHEL	Capital goods	40	NM	87	68	27	NM	NM	39	51	305	363
NHPC	Electric Utilities	9	10	12	11	10	7	8	8	10	25	28
IRCTC	Commercial & Professional Services	NA	NA	NA	NA	NA	31	751	94	46	67	72
Rail Vikas Nigam	Construction & Engineering	NA	NA	NA	NA	NA	4	6	6	10	34	54
Mazagon Dock	Capital goods	NA	NA	NA	NA	NA	NA	8	8	12	19	41
Container Corp.	Transportation	29	25	29	71	26	50	72	39	30	43	51
SAIL	Metals & Mining	13	NA	NA	NA	9	4	8	3	16	18	20
Bharat Dynamics	Capital goods	NA	NA	NA	15	12	6	24	20	51	52	95
Cochin Shipyard	Capital goods	NA	NA	NA	16	11	5	8	7	21	29	73
SJVN	Electric Utilities	6	8	9	11	7	5	6	11	10	52	56
Fertilizers & Chemicals Travancore	Fertilizers & Agricultural Chemicals	NA	NA	NA	NA	15	2	20	24	22	278	442
Hindustan Copper	Metals & Mining	86	124	99	73	31	NM	100	29	32	91	108
NLC India	Electric Utilities	7	139	7	7	7	4	5	8	8	17	17
ITI	IT services	NA	3	10	32	129	39	1,125	76	NM	NM	NM
NBCC	Construction & Engineering	41	293	44	91	32	38	37	29	24	53	72
KIOCL	Metals & Mining	NA	NA	NA	171	80	85	29	40	NM	NM	NM
IRCON International	Construction & Engineering	NA	NA	NA	NA	8	7	11	6	7	22	28
Financial PSUs							Trailing P/B (X)					
IRFC	Diversified financials	NA	NA	NA	NA	NA	NA	0.8	0.7	0.8	NA	4.8
Indian Overseas Bank	Banks	0.3	0.3	0.5	0.6	0.8	0.7	1.6	1.5	1.7	4.1	4.4
Central Bank of India	Banks	1.0	0.7	1.1	1.1	0.8	0.3	0.4	0.6	0.7	1.6	1.7
HUDCO	Diversified financials	NA	NA	NA	1.3	0.8	0.3	0.7	0.5	0.6	NA	3.5
IREDA	Diversified financials	NA	NA	NA	NA	NA	NA	NA	NA	NA	4.3	5.8
Bank of Maharashtra	Banks	0.5	0.4	0.5	0.4	0.6	0.5	1.1	0.8	1.1	2.2	2.3
Punjab & Sind Bank	Banks	0.3	0.2	0.4	0.3	0.3	0.1	0.9	0.7	1.2	2.6	2.6

Source: Factset, Kotak Institutional Equities

Bullish assumptions, incorrect valuation approaches and unrealistic narratives at play for PSUs

Exhibit 5: Summary of Street assumptions versus KIE views on expensive PSU stocks

	Assumptions		Valuation methodology	
Sector	Street	KIE view	Street	KIE view
Capital goods (defense)	(1) Elevated government spending for an extended period of time, (2) increase in indigenization	Risks from (1) ordering delays and (2) elevated profitability disregarded in current high multiples	P/E	Extant elevated multiples will depend on (1) continued high growth and (2) RoEs sustaining at current high levels in a largely B2G business
Capital goods (electric equipment)	(1) Increased ordering from increase in thermal electricity demand over the next 3-5 years, (2) improvement in profitability	Optimistic assumptions on opportunity size	P/E	Limited-period opportunity should be valued on an NPV basis; high P/E multiple implies strong earnings for an extended period of time
Electric utilities	(1) Long-term transition from thermal to renewable energy, (2) medium-term increase in regulated equity base from new thermal capacity	(1) Optimistic assumptions on regulated equity base, (2) oversight of fundamental negative shift in business model, (3) cashflows from extant capacities required to fund new capacities with lower IRR and (4) questionable terminal value of thermal assets	P/E	Valuations need to be looked at on a P/B basis relative to regulated return and cost of equity. Stocks trading around 3X P/B of regulated entity
Oil, gas & consumable fuels	(1) Strong near-term earnings, (2) elevated profitability on automobile fuels to sustain for an extended period of time	Low earnings predictability due to (1) large volatility in global crude prices, (2) unpredictable pricing policy of the government	P/E	Low FCF/PAT ratio renders valuation on P/E basis meaningless. GAIL and OMCs are expensive on (1) price/FCFS basis and (2) low terminal value
Transportation	(1) Privatization of CCRI, (2) sharp improvement in efficiency post-privatization	(1) Privatization has proven to be surprisingly challenging, (2) low visibility on terms of trade with government entities	P/E	(1) Low FCF/PAT ratio renders valuation on P/E basis meaningless, (2) CCRI's rich valuation may be an obstacle to privatization

Source: Kotak Institutional Equities estimates

Current market cap. of BHEL implies 25-30 GW of annual BTG sales

Exhibit 6: Implied annual thermal electricity generation capacity to be supplied by BHEL (GW)

	P/E (X)		
	10	12	15
Current market cap. (Rs bn)	1,030		
Implied PAT (Rs bn)	103	86	69
Assumed PAT margin (%)	5.0	5.0	5.0
Implied annual sales (Rs bn)	2,060	1,716	1,373
Revenue/GW (Rs bn)	60	60	60
Implied annual sales (GW)	**34**	**29**	**23**

Notes:

(a) BHEL derives a portion of its revenues from industrial sales. However, the implied BTG numbers are so large that we can ignore the same in this exercise.

Source: Company, Kotak Institutional Equities estimates

Current market cap. implies that the company will build 6-10 aircraft carriers (today's value)

Exhibit 7: Reverse valuation exercise of Cochin Shipyard, June 2024 (X)

	PAT margin (%)		
	12	15	18
Expected value of IAC-2 (Rs bn)	**400**	**400**	**400**
Total profits (not adjusted for PV) (Rs bn)	48	60	72
Current market cap. (Rs bn)	581	581	581
Value of existing order book (Rs bn)	124	124	124
Implied aircraft carriers (X)	**10**	**8**	**6**

Source: Company, Kotak Institutional Equities estimates

Current market cap. implies that the company will expand its sales by 8-17X in the near future

Exhibit 8: Reverse valuation exercise of Fertilizers and Chemicals Travancore, June 2024 (X)

	Steady state P/E (X)		
	10	12	14
Current market cap. (Rs bn)	**654**	**654**	**654**
Implied net profits @ steady-state P/E (Rs bn)	65	54	47
Current PAT margin (%)	8	8	8
Implied sales on current PAT margin (Rs bn)	**843**	**703**	**602**
FY2024 sales (Rs bn)	**51**	**51**	**51**
Growth required (X)	**17**	**14**	**12**
Assuming expansion in PAT margin (%)	12	12	12
Implied sales on improved PAT margin (Rs bn)	**545**	**454**	**389**
Growth required (X)	**11**	**9**	**8**

Source: Company, Kotak Institutional Equities estimates

A number of PSU companies have low free-float despite their large market-cap.

