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Markets Research

Asia
India

Strategy
India Equity Strategy: 2015 Outlook

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Strategy Update

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A year of public investment driven macro economic vigour

Rising public investment to emerge as key market catalyst for 2015
We expect 2015 to mark the beginning of government policy making a transformational shift towards the long pending issues of addressing supply-side constraints in the domestic economy and reallocating government spending from consumption to investment. In 2015, we see India harnessing its commodity pricing dividend to realign policy towards an investment driven macroeconomic stabilization which will not only drive economic growth higher but also reduce inflation and create jobs. Returns on public spending accompanied by the organizational capacity to spend will have a significantly higher multiplier impact on the economy relative to spending on redistribution economics where leakages are extremely high.

2015 year end Sensex target of 33,000
We are setting year end (December 2015) Sensex target at 33,000 (imputed Nifty target of 9,936) implying an upside of 23% from current levels. At our target the Sensex would trade at 18.4x FY16 EPS and 15.5x FY17 EPS, with earnings CAGR of 17.7% over FY15-17. Our key overweights are Financials, Industrials, and Materials while our key underweights are Consumer Staples, IT Services. and Telecom.
Our **Large Cap** Picks are: **Axis Bank, CONCOR, Godrej Consumer, HDFC Bank, M&M, Maruti, REC, SAIL, SBI, Tata Steel, Tech Mahindra,** and **Ultratech**.
Our **Mid Cap** picks are: **Bharat Forge, CESC, Cummins, Gujarat Pipavav, HPCL, IRB Infra and JSW Energy.**

Improving economics and govt actions increase probability of ratings upgrade
We assign a high likelihood of a sovereign ratings upgrade for India as most macro indicators have exhibited improvements in past 2 years. A rating upgrade will likely entail multi-layered benefits for Indian economy and markets. Over the past decade we have witnessed 4 instances of rating upgrades by S&P and Moody's and on an average Sensex has returned 9% in the following 6 months and 40% in the following 12 months of ratings upgrade. Boost to capital inflows and improved perception of India on the back of rating upgrade should help moderate volatility associated with US rate normalization and create some headroom for RBI to ease monetary stance.

India likely to remain one of the favored emerging markets
Expectations of normalization by the US Fed and a subdued commodity pricing environment will continue to drive multi-asset differentiation within Emerging markets. India's embrace of long pending, supply side reforms together with an investment driven macroeconomic stabilization will allow it to deepen its relative attractiveness in 2015. Among key EMs, India has demonstrated one of the best improvements on external front with CA deficit now in comfort zone at (2.1% in Sep'14 qtr. 4.7% in FY13), appreciable FX reserves accumulation and sharp uptick in capital inflows.

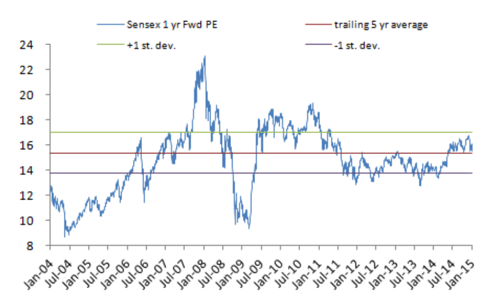
Government must ensure its economic agenda is not side tracked
While the urgency in moving ahead on key ordinances is indicative of the commitment to reform, passing bills in parliament will be vital to ensure that reform is structural, enduring and getting institutionalized. Translation of many of the recent ordinances into law in the next session of parliament will be viewed as crucial determinants of the government's execution prowess. Other risks: Faster- and steeper-than-anticipated Fed rate normalization and any systemic risk associated with steep decline in oil prices.

DB India portfolio positioning

Overweight	Underweight
Consumer Disc	Consumer Staples
Energy	IT Services
Financials	Telecom
Industrials	Utilities
Materials	

Source: Deutsche Bank

Sensex 1 yr fwd PE



Source: Deutsche Bank; Bloomberg Finance L.P.

Sensex earnings and valuation

	FY15e	FY16e	FY17e
P/E	17.5	15.0	12.7
EPS	1,534	1,792	2,126
EPS Growth (%)	16.3	16.8	18.6
P/BV	2.7	2.4	2.1
RoE (%)	16.2	16.8	17.6

Source: Deutsche Bank

Table Of Contents

A year of rising public investment

Rising public investment and focus on easing supply side constraints to fuel economic revival

We expect 2015 to mark the beginning of government policy making a transformational shift towards the now critically urgent issues of addressing supply constraints in the domestic economy and reallocating government spending from consumption to investment. If not addressed with immediate effect these supply-side constraints will erode the productive capacity of the economy, keep interest rates elevated and systemically impede the investment cycle.

In 2015, we see India harnessing its commodity pricing dividend (imports of Petroleum, Coal, gold and silver together constitute 51% of total merchandise imports and are equivalent to 12% of GDP) to realign policy towards an investment driven macroeconomic stabilization which will not only drive economic growth higher but also reduce inflation and create jobs. Returns on public investment will have a significantly higher multiplier impact on the economy relative to spending on subsidies where leakages are extremely high.

Figure 1: Additional resource for infra spending from oil arithmetic

	FY14	FY15E	FY16E	FY16E	FY16E
Brent crude oil avg (USD/bbl)	107.6	90.8	74.3	60.0	50.0
USD/INR	60.5	61.0	64.0	64.0	64.0
Excise revenue from oil (INR bn)	780	929	1,301	1,260	1,231
Customs revenue from oil (INR bn)	50	43	37	30	25
Oil subsidy budgeted (INR bn)	855	634	286	171	140
Incremental revenue from oil (INR bn)		142	366	318	284
Oil subsidy saving (INR bn)		221	348	463	495
Additional funds with govt from oil (INR bn)		362	715	781	778

Source: Deutsche Bank, Bloomberg Finance L.P.

According to our oil and gas analysts, Harshad Katkar and Amit Murarka, on account of lower oil prices coupled with recent increases in excise duties on petrol and diesel, government may accrue a gain of INR700bn in FY16. At Deutsche Bank's average annual oil price forecast of USD74/bbl for FY16, we estimate government's oil subsidy budget for FY16 at INR286bn which would imply a reduction/ saving of INR350bn compared to FY15 (government has budgeted INR634bn for oil subsidies in FY15). We also expect additional revenue of INR370bn in FY16 (vs FY15) from higher excise duty collections on oil products driven by the recent duty hike of INR4.5/lit in diesel and INR5.75/lit in petrol.

We estimate that every INR1/lit increase in excise duty on petrol and diesel will generate additional revenue of INR100bn for the government. Similarly, every 2.5% increase in customs duty on oil will generate additional revenue of INR100bn for the government.

Public spending to do heavy lifting as private sector investment sentiment remains weak

With a highly levered and still bruised, private sector - which remains reluctant to invest - we see the government harnessing the fiscal space created through lower commodity prices to consciously allocate large commitments to public investment with two critical objectives – (1) focus on investments to those infrastructure sectors which improve the competitiveness and productivity of the economy, ultimately reducing the infrastructure deficit and making the investment environment even more conducive for the return of domestic private investment and facilitating higher foreign investment in key sectors where norms have been liberalized (2) invest in those sectors which have the highest multiplier impact on growth and job creation. We see following sectors where public investment is likely to be committed meaningfully – roads, irrigation, and railways. The road sector has an employment elasticity of ~1.5 to 1.7, implying that a 1% increase in value added generates 1.54% growth in employment. With the government committed to meeting its fiscal deficit target in the current fiscal year, we expect the marked departure in government spending to capital expenditure being articulated in the forthcoming budget as a key policy initiative for the next fiscal year.

The government's policy quiver on easing supply side constraints is likely to have additional arrows over and above the public investment commitment. These will be (1) a continuous focus on governance and improving the environment for project clearances, reforming the land and labour markets, bring in the landmark GST tax reform. We expect these initiatives to not only accelerate clearance of stalled projects but also rebuild the confidence of the private sector to embark on a new investment cycle.

Economy is improving, but still fragile. Monetary policy at inflection point, ratings upgrade in 2H

The combination of a government committed to accelerating economic growth and a continuing environment of subdued commodity prices should manifest in a virtuous economic cycle, allowing the government to liberalize the economy, rein in subsidy spending and reallocate savings on subsidies to ramp up public spending in vital infrastructure projects, without raising fiscal risks and within the confines of realistic fiscal deficit targets. Vital reform in agriculture, land and labour markets, resisting the urge to embark on populist schemes, ahead of a busy election calendar from October this year and getting bills passed in parliament will emerge as the core determinants of a move to higher economic growth and keeping the economic and confidence- business, consumer and investor - cycles virtuous.

Government must ensure its economic agenda is not side tracked

We see a high possibility of India's sovereign credit rating being revised upwards in 2015 as the domestic, monetary and external environment continues to improve and the government's economic agenda is not side tracked by political factors. While the urgency in moving ahead on key ordinances is indicative of the commitment to reform, passing bills in parliament will be vital to ensure that reform is structural, enduring and getting institutionalized. Translation of many of the recent ordinances into law in the next session of parliament will be viewed as crucial determinants of the government's execution prowess. International Rating agencies are likely to look out for a continuing improvement in GDP growth prospects, improving external indicators, fiscal reform and continuing liberalization of the economy. The government's increasing focus on addressing supply side constraints coupled with improving the delivery mechanism of public expenditure are likely to be seen as additional boosters for both a rating upgrade as well as RBI policy action.

Investor positioning – Themes and Top Picks

A public investment driven economic recovery, monetary loosening and a shift in consumption from rural to urban India will be the key themes for 2015. Our sector focus therefore centers primarily on the domestic economy and cyclical recovery plays, particularly those sectors that will benefit from rising public investment declining interest rates and lower inflation.

Sensex target at 33,000 implying 23% upside from current levels

We are setting our year end – Dec 15 – Sensex target at 33,000 implying an upside of 23% from current levels. At our target the Sensex will trade at 18.4 times FY16 EPS and 15.5x on FY17 EPS. We see upside risks to the forward market multiple as India makes the transformational policy shift from a consumption-oriented bias to investment formation and importantly addressing supply constraints, using the savings generated from lower global commodity prices. A significant re-rating could occur once the private sector embarks on a new investment cycle.

Portfolio positioning

Portfolio recommendations

Figure 2: DB India portfolio positioning

Overweight	Equalweight	Underweight
Consumer Discretionary	Healthcare	Consumer Staples
Energy		IT Services
Financials		Telecom
Industrials		Utilities
Materials		

Source: Deutsche Bank

Figure 3: DB India Top Picks. Share prices as of market close, Jan. 7, 20015

BBG Ticker	Share Price (INR)	Target Price (INR)	Upside (%)	DB Rec	PE (x) FY15e	PE (x) FY16e	EPS Growth (%) FY15e	EPS Growth (%) FY16e	PBV (x) FY15e	PBV (x) FY16e	ROE (%) FY15e	ROE (%) FY16e
Top Large Cap Picks												
Axis Bank	499	560	12.3	Buy	15.2	13.0	23.8	17.0	2.6	2.3	18.6	18.7
CONCOR	1,355	1,750	29.1	Buy	31.2	27.9	-10.8	11.8	3.5	3.2	11.8	12.1
Godrej Consumer	960	1,100	14.6	Buy	36.6	28.5	19.1	28.5	7.4	6.2	21.9	23.7
HDFC Bank	945	1,060	12.2	Buy	21.9	17.9	21.6	22.2	4.4	3.7	21.8	22.4
M&M	1,224	1,500	22.5	Buy	20.8	15.4	-3.4	34.9	4.0	3.3	20.2	23.4
Maruti Suzuki	3,438	3,900	13.4	Buy	26.1	18.0	44.1	44.8	4.4	3.6	18.0	22.0
REC	318	380	19.6	Buy	5.7	5.0	18.4	13.1	1.2	1.0	24.1	22.5
SAIL	78	100	28.5	Buy	11.8	9.1	64.3	29.4	0.7	0.7	6.2	7.6
State Bank of India	300	340	13.3	Buy	12.3	9.8	24.0	25.5	1.4	1.3	12.2	13.8
Tata Steel	389	675	73.6	Buy	7.2	6.1	54.6	17.5	0.8	0.8	12.4	13.0
Tech Mahindra	2,524	3,500	38.6	Buy	16.6	12.6	21.4	32.1	3.7	2.9	27.8	26.3
UltraTech	2,660	3,050	14.7	Buy	30.7	23.0	7.2	33.2	3.8	3.3	13.1	15.3
Top Mid Cap Picks												
Bharat Forge	900	1,050	16.6	Buy	28.4	19.7	72.4	43.9	6.9	5.5	25.9	31.1
CESC	663	850	28.3	Buy	17.6	10.2	-3.1	72.9	1.5	1.3	8.6	13.4
Cummins India	900	1,065	18.3	Buy	37.5	31.0	14.7	20.7	8.8	7.9	27.0	26.9
Gujarat Pipavav	221	234	5.9	Buy	33.3	28.7	82.8	16.2	6.2	5.3	20.5	20.0
HPCL	569	690	21.4	Buy	14.8	10.3	15.7	43.0	1.3	1.2	9.1	12.3
IRB Infra.	227	300	32.0	Buy	13.2	10.4	24.3	27.0	1.9	1.7	15.1	17.0
JSW Energy	97	117	20.4	Buy	11.4	10.7	34.9	5.6	2.1	1.8	19.9	18.3

Source: Deutsche Bank, Bloomberg Finance L.P.

