Sharekhan Special

July 11, 2017

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by BNP PARIBAS

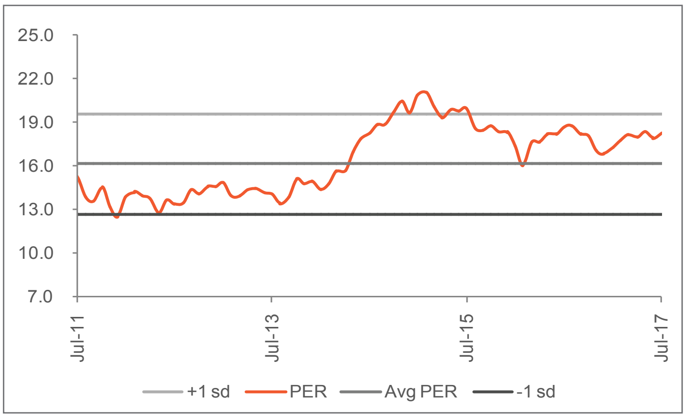
Soft start to FY2018 earnings, though macros remain ideal: We expect the earnings season for FY2018E to start on a soft note owing to GST roll out and continued weakness in sectors such as pharma, telecom and oil & gas (these are largely downstream companies affected by weak crude price). On the brighter side, with advancement of normal monsoon, successful roll out of GST coupled with stable currency, easing inflationary pressure and a low interest rate environment, macro indicators look ideal. Additionally, the much-awaited clarity on NPA resolution framework has provided a big relief to the banking sector. Moreover, escalated project clearance in the power, roads and railways sectors is expected to boost overall investment revivals. On the flip side, series of farm loan waivers in some states have been setting a bad precedence for government budget plans. Nevertheless, government thrust for big reforms in a backdrop of a more conducive macro environment will benefit earnings growth over the next two-three years, notwithstanding some near-term hiccups.

GST roll out to impact Q1 performance: We believe earnings performance in Q1FY2018 will be adversely affected because of the recent GST roll out and the after-effects of demonetisation (which are yet to get fully normalised and absorbed in the corporate earnings performance of companies). The impact would primarily affect B2C companies owing to disruptions in supply chain and destocking of inventories in the run up to GST roll out. Though the magnitude and quantum of the impact due to GST implementation is still uncertain, we expect it will negatively affect H1FY2018 earnings performance. Also, at the same time, we see GST roll out as a big reform push from the government, which will be a boon for organised sectors and more so for the Indian economy per se, as tax base will expand and aid businesses in the long run. For Q1FY2018, we expect muted earnings growth for overall Sensex companies, except telecom and pharma companies, to deliver weak performance because of sector-specific issues. We expect B2C companies to have GST-related earnings impact. However, once the GST event normalises, we expect B2C companies to revive much faster in H2FY2018.

Outlook – Downside risks to FY2018 estimates; double-digit growth over FY2017-FY2019E looks probable: Management commentary on the timeline of GST-related disruption normalisation will be key monitorables for B2C companies during the upcoming earnings season. Moreover, the banking sector's commentary on RBI's new provisioning norms, with 12 cases referred to NCLT, will be another key commentary to watch out for. Owing to demonetisation event last year and GST roll out this year, earnings recovery is taking longer-than-anticipated time. Further, with uncertainties over GST-related disruption, we expect some more downside risks for FY2018 earnings estimates. Nevertheless, with normalisation expected over H1FY2018, we expect earnings growth to rebound in H2FY2018 in the banking sector and across B2C sectors as well as in some sectors of infra and building materials. Overall, we expect high double-digit growth over FY2017-2019E, though growth will be back-ended in FY2018E and will strongly accelerate in FY2019E.

Valuation: Short-term hiccups possible, long-term equity outlook remains robust: The Indian market is rallying along with global markets, led by re-rating of equity as asset class and strong liquidity. Valuation of the Indian market is already at a premium to long-term averages. However, we need to view this in context of the Indian market, which is on an economic and earnings upcycle, so early cycle valuation looks stretched. Having said that, earnings revival is key for further sustenance of an uptrend, as valuation multiple expansions seem difficult from current levels. Thus there could be possibility of some hiccups in the near term on account of earnings disappointments. Nevertheless, we remain highly constructive on equities as an asset class for long-term investment, as we expect earnings growth to accelerate over the next 2-3 years, led by new reforms and a supportive macro environment.

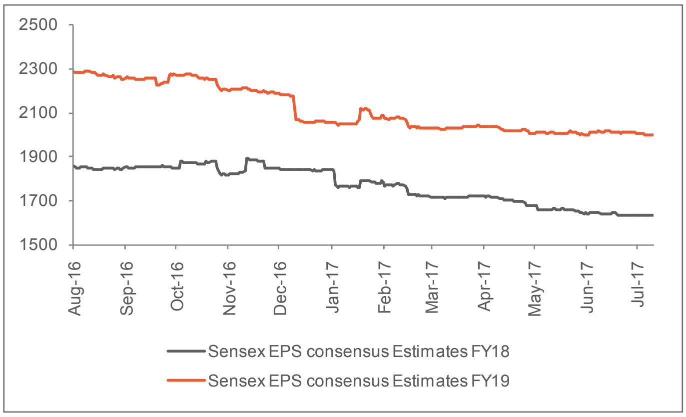
Sensex' one-year forward P/E band



Source: Bloomberg, Sharekhan Research

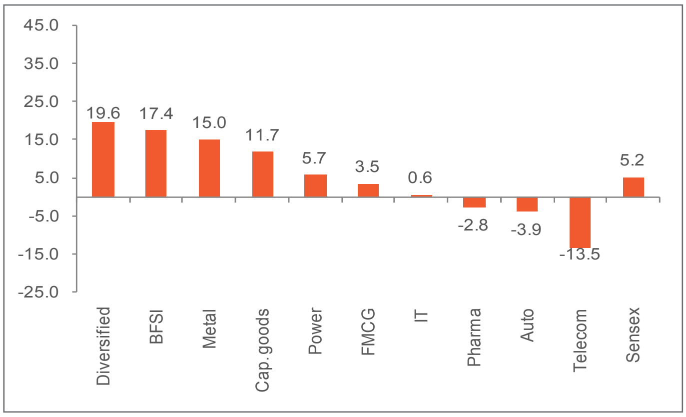
Leaders	Laggards
HCL Tech, Info Edge	Tech Mahindra, Wipro, Bharat Electronics
TVS Motors, Maruti Suzuki, Eicher Motors	Ashok Leyland, Apollo Tyres, Bajaj Auto
L&T , Skipper, Va Tech Wabag, Powergrid, KEC	CG Power
Relaxo Footwears, Trident, S.P. Apparels	Arvind, Raymond, KKCL
HUL, ITC, GCPL	Emami, Jyothy Laboratories, Bajaj Corp
Petronet LNG, GSPL	IOCL, BPCL, HPCL, Oil India
Grasim, Ultratech,	Shree Cement, India Cements
Glenmark Pharma, UPL	Cipla, Divis, Lupin, Sun Pharma, Torrent Pharma
IndusInd Bank, HDFC Bank, Bajaj Finance, Capital First	Bank of India

Sensex earnings (EPS) consensus estimates



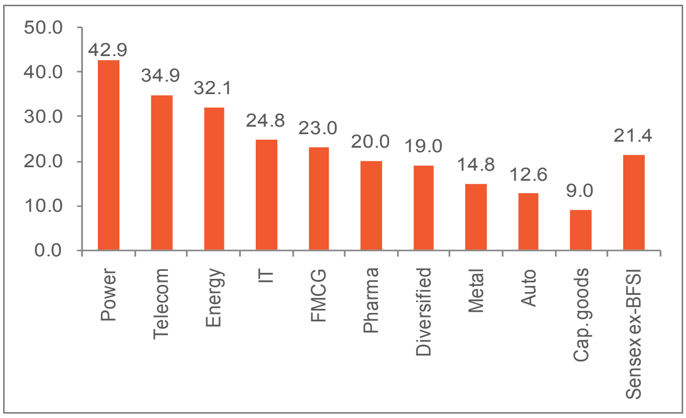
Source: Bloomberg

Estimated revenue growth by sector (%)



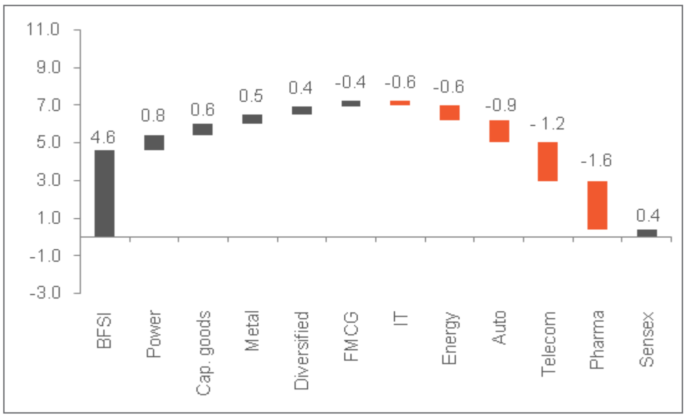
Source: Bloomberg, Sharekhan Research

Estimated EBITDA margin by sector ex-BFSI (%)



Source: Bloomberg, Sharekhan Research

Estimated sector-wise contribution to Sensex' earnings growth (%)



Source: Bloomberg, Sharekhan Research

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Automobiles

Margin pressures to sustain

Revenue growth to remain strong due to improved rural sentiments and strong macroeconomic environment: Sharekhan Auto universe (ex TAMO) is likely to maintain healthy growth momentum with expected 8% yoy topline growth in Q1FY2018. Volume pick-up on account of improved rural sentiments on the back of forecast of a normal monsoon for the second consecutive year and higher sowing coupled with price hikes are likely to result in decent topline growth. All segments except CV have reported high single-digit growth (2W segment and passenger vehicle segment have grown by 8% and 6%, respectively). The CV segment's volumes have dipped 8% YoY on account of uncertainties ahead of GST rollout. From our coverage universe, we expect TVS Motors and Maruti Suzuki to outperform with topline growing by 22% and 19%, respectively, led by new launches. Ashok Leyand (due to a steep drop in MHCV volumes) and Bajaj Auto (due to volume drop in domestic sales and exports) are estimated to report a decline of 15% and 4% in revenue, respectively. In the auto ancillary space, Bharat Forge (due to improved demand scenario) and Exide Industries are expected to outperform reporting double-digit growth. Jamna Auto is estimated to underperform reporting a decline of 18% YoY due to weak MHCV volumes.