Exhibit 9: Free float of select PSUs with current market cap. >Rs100 bn, March 2024 (%)

Company	Market cap. (Rs bn)	Free float (%)
Non-financial PSUs		
Hindustan Aeronautics	3,535	28
Bharat Electronics	2,243	49
BHEL	1,031	37
NHPC	998	27
IRCTC	792	38
Rail Vikas Nigam	853	27
Mazagon Dock	823	15
Container Corp.	638	45
SAIL	595	35
Bharat Dynamics	583	25
Cochin Shipyard	581	27
SJVN	509	18
Fertilizers & Chemicals Travancore	654	10
Hindustan Copper	312	34
ITI	296	10
NBCC	285	38
KIOCL	279	1
IRCON International	254	35
Garden Reach Shipbuilders & Engineers	239	26
NMDC Steel	169	39
RITES	167	28
BEML	189	46
CPCL	142	32
Engineers India	139	49
Railtel Corp.	150	27
GMDC	128	26
Shipping Corp.	119	36
MMTC	122	10
MOIL	104	35
Rashtriya Chemicals & Fertilizers	105	25
Financial PSUs		
IRFC	2,289	14
Indian Overseas Bank	1,213	4
Central Bank of India	546	7
HUDCO	571	25
IREDA	523	25
Bank of Maharashtra	458	14
Punjab & Sind Bank	403	2

Source: Companies, Kotak Institutional Equities

Top-performing PSUs have seen trailing 6-month delivery volumes exceeding their free float market caps

Exhibit 10: Delivery value/free float market cap. of top- and bottom-performing mid-cap. stocks, May 2024 (%)

	Delivery value/free float market cap. (%)						
Company Name	**Dec-23**	**Jan-24**	**Feb-24**	**Mar-24**	**Apr-24**	**May-24**	**6M Total**
Top-20 stocks on the basis of 6M performance							
BSE	6	7	5	5	5	5	33
Suzlon Energy	1	7	7	7	7	7	35
Mazagon Dock	32	30	22	17	38	38	176
SJVN	30	53	52	52	52	52	290
BHEL	16	23	23	14	11	13	100
Kalyan Jewellers	12	15	27	27	27	27	133
Prestige Estates	9	10	9	8	7	8	52
Rail Vikas	30	54	25	15	17	25	165
Bharat Dynamics	27	13	20	11	19	21	111
Macrotech Developers	4	4	7	8	5	5	32
Dixon Technologies	10	8	6	5	7	6	42
NMDC	10	13	24	13	11	9	80
Torrent Power	3	3	8	6	4	5	29
Oil India	14	11	15	9	10	8	67
Indus Towers	12	22	84	24	26	12	180
JSW Energy	8	9	8	6	9	9	50
NHPC	11	37	44	17	16	25	150
FACT	12	10	6	3	4	3	38
Cummins India	5	4	6	4	4	4	27
Union Bank (I)	13	13	24	9	9	9	77
Average	**13**	**17**	**21**	**13**	**14**	**15**	**93**
Bottom-20 stocks on the basis of 6M performance							
Bandhan Bank	15	23	17	14	23	13	105
AU Small Finance	3	8	6	5	9	4	36
Zee Entertainment	23	46	33	25	13	14	154
Page Industries	6	6	4	5	7	4	31
Dalmia Bharat	5	6	6	6	8	4	37
Syngene International	9	8	5	6	6	5	38
MMFSL	9	10	5	5	7	7	42
Indraprastha Gas	8	9	6	6	9	6	44
Jubilant Food.	6	9	11	8	10	6	50
Tata Elxsi	3	4	4	4	5	3	22
Piramal Enterprises	14	9	10	10	10	9	62
Tata Chemicals	8	5	6	16	9	4	48
Deepak Nitrite	6	3	3	2	6	3	23
Delhivery	6	10	13	9	8	7	53
Gujarat Gas	11	13	7	4	6	4	44
IDFC First Bank	13	13	8	12	11	9	64
Sona BLW	5	5	5	5	4	5	29
Coforge	6	7	5	7	6	17	47
Average	**9**	**11**	**8**	**8**	**9**	**7**	**52**

Source: Companies, Bloomberg, Kotak Institutional Equities

Top-performing PSUs have seen trailing 6-month delivery volumes exceeding their free float market caps

Exhibit 11: Delivery value/free float market cap. of top- and bottom-performing small-cap. stocks, May 2024 (%)

	Delivery value/free float market cap. (%)						
Company Name	**Dec-23**	**Jan-24**	**Feb-24**	**Mar-24**	**Apr-24**	**May-24**	**6M Total**
Top-15 stocks on the basis of 6M performance							
Cochin Shipyard	46	48	16	16	16	16	157
HUDCO	51	39	34	34	34	34	226
NBCC	29	56	39	39	39	39	241
Hindustan Copper	43	27	16	16	16	16	132
National Aluminium	33	34	26	26	26	26	172
Century Textiles	3	9	3	3	3	3	24
IRB Infra	19	28	15	15	15	15	109
MRPL	17	25	28	28	28	28	156
IOB	25	27	46	46	46	46	237
Exide Industries	6	9	4	4	4	4	32
Rites	15	40	30	30	30	30	175
NMDC Steel	9	15	12	12	12	12	73
JBM Auto	8	14	10	10	10	10	63
HFCL	23	34	28	28	28	28	168
Data Pattern	6	8	35	35	35	35	155
Average	**22**	**28**	**23**	**23**	**23**	**23**	**141**
Bottom-15 stocks on the basis of 6M performance							
IIFL Finance	24	8	3	3	3	3	42
Sonata Software	4	3	2	2	2	2	17
PVR Inox	10	14	8	8	8	8	54
Shree Renuka Sugar	15	10	18	18	18	18	96
CreditAccess Gramin	5	6	5	5	5	5	30
Angel One	10	11	5	5	5	5	39
Praj Industries	14	7	8	8	8	8	51
Tata Tele	10	13	16	16	16	16	86
Cyient	6	6	5	5	5	5	30
GNFC	9	11	7	7	7	7	46
KRBL	7	5	3	3	3	3	25
PVR Inox	10	14	8	8	8	8	54
Campus Activewe.	14	10	14	14	14	14	81
VIP Industries	16	15	10	10	10	10	72
Medplus Healthcare	4	4	10	10	10	10	50
Jyothy Labs	6	8	6	6	6	6	38
Happiest Minds	10	8	4	4	4	4	36
Tanla Platforms	11	12	3	3	3	3	37
Can Fin Homes	10	10	7	7	7	7	47
IDFC	5	5	4	4	4	4	26
Average	**10**	**9**	**7**	**7**	**7**	**7**	**48**

Source: Companies, Kotak Institutional Equities

Government can raise large amounts of funds from stake sales in PSU stocks

Exhibit 12: List of PSUs with more than 51% government holding (sorted on market cap.)