Model Portfolio

DB India Model Portfolio benchmarked to MSCI India

Figure 4: DB India Model Portfolio. Share prices as of market close, Jan. 7, 20015

		Last Price	Mcap	LATEST			P/E (x)		EPS Growth (%)		P/BV (x)		ROE (%)	
Company	Reco	INR	USD Mn	MSCI wt.	DB wts	O/U-wt	FY15e	FY16e	FY15e	FY16e	FY15e	FY16e	FY15e	FY16e
CONSUMER DISCRETIONARY				8.36	9.33	97 bps								
Automobiles & Components				7.22	8.83	161 bps								
Apollo Tyres	Buy	219	1,762		0.50	50 bps	9.7	8.6	8.4	12.2	2.0	1.6	22.5	20.6
Bharat Forge	Buy	900	3,319		1.00	100 bps	28.3	19.7	72.4	43.9	6.9	5.5	25.9	31.1
M&M	Buy	1224	12,040	2.47	3.47	100 bps	20.8	15.4	-3.4	34.9	3.9	3.3	20.2	23.4
Tata Motors	Buy	494	23,563	2.26	2.36	10 bps	8.2	7.3	44.8	13.4	1.9	1.5	25.8	23.1
Maruti	Buy	3438	16,381		1.50	150 bps	26.1	18.0	44.1	44.8	4.4	3.6	18.0	22.0
Consumer Durables & Apparel				0.00	0.50	50 bps								
Titan	Buy	375	5,223		0.50	50 bps	36.3	28.2	23.5	28.8	10.4	8.3	32.1	32.8
Media				1.14	0.00	-114 bps								
Retailing				0.00	0.00	0 bps								
CONSUMER STAPLES				12.04	10.41	-163 bps								
Food Beverage & Tobacco				7.02	4.92	-210 bps								
ITC	Buy	354	44,917	4.72	4.92	20 bps	28.4	24.9	12.8	14.0	9.8	8.9	36.0	37.3
Household & Personal Products				5.02	5.49	47 bps								
Godrej Consumer Products	Buy	960	5,149	0.68	1.68	100 bps								
HUVR	Buy	802	27,492	3.61	3.81	20 bps	41.2	34.7	18.4	18.9	42.1	44.2	113.8	124.4
ENERGY				10.91	11.81	90 bps								
Consumable Fuels				1.13	1.14	1 bps								
Coal India	Hold	375	37,623	1.13	1.14	1 bps	17.8	14.5	-11.9	22.8	5.6	5.3	31.6	37.8
Oil & Gas				9.77	10.67	90 bps								
BPCL	Buy	645	7,380	0.67	1.55	88 bps	15.1	12.4	-20.9	22.2	2.2	2.0	15.2	16.7
HPCL	Buy	569	3,037		1.00	100 bps	14.8	10.3	15.7	43.0	1.3	1.2	9.1	12.3
ONGC	Buy	338	45,403	1.54	1.55	1 bps	9.9	8.6	10.2	14.6	1.5	1.4	16.1	16.7
RIL	Buy	854	43,601	6.57	6.57	0 bps	11.3	10.5	8.5	7.8	1.3	1.1	11.7	11.4
FINANCIALS				18.26	20.96	270 bps								
Banks				4.89	8.19	330 bps								
Axis Bank	Buy	499	18,617		1.00	100 bps	15.2	13.0	23.8	17.0	2.6	2.3	18.6	18.7
HDFC Bank	Buy	945	36,218		1.10	110 bps	23.6	19.3	21.6	22.2	4.4	3.7	21.8	22.4
ICICI Bank	Buy	338	30,931	2.21	2.31	10 bps	17.5	14.8	14.9	18.4	2.4	2.2	14.6	15.6
SBI	Buy	300	35,500	2.68	3.78	110 bps	11.8	9.5	24.0	25.5	1.4	1.3	12.2	13.8
Diversified Financials				2.44	2.48	4 bps								
REC	Buy	318	4,985	0.56	1.56	100 bps	5.7	5.0	18.4	13.1	1.2	1.0	24.1	22.5
Shriram Trans Fin	Buy	1040	3,725	0.91	0.92	1 bps	16.6	14.1	4.4	17.7	2.4	2.1	15.5	15.9
Thrifts and Mortgage Finance				10.60	9.94	-66 bps								
HDFC	Buy	1099	27,591	9.84	9.94	10 bps	28.4	23.5	13.9	20.6	5.5	5.0	21.1	22.9
Real Estate				0.34	0.35	1 bps								
DLF	Hold	135	3,801	0.34	0.35	1 bps	23.8	13.1	54.0	81.3	0.8	0.7	3.3	5.5

Source: Deutsche Bank, Bloomberg Finance L.P.

Figure 4: DB India Model Portfolio. Share prices as of market close, Jan. 7, 20015 Cont'd.

		Last Price	Mcap	LATEST			P/E (x)		EPS Growth (%)		P/BV (x)		ROE (%)	
Company	Reco	INR	USD Mn	MSCI wt.	DB wts	O/U-wt	FY15e	FY16e	FY15e	FY16e	FY15e	FY16e	FY15e	FY16e
HEALTH CARE				9.44	9.44	0 bps								
INDUSTRIALS				5.81	8.05	224 bps								
Construction & Engineering				2.82	4.22	140 bps								
IRB Infra	Buy	227	1,190		1.00	100 bps	13.3	10.4	24.3	27.0	1.9	1.7	15.1	17.0
L&T	Hold	1501	22,025	2.82	3.22	40 bps	30.1	26.4	15.8	14.1	3.4	3.1	12.2	12.3
Electrical Equipment				0.89	0.00	-89 bps								
Industrial Conglomerates				1.15	1.13	-2 bps								
Machinery				0.00	1.70	170 bps								
Cummins India	Buy	900	3,950		1.20	120 bps	37.6	31.2	14.7	20.7	8.8	8.0	27.0	26.9
Jain Irri	Hold	66	473		0.50	50 bps	20.5	11.1	NA	85.0	1.4	1.2	4.4	11.7
Road & Rails				0.00	1.00	100 bps								
CONCOR	Buy	1355	4,177		1.00	100 bps	31.3	28.0	-10.8	11.8	3.5	3.3	11.8	12.1
Transporation Infrastructure				0.95	0.00	-95 bps								
INFORMATION TECHNOLOGY				22.56	19.26	-330 bps								
Infosys	Buy	1964	35,583	10.73	10.63	-10 bps	18.4	16.6	12.5	10.6	4.1	3.6	24.0	23.2
TCS	Buy	2418	74,893	6.77	6.78	1 bps	22.0	18.6	12.4	18.5	7.4	5.9	36.2	35.3
Tech Mahindra	Buy	2524	9,591	0.85	1.85	100 bps	16.6	12.6	21.4	32.1	3.7	2.9	27.8	26.3
MATERIALS				6.97	9.19	222 bps								
Chemicals				1.32	2.07	75 bps								
Asian Paints	Buy	772	11,725	1.32	2.07	75 bps	46.8	38.8	29.8	20.7	15.3	12.7	35.7	35.8
Construction Materials				1.64	2.42	78 bps								
Shree Cement	Buy	9064	4,964		0.80	80 bps	36.6	22.5	-0.2	62.7	5.6	4.5	16.7	22.2
Ultratech	Buy	2660	11,539	0.57	1.62	105 bps	30.7	23.0	7.2	33.2	3.8	3.3	13.1	15.3
Containers and Packaging				0.00	1.00	100 bps								
Gujarat Pipavav Port	Buy	221	1,689		1.00	100 bps	33.3	28.7	82.8	16.2	6.2	5.3	20.5	20.0
Metals & Mining				4.01	3.70	-31 bps								
Hindalco	Buy	149	4,888	1.00	1.50	50 bps	10.0	8.2	23.7	21.9	0.7	0.7	6.6	8.2
SAIL	Buy	78	5,092		0.75	75 bps	11.8	9.1	64.3	29.4	0.7	0.7	6.2	7.6
Tata Steel	Buy	389	5,976	0.70	1.45	75 bps	7.2	6.1	54.6	17.5	0.8	0.8	12.4	13.0
TELECOMMUNICATION SERVICES				2.63	0.00	-263 bps								
UTILITIES				3.00	1.55	-145 bps								
Electric Utilities				0.52	0.75	23 bps								
CESC	Buy	663	1,394		0.75	75 bps	17.5	10.1	-3.1	72.9	1.4	1.3	8.6	13.4
Gas Utilities				0.79	0.00	-79 bps								
IPP				1.69	0.80	-89 bps								
JSW Energy	Buy	97	2,490		0.80	80 bps	11.3	10.7	34.9	5.6	2.1	1.8	19.9	18.3

Source: Deutsche Bank, Bloomberg Finance L.P.

Top Large Cap Picks

Axis Bank (Buy, Target Price: INR560, Upside: 12%)

- Axis has now transitioned from being a largely wholesale bank to a more diversified entity in terms of assets, liabilities and fees, with retail becoming a big growth driver.
- In fact, it is one of the fastest-growing bank in retail loans, retail fees and CASA deposits.
- Valuations for Axis Bank do not reflect likely long term RoEs due to its concerns on asset quality. As the economy revives, we believe that concerns will reduce, resulting in better valuations.
- Asset quality issues remain important, we note that it now makes much higher margins and RoAs and has enough capital, putting it in a better position to absorb any losses. So far, it has not allowed its NPL % to deteriorate.
- Its 40%+ CASA ratio and a strong corporate and retail positioning would result in a consistent 1.8%+ RoAs with a ~18% RoE over the medium term. It appears well capitalised and does not require any capital.
- Valuations at 2.35x FY16E PBR and 13.6x FY16E PER for a likely 18-19% RoE remain attractive. It is the best geared for an economic recovery, in our opinion.

Container Corporation of India (Buy, Target Price: INR1,750, Upside: 29%)

CONCOR is one of our preferred infra picks given

- Its 63 dry ports and the largest container train operations (79% market share) in the country make the business a unique one.
- Its cargo-carrying capacity in the key northwestern hinterland (c60% of current trade) looks well set to see a 6x rise in four years with the DFC.
- It is poised to be one of the biggest beneficiaries of the rising containerization levels in India at 47% vs the global average of 75%.
- Our model estimates for earnings and FCFE CAGRs of 19% and 48%, respectively, over FY15-17.
- Our DCF model offers a 29% 12 month return and the stock being a potential 2 bagger over the next five years. Lower-than-expected volume growth remains the key risk for Concor.

Godrej Consumer (Buy, Target Price: INR1,100, Upside: 15%)

- Godrej Consumer (GCPL) has transformed into an Indian consumer multinational with its focus on a “3x3” strategy (three continents and three categories).

- Its strong innovation agenda and cross-pollination opportunities across geographies should drive 14.3% revenue growth in FY15-17e.
- Its demonstrated execution (evidenced by strong market share gains) and strong innovation pipeline form the bedrock of our 21.3% CAGR earnings growth forecast in FY15-17e – one of the best in Indian Consumer Staples.
- Pursuing innovation and inorganic growth: While GCPL has a long growth runway in its key categories of insecticides and hair, its demonstrated execution will likely help it to extend its leadership. It has multiple growth levers (and hence is de-risked) – Indian insecticides, Indian hair color and African hair extensions. Growth in the Indonesian Megasari business accelerated after GCPL's acquisition, indicating its ability to integrate and realize synergies.
- We value GCPL on an SOTP basis and assign a target price of INR1,100. We believe SOTP is the best methodology, due to its operations in multiple geographies with different growth profiles.

HDFC Bank (Buy, Target Price: INR1,060, Upside: 12%)

- Strong liability franchise (CASA ratio ~46%) to help maintain NIM and fuel growth. HDFC has consistently grown its CASA franchise and it now sees the rural engine to provide next set of growth for HDFC Bank. It has been very aggressive in opening new branches in the rural area.
- Fee income growth continues to remain robust – and is getting more diversified with investment banking fees now also starting to contribute.
- Asset quality continues to remain favorable despite relatively higher unsecured credit. One of the key hallmark of HDFC Bank has been its impeccable asset quality and despite having more than 10% of the loan book unsecured, asset quality remains very strong.
- A high provisioning buffer will result in steady earnings for the bank – It carries a floating provisions of 0.8% of loan book.
- Valuations at 3.74x FY16E PBR and 18.1x FY16E PER for a likely 22% RoE remain attractive.

Mahindra & Mahindra (Buy, Target Price: INR1,500, Upside: 22%)

- Our BUY rating is premised on expectations of marketshare gains in the UV segment which would be aided through new launches in 1HCY15. We are also expecting a normalisation of tractor volumes in FY16.
- We believe current valuations at 10.5xFY16E core PE (40% discount to Maruti) does not factor the impact of new launches and provides adequate valuation cushion.
- Product gaps in compact UVs have hurt M&M's marketshare. We expect that the new launches will result in share expanding from 38% in FY15E to 41% by FY17E.

- Our conversations with auto consultants and global suppliers indicate a maturity in the R&D processes of M&M.
- What to watch: announcement of new launches in the UV segment. We expect this to happen around March-April 2015.