Margin pressure to sustain on rising raw-material costs and higher discounting; PAT to decline for the first time in the last several quarters: Margin pressures for the auto universe (ex TAMO) are likely to sustain in Q1FY2018 as the universe is expected to report a margin drop of 140 bps YoY to 14.3% (Q4FY2017 saw a similar drop of 160 bps YoY). Rising raw-material prices (steel, aluminium and lead) would exert pressure on profitability. Also increased discounting, before the GST rollout to liquidate inventory would also impact margins of automotive companies. The auto universe is likely to report a marginal drop of 2% in operating profits as against high single-digit revenue growth. Ashok Leyland (on back of operating deleverage) and Bajaj Auto (on account of higher raw-material prices) are likely to report 430 and 300 bps YoY drop in operating margin, respectively. On the other hand, operating margins of Eicher Motors and TVS Motors are expected to improve by 80 bps and 40 bps YoY, respectively, due to operating leverage and cost-control measures. Tyre companies such as Apollo Tyres and Balkrishna Industries would face the maximum pressure of higher raw-material costs, with margins likely to drop by 450 bps and 310 bps, respectively. Given the pressure on the margins, the auto universe is estimated to post a 5% decline in net profits during Q1FY2018 (the first instance of profit drop in the last six to eight quarters).

Outlook: Volume growth to accelerate post GST implementation: With the implementation of GST, wef from 1st July 2017, economic growth is expected to gain momentum, which would have positive rub-off on the automotive sector. Improved economic growth coupled with strong rural sentiments is likely to result in strong volume traction for the automotive industry. Also, GST rates have been favourable for the automotive industry (rates under GST have been lower by 2% to 10% across most of the automotive segments), which would aid in growing automotive demand. Also, Auto ancillary players are likely to benefit under GST as demand is likely to shift from unorganised players.

Preferred picks: We continue to prefer Maruti Suzuki in the automotive space, given the long waiting period on recent launches (Baleno, Vitara Brezza and Dzire). This would enable Maruti Suzuki to continue outpacing the PV segment's growth going forward. We also like Hero MotoCorp given the improved rural demand scenario and increased focus on exports, which is likely to spur growth.

Earnings outperformers for Q1FY2018: TVS Motors, Maruti Suzuki and Eicher Motors

Earnings underperformers for Q1FY2018: Ashok Leyland, Apollo Tyres and Bajaj Auto.

Q1FY2018 results estimates

Company	Sales (Rs cr)				EBIDTA margins (%)				PAT (Rs cr)			
	Q1 FY18E	Q1 FY17	YoY (%)	QoQ (%)	Q1 FY18E	Q1 FY17	YoY bps	QoQ bps	Q1 FY18E	Q1 FY17	YoY %	QoQ %
Maruti Suzuki	17,732.5	14,920.4	18.8	(3.3)	13.8	14.9	(100)	(12)	1,598.8	1,486.2	7.6	(6.4)
Hero Motocorp	7,964.3	7,398.9	7.6	15.2	16.2	16.6	(38)	240	912.4	883.1	3.3	27.1
Bajaj Auto	5,524.1	5,748.0	(3.9)	12.8	17.5	20.5	(296)	(100)	812.2	978.4	(17.0)	1.3
TVS Motors	3,516.0	2,880.9	22.0	23.6	7.3	7.0	37	164	160.8	121.3	32.6	26.9
M&M #	10,871.9	10,524.7	3.3	2.4	12.9	14.1	(120)	129	830.8	870.6	(4.6)	6.5
Ashok Leyland	3,627.1	4,258.8	(14.8)	(45.2)	7.0	11.3	(431)	(402)	96.5	290.8	(66.8)	(88.0)
Apollo Tyres @	3,518.9	3,311.6	6.3	5.8	11.8	16.3	(449)	66	211.4	314.7	(32.8)	(7.4)
Greaves Cotton	424.8	400.7	6.0	8.7	14.7	15.1	(41)	101	43.9	44.1	(0.4)	8.7
Gabriel	385.2	370.4	4.0	(1.5)	9.4	9.2	16	(3)	20.8	19.6	6.1	(10.7)
Rico Auto @	298.8	271.7	9.9	8.8	9.7	12.3	(257)	173	12.4	16.1	(22.8)	73.2
Soft Coverage:												
Tata Motors @	58,361.1	65,895.0	(11.4)	(24.4)	11.2	11.6	(33)	(275)	1,182.7	1,912.8	(38.2)	(72.6)
Eicher Motors @	1,945.4	1,555.7	25.1	3.0	31.0	30.2	83	7	428.3	376.3	13.8	(6.8)
Exide Industries	2,216.4	2,011.1	10.2	12.2	14.4	15.7	(126)	115	192.6	196.1	(1.8)	16.9
Bharat Forge	1,035.4	904.4	14.5	(8.0)	26.8	27.0	(17)	(157)	140.1	122.1	14.8	(17.3)
Suprajit Engg @*	345.7	254.4	35.9	(5.2)	17.4	16.1	130	(50)	31.4	19.7	59.6	(21.2)
Ceat @	1,558.5	1,470.3	6.0	5.9	10.6	12.6	(204)	157	78.7	104.1	(24.4)	18.6
Balkrishna Industries	1,078.4	928.1	16.2	7.5	28.3	31.4	(310)	280	169.7	149.1	13.8	23.4
Jk Tyres @	1,869.8	1,780.8	5.0	(13.1)	13.3	20.0	(671)	404	73.1	140.6	(48.0)	84.9
Jamna Auto Industries @	274.4	335.1	(18.1)	(28.7)	11.3	15.8	(450)	(323)	17.2	27.4	(37.3)	(51.6)
Minda Industries@*	1,023.9	766.6	33.6	8.0	11.5	9.4	205	(19)	55.8	27.1	105.6	(3.4)
Subros	356.8	324.4	10.0	(14.0)	10.9	10.1	78	(10)	5.1	(0.8)	(767.4)	(29.8)
Sundram Fasteners	770.0	713.0	8.0	(0.7)	18.5	18.9	(41)	5	85.5	75.7	13.0	(2.5)
Endurance Technologies@	1,510.0	1,438.1	5.0	10.5	12.5	12.8	(37)	(37)	81.0	83.2	(2.6)	(3.1)
Auto Universe	**126,209.4**	**128,463.1**	**(1.8)**	**(13.4)**	**12.9**	**13.6**	**(73)**	**(100)**	**7,240.9**	**8,257.9**	**(12.3)**	**(33.6)**
Auto universe (ex TAMO)	**67,848.3**	**62,568.1**	**8.4**	**(0.9)**	**14.3**	**15.7**	**(147)**	**55**	**6,058.3**	**6,345.1**	**(4.5)**	**(8.0)**

MM+MVML ; @ Consolidated; @* not comparable due to Acquisition

Valuation

Company	EPS			P/E (x)			Reco	PT (Rs)
	FY17	FY18E	FY19E	FY17	FY18E	FY19E		
Maruti Suzuki	242.9	286.6	329.1	30.6	25.9	22.6	Buy	7,900
Hero Motocorp	169.1	189.4	215.6	22.1	19.7	17.3	Buy	4,100
Bajaj Auto	132.3	132.9	150.4	20.6	20.5	18.2	Hold	2,900
TVS Motors	12.9	16.5	24.1	44.1	34.5	23.6	Buy	580
M&M @	59.4	65.1	73.8	23.0	21.0	18.5	Buy	1,525
Ashok Leyland	5.4	4.9	5.5	19.4	21.4	19.1	Buy	UR
Apollo Tyres #	21.6	22.6	26.2	11.9	11.4	9.8	Buy	270
Greaves Cotton	7.2	8.0	9.0	22.5	20.3	18.0	Buy	190
Gabriel India	5.8	7.0	8.2	25.9	21.4	18.3	Buy	UR
Rico Auto Industries #	3.7	4.3	5.4	17.3	14.9	11.9	Buy	65
Soft Coverage:								
Tata Motors #	21.9	40.0	60.7	20.4	11.2	7.4	Neutral	
Eicher Motors #	612.7	829.9	1,099.2	45.6	33.7	25.4	Neutral	
Exide Industries	8.2	8.7	10.3	27.9	26.3	22.2	Positive	
Bharat Forge	29.7	35.0	47.3	37.8	32.0	23.7	Neutral	
Suprajit Engineering #	8.8	11.3	12.9	34.4	26.8	23.5	Neutral	
CEAT #	89.3	115.3	139.9	21.1	16.3	13.5	Neutral	
Balkrishna Industries	74.0	84.4	99.2	23.0	20.2	17.1	Neutral	
JK Tyre & Industries #	16.6	19.5	25.6	10.2	8.7	6.6	Positive	
Jamna Auto Industries	13.1	13.2	15.3	19.9	19.8	17.1	Neutral	
Minda Industries #	19.4	26.7	34.1	34.6	25.1	19.7	Positive	
Sundram Fasteners	16.2	19.0	22.1	26.4	22.5	19.4	Positive	
Subros	7.5	9.7	14.6	33.9	26.2	17.4	Neutral	
Endurance Technologies #	23.5	29.8	38.1	37.4	29.5	23.1	Positive	

@ MM+MVML; # Consolidated Nos
UR Target under review

Banking and NBFC

Modest performance to continue tempered by high provision

Loan growth yet to gain momentum, margins to stay steady: As per the latest RBI Data (23rd June 2017), credit growth in the banking system stood at 6.0%, which is still below the pre-demo levels. We expect corporate portfolios of banks to remain subdued, while retail loans, especially housing and personal loans, would be the bright spots in an overall lacklustre growth performance. For our coverage universe, we expect PSU banks (PSB) to maintain credit growth in line with the industry's average, while private banks (PB) are expected to show better growth. Non Banking finance corporation (NBFCs)are also expected to witness higher growth due to pre-GST sales boost. In addition, rural recovery would add to some demand, especially in the consumer durable and auto lending space. We expect cushioning provided by better Current & Savings Account (CASA) and lower interest reversals due to relatively lower slippages would help banks to maintain steady margins on a sequential basis.