	Market Cap.		Govt holding	Stake sale	
Company	**(Rs bn)**	**(US$ bn)**	**(%)**	**Entire**	**up to 51%**
Non-financial PSUs					
NTPC	3,540	42	51.1	1,809	4
Hindustan Aeronautics	3,535	42	71.6	2,532	730
ONGC	3,368	40	58.9	1,984	266
Coal India	2,889	35	63.1	1,824	350
Power Grid Corp.	3,039	36	51.3	1,560	10
IOCL	2,320	28	51.5	1,195	12
Bharat Electronics	2,243	27	51.1	1,147	3
GAIL (India)	1,403	17	51.5	723	7
BPCL	1,295	16	53.0	686	26
BHEL	1,030	12	63.2	651	125
NHPC	1,001	12	67.4	675	164
IRCTC	792	9	62.4	494	90
Rail Vikas Nigam	853	10	72.8	621	186
NMDC	730	9	60.8	444	72
Mazagon Dock	823	10	84.8	698	278
Oil India	760	9	56.7	431	43
Container Corp.	638	8	54.8	350	24
SAIL	595	7	65.0	386	83
Bharat Dynamics	583	7	74.9	437	139
Cochin Shipyard	581	7	72.9	423	127
SJVN	510	6	81.9	417	157
Fertilizers & Chemicals Travancore	652	8	90.0	587	254
National Aluminium Co.	343	4	51.3	176	1
Hindustan Copper	312	4	66.1	206	47
NLC India	335	4	72.2	242	71
ITI	296	4	90.0	266	115
NBCC	285	3	61.8	176	31
KIOCL	279	3	99.0	276	134
IRCON International	254	3	65.2	166	36
Total	**37,567**	**450**		**23,149**	**3,990**
Financial PSUs					
State Bank of India	7,544	90	56.9	4,294	447
LIC	6,334	76	96.5	6,112	2,882
IRFC	2,288	27	86.4	1,975	809
PFC	1,584	19	56.0	887	79
Bank of Baroda	1,453	17	64.0	929	188
Punjab National Bank	1,369	16	73.2	1,002	303
Indian Overseas Bank	1,213	15	96.4	1,169	551
Union Bank	1,072	13	74.8	802	255
Canara Bank	1,077	13	62.9	678	128
Indian Bank	728	9	73.8	538	166
GIC	676	8	85.8	580	235
UCO Bank	659	8	95.4	629	293
Bank of India	564	7	73.4	414	126
Central Bank of India	546	7	93.1	508	230
HUDCO	571	7	75.0	428	137
IREDA	523	6	75.0	392	126
Bank of Maharashtra	458	5	86.5	396	162
Punjab & Sind Bank	403	5	98.3	396	190
New India Assurance	396	5	85.4	338	136
Total	**29,774**	**357**		**22,675**	**7,490**
Total	**67,341**	**807**		**45,824**	**11,480**

Source: Capitaline, Bloomberg, Kotak Institutional Equities

India – Telecom

27 June 2024

Spectrum auction: Vi's spend surprisingly high

In the recently concluded spectrum auction, JIO/Bharti/Vi spent Rs10bn/Rs69bn/Rs35bn. While the total spend of Rs113bn was 10% lower than our estimates, Vi's spend was surprisingly high as it picked up small chunks of 900MHz in many circles, probably to park 2G traffic as it frees up blocks of 5MHz for data. Bharti renewed its 900MHz in six circles and augmented its 900MHz holdings in a few others while also picking up capacity spectrum in the mid-band (to be initially used for 4G and re-farmed later to 5G). JIO picked up mid-band spectrum in just two circles. That said, its low-band holdings remain well above the peers. The consequent increase in the leverage ratio for all three telcos is modest. With spectrum auctions behind, all eyes are now on tariff hikes which appear to be imminent.

Spectrum worth Rs113bn sold; Rs11bn annual instalment for 20 years: Spectrum in 4 out of the 8 bands saw bids, with 9-51% of supply getting sold in the bands that saw bids. Except for the 1800MHz band in two circles, all spectrum got sold at base price. Total bid value of the spectrum stood at Rs113bn, which is 12% of the total spectrum on offer at reserve price. Based on the most relaxed payment option, the government will see annual receipts of Rs11bn for 20 years, starting from FY25 (8.65% interest rate).

Bharti and JIO add spectrum to complete blocks of 5MHz: Despite posting the highest earnest money deposit (EMD) that made it eligible to pick up ~Rs360bn worth of spectrum — JIO's total spend was just Rs10bn (in line with estimate). It acquired spectrum in the 1800MHz band in just two circles topping up its holdings in these circles to 15/20MHz. Bharti renewed 900MHz in six circles; it also augmented its low-band holdings in a few key circles. It picked up capacity spectrum in mid-band (1800 and 2100), taking its holding in a few circles to 10/15/20MHz. Bharti's Rs69bn spend was well below our estimate of Rs104bn.

Vi's spends surprisingly high as it picks up small chunks in the 900MHz band: Vi's outlay of Rs35bn was well above our estimate of Rs12bn. While it faced 900MHz renewal in two circles, the telco picked up

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spectrum in this band in seven more circles. In many of these bands, Vi picked up fractional amounts of spectrum like 1.2MHz or 2.4MHz. In our view, this spectrum could be used to park 2G traffic, as Vi frees up blocks of 5MHz from its existing holdings and re-farms it for 4G (and eventually 5G). Interestingly, Vi has also acquired spectrum in the 2500MHz band in a single circle.

Telco cash payouts from these auctions manageable; change in leverage ratio negligible: If all telcos opt for the most relaxed payment option (20 equal annual instalments), the annual payout works to ~10% of total bid value for NPV preservation at 8.65% interest rate. This translates into Rs1bn/Rs7bn/Rs3.5bn for JIO/Bharti/Vi, quite manageable.