Maruti Suzuki (Buy, Target Price: INR3,900, Upside: 13%)

- Our BUY rating is premised on an expectation of industry demand revival and Maruti's strong competitive position which should lead to marketshare gains.
- We forecast 14% volume CAGR over FY14-17E and expect Maruti's market share to improve by 280bps, from 42.1% in FY14 to 44.9% in FY17E.
- We also expect Maruti's margins to improve on the back of lower discounts as demand revives. Maruti will also gain from a weaker JPY – a 5% depreciation in JPY leads to a 10% increase in EPS.
- Contrary to the dominant investor view, we do not see the Suzuki deal (Suzuki's plant investment) as –ve for the minority shareholders of MSIL. The 100% ownership of Gujarat plant investment by Suzuki remains an investment concern.
- Valuation: The stock currently trades at 17.5xFY16E EPS – long-term range is 10x-22x. Maruti's valuation normally expands during time of strong industry demand. Risks include lower-than expected volume growth.
- What to watch: a) sales of entry segment (current run-rate 36K/month) which is expected to lead the revival, b) Performance of Ciaz (premium sedan – Oct-14 launch).

Rural Electrification Corp (Buy, Target Price: INR380, Upside: 20%)

- Growth is unlikely to be challenge for REC as funding requirement remain very large in the power segment. We expect loan book to grow at 17% p.a. over the next 3 years.
- Likely power sector reforms under the new government augur well for the sector and hence REC.
- The company has managed to keep its NPLs at very low levels and we do not expect any material increase from current levels. It remains well capitalised and hence would not be required to raise capital in near term.
- Lower wholesale funding rates and stable credit costs are key positives for REC & will help in reporting ~22% RoE.
- Valuations at 1.1x FY16E P/B and 5.3x FY16E P/E look attractive.

SAIL (Buy, Target Price: INR100, Upside: 28%)

Our positive investment case on SAIL is underpinned by

- We believe the worst of the delays in project implementation are now behind and we should see an improving volume and profitability trajectory as newly commissioned facilities ramp up and benefits of operating leverage begin to flow through

- We forecast SAIL to report EBITDA and PAT CAGR of 37%/36% respectively over FY14-17 – amongst the strongest in the sector, driven by a combination of higher volumes (+28%) and improved profitability (+100%)
- Resolution of regulatory issues related to SAIL's captive iron ore mines should assuage investor concerns over company's iron ore sufficiency
- However, investors will need to look beyond the near term earnings volatility as the benefits of SAIL's expansion and modernization plan will begin to reflect only in 1H'FY16
- Coking coal constitutes ~35% of total operating costs for SAIL, and weak coking coal prices should aid profitability improvement

Near term triggers that should drive stock price

- Volume ramp up from the new blast furnace at IISCO
- Improved visibility on benefits coming from the high-profile commissioning of modernized facilities at new blast furnace at Rourkela (commissioned), IISCO (under commissioning) and new coke oven batteries (commissioned).
- We rate the stock as Buy with a target price of INR100/share.

State Bank of India (Buy, Target Price: INR340, Upside: 13%)

- We believe that SBI is among India's top beneficiaries of an emerging macro recovery, where indicators are turning positive.
- On the back of an improving macro outlook, we expect both slippages and restructuring to decline in FY15. A strong recovery/upgradation cycle from FY16 should drive a sharp NPL decline, resulting in lower credit costs.
- SBI has taken slew of measure to address concerns relating to costs. it has slowed down its branch additions; 2) retirements are now likely to outnumber new joiners; 3) it has very tight control over non-salary costs; and 4) retiral costs are now fully provided.
- Its 43%+ CASA ratio and a strong liability franchise would result in a consistent 3.5%+ margins in medium term.
- Valuations at 1.33x FY16E PBR and 10.1x FY16E PER for a likely 14% RoE remain attractive. It is the best geared for an economic recovery, in our opinion.

Tata Steel (Buy, Target Price: INR675, Upside: 74%)

Our positive investment case on Tata Steel is underpinned by:

- Commissioning of Odisha plant in 1Q'FY16, leading to low cost, high margin Indian operations constituting 35% of consolidated production and 73% of consolidated EBITDA in FY16,

- Resolution of regulatory issues related to company's captive iron ore mining operations in Odisha and Jharkhand should assuage investor concerns over raw material procurement,
- Robust cash flow generation allowing company to fund Odisha Phase II from internal generation and helping alleviate investor angst over perennially stretched balance sheet,
- Expectations of sharp and significant working capital savings in Europe following large decline in raw material prices.
- The proposed commissioning of phase I of the Odisha Greenfield plant within a twelve month period of achieving optimal ramp up of legacy Jamshedpur operation will be transformational for Tata Steel. We rate the stock as Buy with a target price of INR675/share.

Tech Mahindra (Buy, Target Price: INR3,500, Upside: 39%)

- Only secular business turnaround play in the Indian IT services sector: Tech Mahindra gains from the twin advantages of
  - Sales aggression of the telecom business and
  - Strong client relationships in the enterprise business. Commendable improvement in the quality of delivery and significantly better balance sheet (net cash of USD600mn) forms the base of Tech Mahindra's business turnaround and above industry average growth rates.
- High customer satisfaction and share gains with existing customers : Share gains in spending from existing customers, (2) strong deal signings from new customers in recent quarters has ensured no significant impact on margins or revenue growth rates despite cessation of revenue amortization from top client BT (British Telecom) in 4QFY14.
- Impressive growth and inexpensive valuations: We expect TechM to deliver a 17% USD revenue CAGR over FY14-20E. Large acquisition could stall/derail the turnaround:
- Large acquisition (revenues 400mn-USD1bn) over the next six months remains the only notable risk to our Buy call. While the balance sheet can support an acquisition of this size, we are worried this will stall the revival of the enterprise business of Tech Mahindra.

UltraTech Cement (Buy, Target Price: INR3,050, Upside: 15%)

Our investment thesis is premised on

- It is the market leader, enjoying a substantial profitability premium on a pan-India basis, driven by benefits from its low operating and distribution costs.
- It has used this downcycle to grow through both organic and inorganic routes. Any pick-up in demand could mean that market share gains could be disproportionate and more profitable. We note that the current utilization rates are below 70% – much lower than All-

India levels (and peers), resulting in the company having significant operating leverage benefits.

- The company's strategy to acquire limestone reserves and land across the various regions in the country could mean a sizeable competitive advantage – in terms of both time and cost to grow its market share.
- Current valuations, at EV/t of USD 176/t (at around replacement cost of a greenfield unit), do not factor in the benefits of re-rating enjoyed by sector leaders, as we head into an upturn.
- Our 12M TP of INR 3050/sh is based on average of exit P/E of 20xFY16E, EV/t of US$ 205, EV/t of reserves of US$ 3.5 and Life of Mine DCF. Any M&A (both overseas and domestic) at a significant premium to replacement cost is a key risk. On the operational front, lower than expected demand/pricing are key risks.

Top Mid Cap Picks

Bharat Forge (Buy, Target Price: INR1,050, Upside: 17%)

- Our positive thesis on Bharat Forge is driven by a) improving truck volume momentum and market share in its end markets (US/EU/India), and b) ramp-up in the non-auto segment, led by new products and customer wins.
- Bharat Forge has utilised the downturn to enhance capabilities and improve efficiencies. Its EBITDA/tonne today is 50% higher than in past periods of similar capacity utilisation.
- We expect strong FCF generation (Rs 16bn over FY16-17E) which should result in the company becoming debt-free by FY17E.
- Valuations – trading at FY16E EV/EBITDA of 11.5x and PE of 20x – above long-term average. However this is supported by EBITDA and EPS CAGR (FY15-17E) of 24% and 32%.
- What to watch: announcements of new order wins in non-auto verticals of aerospace, railway, and construction.

CESC (Buy, Target Price: INR850, Upside: 28%)

CESC is our top pick as

- a) core power business could deliver 22% CAGR over the next three years on capacity expansion;
- b) non-core businesses are turning around with aggressive cost rationalization;
- c) a possibility of strong business momentum. Coal auctions, Dhariawal PPA approval with Noida Power and Haldia commissioning by Q4 are upcoming catalysts.

Cummins India (Buy, Target Price: INR1,065, Upside: 18%)

Our investment thesis is premised on

- It's top of the line product offering catering to virtually every segment of India's investment demand including global exports/services.
- India requires significant investment in new diesel engines for varied segments like road construction, mine restarts, oil rigs, CVs, rail engines, defense ships/vehicles, water pumps, etc. Current utilization levels at <65% could offer scope for 27% EPS CAGR in a robust demand environment, vs. our EPS CAGR of 14% (over 2HFY15-FY17E).
- More importantly, what makes this sector special is its "maturity", as we seldom find players resorting to high inventory build-out or price war - a rarity in our coverage.
- With the BSETCG Index trading at high hurdle rate of 27xFY16e P/E; we find CUMM offers a better risk-reward pay-off v/s peers – its RoE is amongst the highest in the Indian Industrial space at around 27%.

- We rate the stock a Buy with a DCF based target price of INR 1065/share (using risk-free rate of 6.5% and risk premium of 7.6%). We believe that in our 'blue-sky' scenario, which assumes sales growth of 20% (as in previous up-cycles), the stock price could double in three years. Sharp rise in steel/casting prices remains the key risk.

Gujarat Pipavav Port (Buy, Target Price: INR234, Upside: 6%)

Gujarat Pipavav Port s our top pick among Infrastructure developers as

- It is a key gateway port with a large hinterland (c60% of trade in India is carried out in the North Western part of India) – a big positive given the current capacity constraints at JNPT port in Mumbai.
- Has significant under-utilised rail capacity - which will come in handy over the next 12-18 months.
- Has reasonable pricing power - revenues are USD linked whereas costs are in INR terms. It operates one of the well-established gateway ports on the west coast, with a primary focus on the growing container business.
- It is a debt-free infrastructure company – a rarity in India.
- Last but not least, being an MNC subsidiary (owned by a Global shipping line major), dividends are a major way to return money to shareholders. This can increase RoE. We expect the company to pay its maiden dividend in CY15E as its free reserves are poised to turn positive.
- We rate the stock a Buy with a top of the street NPV based 12 month target of INR 234/sh (using 10.3% CoE). Weak economic activity remains the key downside risk.

HPCL (Buy, Target Price: INR690, Upside: 21%)

- We estimate 22% EPS CAGR for HPCL over FY14-17e driven by higher marketing margin and lower interest costs. We expect diesel marketing margin to improve significantly over the next two years as its price has now been deregulated – every INR0.5/lit increase in diesel marketing margin improves HPCL's FY16e EPS by 32%.
- We estimate oil subsidies to fall 70% over FY14-16 to INR411bn driven by lower oil price, diesel price deregulation and rationalization of LPG subsidies. Reduction in oil subsidies will reduce HPCL's working capital debt by USD1bn over FY14-16 resulting in significant savings in interest cost.
- HPCL is currently trading at FY16 P/BV of 1.2x which is at the mid range of its last 5 years' P/BV. Key risks are sharp increase in oil prices and imposition of subsidy sharing on OMCs.

IRB Infra (Buy, Target Price: INR300, Upside: 32%)

Our Buy call on IRB is premised on

- The company being one of the few companies with the strength of balance sheet and cashflows to support new order wins from the National Highways Authority.
- This in the scenario where NHAI is looking to accelerate its annual orders to over 5000 kms augurs well.
- The company's three recent project wins being taken during a period of low competitive intensity. This, we believe, can help lift the Blended RoE by a good 100-200 bps.
- Our target price of INR 300/sh is based on SOTP – (a) toll road assets using DCF (CoE of 6.5%, market risk premium of 7.6% and beta of 1), (b) Construction (EPC) business at 7x FY16E EV/EBITDA and (c) Real estate at 1x price/book
- Aggressive bidding, if any, by the company in upcoming projects and adverse outcome in the ongoing investigations by regulatory authorities remain the key risks.

JSW Energy (Buy, Target Price: INR117, Upside: 20%)

JSW Energy is our top mid-cap pick on

- a) Potential for earnings pick-up with economic revival and manufacturing push of the government;
- b) low coal prices (-22% in 1 year), revival in power demand (+10%), and potential for interest rate cuts in 2015 (5% earnings sensitivity);
- c) JSWE we believe is strongly placed to reap benefits of consolidation in the power sector- on visible triggers of strong free cash-flows, unlevered balance sheet, stable core business (infact improving), and emerging inorganic growth opportunities.
- Valuations at 1.9x one year P/B is re-rated to historical average and still doesn't capture robust ROEs (17-18%), and strong tailwinds of low-coal price as well as potential of interest rate saving.

Rating upgrade likely to be a key market driver in 2015

Improving external balances and government actions may drive a sovereign ratings upgrade for India

We assign a high likelihood of a sovereign ratings upgrade for India as most macro indicators have exhibited improvements in past 2 years. The economy has indeed witnessed a turnaround since 2012, when it faced an imminent threat of ratings downgrade from global rating agencies. The upward revision in the outlook from negative to stable in Sep'14 was a first development suggesting a perceptibly improving outlook for the Indian economy. While market is not yet factoring in a rating upgrade, we believe that rating agencies may surprise markets by a likely rating upgrade.