Expect encouraging asset quality trend, other income to help offset elevated provision: We expect some volatility in asset quality across banks as some large corporate exposures are likely to slip into NPAs. Following the RBI's instructions, banks and National Company Law Tribunal(NCLT) have begun the process of resolution, but little positive is expected to emanate in this quarter. Provisions are expected to be still elevated due to fresh corporate slippages, ageing of earlier NPAs and accounts nearing the end of the moratorium period. However, we do not expect a significant impact on provisions due to NCLT referred cases. Income from forex could also be marginally better due to exchange rate volatility during the quarter. We expect the stronger other income stream to help offset the impact of higher provisions on the bottom line.

Outlook – Largely similar quarter as Q4FY2017 expected: As observed, several factors have been similar to the Q4FY2017 quarter. High liquidity, low interest rates and slow credit demand continues. The ~40 bps intra quarter fall in G-Sec yields would benefit the banks' treasury gains and other income stream. We expect core fee income growth would be subdued, in sync with the slow capital expenditure cycle. Further, intense competition on the retail front will limit retail fee growth. We believe the commentary and outlook on a few M&A transactions (asset sales to de-leverage balance sheets) and the 12 accounts referred to NCLT by RBI will be key things that the market will be looking out for.

Valuation:

There has been significant run-ups in banks and NBFC stocks as the market is building upon hopes of fast NPL resolutions. We believe earnings performance, lower delinquencies and further interest rate softening in the coming quarters remain the key positives. Some of the imminent challenges include delay in investment cycle revival. Meaningful steps on NPA resolution would result in re-rating of corporate lending focused banks.

Earnings outperformer: IndusInd Bank, HDFC Bank, Bajaj Finance, Capital First

Earnings under performer: Bank of India

Preferred Picks: ICICI Bank, L&T Finance Holdings

Q1FY2018 results estimates

Particulars	Net interest income				Pre-provisioning profit				Profit after tax			
	Q1 FY18E	Q1 FY17	YoY %	QoQ %	Q1 FY18E	Q1 FY17	YoY %	QoQ %	Q1 FY18E	Q1 FY17	YoY %	QoQ %
Public												
PNB Bank	3,792.7	3,699.0	2.5	3.0	3,287.3	3,274.6	0.4	-47.2	247.2	306.4	-19.3	-5.6
Bank of Baroda	3,542.5	3,371.1	5.1	-1.1	2,727.4	2,669.5	2.2	-9.7	367.5	423.6	-13.2	137.5
Bank of India	3,000.6	2,775.2	8.1	-13.5	1,977.1	1,653.9	19.5	-36.8	(510.3)	(741.4)	NA	NA
Union Bank	2,343.4	2,102.3	11.5	-1.8	1,848.0	1,625.1	13.7	-13.4	103.3	166.3	-37.9	-4.6
PSBs total	**12,679.2**	**11,947.5**	**6.1**	**-3.4**	**9,839.8**	**9,223.0**	**6.7**	**-32.2**	**207.7**	**154.9**	**34.1**	**NA**
Private												
ICICI Bank	5,708.2	5,158.5	10.7	-4.3	5,531.2	5,214.7	6.1	8.2	2,009.0	2,232.4	-10.0	-0.8
HDFC Bank	9,460.7	7,781.4	21.6	4.5	7,124.7	5,819.2	22.4	-2.1	3,870.2	3,238.9	19.5	-3.0
Axis Bank	4,124.6	4,516.9	-8.7	-12.8	4,016.6	4,469.4	-10.1	-8.2	1,178.3	1,555.5	-24.2	-3.8
Federal Bank	840.4	692.7	21.3	-0.2	553.4	425.9	29.9	0.8	241.4	167.3	44.3	-5.9
Yes Bank	1,710.7	1,317.2	29.9	4.3	1,607.9	1,307.4	23.0	-4.9	887.2	732.4	21.1	-2.9
Private banks total	**21,844.6**	**19,466.7**	**12.2**	**-1.7**	**18,833.7**	**17,236.5**	**9.3**	**-0.9**	**8,186.1**	**7,926.5**	**3.3**	**-2.7**
Grand total	**34,523.8**	**31,414.2**	**9.9**	**-2.3**	**28,673.5**	**26,459.6**	**8.4**	**-14.5**	**8,393.8**	**8,081.4**	**3.9**	**6.4**
Soft Coverage												
IndusInd Bank	1,696.0	1,356.4	25.0	1.7	1,541.8	1,233.8	25.0	-1.9	888.8	661.4	34.4	18.3
RBL Bank	353.2	244.7	44.4	0.3	285.7	184.5	54.9	1.4	131.5	97.3	35.0	1.0
L&T Finance Holding	999.0	840.8	18.8	-0.6	759.0	552.9	37.3	-1.9	257.8	204.8	25.9	-17.9
Repco Home Finance	105.9	84.0	26.2	3.0	95.4	77.1	23.8	5.9	49.6	39.5	25.5	-1.9
GIC Housing Finance	89.4	72.1	24.0	-10.4	69.5	55.6	25.0	-13.5	39.8	32.3	23.0	-14.7
NBFCs												
HDFC	2,528.6	2,229.2	13.4	-11.4	3,303.7	3,039.7	8.7	7.1	1,909.0	1,870.7	2.0	-6.6
LIC Housing Finance	960.4	824.5	16.5	-10.5	863.1	739.9	16.7	-3.6	504.4	407.8	23.7	-4.7
Capital First	368.1	277.9	32.4	-1.7	239.2	174.8	36.8	2.0	67.7	49.2	37.6	-4.4
Bajaj Finance	1,751.6	1,282.6	36.6	18.6	1,152.7	831.2	38.7	17.7	570.1	424.0	34.5	26.9
PTC India Fin. Ser.	141.3	99.4	42.1	25.6	148.6	105.4	41.0	-45.2	79.9	67.4	18.5	-27.2
NBFCs Total	**5,750.0**	**4,713.6**	**22.0**	**-2.4**	**5,707.2**	**4,891.0**	**16.7**	**4.4**	**3,131.2**	**2,819.2**	**11.1**	**-2.2**

Valuation

Banks	Reco.	Price target (Rs)	RoA (%)			RoE (%)			P/BV(x)		
			FY17	FY18E	FY19E	FY17	FY18E	FY19E	FY17	FY18E	FY19E
Public											
PNB Bank	Hold	175	0.2	0.4	0.5	3.3	7.3	9.9	0.8	0.8	0.7
Bank of Baroda	Hold	192	0.2	0.4	0.5	3.4	7.2	9.1	1.0	1.0	0.9
Bank of India	Hold	176	-0.3	0.2	0.3	-4.8	3.1	6.9	0.5	0.5	0.5
Union Bank	Hold	210	0.1	0.4	0.5	2.4	7.3	10.5	0.5	0.5	0.4
PSBs total / avg.			**0.1**	**0.3**	**0.5**	**1.1**	**6.2**	**9.1**	**0.7**	**0.7**	**0.6**
Soft Coverage											
IndusInd Bank	Positive		1.7	1.8	1.9	16.3	17.2	18.6	4.7	4.0	3.4
RBL Bank	Neutral		1.0	1.1	1.1	12.2	14.3	17.8	4.6	4.1	3.5
L&T Finance Holding	Positive		1.5	1.6	1.7	11.9	13.3	14.7	2.9	2.5	2.2
Repco Home Finance	Positive		2.1	1.8	1.7	16.0	13.9	14.8	4.4	3.9	3.4
GIC Housing Finance	Positive		1.7	1.8	1.8	18.8	20.3	21.9	3.6	3.0	2.5
Private											
ICICI Bank	Buy	320	1.3	1.1	1.2	10.3	9.4	11.5	1.8	1.7	1.6
HDFC Bank	Buy	1,750	1.9	1.9	1.9	17.9	18.7	19.9	4.8	4.4	3.8
Axis Bank	Hold	570	0.7	0.9	1.3	6.8	10.1	15.0	2.2	2.0	1.8
Federal Bank	Buy	125	0.7	0.7	0.9	9.8	9.7	12.6	2.3	2.1	1.9
Yes Bank	Hold	1,780	1.8	2.2	2.2	18.6	20.4	21.9	3.1	2.7	2.3
Private banks total / avg.			**1.3**	**1.4**	**1.5**	**12.7**	**13.7**	**16.2**	**2.8**	**2.6**	**2.3**
Grand total / avg.			**0.7**	**0.8**	**1.0**	**6.9**	**9.9**	**12.6**	**1.8**	**1.6**	**1.5**
NBFCs											
HDFC Ltd	Buy	1,780	2.4	2.3	2.2	20.1	19.5	19.3	6.6	5.8	5.1
LIC Housing Finance	Buy	855	19.1	19.3	19.6	0.0	0.0	0.0	3.4	2.9	2.5
Capital First	Buy	880	1.5	1.7	1.8	11.9	13.4	15.0	3.0	2.6	2.3
Bajaj Finance	Buy	1,550	3.3	3.3	3.3	21.6	22.4	23.8	8.0	6.6	5.3
PTC India Fin. Ser.	Hold	50	3.5	3.4	3.3	16.6	16.3	17.8	1.1	1.0	0.9
NBFCs Total / Average				**6.0**	**6.0**	**14.0**	**14.3**	**15.2**	**4.4**	**3.8**	**3.2**

Capital Goods & Engineering

Early signs of domestic recovery dubious; GST to be temporary disrupter

Steady topline growth seen at 10% YoY except CG Power and Thermax; product-centric companies to do well: We expect Sharekhan coverage universe to deliver ~10% YoY topline growth driven by project based heavyweights like BHEL (focus on converting slow moving orders into executable orders) and L&T (better order execution). Among the other project based company, AIA, KPTL, KEC, Skipper and Va Tech to deliver topline growth in the range of 17-24% YoY. CG Power revenues to decline due to discontinuing of the overseas operations while Thermax revenues to remain flat due to poor order backlog at the start of FY2018 and tepid order inflow during FY2017. We expect Triveni Turbine revenue to grow in double digit driven by export revenues despite muted domestic cycle. Among the electrical consumer durable companies like V-Guard, Finolex and Crompton, we expect topline to grow in the range of 8-18% YoY due to seasonally strong quarter for most of the products like Fans, Switchgears, UPS and coolers.