Figure 1: Spectrum spending by telcos across bands (Rsbn)

Rsbn	26GHz	3.5GHz	2500	2300	2100	1800	900	800	Total
JIO						10			10
Bharti					5	25	38		69
Vi			2			1	32		35
Total			**2**		**5**	**36**	**71**		**113**
Spectrum value at reserve price	**27**	**163**	**23**	**44**	**118**	**218**	**157**	**213**	**963**
% sold			**7%**		**5%**	**16%**	**45%**		**12%**

Source: DoT, IIFL Research

Figure 2: Spectrum holding – pre and post auctions

	Post auctions				Pre auctions			
MHz	mmWave	Mid band	LF band	Total	mmWave	Mid band	LF band	Total
JIO	1000.0	163.0	20.7	1183.8	1000.0	162.2	20.7	1183.0
Bharti	800.0	161.8	7.7	969.5	800.0	160.5	7.4	967.9
Vi	278.1	91.6	7.8	377.6	278.1	90.8	7.3	376.2

Source: DoT, IIFL Research

mmWave denotes 26GHz

Mid band denotes 1800, 2100, 2300, 2500MHz and 3.5GHz

LF or low frequency band denotes 600, 700, 800 and 900MHz

Figure 3: Only 4 of 8 bands on offer saw bids

MHz	26GHz	3.5GHz	2500	2300	2100	1800	900	800	Total
JIO						0.8			0.8
Bharti					0.5	1.4	1.6		3.4
Vi			0.7			0.1	1.1		1.8
Total demand			**0.7**		**0.5**	**2.2**	**2.7**		**6.0**
Total supply	353.7	45.0	3.6	3.4	5.3	8.6	5.2	6.1	430.8
% sold			**19%**		**9%**	**26%**	**51%**		**1%**

Source: DoT, IIFL Research; Value denotes unpaired spectrum for TDD bands and paired spectrum for FDD bands; We have taken industry revenue-weighted spectrum holdings for all bands

Figure 4: The increase in net debt-to-Ebitda is modest for all telcos

	JIO	Bharti	Vi
As of 4QFY24			
Net debt (Rsbn)	1,743*	2,170&	1,850$
TTM Ebitda (Rsbn)	524	783	84^
Net debt to Ebitda (x)	3.33	2.77	21.99
Post auction			
Net debt (Rsbn)	1,753	2,238	1,885
TTM Ebitda (Rsbn)	524	783	84
Net debt to Ebitda (x)	3.34	2.86	22.41

Source: Companies, DoT, IIFL Research
*Includes JIO's lease liabilities
&Includes US$1.5bn perpetual bonds issued by Bharti
$After the Rs200bn equity raise concluded in 1QFY25 and the recently announced Rs25bn equity issue to Nokia and Ericsson
^Ebitda after removing Ind-AS 116 impact

Figure 5: JIO– Circle-wise spectrum details

Jio (MHz)	Holdings pre 2024 auctions						
	26GHz	3.5GHz	2500	2300	2100	1800	900
A.P.	1000.0	100.0		40.0		10.0	
Assam	1000.0	100.0		40.0		10.0	
Bihar	1000.0	100.0		40.0		10.0	
Delhi	1000.0	100.0		40.0		10.0	
Gujarat	1000.0	100.0		40.0		20.0	
Haryana	1000.0	100.0		40.0		10.0	
H.P.	1000.0	130.0		40.0		10.4	
J&K	1000.0	130.0		40.0		10.0	
Karnataka	1000.0	130.0		40.0		10.0	
Kerala	1000.0	130.0		40.0		10.0	
Kolkata	1000.0	100.0		40.0		10.0	
M.P.	1000.0	130.0		40.0		20.0	
Maha	1000.0	100.0		40.0		20.0	
Mumbai	1000.0	100.0		40.0		10.0	
N.E.	1000.0	130.0		40.0		10.0	
Orissa	1000.0	100.0		40.0		20.0	
Punjab	1000.0	100.0		40.0		10.0	
Rajasthan	1000.0	130.0		40.0		20.0	
T.N.	1000.0	100.0		40.0		10.0	
U.P.(E)	1000.0	100.0		40.0		20.0	
U.P.(W)	1000.0	130.0		40.0		10.0	
W.B.	1000.0	100.0		40.0		10.6	
Rev we. Avg holding	**1000.0**	**108.7**		**40.0**		**13.6**	

Source: DoT, IIFL Research; Value denotes unpaired spectrum for TDD bands and paired spectrum for FDD

		Purchases in 2024 auction							
800	**700**	**26GHz**	**3.5GHz**	**2500**	**2300**	**2100**	**1800**	**900**	**800**
10.0	10.0								
15.0	10.0								
10.0	10.0						5.0		
10.0	10.0								
10.0	10.0								
11.3	10.0								
12.5	10.0								
12.5	10.0								
10.0	10.0								
10.0	10.0								
11.3	10.0								
10.0	10.0								
10.0	10.0								
15.0	10.0								
15.0	10.0								
11.3	10.0								
12.5	10.0								
10.0	10.0								
10.0	10.0								
10.0	10.0								
11.3	10.0								
11.3	10.0						9.4		
10.7	**10.0**						**0.8**		

bands; We have taken industry revenue-weighted spectrum holdings for all bands

Figure 6: Bharti– Circle-wise spectrum details

Bharti (MHz)	Holdings pre 2024 auctions						
	26GHz	3.5GHz	2500	2300	2100	1800	900
A.P.	800.0	100.0		30.0	5.0	21.4	9.0
Assam	800.0	100.0		40.0	10.0	15.5	11.8
Bihar	800.0	100.0		40.0	15.0	18.0	11.2
Delhi	800.0	100.0		30.0	15.0	7.0	6.0
Gujarat	800.0	100.0		40.0	15.0	10.0	4.2
Haryana	800.0	100.0		40.0	15.0	10.0	
H.P.	800.0	100.0		40.0	5.0	20.0	10.0
J&K	800.0	100.0		40.0	10.0	15.0	11.2
Karnataka	800.0	100.0		30.0	10.0	20.0	8.8
Kerala	800.0	100.0		30.0	15.0	10.0	4.6
Kolkata	800.0	100.0		30.0		15.0	7.0
M.P.	800.0	100.0		30.0	10.0	15.0	
Maha	800.0	100.0		30.0	10.0	20.0	
Mumbai	800.0	100.0		30.0	5.0	15.0	5.0
N.E.	800.0	100.0		40.0	10.0	10.0	14.0
Orissa	800.0	100.0		40.0	5.0	19.6	11.2
Punjab	800.0	100.0		40.0	5.0	15.0	10.0
Rajasthan	800.0	100.0		40.0	15.0	10.0	6.0
T.N.	800.0	100.0		30.0	10.0	20.0	5.0
U.P.(E)	800.0	100.0		40.0	5.0	16.8	11.2
U.P.(W)	800.0	100.0		40.0	10.0	15.0	
W.B.	800.0	100.0		40.0	15.0	10.0	9.4
Rev we. Avg holding	**800.0**	**100.0**		**34.8**	**10.2**	**15.4**	**6.3**

Source: DoT, IIFL Research; Value denotes unpaired spectrum for TDD bands and paired spectrum for FDD