A rating upgrade will likely entail multi-layered benefits for Indian economy and markets. In a year of impending rate normalization by the US Fed, a rating upgrade could moderate potential outflows from India's debt market, which had witnessed a record US$26bn inflow in 2014. Moreover, improved rating should raise India's perception among foreign investors, particularly the longer-term oriented investors like sovereign funds, pension funds, endowment funds etc. which should result in continuing inflows from this investor class both in equities and debt. Already, in 2014 several new and non-traditional India investors have pumped money into Indian assets, and we firmly believe that a rating upgrade will lend a strong momentum to capital inflows. Boost to capital inflows on the back of rating upgrade should help moderate the impact of outflows driven by US rate normalization. This should also help RBI in containing the volatility in INR, thereby giving it some more elbow room to ease its monetary stance.

Figure 5: Sensex performance after sovereign ratings upgrade

Effective	Rating	Rating agency	Sensex 6 mth. After	Sensex 12 mth. After
22-Jan-04	From Ba1 to Baa3	Moody's	-9.6%	10.5%
3-Feb-03	From Ba2 to Ba1	Moody's	16.9%	71.4%
30-Jan-07	From BB+ to BBB-	S&P	8.3%	26.0%
2-Feb-05	From BB to BB+	S&P	18.8%	50.7%

Source: Deutsche Bank, S&P, Moody's, Bloomberg Finance L.P.

While rating changes are not a common occurrence, we do believe that the current macro economic and political situation should give enough confidence to rating agencies to upgrade India's sovereign rating. Over the past decade we have witnessed 4 instances of rating upgrades between S&P and Moody's and on an average Sensex has returned 9% in the immediately following 6 months and 40% in the following 12 months. There was only one instance of negative return 6M post facto while for all other time buckets the returns have been positive. This further raises our confidence that a rating upgrade will likely act as an unexpected catalyst for the market.

Over the past decade we have witnessed 4 instances of rating upgrades between S&P and Moody's and on an average Sensex has returned 9% in the immediately following 6 months and 40% in the following 12 months

Government likely to stick to economic agenda

Government efforts have been laudatory, inherent parliamentary constraints notwithstanding

While some market participants have been underwhelmed by government's reform efforts, we are impressed with government's actions till date and believe that government will continue on its mandated path of adopting tough measures which will help revive India's economy. Adding up all the small and big measures announced by the government indeed yields a long and impressive list, which we have reproduced in the table below. We believe that the reason for perceived disappointment could be attributed to extremely elevated expectations from the new government. For a new government still in the first year in its office, the NDA has actually performed commendably despite the fact that it is does not enjoy majority in the upper house of the parliament.

Strong push through ordinance route suggests strong intent to move things fast;

As the government does not enjoy majority in the upper house of parliament, it is facing difficulties in getting legislations cleared on several important issues (such as insurance FDI, coal mining, land acquisition, GST constitutional amendment etc.). However, it has endeavored to set these measures rolling by adopting the ordinance route. Already, the cabinet has cleared key ordinances on coal, insurance, and land acquisition. While the ordinance route of policy making is fraught with inadequacies and lacks legislative rigor, the evolving political environment has forced the government's hand to resort to an alternate, constitutionally provided route of ordinances.

Further, due to the limited period validity of an ordinance, if political gridlock continues in the Upper House of parliament, the government may move a step further and convene a joint session of parliament to pass all the ordinances in one session. The NDA enjoys an absolute majority in the combined strength of two houses of parliament and hence it is likely that it may be able to convert ordinances into legislation, albeit it will be a protracted process.

Figure 6: Key government measures and announcements

Month of Announcement	Measures/Announcement
May, 2014	Constitution of SIT on black money
May, 2014	Abolition of all GoMs and EGoMs
June, 2014	Discontinues four Standing Committees of Cabinet
June, 2014	Delisting of fruit and vegetables from APMC act
June, 2014	2 week deadline for inter-ministerial consultations
June, 2014	Task Force Set up to Rationalization of Coal Linkages
June, 2014	Modest single digit increase in MSPs of kharif prices
June, 2014	Faster liquidation of surplus stock in godown of food corporation of India
July, 2014	Inclusion of onion and potato under the purview of stock holding limits under the Essential Commodities Act, 1955
July, 2014	Governement accords Investment Trusts tax pass through status, thus paving way for introduction of REITs and InVITs
August, 2014	Approval of Digital India – A programme to transform India into digital empowered society and knowledge economy.
September, 2014	Approval for financial support to the National Export Insurance Account (NEIA) for overseas project exports by increasing the authorized corpus of the NEIA Trust to Rs. 4000 crore with risk underwriting capacity upto 20 times of the actual corpus.
July, 2014	Liberalization of FDI in Railways and Defence
August, 2014	Rollout of the Jan Dhan Yojana to foster financial inclusion and direct benefit transfer
August, 2014	Approval to the Ministry of Road Transport and Highways (MoRTH) to (a) amend the Model Concession Agreement (MCA) as may be required from time to time; and (b) to decide the mode of delivery of projects
September, 2014	Approved the "Scheme for Enhancement of Competitiveness of the Capital Goods Sector" to boost the Indian economy.
September, 2014	Launch of the ambitious Make in India campaign to boost India's manufacturing prowess
October, 2014	Launch of Pt. Deen Dayal Upadhyay Shramev Jayate scheme for labor reforms
October, 2014	Revision of Domestic Gas Prices
October, 2014	Deregulation of Diesel Prices
August, 2014	Direct benefit transfer for cooking gas to be implemented from Jan 2015.
October, 2014	Policy framework for relaxations, extensions and clarifications at the development and production stage under PSC regime for early monetization of hydrocarbon discoveries
October, 2014	Conditions for FDI in real estate relaxed. Allows FDI in projects of 20000 sq mt vs. 50000 sq mt and FDI floor lowered to US$1mn vs. US$ 5 mn earlier. Also repatriation for under construction project allowed on case by case.
October, 2014	Rabi crops MSPs raised very nominally by upto 4.2%
November, 2014	Government launched E-Biz portal for providing single online platform to help companies get over five dozen approvals to start project through a single online platform as part of its attempt to make it easier to do business
November, 2014	Launch of Deendayal Upadhyaya Gram Jyoti Yojana (DDUGJY) to strengthen rural electrification
December, 2014	Approved the introduction of the Companies (Amendment) Bill, 2014 in Parliament to make certain amendments in the Companies Act, 2013 (for ease of doing business)
December, 2014	Implementation of scheme for development of Solar Parks and Ultra Mega Solar Power Projects
December, 2014	Approval for allowing Public Sector Banks (PSBs) to raise capital to meet their additional capital requirements under BASEL-III by diluting Government holding upto 52 percent in a phased manner
December, 2014	Introduction of Constitutional Amendment Bill for Goods & Services Tax (GST) in Lok Sabha
December, 2014	Two bills on labour reforms namely The Labor Laws (Exemption from Furnishing Returns and Maintaining Registers by Certain Establishments) Amendment Bill, 2011 and The Apprentices (Amendment) Bill, 2014 were cleared in lok Sabha.
December, 2014	Approved ordinances on Insurance Bill and Coal blocks allocation Bill
December, 2014	Approved amendments in the Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement Act, 2013
January, 2015	Approved changes to MMDR Act which makes auction the preferred mode to sell important minerals

Source: Deutsche Bank; Press Information Bureau

Election free window should help in bold measures

We have been highlighting that the government has a clear 9-10 month runway of election free window, which should help it to adopt business-friendly measures. We see the approaching runway of a of election free window as a very fortuitous situation for the government (especially in the backdrop of lower global commodity prices) which it should not atrophy. We believe that the government understands and recognizes this opportunity and will do whatever it takes to get the wheels of investment churning yet again

Figure 7: Election calendar

State	Likey election timeline	Ruling party	LS seats	% of total LS seats
NCT Delhi	Feb, 2015		7	1.3%
Bihar	Nov, 2015	JD (U)	40	7.3%
Assam	April, 2016	INC	14	2.6%
Kerala	April, 2016	UDF	20	3.7%
Tamil Nadu	April, 2016	AIADMK	39	7.2%
West Bengal	April, 2016	AITC	42	7.7%
Manipur	Jan, 2017	INC	2	0.4%
Punjab	Jan, 2017	SAD+BJP	13	2.4%
Uttar Pradesh	Mar, 2017	SP	80	14.7%
Uttarakhand	Jan, 2017	INC	5	0.9%
Goa	Mar, 2017	BJP	2	0.4%
Himachal Pradesh	Nov, 2017	INC	4	0.7%
Gujarat	Dec, 2017	BJP	26	4.8%
Meghalaya	Feb, 2018	INC	2	0.4%
Tripura	Feb, 2018	CPI (M)	2	0.4%
Karnataka	May, 2018	INC	28	5.1%
Madhya Pradesh	Nov, 2018	BJP	29	5.3%
Rajasthan	Dec, 2018	BJP	25	4.6%
Chhattisgarh	Nov, 2018	BJP	11	2.0%
Odisha	Apr, 2019	BJD	21	3.9%
Andhra Pradesh	May, 2019	TDP	25	4.6%
Telangana	May, 2019	TRS	17	3.1%

Source: Deutsche Bank, Election commission of India

NDA's efforts on ordinances spell out a strong intent on moving forward

The ruling NDA coalition, while enjoying a strong majority in the lower house of the parliament (Lok Sabha), is still far short of the half way mark in the upper house of the parliament (Rajya Sabha) where it has 59 seats out of the total 245 seats and far short of the majority requirement of 123 seats. The BJP led NDA coalition has been faring well in recent state elections held after the General elections in May'14, and been able to form majority government in the state of Maharashtra, Haryana and Jharkhand.

Figure 8: NDA strength in parliament

	Total seats	Majority mark	BJP MPs	NDA MPs	% BJP MPs	% NDA MPs
Lok Sabha	545	273	281	335	52%	61%
Rajya Sabha	245	123	45	59	18%	24%
Both Houses	790	396	326	394	41%	50%

Source: Deutsche Bank, Lok Sabha, Rajya Sabha

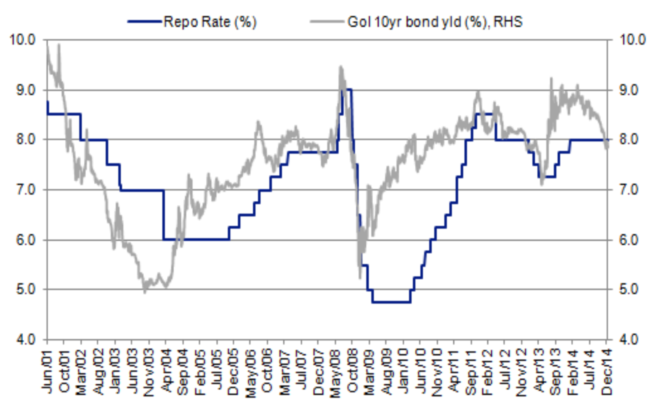
However, despite this impressive performance in state elections, majority in the Upper House is still likely to elude NDA combine for a protracted time period. It is highly unlikely that BJP will garner a majority in Rajya Sabha before end 2016-early 2017, chiefly due to the fact that only 1/3rd of Rajya Sabha is re-elected every 2 years in a staggered manner, implying that even a party with majority in a particular state assembly may not have proportionate representation in the Upper House. We think that government recognizes this well and hence has already passed ordinances for coal allocation, insurance FDI, land acquisition, which clearly lays out the willingness to move ahead on critical reforms, even though they may not possess the ability to pass legislations due to lack of majority in Rajya Sabha.

Monetary accommodation to begin in 2015

Improvement across key indicators should encourage RBI to take a more accommodative stance

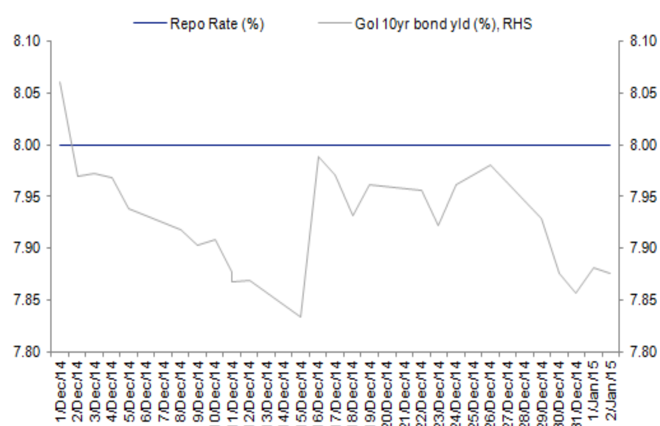
All indicators suggest that RBI is likely to embark on a rate cut cycle in 2015. Both CPI and WPI inflation have dipped sharply to multi-year low levels, the government has either taken or indicated strong intent to take supply-enhancing measures across key segments of the economy (especially measures to contain food inflation, fuel subsidy rationalization, and intent to take up tough measures through ordinance route) global commodity prices have eased lending support to lower inflation, and foreign capital inflows have been robust enough to support INR's global purchasing power (while on a nominal basis INR is down ~2% yoy, it has actually on a REER basis).