Operating profit to exceed topline growth despite elevated input cost during Q1: We expect operating profit to grow by 18% YoY on topline growth of 10% in Q1FY2018 on back of operating leverage and cost control measures adopted by the companies despite elevated commodity prices. Sharekhan's universe Operating Profit Margin (OPM) to improve slightly by 50BPS to 8%. All the product based (FCL, Crompton Consumer, V-Guard) companies margin to be under pressure due to rise in raw material prices despite price hike taken in certain product categories. However in the project based companies like BHEL, L&T, KEC, Triveni and Thermax is expected to show margin expansion during the quarter. Cost control measures undertaken by the management led to margin expansion of Thermax and BHEL (coupled with provision write back) while margin expansion in KEC , Va Tech Wabag and Triveni is attributable to execution of better margin export orders. AIA is expected to show decline in margin as management guided for unsustainable of margins at this level. Bottomline of our coverage universe is expected to show growth of 31% YoY in Q1FY2018.

Outlook- Early signs of domestic recovery dubious; GST to be temporary disrupter: We broadly bifurcate our Capital Goods & Engineering coverage universe companies into Industrial (project oriented) and Consumer (product-oriented). For Project based companies, the waiting period for revival in the domestic market just got elongated. While there have been signs of recovery in the past few months, these are still early days to infer whether this is a sustainable recovery or just a post-demonetization adjustment. Though margins are expected to increase in this quarter; sustainability is doubtful ahead of GST and economic recovery. The global economy continues to face different challenges including geopolitical and Brexit. However certain geographies like Middle East, Africa, LATAM and South East Asia continue to show upward growth trajectory. On the other hand, Product based companies despite the temporary setback of demonetisation in H2FY2017; higher rural demand, with a good monsoon, and improved consumer sentiment on back of improving macro conditions augur well for the future. The transition to GST in the coming year will further boost business sentiment and operating environment. However, such a major change could result in temporary business disruption during migration. While domestic private investment has remained weak due to debt overhang, the government has stepped up investment in infrastructure projects related to electrification and connectivity, leading to road, rail and ports development. While construction sector growth is subdued, government push for affordable housing can help bridge the gap in the interim. Multiple smart city projects have been initiated, which will help improve city infrastructure as well as create pockets for wider replication.

Preferred picks: We prefer L&T in the large-cap space; among the smaller companies we like Skipper, Va Tech Wabag and KEC.

Q1FY2018 results estimates

Companies	Sales (Rs cr)		OPM		PAT	
	Q1FY18E	Y-o-Y growth	Q1FY18E	bps (YoY)	Q1FY18E	Y-o-Y growth
BHEL*	5,757	4.2%	1.0	147	156	100.0%
CG Power	1,407	-7.6%	6.9	(104)	37	-7.2%
Finolex cables*	703	17.8%	13.5	(162)	75	12.3%
KPTL*	1,349	16.9%	10.7	(64)	76	18.0%
KEC *	2,098	20.0%	9.3	75	72	131.7%
L&T	24,436	11.7%	9.0	29	745	22.2%
Skipper*	333	17.7%	14.0	(42)	17	37.8%
Triveni Turbines	177	9.5%	21.5	57	29	7.4%
Thermax *	813	-0.2%	9.5	168	60	33.1%
V-Guard*	656	14.6%	10.5	(64)	48	12.7%
Va Tech Wabag	722	24.4%	6.5	177	25	NA
Sharekhan coverage	38,450	10.4%	8.0	51	1,340	31.7%
Non coverage companies						
AIA Engg**	560	19.8%	26.1	(437)	110	1.1%
Crompton Consumer**	1,207	7.7%	13.5	(31)	97	5.8%

*- Standalone numbers,**-Soft coverage, CG Power numbers are not comparable as operations are discontinued

Valuation

Companies	PT (Rs)	Reco	EPS			P/E		
			FY17	FY18E	FY19E	FY17	FY18E	FY19E
BHEL*	160	Hold	2.0	2.9	4.4	67.6	47.0	30.8
CG Power	100	Hold	2.9	2.4	4.1	28.5	34.2	20.4
Finolex cables*	530	Hold	20.6	20.3	22.3	23.5	23.9	21.8
KPTL*	400	Buy	17.5	21.5	24.7	19.3	15.8	13.7
KEC *	290	Buy	11.9	16.2	19.4	21.7	15.9	13.3
L&T	1,840	Hold	63.6	68.4	78.8	26.8	24.9	21.6
Skipper*	240	Buy	9.6	11.3	14.1	22.7	19.2	15.4
Triveni Turbines*	UR	Buy	3.7	4.4	5.0	41.7	35.3	31.2
Thermax *	1,030	Hold	23.3	24.8	27.8	40.0	37.6	33.6
V-Guard*	205	Hold	3.6	4.7	5.8	50.3	38.5	31.0
Va Tech Wabag	800	Buy	18.8	33.1	39.9	36.5	20.7	17.2
Crompton Consumer**#	Positive Stance		4.7	5.7	7.0	48.9	40.2	32.1
AIA Engg**	Positive Stance		48.4	46.2	54.7	29.1	30.5	25.7

*- stand-alone, UR- Under Review, **- Soft coverage, #- Bloomberg consensus

Cement

A better quarter despite cost pressures

Healthy demand along with uptick in realization to restrict input cost pressure: The cement companies under our coverage (ex-Grasim) is expected to grow its Q1FY2018 revenue by 11% YoY largely driven by higher volumes (up 7.6% YoY) and better realization (up 2.7% YoY). The average pan-India cement prices for Q1FY2018 increased 6.6% YoY (up 9.4% YoY) which was lead by strong growth in Western (up 12% YoY) and Eastern region (up 10% YoY). The Northern and Central region witnessed 5-6% YoY growth while the southern region remained subdued at just 1% YoY growth. We expect the earnings of cement companies under our coverage (ex-Grasim) to decline marginally by 1.3% YoY (up 28.2% QoQ), as higher power & fuel cost and freight costs puts pressure on operating margins.

Southern players expected to suffer on relatively muted realization growth: The South India-based cement players like The Ramco Cements and India Cements are likely to post relatively higher volume growth although realizations are expected to witness a marginal rise YoY. Consequently, we expect the pressure on Operating Profit Margin (OPM) to result in a muted earnings growth.

Outlook – Uptick expected post a seasonally weak Q2: The demand of cement is likely to improve on account of diminishing effects of demonetisation and an uptick in government spending on infrastructure development and housing projects. The average cement price is likely to decline sequentially in Q2FY2018 which is a seasonally weak quarter due to onset of monsoons. The key monitorables during current fiscal would be the improvement of cement demand, sustenance of cement pricing discipline and containment of higher input costs (power & fuel and freight costs). The improvement in capacity utilization along with revival in cement prices in Southern region will also be tracked keenly.

Valuation – high on expectations: We believe that cement stocks have largely factored in expectations of an improvement in demand supported by pricing discipline. We would await for strong cement demand outlook from Infrastructure and housing sectors and subsiding effects of higher input costs. The materialization of above events can trigger further re-rating of valuation multiples as operating leverage kicks in with strong cash flow generation. The delay in demand revival, pressure on cement prices and further increase in input cost are key risks for the sector. At this juncture we maintain a Hold rating on the stocks under our coverage.

Preferred picks for Q1FY2018: Grasim, Ultratech and The Ramco Cements.

Q1FY2018 results estimates

Particulars	Sales (Rs cr)				OPM (%)				PAT (Rs cr)			
	Q1 FY18E	Q1 FY17	YoY (%)	QoQ (%)	Q1 FY18E	Q1 FY17	YoY (%)	QoQ (%)	Q1 FY18E	Q1 FY17	YoY (%)	QoQ (%)
Coverage												
Grasim	9610	9004	6.7	-3.9	21.2	21.4	-25	244	951	830	14.5	22.8
UltraTech	6750	6182	9.2	2.3	22.4	22.2	23	305	849	775	9.5	20.9
Shree Cement	2489	2199	13.2	4.6	29.2	33.2	-402	775	398	508	-21.6	30.7
The Ramco Cements	1074	996	7.8	4.6	31.6	32.9	-138	696	195	180	8.7	45.3
Soft Coverage												
India Cements	1219	1052	15.9	-9.2	17.1	19.1	-204	297	44	44	0.4	28.8
JK Lakshmi Cement	849	777	9.2	5.2	14.4	15.1	-70	555	32	29	10.5	51.8
Mangalam Cement	259	224	15.5	1.8	19.1	20.6	-143	940	20	23	-11.1	476.8
Total	**22249**	**20435**	**8.9**	**-0.7**	**22.5**	**23.1**	**-67**	**370**	**2489**	**2388**	**4.2**	**26.1**
Total (ex-Grasim)	**12,639**	**11,430**	**10.6**	**18.9**	**23.4**	**24.5**	**-104**	**466**	**1538**	**1558**	**-1.3**	**28.2**