		Purchases in 2024 auction							
800	**700**	**26GHz**	**3.5GHz**	**2500**	**2300**	**2100**	**1800**	**900**	**800**
						5.0	4.0	5.0	
							5.2	7.0	
5.0							5.0		
						5.0		10.0	
							5.0		
5.0									
5.0									
						5.0		1.0	
							1.0	5.0	
							5.0		
							5.0	4.0	
							1.0	5.0	
5.0						5.0			
							3.8	5.0	
1.1						**0.5**	**1.4**	**1.6**	

0 bands; We have taken industry revenue-weighted spectrum holdings for all bands

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Figure 7: Vi– Circle-wise spectrum details

Vi (MHz)	Holdings pre 2024 auctions						
	26GHz	**3.5GHz**	**2500**	**2300**	**2100**	**1800**	**900**
A.P.	200.0	50.0	20.0		5.0	10.0	5.0
Assam			20.0		5.0	24.9	
Bihar		50.0	10.0		5.0	17.8	
Delhi	200.0	50.0	20.0		5.0	10.6	10.0
Gujarat	450.0	50.0	30.0		10.0	20.8	11.0
Haryana	400.0	50.0	20.0		15.0	15.8	12.2
H.P.			10.0		5.0	11.2	
J&K			10.0		5.0	17.0	
Karnataka	200.0	50.0			10.0	15.0	5.0
Kerala	800.0	50.0	20.0	10.0	10.0	20.0	12.4
Kolkata	200.0	50.0	20.0		10.0	15.0	7.0
M.P.	400.0	50.0	20.0	10.0	5.0	18.6	7.4
Maha	400.0	50.0	30.0	10.0	15.0	12.4	14.0
Mumbai	200.0	50.0	20.0		10.0	14.6	11.0
N.E.			20.0		5.0	25.8	
Orissa			20.0		5.0	17.0	5.0
Punjab	300.0	50.0	20.0		10.0	15.0	5.6
Rajasthan	300.0	50.0	20.0		15.0	10.0	6.4
T.N.	300.0	50.0			15.0	11.4	5.0
U.P.(E)	250.0	50.0	20.0		20.0	10.0	5.6
U.P.(W)	350.0	50.0	20.0		10.0	15.0	11.2
W.B.	400.0	50.0	20.0		5.0	23.4	7.4
Rev we. Avg holding	**278.1**	**46.3**	**17.9**	**1.8**	**10.0**	**14.9**	**7.3**

Source: DoT, IIFL Research; Value denotes unpaired spectrum for TDD bands and paired spectrum for FDD

		Purchases in 2024 auction							
800	700	26GHz	3.5GHz	2500	2300	2100	1800	900	800
								2.4	
				10.0					
								2.2	
								0.2	
							1.2		
								1.2	
								0.4	
								2.4	
								1.2	
								5.0	
								3.8	
				0.7			**0.1**	**1.1**	

) bands; We have taken industry revenue-weighted spectrum holdings for all bands

Figure 8: Spectrum holdings post auctions

MHz	Bharti									
	26Hz	3.5G	2300	2100	1800	900	800	Total	26GHz	3.5G
A.P.	800.0	100.0	30.0	5.0	21.4	9.0		965.4	200.0	50.0
Assam	800.0	100.0	40.0	15.0	15.1	15.0		985.1		
Bihar	800.0	100.0	40.0	15.0	20.2	12.0		987.2		50.0
Delhi	800.0	100.0	30.0	15.0	7.0	6.0		958.0	200.0	50.0
Gujarat	800.0	100.0	40.0	15.0	10.0	4.2		969.2	450.0	50.0
Haryana	800.0	100.0	40.0	15.0	15.0		5.0	975.0	400.0	50.0
H.P.	800.0	100.0	40.0	5.0	20.0	10.0		975.0		
J&K	800.0	100.0	40.0	15.0	15.0	15.0		985.0		
Karnataka	800.0	100.0	30.0	10.0	20.0	8.8		968.8	200.0	50.0
Kerala	800.0	100.0	30.0	15.0	10.0	4.6		959.6	800.0	50.0
Kolkata	800.0	100.0	30.0		20.0	7.0		957.0	200.0	50.0
M.P.	800.0	100.0	30.0	10.0	15.0		5.0	960.0	400.0	50.0
Maha	800.0	100.0	30.0	10.0	20.0		5.0	965.0	400.0	50.0
Mumbai	800.0	100.0	30.0	5.0	15.0	5.0		955.0	200.0	50.0
N.E.	800.0	100.0	40.0	15.0	10.0	15.0		980.0		
Orissa	800.0	100.0	40.0	5.0	18.8	10.0		973.8		
Punjab	800.0	100.0	40.0	5.0	20.0	10.0		975.0	300.0	50.0
Rajasthan	800.0	100.0	40.0	15.0	15.0	10.0		980.0	300.0	50.0
T.N.	800.0	100.0	30.0	10.0	20.0	5.0		965.0	300.0	50.0
U.P.(E)	800.0	100.0	40.0	5.0	16.8	10.0		971.8	250.0	50.0
U.P.(W)	800.0	100.0	40.0	15.0	15.0		5.0	975.0	350.0	50.0
W.B.	800.0	100.0	40.0	15.0	12.0	10.0		977.0	400.0	50.0
Industry rev wt avg	**800.0**	**100.0**	**34.8**	**10.7**	**16.3**	**6.6**	**1.1**	**969.5**	**278.1**	**46.3**

Source: DoT, IIFL Research; Value denotes unpaired spectrum for TDD bands and paired spectrum for FDD