Figure 9: Repo rate (%) and GoI bond yield (%)



Source: Deutsche Bank, Bloomberg Finance L.P

Figure 10: Repo rate (%) and GoI bond yield (%)



Source Deutsche Bank, Bloomberg Finance L.P

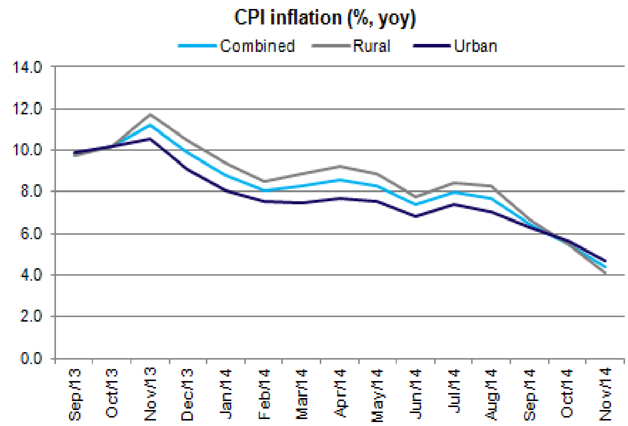
Bond yields lower than repo rate presage an imminent rate cut

GoI 10 yr bond yield has also rallied sharply with the YTM falling to 7.89%. More importantly bond yields have been lower than the policy repo rate for more than a month now. Empirically this situation has presaged an easing policy rate environment, especially in the backdrop of falling inflation. In the last policy meet, while RBI stuck to status quo by not lowering the policy rate, there was a clear easing of commentary and our economists believe that the central bank now looks more confident over inflation trajectory. Consequently, they now believe that the start of rate cut cycle will now be pulled forward to Mar'15 (vs. earlier expectation of Sep'15) with likely 100bps cut in interest rates over 2015.

Our economists believe that the start of rate cut cycle will now be pulled forward to Mar'15 (vs. earlier expectation of Sep'15) with likely 100bps cut in interest rates over 2015

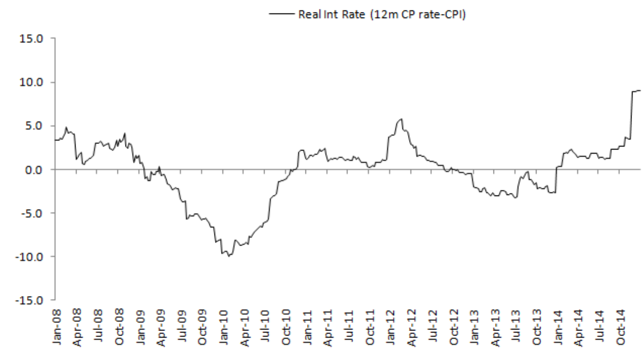
We however, believe that the equity market may start to price in a rate cut earlier in case the Dec'14 CPI inflation (due to be released in mid Jan'15) indicates that the reversal of favorable base effect is not as steep as currently anticipated.

Figure 11: Trend in CPI Inflation (%, yoy)



Source: Deutsche Bank, Reserve Bank of India, MOSPI

Figure 12: Trend in Real interest rate (%)



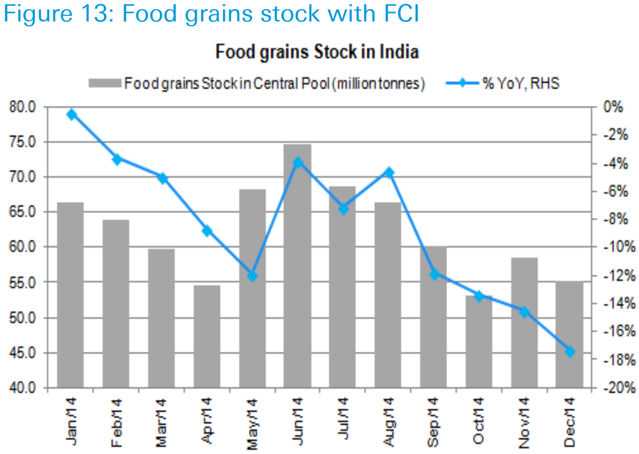
Source: Deutsche Bank, Bloomberg Finance L.P.

While we share RBI's cautionary stance towards rate cuts (as it desires to be absolutely certain that the specter of inflation has been decisively controlled) we think that several other enabling factors (such as lower bond yield, falling inflation, and government overdrive) should encourage RBI to adopt an incrementally dovish stance.

Global factors and deliberate executive actions should encourage RBI

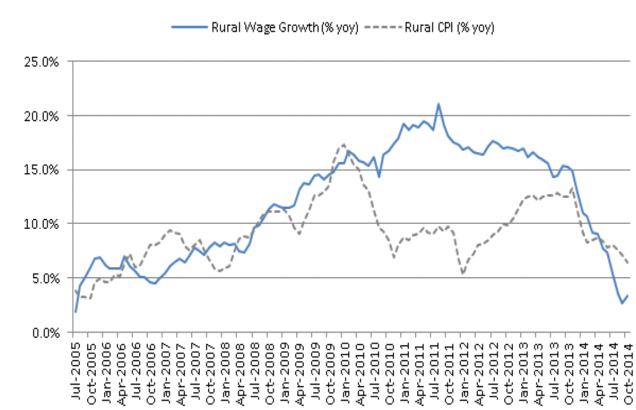
In addition to the providential decline in global oil prices, we believe that several deliberate actions by the government has also helped to lower hurdles for RBI to cut rates. For example, the government has been proactive in liquidating the food stock surplus of Food Corporation of India warehouses into the open market. Since assuming power, the government has reduced the food stock by 10% yoy between May'14-Dec'14, which is the fastest pace of liquidation in past 5 years. Moreover, the government has displayed caution in raising the minimum support prices of the agricultural produce, thereby controlling inflationary impulse in the rural economy.

Figure 13: Food grains stock with FCI



Source: Deutsche Bank, Food Corporation of India

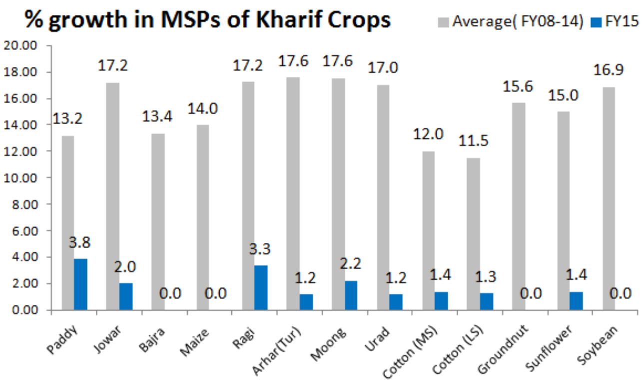
Figure 14: Trend in Rural wages and rural CPI



Source: Deutsche Bank, Reserve Bank of India

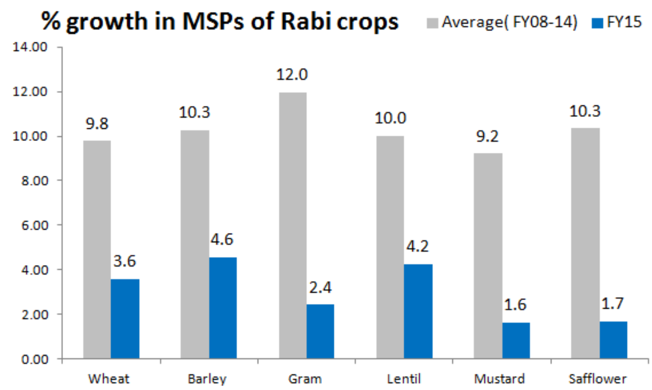
After having raised FY15 kharif crop prices modestly between 0%-4% (vs. annual average increase of 12%-18% between FY08-14), the government raised rabi crop prices by 2%-4% (vs. average of 10%-12% between FY08-14) - underscoring its intent to control food inflation.

Figure 15: Growth in MSPs of Kharif Crops



Source: Deutsche Bank; CMIE

Figure 16: Growth in MSPs of Rabi Crops



Source: Deutsche Bank; CMIE

India's move to address supply constraints may lay the case for additional monetary loosening

As we have highlighted, we see a transformational shift in government policy from consumption oriented spending to investment oriented spending. We see the government boosting capital spending meaningfully in FY16 while simultaneously reforming the institutional framework of the delivery of public expenditure including subsidies and rural wages. With the government using the fiscal space - created through lower global commodity prices – to reorient expenditure from subsidies to public investment in critically needed infrastructure areas like roads and railways, the government will be addressing a key concern of the RBI that it would like to see the government address the supply side constraints that hamper investment growth.

Investment environment still in a flux

Corporates/banks still not reporting any appreciable uptick in investment cycle

While the current government was elected to power on the twin planks of development and economic turnaround, investment activity in the economy remains subdued. We have not yet seen any meaningful optimism either from corporates or banks over a turnaround in the capex cycle. Most banks report that on-the-ground activity has been almost non-existent.

A year of public Investment and focus on easing supply side constraints
We expect 2015 to mark the beginning of government policy making a transformational shift towards the now critically urgent issues of addressing supply constraints in the domestic economy and reallocating government spending from consumption to investment. If not addressed with immediate effect these supply side constraints will erode the productive capacity of the economy, keep interest rates elevated and systemically impede the investment cycle.

In 2015 we see India harnessing its commodity pricing dividend (Petroleum, Coal, gold and silver together constitute 51% of imports and are equivalent to 12% of GDP) to realign policy towards an investment driven macroeconomic stabilization which will not only drive economic growth higher but also reduce inflation and create jobs. Returns on public investment will have a significantly higher multiplier impact on the economy relative to spending on subsidies where leakages are extremely high.

With a highly levered and still bruised, private sector - which remains reluctant to invest - we see the government harnessing the fiscal space created through lower commodity prices to consciously allocate large commitments to public investment with two critical objectives – (1) focus on investments to those infrastructure sectors which improve the competitiveness and productivity of the economy, ultimately reducing the infrastructure deficits and making the investment environment even more conducive for the return of domestic private investment and facilitate higher foreign investment in key sectors where norms have been liberalized (2) invest in those sectors which have the highest multiplier impact on growth and job creation. We see three sectors where public investment is likely to be committed meaningfully – Roads, Irrigation, and railways. With the government committed to meeting its fiscal deficit target in the current fiscal year, we expect the marked departure in government spending to public expenditure being articulated in the forthcoming budget as a key policy initiative for the next fiscal year.

The government's policy quiver on easing supply side constraints is likely to have additional arrows over the public investment commitment. These will be (1) a continuous focus on governance and improving the environment for project clearances, reforming the land and labour markets, bring in the landmark GST tax reform. We expect these initiatives to not only accelerate clearance of stalled projects but also rebuild the confidence of the private sector to embark on a new investment cycle.

We believe that 2015 can go down as a make-or-break year for India's economy and investment sentiment has to necessarily improve for repairing the economic structure of a supply-deficient and infrastructure-constrained economy like India's. We see the approaching runway of a long 9-10months of election free window as a very fortuitous situation for the government (especially in the backdrop of lower global commodity prices) which it should not atrophy. We believe that the government understands and recognizes this opportunity and will do whatever it takes to get the wheels of investment churning yet again.

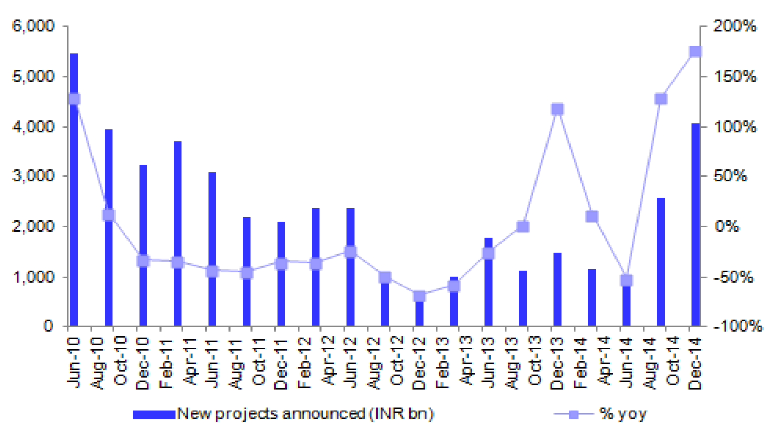
We remain confident of government's intent to move through with the exigent economic measures as evidenced by a sudden spike in executive actions (food inflation measures, diesel de control, Pahal rollout for LPG gas connection, unclogging bureaucratic machinery, and ordinances etc.). Moreover it is likely that the government will embark on a Keynesian style stimulation of the economy through heavy public infrastructure projects, which should help stimulate the investment cycle and also create big multiplier effect through numerous economic linkages.

Investment data seems to suggest greenshoots of a recovery

Despite subdued commentary from corporates and banks on investments and movements in stalled projects, the aggregate data as compiled by CMIE seems to suggest a sharp improvement in both new investment project announcement and revival of old projects. This suggests improvements on two fronts (i) on restarting of stalled projects in form of revived projects and (ii) on rising investment confidence as demonstrated in new announcements.

In the Dec'14 quarter projects worth INR4074bn were announced, which is highest absolute level in past 18 quarters. Additionally in the past two quarters (i.e Sep'14 and Dec'14) projects worth INR6643bn have been announced-which is equivalent to the projects announced in preceding 6 quarters.