Valuation

Companies	Reco	Price target (Rs)	Ev/Ebitda (x)			P/E (x)		
			FY17	FY18E	FY19E	FY17	FY18E	FY19E
Shree Cement	Hold	20,300	25.7	20.0	15.2	47.6	37.9	27.8
UltraTech	Hold	4,500	22.0	20.3	17.5	42.6	45.9	38.7
Grasim	Hold	1,200	7.9	6.0	-	18.5	16.4	-
The Ramco Cements	Hold	805	15.6	13.2	11.4	26.1	20.8	18.0
India Cements#	Cautious		9.7	8.7	8.0	36.2	23.8	19.0
JK Lakshmi#	Positive		18.4	14.7	12.4	67.8	44.2	29.3
Mangalam Cement#	Positive		10.4	8.2	6.1	26.4	14.9	10.2

soft coverage

Consumer Discretionary

Q1FY2018 to be muted due to de-stocking, margins under pressure because of early EOSS

Q1 performance to be muted due to de-stocking prior to GST: The Q1FY2018 performance of textile and apparel companies under our coverage is expected to be muted, due to de-stocking at wholesalers/retailers level prior to the implementation of GST and an early end-of-season sale (EOSS). Though sales volume for branded apparel companies such as Arvind and Aditya Birla Fashion and Retail (ABFRL) will get boosted due to early EOSS, their margins will get affected due to substantial discounts (available for 30-40 days). Arvind and Relaxo Footwears are expected to report single-digit revenue growth (ABFRL is expected to report double-digit growth of 13.4%), while Raymond and Kewal Kiran Clothing (KKCL) are expected to report a single-digit decline in revenue for Q1FY2018 (7-8% YoY). Revenue of export-driven companies such as Trident and S.P. Apparels (main revenue garnered through exports) is expected to grow in double digits. However, the 3.7% rupee appreciation during Q1FY2018 will affect the revenue of these companies to some extent and will, therefore, be lower than the growth registered in earlier quarters.

Rise in cotton prices and early EOSS to dent OPM: Average cotton prices have been on an uptrend since Q3FY2017 due to lower acreage. Owing to high cotton prices (up by 15% YoY in Q1FY2018), gross margin is expected to remain under pressure. Also, early EOSS will have an adverse impact on the revenue mix in Q1FY2018. This will put pressure on the operating profit margin (OPM) of most companies under our coverage. Rubber prices corrected during June 2017, which will lead to a ~135 bps YoY increase in Relaxo Footwears' OPM in Q1FY2018. Though the recent increase in cotton price is likely to compress margins in the near term, improved realisations by passing on higher input costs would help in mitigating the pressure on profitability to some extent only (due to the impending transition impact of GST on the sector as a whole). Adjusted PAT of our coverage universe is expected to grow by 5.5% in Q1FY2018.

Outlook – GST to disrupt growth in H1FY2018; good monsoon and streamlined compliance process to drive stabilisation in H2FY2018: FY2017 performance of branded apparel/retail companies was affected by unforeseen events such as demonetisation. As things were getting back to normal, GST implementation affected the supply chain due to the de-stocking observed by wholesalers to avoid any inconvenience in invoicing before 1st July. We expect consumer spending on branded items to improve in H2FY2018, when there will be stability in the entire value chain. Also, the upcoming wedding season during H2FY2018 will revive sales volume. GST implementation would largely help branded retail companies in the long run due to the large shift from non-branded to branded goods. Margins are also expected to stabilise from H2FY2018, once realisations pick up pace. Therefore, the increasing acceptance of branded products pan-India, shift from non-branded to branded goods and the emergence of e-commerce would remain some of the key growth drivers for branded retail players going forward. On the other hand, better demand for Indian textile products would enhance the prospects of companies such as Trident and S.P. Apparels in the short to medium term.

Preferred picks: In the textile and branded apparel space, we continue to like Arvind due to its focus on shifting its business model to B2C from B2B and ABFRL because of its brand portfolio. Also, Relaxo Footwears will be a major gainer in the new tax regime as 70% of its product portfolio attracts 5% GST rate, which was earlier taxed at 12-12.5%.

Earnings outperformers in Q1FY2018: Relaxo Footwears, Trident and S.P. Apparels.

Earnings laggards in Q1FY2018: Arvind, Raymond and KKCL.

Q1FY2018 results estimates Rs cr

Companies	Net sales			OPM (%)		BPS	Adjusted PAT		
	Q1FY18E	Q1FY17	YoY %	Q1FY18E	Q1FY17	(YoY)	Q1FY18E	Q1FY17	YoY %
Under Coverage Stocks									
Textile & Retail									
Arvind	2219.5	2104.1	5.5	10.0	11.5	-145	65.6	73.5	-10.8
Orbit Exports	39.0	37.2	5.0	31.5	33.1	-155	7.0	7.4	-5.3
KKCL	98.0	107.0	-8.4	17.4	17.9	-48	11.8	12.6	-6.2
Relaxo Footwear	455.4	433.8	5.0	17.6	16.3	134	43.6	36.2	20.4
Soft coverage									
ABFRL	1600.6	1411.9	13.4	4.2	5.0	-82	-21.7	-20.8	-4.4
Raymond	987.4	1061.9	-7.0	3.0	3.4	-36	-23.0	-12.6	0.0
S.P. Apparels	194.9	162.4	20.0	18.8	19.7	-91	20.4	15.6	31.0
Trident	1327.6	1155.0	15.0	19.2	20.9	-173	97.2	78.5	23.9
Grand Total	**6922.5**	**6473.3**	**6.9**	**10.4**	**11.2**	**-76**	**200.8**	**190.3**	**5.5**

Valuations

Companies	Reco.	Price Target (Rs)	EPS (Rs.)			PE (x)		
			FY17	FY18E	FY19E	FY17	FY18E	FY19E
Textile and Retail								
Arvind	Buy	485	12.9	16.6	25.5	28.8	22.3	14.5
Orbit Exports	Hold	177	7.1	8.1	10.6	22.3	19.5	14.9
KKCL	Buy	1910	69.2	73.4	86.9	25.6	24.1	20.4
Relaxo Footwear	Buy	525	10.2	12.8	15.9	50.1	39.9	32.1
Under Soft coverage								
ABFRL	Positive	-	0.7	1.7	3.0	-	-	-
Raymond*	Book Out	-	4.2	19.0	28.3	-	43.0	28.8
S.P. Apparels	Positive	-	24.6	28.4	36.1	18.6	16.1	12.7
Trident*	Book Profit	-	6.6	7.6	10.4	12.4	10.7	7.9

*Bloomberg Consensus

Consumer Goods and Services

GST driven de-stocking to dent Q1 performance

Primary sales to remain under pressure; Q1FY2018 will be another weak quarter for FMCG companies: Most of the consumer goods companies witnessed de-stocking by trade channels (10-15 days) prior to implementation of Goods and Service Tax (GST) in the month of June 2017. As a result, we expect most companies to post a decline in the sales volume in Q1FY2018. But the companies having lesser dependence to wholesale channel or having strong relationship with various trade channels would see limited impact of traders de-stocking in Q1FY2018. Hence the companies such as Hindustan Unilever (HUL), Godrej Consumer Products (GCPL), ITC and Britannia Industries would see flat to low single digit decline in sales volume as compared with companies such as Emami, Bajaj Corp and Jyothy Laboratories which might see higher decline in the sales in Q1FY2018. Overall the Sharekhan's FMCG universe is expected to post 2.3% revenue growth in Q1FY2018.

Higher input cost to put pressure on margins; cut in ad-spends would provide some cushion: The key input prices such as Palm oil, linear alkyl benzene (LAB) and copra have remained high by ~6%, 20% and ~60% respectively, which will continue to put pressure on gross margins in Q1FY2018. The price hikes undertaken by few companies would provide some cushion but will not fully mitigate the impact due to lower sales volume. Further the advertisement and promotional spends are also expected to remain lower on a y-o-y basis, which will mitigate the impact of higher raw material prices. Overall, we expect the Operating Profit Margin (OPM) of Sharekhan's FMCG universe to remain flat on y-o-y basis with large companies such as HUL, ITC and Emami expected to post marginal improvement in the OPM.

Outlook – GST pangs to ease out; expect pick up in H2FY2018: We believe the re-alignment of supply chain and re-stocking of goods at wholesaler/retailer level will happen by Q2FY2018. The secondary sales (retailer-to-consumer) are expected to remain intact as the demand environment is improving in the domestic market. Further, the second consecutive year of normal monsoon will play a key role in the recovery of rural demand. Thus, the performance of FMCG companies is expected to revive in H2FY2018. We expect the companies to pass on some benefits of lower GST rates to the consumers in the form of price declines/increase in grammage/promotional offerings, which would further add-on to the sales in the coming quarters. Though the gross margins might remain under pressure, the OPM is expected to remain stable on y-o-y basis due to lower ad-spends and better operating efficiencies in the near term.

Valuation - remain selective: We believe the companies which are quick in adapting changes under the GST structure will be larger beneficiaries of GST implementation and would be our top picks in the FMCG space. Also the FMCG stocks have seen strong run up in the stock price in the recent past, which makes us selective in the space with decent upside. Thus in large cap space we like ITC (as tax concerns over the core cigarette business are receding) and Britannia Industries (as it will have limited impact of GST implementation in comparison to other FMCG stocks).