Vi						JIO						
2500	2300	2100	1800	900	Total	26GHz	3.5G	2300	1800	800	700	Total
20.0		5.0	10.0	7.4	292.4	1000.0	100.0	40.0	10.0	10.0	10.0	1170
20.0		5.0	24.9		49.9	1000.0	100.0	40.0	10.0	15.0	10.0	1175
20.0		5.0	17.8		92.8	1000.0	100.0	40.0	15.0	10.0	10.0	1175
20.0		5.0	10.6	10.0	295.6	1000.0	100.0	40.0	10.0	10.0	10.0	1170
30.0		10.0	20.8	11.0	571.8	1000.0	100.0	40.0	20.0	10.0	10.0	1180
20.0		15.0	15.8	12.2	513.0	1000.0	100.0	40.0	10.0	11.3	10.0	1171
10.0		5.0	11.2		26.2	1000.0	130.0	40.0	10.4	12.5	10.0	1203
10.0		5.0	17.0		32.0	1000.0	130.0	40.0	10.0	12.5	10.0	1203
		10.0	15.0	7.2	282.2	1000.0	130.0	40.0	10.0	10.0	10.0	1200
20.0	10.0	10.0	20.0	12.4	922.4	1000.0	130.0	40.0	10.0	10.0	10.0	1200
20.0		10.0	15.0	7.2	302.2	1000.0	100.0	40.0	10.0	11.3	10.0	1171
20.0	10.0	5.0	19.8	7.4	512.2	1000.0	130.0	40.0	20.0	10.0	10.0	1210
30.0	10.0	15.0	12.4	14.0	531.4	1000.0	100.0	40.0	20.0	10.0	10.0	1180
20.0		10.0	14.6	11.0	305.6	1000.0	100.0	40.0	10.0	15.0	10.0	1175
20.0		5.0	25.8		50.8	1000.0	130.0	40.0	10.0	15.0	10.0	1205
20.0		5.0	17.0	5.0	47.0	1000.0	100.0	40.0	20.0	11.3	10.0	1181
20.0		10.0	15.0	6.8	401.8	1000.0	100.0	40.0	10.0	12.5	10.0	1173
20.0		15.0	10.0	6.8	401.8	1000.0	130.0	40.0	20.0	10.0	10.0	1210
		15.0	11.4	7.4	383.8	1000.0	100.0	40.0	10.0	10.0	10.0	1170
20.0		20.0	10.0	6.8	356.8	1000.0	100.0	40.0	20.0	10.0	10.0	1180
20.0		10.0	15.0	10.0	455.0	1000.0	130.0	40.0	10.0	11.3	10.0	1201
20.0		5.0	23.4	6.8	505.2	1000.0	100.0	40.0	20.0	11.3	10.0	1181
18.5	**1.8**	**10.0**	**15.0**	**7.8**	**377.6**	**1000.0**	**108.7**	**40.0**	**14.3**	**10.7**	**10.0**	**1184**

bands; We have taken industry revenue-weighted spectrum holdings for all bands

Wegovy and the Topsy-Turvy World of Weight-Loss Drugs

Ozempic kicked off a craze for weight-loss drugs, but Eli Lilly and Novo Nordisk may not dominate obesity the way they have dominated diabetes.

June 2024

Key Takeaways

- GLP-1 drugs, developed by Eli Lilly and Novo Nordisk in the mid-2000s to treat type 2 diabetes, reinvigorated the moribund market for anti-obesity drugs when they proved effective at inducing weight loss.
- The fen-phen craze of the mid-1990s showed how much demand there could be for effective anti-obesity medications. The potential market, and market opportunity, has only grown since then.
- Given the range of options for people who need or want to lose weight, the dominant position Eli Lilly and Novo Nordisk have in diabetes treatments is not likely to extend into the obesity market.

Eli Lilly and Novo Nordisk have dominated the market for diabetes medicines for a century. They were the first companies to commercialize insulin, and the only companies to have built a business around it, with the scale to consistently develop and sell new therapies. It was a solid, steady business. But Novo Nordisk's introduction of Ozempic, a type 2 diabetes drug that turned out to be surprisingly effective at treating obesity as well, sparked a craze that has fundamentally altered the competitive landscape for these companies.

Diabetes is a disease whereby the body does not produce adequate amounts of insulin, a hormone that helps turn food into energy and manages blood-sugar levels. For diabetics, insulin is often a life-saving therapy. Lilly started manufacturing insulin in the 1920s, Novo Nordisk in the 1930s. Today they are the two largest providers of insulin. Novo has a 33% market share, Lilly 25%.

The market for diabetes drugs has high barriers to entry. Getting a drug approved by regulators is difficult and expensive. Most trials fail; getting a drug to market can cost US$1-2 billion. And it's not enough to just create a new, effective treatment. Existing diabetes treatments work quite well. A new drug must be effective *and* offer something that currently available drugs don't, whether that's better efficacy, a new delivery method, or a more convenient dosing schedule.

Lilly and Novo's competitors fall into two categories. The first are other large pharmaceutical companies. Their strategy tends to be opportunistic rather than focused on the category. If they have a drug in the diabetes market whose patents expire, they pull back and don't continue to build up their expertise the way Lilly and Novo have. Therefore, large competitors haven't been very active. In the last 30 years, only Sanofi and Boehringer Ingelheim have entered the market. The second set of competitors are smaller biotech firms that may have a promising drug candidate, but don't have the resources to see its development through to approval. They can't afford the costs of late-stage clinical trials, manufacturing, marketing, and sales and so they often end up partnering with or being acquired by larger companies.

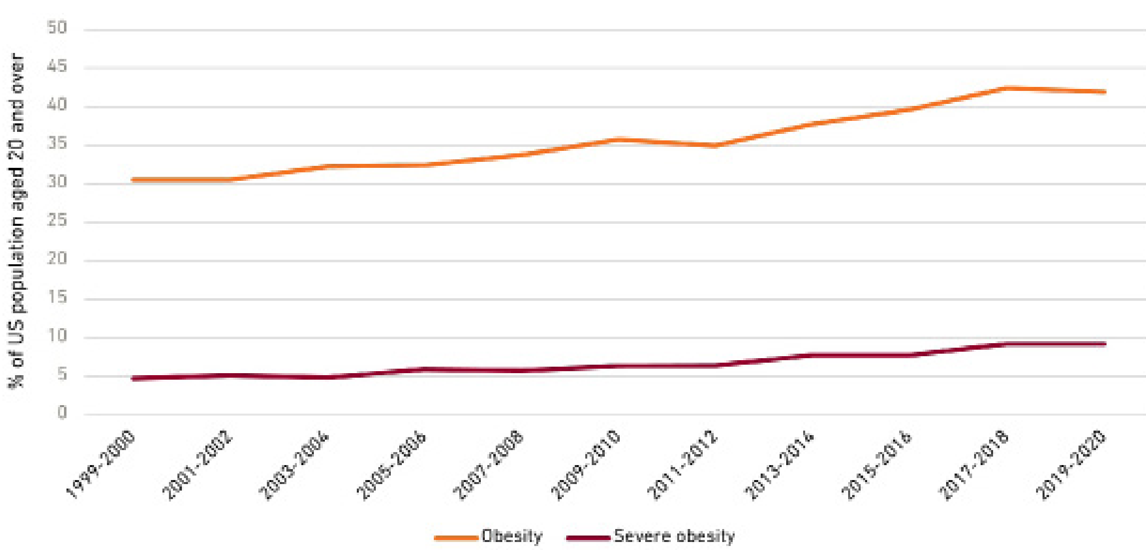
In the mid-2000s, both Novo Nordisk and Eli Lilly developed a new class of treatments that mimicked a human hormone called glucagon-like peptide-1, or GLP-1, which regulates blood sugar. These new drugs were not synthetic insulin; instead, they prompted the body to create insulin. They were designed for type 2 diabetics who were not dependent upon insulin (diabetics who are using insulin can't switch). The goal was to delay the progression to insulin dependence. They also had the advantage of being more convenient to use than earlier therapies, with a less-frequent dosing schedule and also no need for people to check their insulin levels with finger prickers.