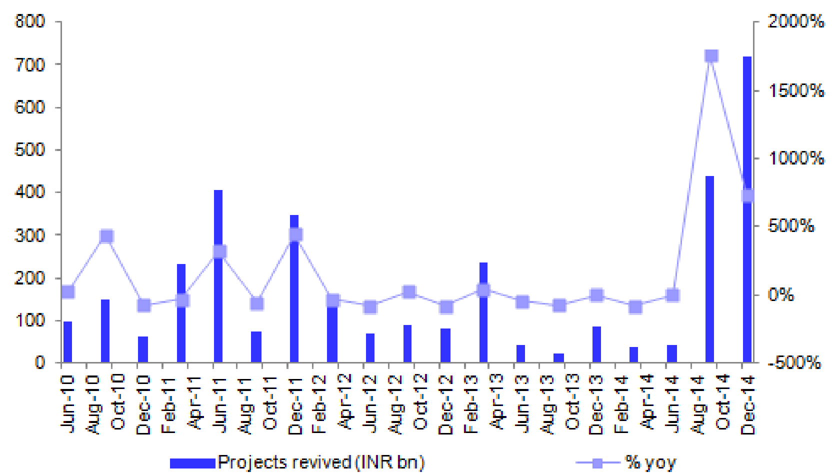
Figure 17: Value and % yoy growth of new projects announced



Source: Deutsche Bank, CMIE

In addition, the revival of old projects have been also robust, indicating that several projects which were stalled earlier have now begun to be commercially utilized and help India's economy through improved ICOR, de-recognition of NPAs on banks' books and better cash-flows for cash-strapped infrastructure sector, although it may still be a few quarters away. In fact, the value of projects revived in Dec'14 quarter (at INR718bn) is the highest ever quarterly number while the value of projects revived in preceding 2 quarters (at INR1155bn) is equivalent to the cumulative value of past 11 quarters.

Figure 18: Value and % yoy growth of investment projects revived



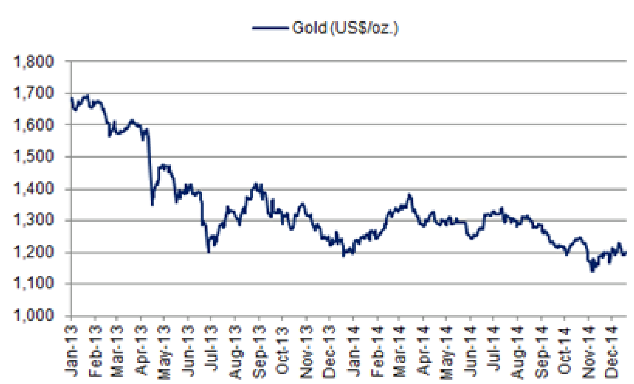
Source: Deutsche Bank, CMIE

Domestic investors should support equities

Domestic investors' preference for financial assets should rise

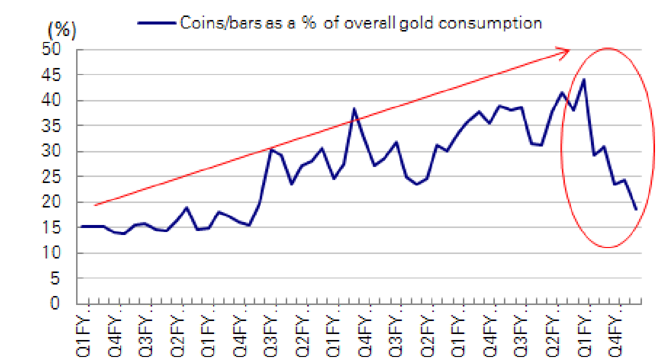
2014 marked an inflection point in flows for domestic investors as domestic equity mutual funds received ~US$7bn in 8 months, which helped them recoup cumulative outflows of almost 6 years. As we have been highlighting, the share of financial assets in India's household savings had dipped to multi-decade lows of 32%, and this should reverse as India's economic distortions start to normalize and real interest rate sustain in positive territory. While 2014 did mark a turning point in allocation towards financial assets, we believe that the transition will continue well into 2015 and even further. At the peak, the allocation to financial assets had reached 52% and we believe that we are still significantly far from the peak and consequently we see continued allocation to financial assets.

Figure 19: Gold (US$/oz.)



Source: Deutsche Bank, Bloomberg Finance L.P.

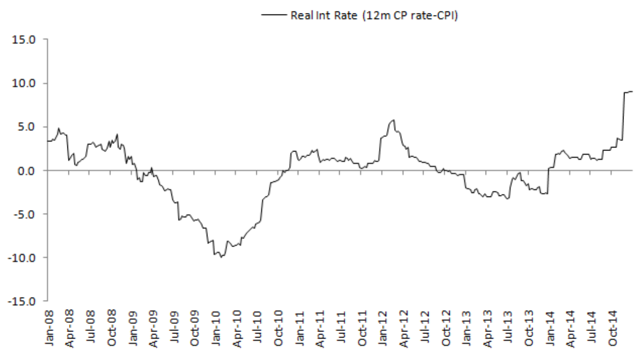
Figure 20: Coins/bars as a % of gold consumption



Source: Deutsche Bank

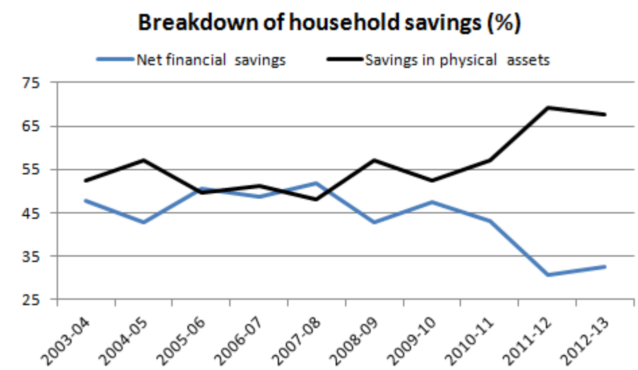
Real interest rates firmly into positive territory

Figure 21: Real interest rate (%)



Source: Deutsche Bank, Bloomberg Finance L.P.

Figure 22: Breakdown of household savings (%)

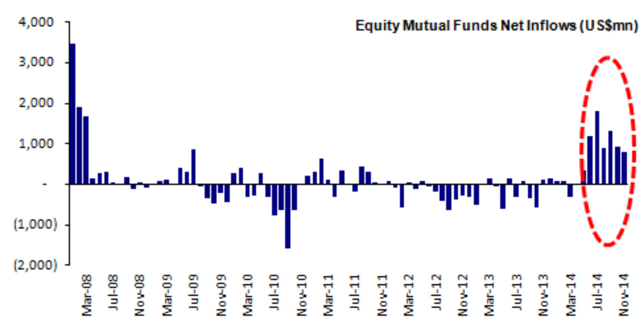


Source: Deutsche Bank

Real interest rates are now firmly in the positive territory and with lower crude prices, it does not appear that the real rates will climb down meaningfully from here. As mentioned earlier, this should help households allocate greater share of their savings to the financial assets and away from physical assets like gold and real estate. The share of financial savings reached its multi-decade lows in FY12-13 and should now begin to inch up over the coming few years.

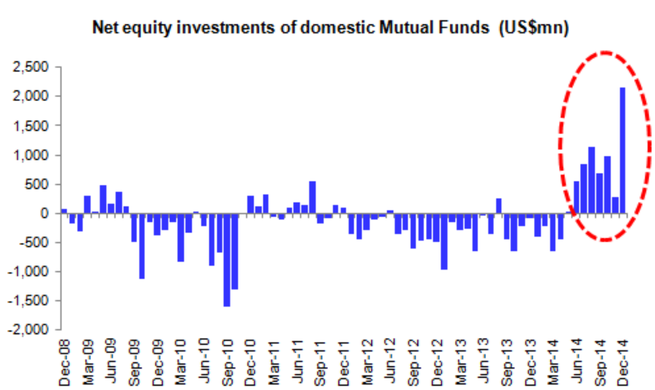
This development should support further inflows into equity mutual funds, which have already witnessed a remarkable turnaround in preceding 7 months. This in turn should also bode well for the flows from MFs into equity instruments. 2014, which marked an inflection point in MFs investments into equities, (2014 witnessed US$4.9bn in MF investments), the highest since at least 2007.

Figure 23: Equity Mutual Funds Net Inflows



Source: Deutsche Bank, Bloomberg Finance L.P.

Figure 24: Net Equity investment of domestic MFs



Source: Deutsche Bank, Bloomberg Finance L.P.

However, one of the key missing pieces in the institutional domain remain the insurance companies which have continued to be net sellers of Indian equities. Despite this, we believe that with rising confidence and conviction of households in equities' potential performance, higher flows should be diverted to ULIP schemes, which should help insurance companies to incrementally invest in equities, in our view.

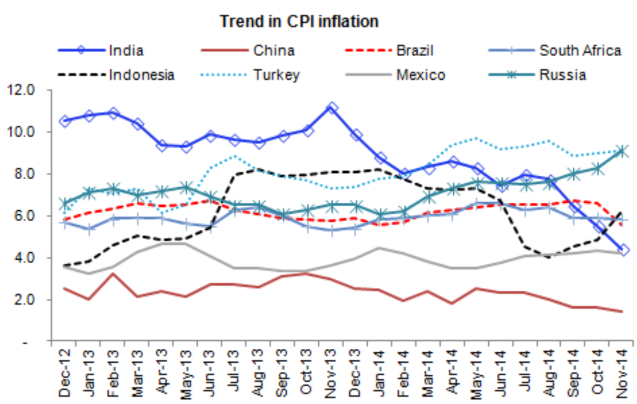
Investment driven macro stabilization to favor India among EM's

Most impressive improvement in eco parameters among key EM

We believe that the relative attractiveness of India vs. its EM peers will continue to hold in 2015 as well. However the government will have to move ahead conclusively on its dual policy of (1) an investment driven macroeconomic stabilization and (2) continuing reform and liberalization, within the realms of 'sensible and appropriate' fiscal deficit targets.

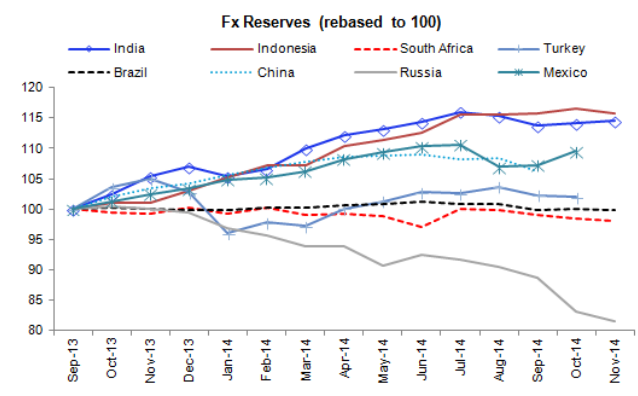
As mentioned earlier India has demonstrated the best improvement in key economic parameters and the proactive measures of both the government and the RBI seems to have engendered a sharp about-turn in India's economic outlook. Among key EMs, India has demonstrated one of the best improvements on external front with CA deficit now in comfort zone at (2.1% in Sep'14 qtrs. 4.7% in FY13), appreciable FX reserves accumulation and sharp uptick in capital inflows. Also, interest rate trajectory has come down sharpest for India, indicating that it is not only the decline in global commodities prices but also cooling of domestic inflation which has pulled headline inflation down.

Figure 25: Trend in CPI inflation of key EMs



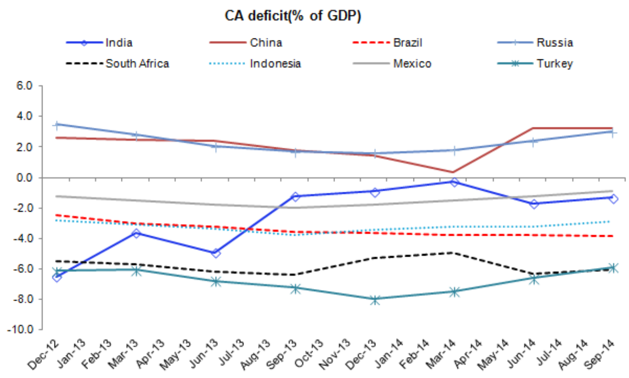
Source: Deutsche Bank, Bloomberg Finance L.P.

Figure 26: Trend in Fx reserves of key EMs



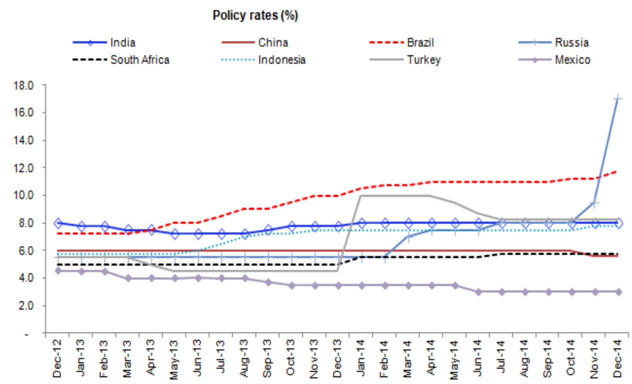
Source: Deutsche Bank, Bloomberg Finance L.P.

Figure 27: Trend in CA deficit of key EMs



Source: Deutsche Bank, Bloomberg Finance L.P.