Preferred picks: ITC and Britannia Industries

Earnings outperformers in Q1FY2018: HUL, ITC and GCPL

Earnings underperformers in Q1FY2018: Emami, Jyothy Laboratories and Bajaj Corp

Q1FY2018 results estimates Rs cr

Companies	Net sales Q1 FY18E	Net sales Q1 FY17	YoY %	Operating profit Q1 FY18E	Operating profit Q1 FY17	YoY %	OPM (%) Q1 FY18E	OPM (%) Q1 FY17	BPS (YoY)	Adjusted PAT Q1 FY18E	Adjusted PAT Q1 FY17	YoY %
HUL	9,019.2	8,802.8	2.5	1,693.7	1,635.9	3.5	18.8	18.6	20	1,156.1	1,124.4	2.8
ITC	13,793.3	13,253.1	4.1	3,685.4	3,526.2	4.5	26.7	26.6	11	2,525.3	2,384.7	5.9
Britannia Industries	2,261.2	2,196.6	2.9	308.9	316.2	-2.3	13.7	14.4	-74	217.0	219.2	-1.0
GSK Consumer	964.0	1,002.6	-3.8	118.7	146.8	-19.1	12.3	14.6	-233	155.5	160.6	-3.2
Emami	583.2	644.4	-9.5	135.9	147.3	-7.7	23.3	22.9	46	94.7	105.3	-10.1
GCPL	2,338.6	2,194.2	6.6	400.0	380.0	5.3	17.1	17.3	-21	266.2	251.2	6.0
Marico	1,772.0	1,754.3	1.0	363.3	374.1	-2.9	20.5	21.3	-82	260.4	268.0	-2.8
Jyothy Laboratories	425.9	437.7	-2.7	69.4	79.5	-12.7	16.3	18.2	-187	41.1	45.0	-8.7
Zydus Wellness	107.8	108.8	-0.9	19.5	19.7	-0.9	18.1	18.1	-1	23.3	23.9	-2.6
Under soft coverage												
Bajaj Corp	194.2	204.3	-4.9	65.6	71.0	-7.5	33.8	34.7	-94	54.1	61.6	-12.1
Dabur India	1,816.1	1,923.9	-5.6	307.3	348.8	-11.9	16.9	18.1	-121	256.2	293.6	-12.7
Total	**33,275.5**	**32,522.7**	**2.3**	**7,167.7**	**7,045.3**	**1.7**	**21.5**	**21.7**	**-12**	**5,049.9**	**4,937.4**	**2.3**
Consumer Services												
Cox & Kings	758.1	701.9	8.0	333.4	315.7	5.6	44.0	45.0	-101	169.2	152.8	10.8
Thomas Cook (India)#	2,767.1	2,476.1	11.8	165.5	142.0	16.6	6.0	5.7	25	73.0	62.0	17.8
Wonderla Holiday	108.0	88.9	21.5	42.7	39.2	8.9	39.5	44.1	-460	23.7	22.5	5.5

Thomas Cook India YoY sales numbers are not comparable due to inorganic initiatives undertaken in the recent past

Valuations

Companies under coverage	Reco.	Target Price	EPS (Rs.) FY17	EPS (Rs.) FY18E	EPS (Rs.) FY19E	PE (x) FY17	PE (x) FY18E	PE (x) FY19E
HUL	Hold	1,165	19.7	23.1	27.7	55.7	47.5	39.6
ITC	Buy	380	8.4	10.3	12.3	39.8	32.5	27.2
Britannia	Buy	3,850	73.7	84.8	104.0	50.1	43.5	35.5
GSK Consumer	Hold	5,800	156.1	180.1	196.8	44.2	30.6	28.0
Emami	Buy	1,245	24.2	30.3	37.7	54.3	34.7	27.9
GCPL	Hold	993	19.1	21.9	26.1	50.7	44.3	37.2
Marico	Hold	325	6.3	7.4	8.8	50.9	43.4	36.5
Zydus Wellness	Buy	1,020	28.5	32.6	39.2	29.8	26.1	21.7
Jyothy Laboratories	Buy	435	11.3	15.2	14.4	32.3	24.0	25.4
							EV/EBIDTA (X)	
Cox & Kings	Hold	295	19.4	21.9	26.8	9.8	8.6	6.9
Thomas Cook India	Hold	**	2.1	4.4	7.3	27.9	17.3	10.8
Wonderla Holidays	Buy	425	6.0	9.2	14.8	26.5	17.3	11.7

**Price under review

IT

Another soft quarter, valuation reflects modest expectation

Soft quarter: Macro challenges coupled with delay in deal cycle time and weakness in some industry pockets will continue to impact the performance of IT sector. March-June quarter, which earlier used to be a seasonally strong quarter is expected to remain soft. The industry pain and transition impact is clearly reflecting in growth deceleration from 11.5% YoY growth in Q1FY2015 to 8.2% in Q1FY16 and current estimates is at 6% YoY growth for Q1FY2017E.

For the quarter, we expect the cross-currency tailwinds will drive USD revenue growth in the range of negative 0.2% to positive 4.1%, whereas the constant-currency (CC) revenue growth is expected to be in the range of negative 1.0% to positive 3.3%. HCL Tech will deliver best-in-class CC revenue growth of 3.3% QoQ (organic growth at 1.3% QoQ), followed by Infosys (2.4% QoQ), TCS (2.3% QoQ), Wipro (negative 1.0% QoQ, at mid-point of its Q1 guidance) and Tech Mahindra (negative 0.8% QoQ). Stronger rupee, soft topline growth coupled with wage hikes (Infosys deferred to July), visa expenses, ramp-up in local hires would impact the margins performance. We expect the Operating Profit Margin (OPM) of top five IT companies will be adversely impacted (50-130 BPS QoQ).

Outlook: Similar set of challenges persist: Increasing protectionist measures (increasing cost of doing business) coupled with pockets of weakness in some industry verticals and appreciation of the rupee (especially against USD) will dampen the earnings performance of IT companies in the near to medium term. Although the managements of most IT companies have expressed their optimism on higher spending in the BFSI segment and enhanced capital allocation for disruptive technologies, and the large deal wins in these areas will be the key to accelerate growth in the coming years. We maintain our Neutral stance on the sector and expect transition impact from legacy services to digital will continue to results in earnings volatility for next 2-3 years. Given the weak earnings growth, a concrete and well laid out long-term capital allocation policy will play a bigger role to support the company's valuation in the transition phase.

Valuations reasonable, but modest growth and macro overhang restrict outperformance: Increasing cost of doing business owing to protectionist measures along with the lingering macro-economic uncertainties will restrict any major outperformance of Indian IT companies in the near to medium term. Valuations of IT companies already reflect modest earnings growth expectations for FY2018E, thus major downside risks from current levels remain protected. We continue to remain selective in terms of our preferred picks in the IT sector, as these companies are investing and building new-age technologies in an efficient manner for driving sustainable growth in the coming years. Given that valuations are reasonable and a major de-rating is already behind, we see select investment opportunity from a long-term perspective (12-15 months' time horizon).

Preferred picks: HCL Tech (in large-cap space) and Persistent Systems (in mid-cap space). HOLD on to Infosys and TCS. Wipro is least preferred stock in top tier pack.

Key issues to watch out for would be: (1) We expect Infosys and HCL Tech would maintain their respective FY2018 revenue growth guidance on a constant currency basis as there is no major changes in demand outlook, while Wipro is expected to provide revenue growth guidance of ~1-3% QoQ for Q2FY2018; (2) Trend in discretionary client spends in key verticals especially in the BFSI segment. Decisions making process for rising spending in the BFSI vertical space has been elongated due to the protectionist stance in the USA, despite a promising environment for potential improvement in BFSI spends (rising interest rates) and an overall improvement in IT demand for digital technologies; (3) Commentary on margin trajectory, given rupee appreciation, wage revision and lower topline growth; (4) pricing outlook and pace of large deal closures; (5) Demand outlook for verticals like Healthcare, Retail and Communication, etc; and (6) Commentary on positioning in the new-age digital/platforms/automation technologies and their growth prospects.

Q1FY2018 results estimates

Particulars	Sales (Rs cr)				OPM (%)				Net profit (Rs cr)			
	Q1 FY18E	Q1 FY17	YoY (%)	QoQ (%)	Q1 FY18E	Q1 FY17	YoY (bps)	QoQ (bps)	Q1 FY18E	Q1 FY17	YoY (%)	QoQ (%)
Infosys	17,007	16,782	1.3	-0.7	26.2	26.5	-29	-100	3,429	3,436	-0.2	-4.8
TCS	29,664	29,305	1.2	0.1	26.1	26.7	-60	-129	6,219	6,317	-1.6	-5.9
Wipro	13,346	13,599	-1.9	-4.6	19.8	19.5	30	-326	2,011	2,052	-2.0	-11.1
HCL Tech	12,213	11,336	7.7	1.3	21.5	22.2	-72	-46	2,063	2,047	0.8	-11.2
Tech Mahindra	7,299	6,921	5.5	-2.6	12.0	14.9	-289	-1	581	750	-22.6	-1.2
Persistent Systems	723	702	3.0	-0.6	16.5	15.1	147	-136	84	73	15.0	15.8
FSL	858	894	-4.0	-3.8	10.6	13.3	-275	-50	59	73	-19.2	-9.4

Source: Company, Sharekhan Research

Valuations

Particulars	Reco	Price target (Rs)	EPS (Rs)			P/E (x)		
			FY17	FY18E	FY19E	FY17	FY18E	FY19E
Infosys	Hold	1,050	62.8	63.4	69.8	15.1	15.0	13.6
TCS	Hold	2,450	133.4	140.5	151.8	17.7	16.8	15.5
Wipro	Hold	275	17.5	18.2	19.0	14.7	14.2	13.6
HCL Tech	Buy	965	59.9	64.6	72.0	14.0	12.9	11.6
Tech Mahindra	Neutral	NA	32.8	30.8	34.7	11.5	12.3	10.9
Persistent Systems	Buy	UR	39.1	43.0	48.0	17.3	15.7	14.1
FSL Ltd	Hold	43	4.2	4.5	5.1	8.4	7.8	6.9

**Under review
Source: Company, Sharekhan Research

Oil & Gas

Fall in oil prices and inventory losses to dampen earnings of upstream and downstream PSUs

Downstream companies to get impacted by inventory losses and appreciation in Indian Rupee despite flat QoQ Singapore Complex GRM: The Brent oil price has declined by around 7% QoQ to $50.8/bbl QoQ in Q1FY2018. This is likely to result in inventory losses to the tune of $0.8-$1.2/bbl for oil marketing companies [OMCs - Indian Oil Corporation (IOCL)/Bharat Petroleum Corporation (BPCL)/Hindustan Petroleum Corporation (HPCL)]. We thus expect a decline in the gross refining margins (GRMs) of OMCs in Q1FY2018 despite a flat Singapore GRM of $6.4/bbl on sequential basis during the quarter. Moreover, appreciation of Indian Rupee by 3.8% QoQ to Rs 64.5 against the US Dollar will further impact the refining earnings. However, on the positive side, the domestic auto fuel consumption is expected to improve sharply in Q1FY2018, with 10% YoY growth in MS and 5.4% YoY increase in HSD consumption during April-May 2017. We expect IOCL/BPCL/HPCL to report earnings de-growth of ~57.1%/38.4%/30.1% YoY respectively in Q1FY2018. We expect Reliance Industries' (RIL) GRM to decline by 4.3% QoQ to $11/bbl in Q1FY2018 while its throughput is expected to be increase marginally by 1.1% QoQ to 17.7mmt and thus expect QoQ decline in the earnings of its refining segment. RIL's Petrochemicals segment's earnings are expected to increase QoQ due to higher Polymer and Polyester spreads. Overall, we expect RIL's Q1FY2018 earnings to decline 6.4% QoQ (+1.1% YoY) to Rs7,630 crore.