> With effective drugs, obesity could become as large a market as diabetes, if not larger. And both Lilly and Novo found themselves with drugs that quite possibly could meet that demand.

This new class of drugs had another feature that differentiated them from previous diabetes drugs: they induced weight loss. In a Phase 3 study of the active ingredient in Ozempic, for instance, patients taking the drug lost 10-12% of their body weight after 68 weeks compared to those patients taking a placebo. What this meant is that these drugs could serve both diabetics and people who were overweight. This was significant. The obesity market is smaller than the diabetes market, but only because there's never really been a truly effective obesity treatment. The demand for such a product would be significant. Obesity rates have tripled

Gaining Weight

The number of overweight Americans has been rising steadily.



Source: National Health and Nutrition Examination Survey, 1999-2019.

since 1975; more than 40% of Americans are considered obese and about 10% are considered severely obese. With effective drugs, obesity could become as large a market as diabetes, if not larger. And both Lilly and Novo found themselves with drugs that quite possibly could meet that demand.

Obesity Is Different

Obesity and diabetes are related to such an extent (the former is a common precursor to developing the latter) that the medical industry has come up with the term "diabesity" to describe them. But the landscape for obesity treatments has been different. Targeted obesity treatments go back 1,000 years, but traditionally obesity hasn't been considered a disease the way diabetes is. There are myriad treatment options, ranging from diet and exercise to weight-loss programs to even surgery. The pharmaceutical industry has long chased after the prospect of finding a drug that could induce weight loss, but the products never seemed to match the need. For example, in 2014 the FDA approved a Novo weight-loss drug called Saxenda that's been moderately successful: patients lost about 5% of their body weight compared to a placebo. But that is not the kind of number that sparks a craze.

The fen-phen craze of the mid-1990s however showed the spike in interest that an effective obesity drug could create. In 1992 a University of Rochester professor showed that a combination of two drugs, fenfluramine and phentermine, could induce patients to lose about 16% of their body weight. That single study sparked a huge demand for the drugs. Fen-phen clinics popped up around the country. The treatment was featured on the cover of Time Magazine. By 1996, doctors were writing 6.6 million annual prescriptions for the drugs, among an obese population in the US of about 50 million; insurers wouldn't cover the combination and patients were paying about US$450 a year. However, the drugs were causing serious heart-valve problems in some patients and in 1997 the FDA had the combination removed from the market (phentermine is still available as a single agent.)

The most prescribed weight-loss drug today is still phentermine, a sign of how little had changed when it comes to pharmaceutical approaches to obesity. There have been new brands that have made it to market with various combinations of older active ingredients, but none have been commercially successful. Insurers have been reluctant to cover obesity as a health condition, and the lack of insurance coverage has been a headwind for pharmaceutical companies. For instance, Medicare is barred by law from covering obesity drugs solely for weight loss, and the reason was that obesity was not seen medically as a significant condition. Another problem has been the lack of success. Between 2008 and 2017 about 80% of people with an anti-obesity drug prescription stopped taking it after three months, dissuaded by a combination of limited effectiveness and the cost.

Because of all that, the launch in 2021 of Wegovy, which comprises the same ingredient as Ozempic though at a higher dose, was like an explosion. It fundamentally changed the moribund obesity market. Using Wegovy, patients lost about 16% of their body weight, just like fen-phen. Wegovy had fen-phen-style efficacy

Shifting Narrative

GLP-1 drugs were originally approved as a diabetes treatment, and then shifted into treating obesity as well.

without the fen-phen-style side effects, and garnered fen-phen-style demand. Soon enough Hollywood stars were suddenly slimming down, the drugs were making headlines, and "Ozempic" became a metonym for the entire class of weight-loss drugs. It was fen-phen all over again. But insurers have been reluctant to cover obesity as a health condition, and the lack of insurance coverage has been a headwind for pharmaceutical companies.

These new anti-obesity drugs were far more effective than previous treatments, and because of that Novo worked to expand insurance coverage for the drug in the US and to a lesser extent overseas. Covered patients rose from virtually zero before the GLP-1 drugs hit to the market to about 50 million currently. Also, the ones labeled for diabetes treatment already are broadly covered by insurance, and these treatments have also proven effective at combating other ailments. Wegovy's new label says it's effective at reducing major heart complications for people who are obese and have already had heart problems. That gives insurers another reason to cover the drug's use.

> The launch in 2021 of Wegovy, which comprises the same ingredient as Ozempic though at a higher dose, was like an explosion. It fundamentally changed the moribund obesity market.

Interestingly, even when insurance won't cover an obesity treatment directly, there are ways around that. Novo's Ozempic and Lilly's Mounjaro (both for diabetes) can be used in place of Wegovy and Zepbound (both for obesity), respectively, given that they are essentially the same drug. A doctor and patient can submit proper paperwork, even if exaggerated, to get Ozempic and Mounjaro approved by the insurance company (or Medicare/Medicaid) off-label for obesity. On the basis of price, it's a bit of a trade down for the manufacturers. Ozempic is about 25% cheaper in the US than Wegovy on a list price basis and about half the price on a net price basis. This is likely similar for Lilly's products. But even at lower prices it can be a benefit to the companies. Zepbound and Wegovy are less broadly covered by insurance than Mounjaro and Ozempic, so fudging the insurance claims for patients without obesity coverage still results in a sale.