Figure 28: Trend in policy rates of key EMs

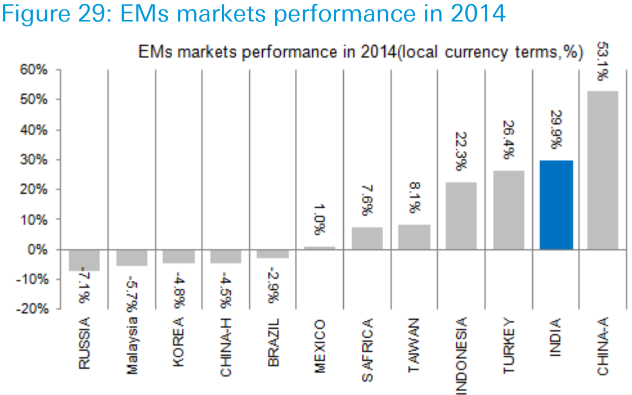


Source: Deutsche Bank, Bloomberg Finance L.P.

Unsurprisingly performance of Indian assets was among the best in 2014

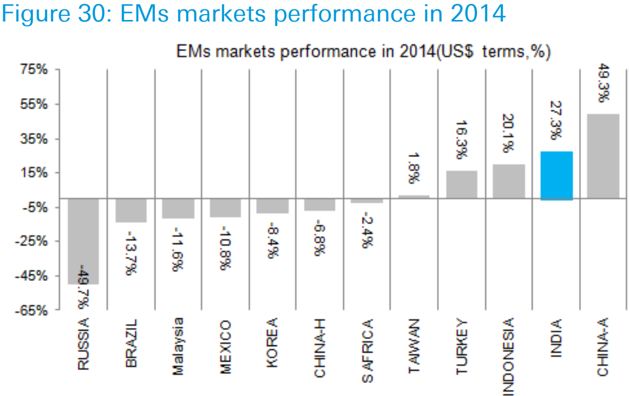
With sharp improvement in economic parameters and a historic political mandate, unsurprisingly India emerged as the top performing EM across all asset classes. Indian equities continued to be the top recipient of FII flows while Indian debt witnessed net FII inflow of US$26bn- the highest ever annual inflow and equivalent to cumulative inflows of past 10 years. Indian equities were up 30% in 2014 while INR depreciated by ~2%- a very creditable performance given that the strong US dollar trade was in force during the year. Indeed, India stood out second only to China in terms of equities performance with markets riding the positive sentiments engendered by a landslide, once-in-a-generation political mandate. In fact, had it not been for the China-connect development, India may have emerged as the best performing EM both in local currency and USD terms.

Figure 29: EMs markets performance in 2014



Source: Deutsche Bank, Bloomberg Finance L.P.

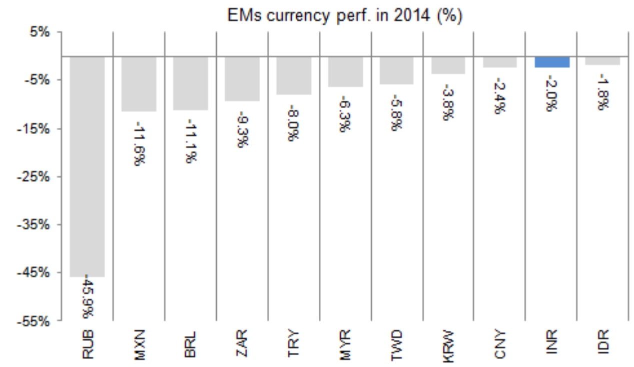
Figure 30: EMs markets performance in 2014



Source: Deutsche Bank, Bloomberg Finance L.P.

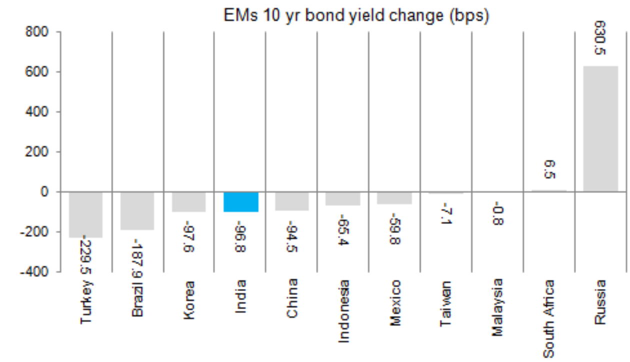
Performance of Indian debt instruments also surprised market participants as bond yields moved lower by almost a full 1% point in 2014 as inflation eased, interest rate outlook softened and FIIs bought US$26bn in Indian debt (largely sovereign bonds) as RBI raised the FII investment limit. We think that this trend will continue into 2015 as well as inflation seems to be in comfort zone.

Figure 31: EMs currency performance in 2014



Source: Deutsche Bank, Bloomberg Finance L.P.

Figure 32: EMs bond performance in 2014

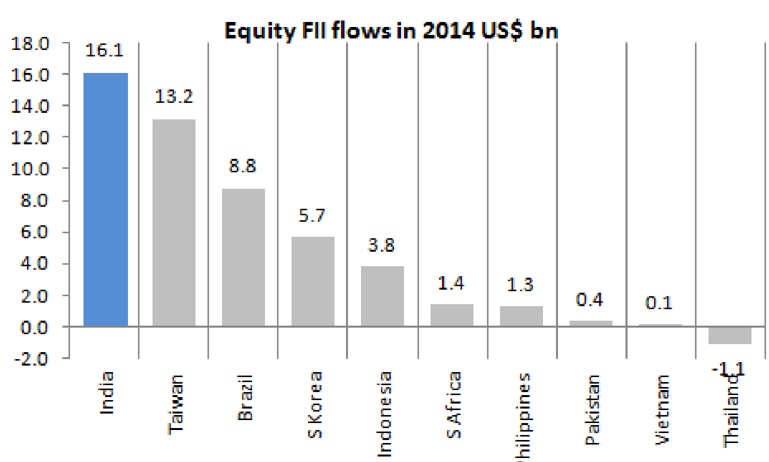


Source: Deutsche Bank, Bloomberg Finance L.P.

We expect continuation of the India outperformance trade

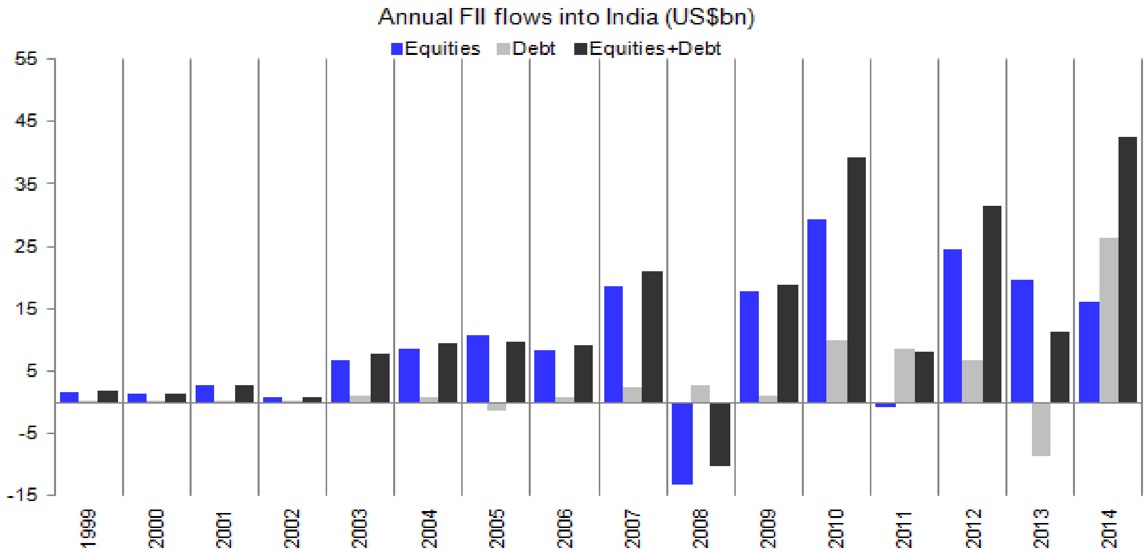
We think that India is standing out amongst EM economies and will likely remain so in 2015 as well, as long as the government continues on its economic trajectory and harnesses its commodity pricing dividend. A long runway of 9-10 months of election free window will likely ensure that the government will continue to be focused on economic agenda, which should help support India's improving macro economic fundamentals. Our discussion with investors suggests that the world funds and EM dedicated funds will continue to look at India favorably due to its relative attractiveness and improving macro. In 2014, India saw highest FII inflow among EM and this should continue if the government continues on its economic agenda, which we think it will.

Figure 33: Equity FII Flows in Key EMs



Source: Deutsche Bank, Bloomberg Finance L.P.

Figure 34: Trend of annual FII inflows into India



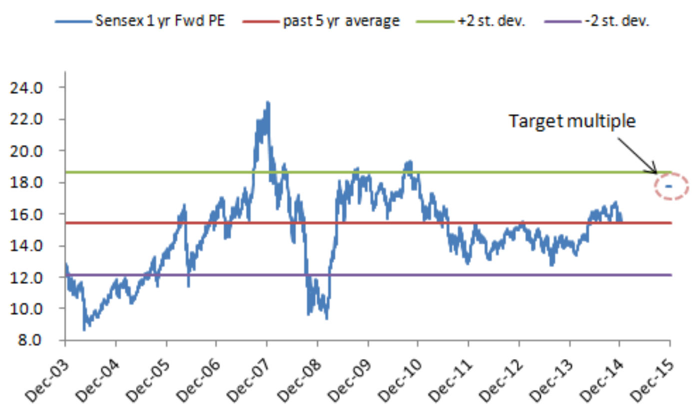
Source: Deutsche Bank, Bloomberg Finance L.P.

Valuations in line with average

Sensex currently trading at past 5 year average

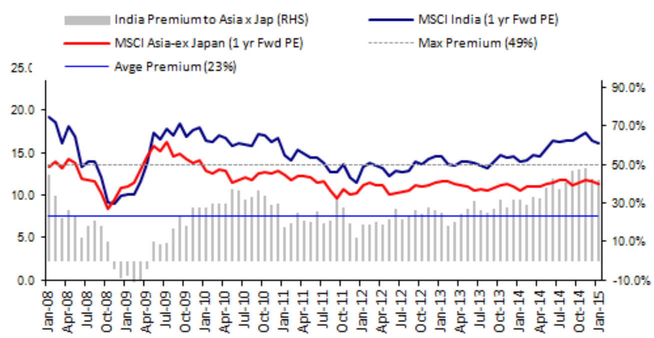
BSE Sensex is currently trading at 15.5x 1 yr forward earnings, which is in line with the average of past 5 years. Contrary to market perceptions, we do not think that valuations are expensive as we expect earnings CAGR of ~17.7% over FY15-17. While we do not rule out likelihood of some pressure on earnings growth expectations, we do not think that the cuts will be material enough to de-rate the market multiple. In fact we find the market valuation reasonable particularly when compared to past 5 year average, a period when India witnessed one of the worst bouts of economic malaise, yet Sensex PE averaged ~15.4x in this period. We continue to believe that Indian economy has turned towards a cyclical upturn which should sustain over next few years (barring occurrence of few tail risks) hence valuations should find support on improving macro which should ultimately filter into corporate earnings as well.

Figure 35: Sensex 1 yr Fwd PE



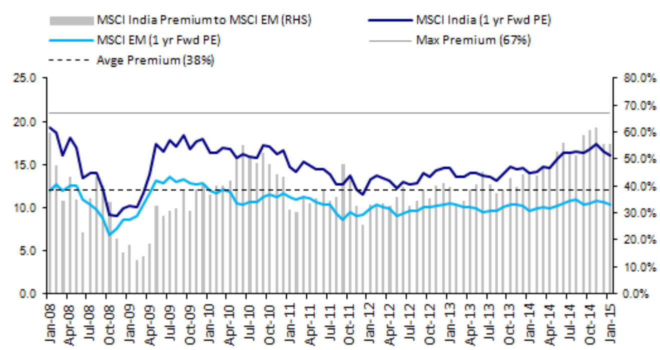
Source: Deutsche Bank; Bloomberg Finance L.P.

Figure 36: MSCI India PE relative to MSCI Asia ex-Japan



Source: Deutsche Bank; Bloomberg Finance L.P.

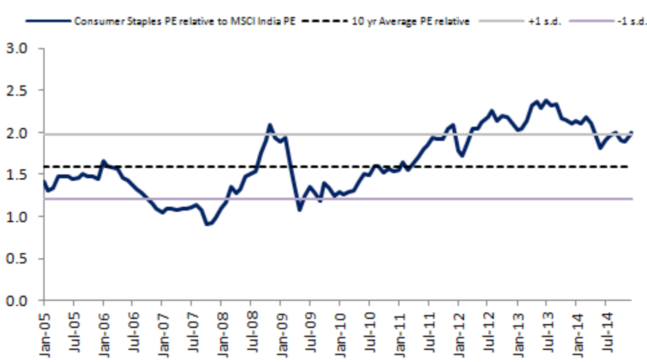
Figure 37: India PE relative to MSCI EM



Source: Deutsche Bank; Bloomberg Finance L.P.