Upstream PSUs earnings to be impacted by lower net oil realization on QoQ basis: The upstream PSUs [ONGC and Oil India (OIL) would be impacted by lower net oil realizations on a sequential basis, as Brent crude oil has declined by $3.8/bbl QoQ to $50.8/bbl in Q1FY2018. We assume that there will be no subsidy burden for upstream PSUs in Q1FY2018. Thus, ONGC's net oil realisation is expected to decline by 7.5% QoQ to $51/bbl partially offset by marginally higher oil/gas production by 1.1%/0.4% QoQ. Accordingly, we expect ONGC to report 23.6% QoQ (flat YoY) decline in PAT to Rs4,225 crore in Q1FY2018 due to a decline in the operating profit and lower other income. We model net oil realisation of $49/bbl (-7% QoQ) and oil/gas production of +1.3%/flat QoQ for OIL. Thus, we expect OIL's earnings to decline by 51% QoQ (-31.8% YoY) due to lower operating profit, lower other income and higher effective tax rate.

Gorgon volumes at Dahej terminal to benefit PLNG; Decent quarter expected for GAIL on back of higher petrochem margins: Petronet LNG (PLNG) is expected to benefit from higher utilisation rate, as Gorgon volume is likely to come to its Dahej terminal with higher re-gas tariff. We thus expect 23% YoY growth in PLNG's PAT to Rs 463 crore in Q1FY2018. GAIL's petrochemicals margins are expected to improve on QoQ basis while the gas transmission volume is likely to remain flat QoQ. We, thus we expect GAIL to report a PAT of Rs1,167 crore (+11.4% QoQ). We expect Gujarat State Petronet Limited's (GSPL) gas transmission volume to increase by 7% QoQ to 25mmscmd in Q1FY2018 that will translate into better operating profitability on a QoQ basis.

Outlook: We maintain our positive view on refining margins over FY2018-19E, as the strong oil demand growth of 1.3mbpd (according to the International Energy Agency estimates) would help reduce excess gasoline and gasoil product inventory in the international markets. Moreover, the domestic auto fuel consumption growth has also revived in Q1FY2018 quarter-to-date. We are thus optimistic of a 6-7% growth in MS/HSD demand in FY2018 and FY2019. However, inventory losses due to volatility in oil prices and the negative impact of Goods and Service Tax (GST) is likely to keep the profitability of OMCs (IOCL, BPCL and HPCL) under pressure in FY2018.

RIL has largely completed its $20billion capex in petrochemical and refining and the projects are nearing the commissioning stage. We, thus expect RIL to benefit from better GRM and petrochem capacity additions in FY2018 and FY2019. Moreover, better-than-expected financials in the Telecom business would be an important trigger for re-rating going forward.

We maintain our neutral stance on upstream PSUs given the concern of lower net realisations and muted domestic gas prices despite sharp correction in the stock prices of ONGC (down 16% YTD) and Oil India (down 23% YTD). Thus, we maintain our 'Neutral' view on OIL.

Valuation and preferred picks: Our preferred picks in the Oil & Gas space are RIL and Petronet LNG, given the strong earnings growth trigger from capacity augmentation and margin expansion over FY2018E-FY2019E. RIL's earnings growth would improve significantly in FY2019, as we expect full utilisation of its RoGC and Petcoke Gasification projects during that fiscal year. We are positive on PLNG given the strong visibility on volume and earnings growth on the back of firm volume off-take commitment under the Use or Pay clause.

Preferred picks: RIL and Petronet LNG

Earnings outperformers in Q1FY2018: Petronet LNG and GSPL.

Earnings underperformers in Q1FY2018: IOCL, BPCL, HPCL and Oil India.

Q1FY2018 results estimates (standalone financials)

Particulars	Sales (Rs cr)				OPM (%)				PAT (Rs cr)			
	Q1 FY18E	Q1 FY17	YoY (%)	QoQ (%)	Q1 FY18E	Q1 FY17	YoY (BPS)	QoQ (BPS)	Q1 FY18E	Q1 FY17	YoY (%)	QoQ (%)
Coverage												
RIL	63,851	53,496	19.4	-4.9	17.3	20.2	-288	54	7,630	7,548	1.1	-6.4
Oil India	2,369	2,221	6.6	-5.7	26.7	38.8	-1211	1	337	494	-31.8	-50.9
Non-coverage												
IOCL	99,295	86,081	15.4	-1.0	7.2	13.5	-627	-375	2,942	6,864	-57.1	-55.7
BPCL	58,241	46,890	24.2	2.1	3.4	5.7	-229	-3	1101	1,786	-38.4	-32.8
HPCL	47,520	44,779	6.1	-7.6	3.7	5.8	-207	-80	990	1,416	-30.1	-29.2
GAIL	14,597	10,667	36.8	8.8	11.1	14.7	-370	-31	1167	1,335	-12.6	11.4
ONGC	19,982	17,670	13.1	-8.0	49.7	53.1	-343	313	4,225	4,233	-0.2	-23.6
Petronet LNG	7,917	5,337	48.3	24.4	9.5	12.0	-257	-21	463	378	22.5	-1.7
GSPL	250	259	-3.4	2.3	86.1	87.6	-152	380	124	113	9.8	-2.5

Source: Sharekhan estimates; Company data

Valuation

Company	EPS			CAGR over FY17-19E(%)	PE(x)			Reco	Price Target
	FY17	FY18E	FY19E		FY16	FY17E	FY18E		
Coverage									
RIL	101.2	101.6	120.1	8.9	14.7	14.7	12.4	Buy	1,550
Oil India#	27.6	28.5	30.1	4.4	9.6	9.3	8.8	Hold	345
Non-coverage									
IOCL	45.2	45.3	49.2	4.3	8.4	8.4	7.8	Neutral	
BPCL*	66.5	59.9	66.7	0.1	10.0	11.1	10.0	NA	NA
HPCL*	81.1	61.2	63.5	-11.5	6.2	8.2	7.9	NA	NA
GAIL*#	16.0	29.3	31.3	39.9	22.4	12.2	11.4	NA	NA
ONGC*	20.7	19.2	21.3	1.4	7.7	8.3	7.5	NA	NA
Petronet LNG#	11.4	14.1	16.0	18.7	19.1	15.5	13.6	Positive	
GSPL#	8.8	12.7	13.0	21.2	19.6	13.6	13.3	Neutral	

Source: Sharekhan estimates, *Bloomberg consensus estimates; # standalone financials; Note: Petronet LNG's FY2017-FY2019E EPS has been adjusted for bonus issue in the ratio of 1:1

Pharma

Weak performance to continue, caution advised

Weak performance continues: We anticipate Q1FY2018 to be a weak quarter due to high base in Q1FY2017 (on account of exclusive opportunities such as gGleevec and gGlumetza) and regulatory and pricing challenges in the U.S. We expect India business to witness a slowdown in growth to 5% (vs. 11% in Q4FY2017) due to GST implementation in July 2017. Although incremental approvals in emerging markets will support sales and earnings growth, regulated market sales are likely to remain under pressure due to heightened competition, pricing pressure, diminishing exclusivity sales, appreciating rupee and delayed key product approvals. Hence, we expect our pharma coverage universe to report weak performance, with sales falling by 0.5%, operating profit margin declining by 630 bps to 21.5% and profit down by 33.2% in Q1FY2018.

Domestic business de-stabilised due to GST; U.S. business to remain under pressure: On the domestic business front, the Indian pharma market (IPM) grew by 5% during Q1FY2018 (vs. 11% in Q4FY2017) on account of GST rollout in July 2017. U.S. business in Q1FY2018 is likely to face pressure due to high base in Q1FY2017 (on account of exclusive opportunities, launch of blockbuster drugs such as gGleevec and gGlumetza), regulatory concerns around key manufacturing facilities, rupee appreciation and increased competition adding to existing pricing pressure.

Outlook: Cautious

FY2018 will be full of hurdles, caution advised: The sector is already under stress and appreciating rupee is going to be an additional challenge in FY2018. We shall keenly monitor FDA remediation updates, key product approvals, management commentary and outlook along with USD/INR rates, as these would decide earnings upgrades/downgrades for FY2018 and FY2019. Therefore, we advise caution.

Valuation: Not in the comfort zone, no preferred pick

Valuations: Most pharma companies in our coverage universe are trading at 12-19x FY2019E earnings, of which frontline stocks are trading at close-to-peak valuation, which is not a comfortable investment zone, and risk reward looks unfavourable. Currently, we do not have any preferred pick in the sector. We advise investors to wait for more clarity and a better entry point for fresh investment.