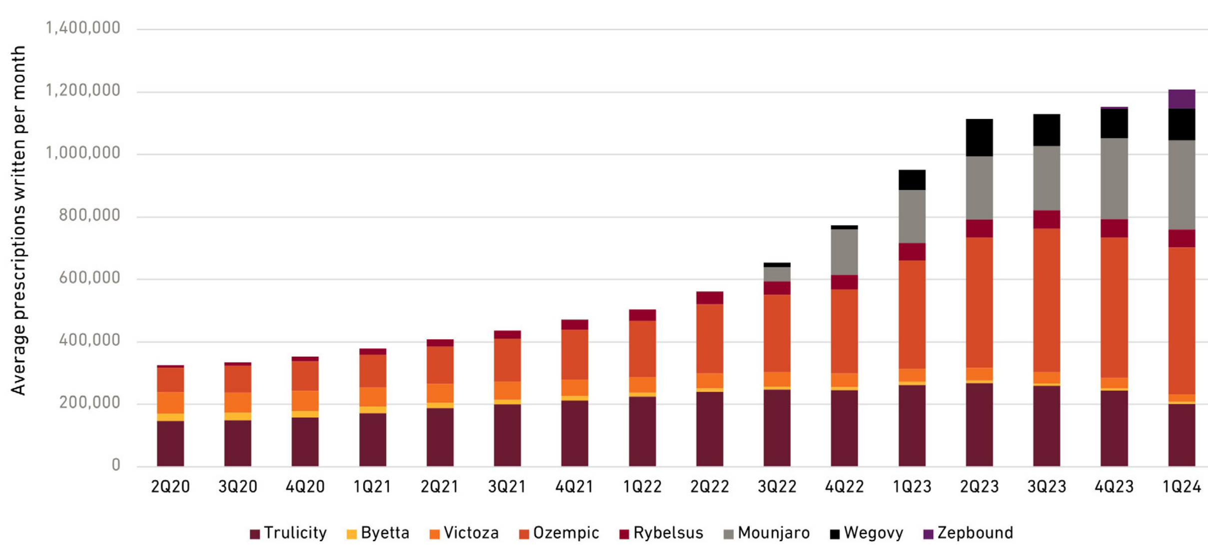
A Challenging Opportunity

There is a widespread expectation that in the coming years the obesity market will become as big as, or bigger than, the diabetes market. Today diabetes is a US$74 billion market while obesity is an US$8 billion market, but the latter is growing faster. Sales of obesity treatments, have grown 72% a year for the last four years and are projected to grow 26% a year for the next five years. The biggest chunk of that is coming from the US, the largest market for both diabetes and obesity treatments. Sales of diabetes treatments, by contrast, have risen 12% a year for the last four years and are projected to grow only 4% a year for the next five years.

The forecast that the obesity market will continue to see rapid growth is unchallenged, but it may already be at a fen-phen level. Today there are about 110 million obese adults, 2.4 times as many as in the 1990s. Annualized prescriptions for obesity medication are at about 22 million today—more than three times the 6.6 million fen-phen prescriptions from the 1990s. It's not clear that the market can engineer not only another fen-phen craze but build one substantially larger. Yet that is what most outsiders are predicting, expecting the obesity market to see sales hit US$75-100 billion by 2030. Those estimates would mean the market would grow at a 37-43% annual rate, uninterrupted, for seven years. That is a tall order. Still, the opportunity for GLP-1

GLP-1's Popularity Surge

The number of prescriptions for GLP-1 drugs has more than tripled in the last four years.



Source: JP Morgan Pharmaceuticals weekly TRx update, sourced from IQVIA.

drugs could extend beyond obesity. They have shown potential to address a range of maladies, sleep apnea for instance, and be a substitute for other kinds of treatments, like bariatric surgery (we wrote about this in September). As we mentioned, Wegovy's label indicates it is effective at reducing some heart conditions arising from obesity.

> The dominance that Eli Lilly and Novo Nordisk built up in diabetes may not translate into obesity.

However, the dominance that Eli Lilly and Novo Nordisk built up in diabetes may not translate into obesity. For one thing, their success in opening the obesity market with GLP-1 drugs has invited a rush of competitors. There are currently 54 potential anti-obesity drugs in development. Twenty seven are in Phase 1 testing, the initial level of testing a drug on volunteers, 20 are in Phase 2, and six are in Phase 3 (including two from Lilly and one from Novo), the last stage before a company would seek regulatory approval. It seems likely that at least some of them will eventually make it to market.

Competition will be an issue, too. There are about 1.8 million prescriptions written for obesity on a monthly basis; about 960,000 are for Wegovy and Zepbound combined, and the balance are for phentermine, according to IQVIA. As a generic drug, phentermine is an option for patients who can't get their insurance company to cover Wegovy or Zepbound. It also is much cheaper, about US$5-15 per prescription compared to Wegovy at around US$900 per prescription. There will be other competitors as well. At last check, there were nine filers for generic versions of Ozempic/Wegovy. And of course, there is always the least costly alternative: diet and exercise.

Developing newer drugs that can command higher pricing will be a key challenge for Novo and Lilly. Novo Nordisk is banking on an improved version of a GLP-1 it calls Cagrisema, expected to launch in 2026 and cost $8,000 a year. Lilly launched Zepbound in November 2023 and it got off to a strong start, capturing 12% share of total obesity prescriptions (TRx) in the US as of Jan. 19, 2024, taking share from phentermine generics, Saxenda, and Wegovy. However, since then its market share has comprised about 15-20%, showing that prescription volume has not grown substantially.

A Reshaped Market

On the surface, it would seem like Eli Lilly and Novo Nordisk are still in an enviable position. But for a variety of reasons, they may struggle with pricing power for the next several years, and beyond that they face an even larger challenge: the patent cliffs for their most popular drugs.

An irony for Eli Lilly and Novo Nordisk is that their success in diabetes and obesity has put them in a position where they are dependent on GLP-1 drugs. As of the first quarter of 2024, Novo and Lilly had a roughly 75%/25% split, respectively, of the US obesity market, by dollar value, and the US market comprises about 80% of the global market. For Novo, GLP-1 represents 70% of revenue and all of its growth. For Lilly, GLP-1 drugs comprised 43% of its first-quarter revenue. Any sagging demand for their GLP-1 products will be felt acutely on the bottom line.

There is already some evidence that the hype over GLP-1 drugs is outstripping the actual demand. Prescription growth for GLP-1 drugs has slowed significantly. New prescriptions for Wegovy in the US have slowed from roughly 50% growth year-over-year in December to 30% year-over-year growth in February to no growth in April and May. Also, while Lilly and Novo have brand value in Zepbound, Ozempic, and Wegovy, that too will be undercut if competitors bring rival obesity drugs to market and negotiate with insurance companies on price. Therefore, pricing power for these companies is likely to see a long, steady decline in the coming years.

Prices are already trending down. For Ozempic, prices have fallen about 5% per year in recent years, according to Novo. That's largely due to a change in payor mix (companies typically first negotiate with payors where they can get the highest prices, like private insurance). Also, Ozempic and Mounjaro's rapid expansion in volume is resulting in payors getting bigger volume rebates.

At the same time, Lilly and Novo will be facing patent expirations on their own products. Ozempic and Wegovy lose their exclusivity in 2031 and 2032, respectively. By 2030, those two drugs are expected to represent 70% of Novo's revenue. The price and volume pressure that will ensue at that point from branded and generic competitors will be a substantial challenge for the company.

The next decade will see this market buffeted by all these swirling dynamics. Rising sales will bring more competition and give buyers more options. But Wall Street analysts continue to discount price erosion as a significant problem and expect Eli Lilly and Novo Nordisk can continue to launch new products at higher prices. That isn't how markets this competitive work. The likelihood of everything continuing in a straight line upward is low; there are too many things that can go wrong: volume demand could be overestimated; pricing comes down; new entrants break the Lilly-Novo duopoly; or insurance companies push back against coverage. We suspect that something, somewhere will have to give.