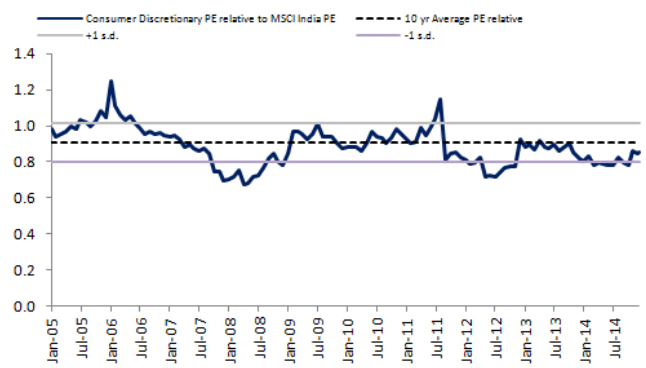
MSCI India sector PE relative to MSCI India PE

Figure 38: MSCI Cons Staples PE relative to MSCI India



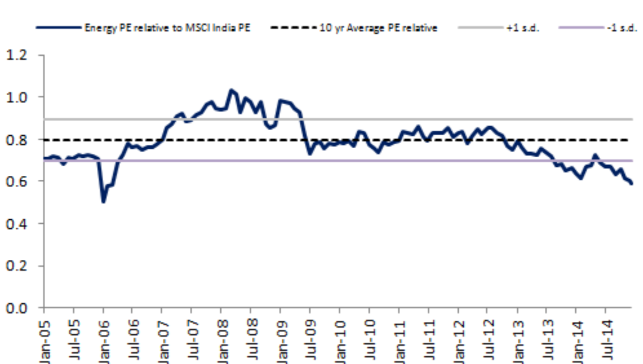
Source: Deutsche Bank; Bloomberg Finance L.P.

Figure 39: MSCI Cons Disc PE relative to MSCI India



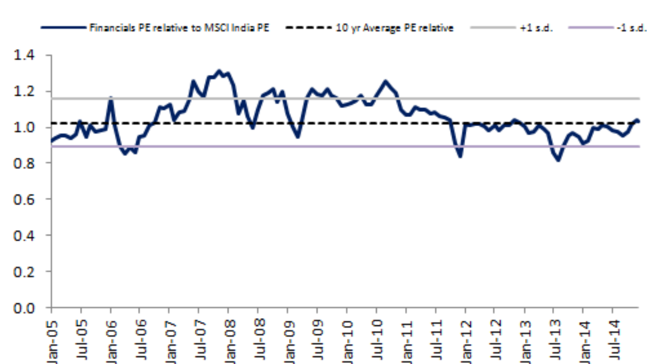
Source: Deutsche Bank; Bloomberg Finance L.P.

Figure 40: MSCI Energy PE relative to MSCI India



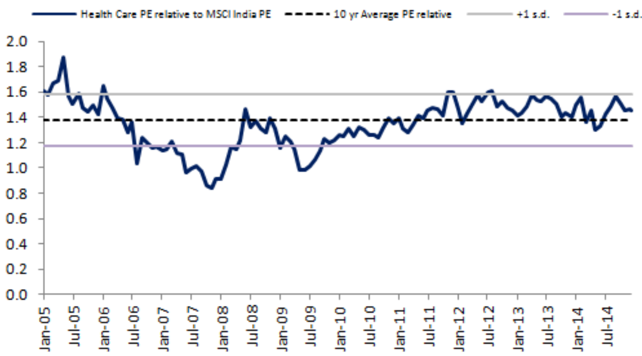
Source: Deutsche Bank; Bloomberg Finance L.P.

Figure 41: MSCI Financials PE relative to MSCI India



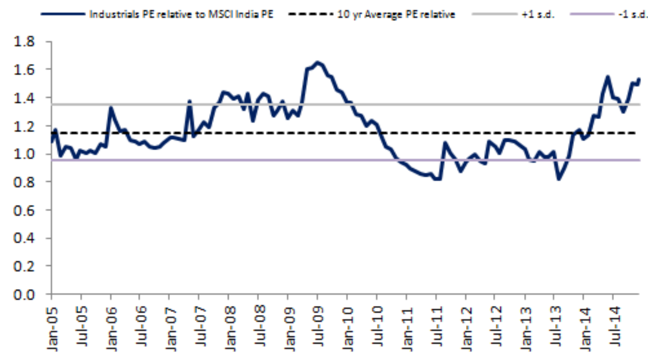
Source: Deutsche Bank; Bloomberg Finance L.P.

Figure 42: MSCI Healthcare PE relative to MSCI India



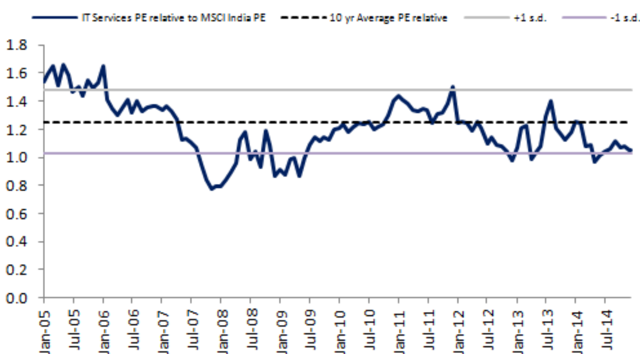
Source: Deutsche Bank; Bloomberg Finance L.P.

Figure 43: MSCI Industrials PE relative to MSCI India



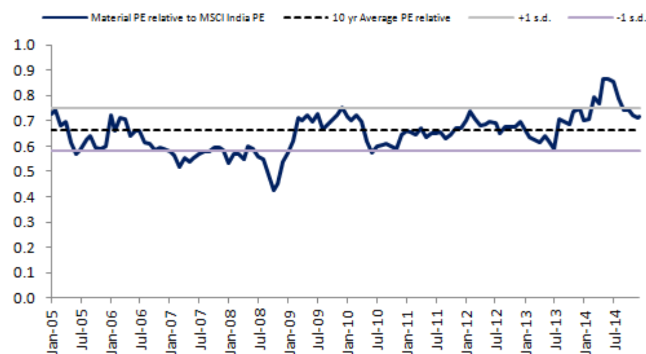
Source: Deutsche Bank; Bloomberg Finance L.P.

Figure 44: MSCI IT Services PE relative to MSCI India



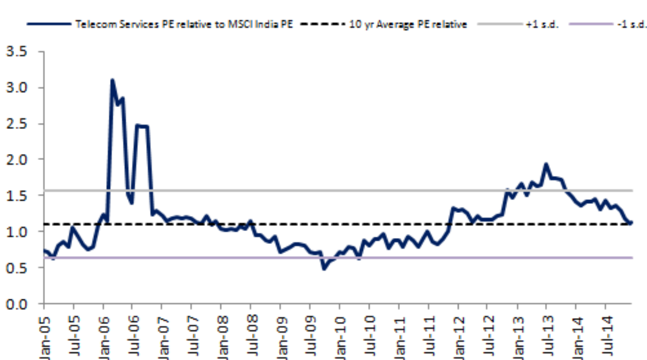
Source: Deutsche Bank; Bloomberg Finance L.P.

Figure 45: MSCI Materials PE relative to MSCI India



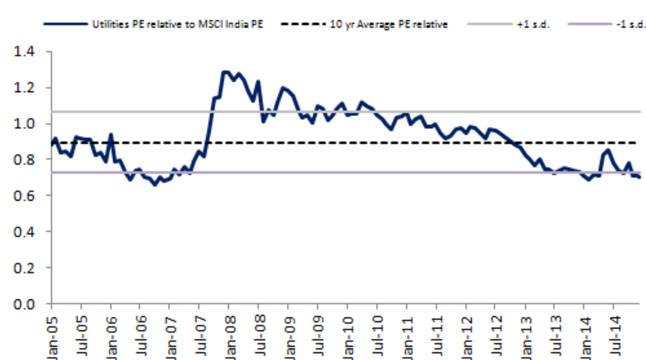
Source: Deutsche Bank; Bloomberg Finance L.P.

Figure 46: MSCI Telecoms PE relative to MSCI India



Source: Deutsche Bank; Bloomberg Finance L.P.

Figure 47: MSCI Utilities PE relative to MSCI India



Source: Deutsche Bank; Bloomberg Finance L.P.

Figure 48: Sector-wise trend in annual PE ratios of DB India universe

	FY12	FY13	FY14	FY15E	FY16E
DB India	**20.2**	**20.1**	**18.3**	**16.5**	**13.9**
Automotives	24.5	26.2	22.8	17.1	13.8
Infrastructure	24.6	25.4	34.3	33.8	28.2
Cement/Construction	23.3	20.8	27.6	24.7	18.9
Consumer	56.9	47.9	43.8	36.4	30.7
Agri & Fertilizers	11.8	14.5	16.6	11.3	9.1
Financials	19.6	17.3	17.3	14.6	12.1
IT Services	32.9	28.0	21.3	19.1	16.6
Media	83.0	70.5	49.3	42.7	28.4
Metals	8.9	14.9	10.6	9.8	8.4
Oil & Gas	11.9	12.2	10.7	10.6	9.5
Telecom	38.6	55.6	31.6	24.4	19.8
Utilities	14.0	13.4	14.5	15.3	12.7

Source: Deutsche Bank

Figure 49: Sector-wise trend in annual PBV ratios of DB India universe

	FY12	FY13	FY14	FY15E	FY16E
DB India	**3.2**	**3.0**	**2.5**	**2.2**	**2.0**
Automotives	7.1	6.1	4.5	3.7	3.0
Infrastructure	4.4	3.8	3.5	3.2	3.0
Cement/Construction	3.4	3.0	2.7	2.5	2.2
Consumer	16.0	15.1	13.7	12.1	10.2
Agri & Fertilizers	1.8	1.8	1.8	1.6	1.4
Financials	3.0	2.6	2.3	2.1	1.8
IT Services	8.8	7.7	6.0	5.0	4.1
Media	12.6	11.1	9.5	8.2	6.7
Metals	1.3	1.6	0.9	0.8	0.7
Oil & Gas	1.8	1.6	1.5	1.3	1.2
Telecom	2.2	2.2	2.1	1.8	1.7
Utilities	2.2	2.0	1.9	1.8	1.7

Source: Deutsche Bank

Figure 50: Sector-wise trend in annual Earnings Growth of DB India universe

	FY12	FY13	FY14	FY15E	FY16E
DB India	**13%**	**0**	**10%**	**10%**	**18%**
Automotives	23%	-6%	15%	31%	24%
Infrastructure	12%	-3%	-26%	1%	19%
Cement/Construction	30%	12%	-25%	12%	31%
Consumer	17%	19%	10%	20%	19%
Agri & Fertilizers	8%	-20%	-13%	47%	24%
Financials	16%	13%	0%	18%	21%
IT Services	30%	37%	32%	12%	15%
Media	26%	17%	43%	15%	51%
Metals	-21%	-37%	42%	8%	17%
Oil & Gas	11%	-3%	14%	1%	12%
Telecom	-24%	-30%	78%	25%	23%
Utilities	17%	3%	-6%	-7%	20%

Source: Deutsche Bank

Figure 51: Sector-wise trend in annual ROE of DB India universe

	FY12	FY13	FY14	FY15E	FY16E
DB India	**17%**	**15%**	**15%**	**14%**	**15%**
Automotives	32%	24%	23%	24%	24%
Infrastructure	20%	17%	12%	10%	11%
Cement/Construction	16%	15%	11%	11%	12%
Consumer	31%	33%	26%	35%	42%
Agri & Fertilizers	15%	10%	10%	14%	16%
Financials	17%	16%	14%	15%	16%
IT Services	30%	29%	31%	28%	27%
Media	14%	18%	21%	21%	26%
Metals	23%	8%	10%	8%	9%
Oil & Gas	15%	14%	14%	13%	13%
Telecom	6%	4%	6%	8%	9%
Utilities	15%	15%	14%	12%	14%

Source: Deutsche Bank

Figure 52: Sector-wise trend in annual Net debt/Equity of DB India universe

	FY12	FY13	FY14	FY15E	FY16E
DB India	**48%**	**52%**	**55%**	**49%**	**39%**
Automotives	15%	17%	5%	2%	-7%
Infrastructure	95%	95%	102%	109%	104%
Cement/Construction	32%	37%	35%	42%	29%
Consumer	32%	12%	9%	-6%	-22%
Agri & Fertilizers	98%	110%	103%	81%	62%
Financials	nm	nm	nm	nm	nm
IT Services	-27%	-28%	-26%	-38%	-45%
Media	20%	20%	11%	3%	-10%
Metals	45%	58%	56%	49%	40%
Oil & Gas	42%	47%	56%	46%	38%
Telecom	99%	91%	94%	91%	74%
Utilities	72%	86%	104%	110%	106%

Source: Deutsche Bank

Appendix 1

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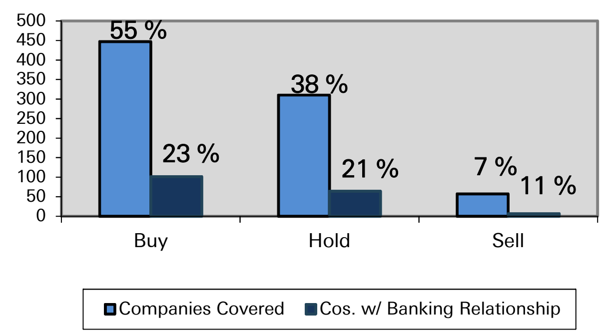
Equity rating dispersion and banking relationships



Asia-Pacific Universe

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