Earnings outperformers in Q1FY2018: Glenmark Pharma

Earnings laggards in Q1FY2018: Cipla, Divis, Lupin, Sun Pharma and Torrent Pharma

Q1FY2018 results estimates Rs cr

Companies	Net sales				OPM (%)		BPS	BPS	Adjusted PAT			
	Q1FY18E	Q1FY17	YoY %	QoQ%	Q1FY18E	Q1FY17	(YoY)	(QoQ)	Q1FY18E	Q1FY17	YoY %	QoQ%
Under coverage												
Aurobindo	3,853.0	3,767.0	2.3	5.8	22.2	23.6	-143.5	236.8	565.0	591.0	-4.4	6.0
Cadila	2,493.0	2,287.0	9.0	-1.3	19.9	22.9	-301.6	155.9	345.0	356.0	-3.1	-10.4
Cipla	3,870.0	3,594.0	7.7	8.0	16.4	17.0	-64.4	223.0	291.0	365.0	-20.3	38.6
Divis	997.0	1,017.0	-2.0	-6.6	33.4	39.7	-631.4	-332.8	240.0	301.0	-20.3	-7.7
Glenmark	2,314.0	1,943.0	19.1	-5.8	22.2	19.5	266.3	409.9	287.0	227.0	26.4	-3.7
Lupin	4,255.0	4,439.0	-4.1	0.0	21.8	29.5	-763.3	-414.9	477.0	882.0	-45.9	-32.2
Sun Pharma	7,439.0	8,243.0	-9.8	4.2	22.6	35.4	-1,281.2	93.4	1,150.0	2,268.0	-49.3	-17.0
Torrent Pharma	1,480.0	1,545.0	-4.2	3.2	21.1	28.3	-720.4	50.9	172.0	292.0	-41.1	-16.5
Total - A	**26,701.0**	**26,835.0**	**-0.5**	**2.3**	**21.5**	**27.8**	**-630.2**	**57.1**	**3,527.0**	**5,282.0**	**-33.2**	**-11.4**
Under soft coverage												
Biocon	960.0	981.0	-2.1	3.8	21.5	25.9	-443.4	1,89.1	125.0	167.0	-25.1	-7.4
Dr Reddy's Lab	3,397.0	3,223.0	5.4	-6.0	16.1	12.1	403.1	-23.0	223.0	146.0	52.7	-31.8
Granules India	371.0	350.0	6.0	2.5	22.1	19.7	238.8	83.2	40.0	32.0	25.0	11.1
Natco	417.0	325.0	28.3	-27.9	30.2	23.7	652.4	-1,148.0	82.0	48.0	70.8	-53.9
Suven	164.0	138.0	18.8	-11.4	28.7	31.2	-250.1	271.3	34.0	33.0	3.0	-15.0
Total - B	**5,309.0**	**5,017.0**	**5.8**	**-6.2**	**22.5**	**20.3**	**212.7**	**-109.3**	**504.0**	**426.0**	**18.3**	**-29.6**
Grand Total (A+B)	**32,010.0**	**31,852.0**	**0.5**	**0.8**	**22.0**	**24.1**	**-208.7**	**30.6**	**4,031.0**	**5,708.0**	**-29.4**	**-14.2**

Valuation

Companies	Reco	EPS (Rs)			P/E (X)			RoCE (%)		
		FY17	FY18E	FY19E	FY17	FY18E	FY19E	FY17	FY18E	FY19E
Aurobindo	Hold	39.1	45.1	56.6	17.7	15.4	12.3	25.7	26.1	27.0
Cadila	Hold	14.5	21.1	27.0	35.9	24.6	19.3	13.5	18.1	20.2
Cipla	Hold	16.3	24.0	32.4	33.8	23.0	17.0	9.5	13.0	15.7
Divis	Hold	39.9	40.2	43.1	16.9	16.8	15.7	25.3	27.1	25.8
Glenmark	Hold	45.2	50.0	57.2	14.7	13.3	11.6	20.5	21.6	21.8
Lupin	Hold	60.1	65.1	76.6	18.8	17.4	14.8	16.8	16.0	16.5
Sun Pharma	Reduce	29.0	28.0	31.9	19.0	19.7	17.3	18.5	16.6	16.8
Torrent Pharma	Hold	54.9	63.1	80.3	23.5	20.5	16.1	18.8	19.2	20.4

Power

Power demand improved YoY, GST to be neutral; prefer Power Grid and CESC

Power generation in India is expected to grow by 8% YoY (up 15% QoQ) to 320BU in Q1FY2018 due to healthy growth in thermal and hydro-generation (seasonal effect) segments. We expect thermal generation to grow by 7% YoY to 273BU due to capacity addition, while hydro generation is expected to grow by 19% YoY due to strong season in Q1FY2018. Base energy deficit is expected to decline to 0.6% in Q1FY2018 as against deficit of 0.8% during Q1FY2017. Thermal power PLF is expected to increase YoY to 64% in Q1FY2018 as against 62% in Q1FY2017 (62% PLF in Q4FY2017). The country added 3,756MW till May 2017, taking total installed capacity at 330.3GW.

We expect CESC to report flat earnings growth to Rs295 crore due to a decline in volumes, offset by higher realisation. Volume is expected to decline by 3% YoY to 2,700MU, while realisation is expected to improve by 2.7% YoY to Rs7.2 per unit. The decline in volume is due to a significant decrease in power generation from older plants. On the other hand, PTC India is expected to witness 15% YoY topline growth to Rs4,205 crore, attributable to volume growth (15%) and flat realisation. We expect adjusted operating profit margin per unit at 5 paisa, translating into a 4% YoY increase in operating profit to Rs53 crore in Q1FY2018. Among the soft coverage companies, consensus expects NTPC to report 4% topline growth, while we expect Power Grid to register 11% topline growth due to higher capitalisation of assets. However, earnings of NTPC are expected to grow by 11% YoY, while that of Power Grid are expected to increase by 10% YoY.

Outlook: Overall, power demand improved on a YoY basis and merchant prices and volumes have also witnessed some improvement due to elongated summer seasons. However, UDAY scheme has also seen some progress in the past few months. Pertinently, stronger power demand hinges on the success of UDAY reforms. The implementation of GST remains neutral for the sector as the rate of GST on thermal coal has reduced from 12% to 5% currently. We expect this to be neutral for regulated utilities, as lower fuel cost will be treated as pass through and subsequently lead to lower tariffs. On the renewable side, GST on solar and wind equipment has been pegged at 5%, which does not materially alter the economics of the projects, given PPAs in the sector have been pegged at aggressive rates. We prefer Power Grid and CESC in the power segment.

Preferred stocks: Power Grid and CESC

Q1FY2018 results estimates

Company	Sales (Rs cr)				OPM				PAT (Rs cr)			
	Q1 FY18	Q1 FY17	YoY (%)	QoQ (%)	Q1 FY18	Q1 FY17	YoY (BPS)	QoQ (BPS)	Q1 FY18	Q1 FY17	YoY (%)	QoQ (%)
Coverage												
CESC	1,913	1,522	(0.3)	1.6	28.5	34.4	(32)	(579)	295	293	(2.0)	(42.2)
PTC India	3,269	2,983	15.4	28.6	0.8	2.0	(12)	86	34	80	4.2	54.9
Non Coverage												
NTPC	20,417	18,325	4.2	(2.7)	26.8	29.7	22	59	2,862	2,793	11.4	(9.1)
Power Grid	6,712	5,741	10.5	0.7	83.7	88.0	4	489	1,916	1,569	9.9	3.3

Valuation

Company	BVPS			CAGR over FY17-19E(%)	PB(x)			Reco	Price Targe (Rs)
	FY17	FY18E	FY19E		FY17	FY18E	FY19E		
Coverage									
CESC	1,000	776	844	-8%	0.9	1.1	1.0	Buy	1,000
PTC India	104	107	114	5%	1.0	1.0	0.9	UR	100
Non Coverage									
NTPC*	117	124	134	7%	1.4	1.3	1.2	NA	NA
Power Grid	95	105	120	12%	2.2	2.0	1.8	Positive stance	

*-Bloomberg consensus

Miscellaneous

Q1FY2018 results estimates

Company	Net sales (Rs Cr)				OPM (%)				Adjusted PAT (Rs Cr)			
	Q1 FY18E	Q1 FY17	YoY (%)	QoQ (%)	Q1 FY18E	Q1 FY17	YoY Bps	QoQ Bps	Q1 FY18E	Q1 FY17	YoY (%)	QoQ (%)
BEL	998	928	7.6	-76.4	-2.5	-4.2	172	-2568	0.9	23	-95.9	-99.9
Bharti Airtel	21983	25573	-14.0	0.0	34.5	37.4	-293	-147	257	1462	-82.4	-31.1
Gateway Distriparks#	103	277	-62.9	-66.5	23.7	19.7	400	689	16	23	-29.0	-30.8
Gayatri Projects	531	432	22.8	-34.6	14.5	14.1	42	-112	18	11	61.9	-62.2
IRB Infrastructure	1436	1517	-5.4	-11.7	47.4	51.0	-365	-314	206	182	13.1	-0.7
Sadbhav Engineering*	932	807	15.5	-9.7	10.8	10.8	9	24	49	49	1.5	-27.6
Century Plyboards	444	406	9.4	-9.1	16.6	16.3	25	-60	48	41	16.2	6.2
Gulf Oil Lubricants	316.9	283.0	12.0	6.0	17.2	16.9	28	188	36.7	31.2	17.7	14.3
Info Edge	222.0	197.6	12.3	6.5	30.2	24.2	602	-11	54	44	22.4	47.3
Inox Leisure	375.9	336.9	11.6	30.3	18.7	18.4	27	1002	29	25	14.7	-
Ratnamani Metal	407.7	357.7	14.0	0.2	16.9	16.9	-3	7	39	31	24.7	-2.4
Supreme Ind*	1220.7	1189.3	2.6	-4.8	17.0	16.9	10	-190	110	115	-4.8	-13.8
ZEE Ent	1484.3	1571.7	-5.6	-2.9	31.2	28.8	236	52	323	330	-2.1	31.9
NBCC	2576	1264	103.8	9.8	5.5	3.5	200	-340	113.5	45.4	150.0	-35.1
UPL	3900.0	3644.0	7.0	-27.0	20.2	19.2	100	80	410	360	13.9	-43.7
PI Industries	676.0	683.4	-1.1	7.8	24.8	24.2	57	31	126	125	1.1	-6.7
Insecticides India	318.6	304.9	4.5	81.0	11.8	12.0	-24	419	22	18	20.4	266.4

* Standalone result #Results not comparable due to deconsolidation of rail business

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