Jefferies

Franchise Report

India | Equity Strategy

Equity Research
January 1, 2024

India Strategy 2024 — Continued Strength

STRATEGY NOTE

Resurgence of a multi-year capex upcycle implies robust 6-7% GDP growth over the next 5-7 years. Potential slowdown in Govt capex in the upcoming budget is not a worry. Foreign investor positioning on India is light & CY24 should see greater inflows which should help banking stocks. We like domestic cyclicals viz. banks, power, telecom, industrial, property. UWT IT, Consumer, Energy. We increase UWT on consumer & raise banks OWT. Trim L&T & add Adani Ports.

India's multi-year capex cycle has started unfolding. India's capex (GFCF) to GDP ratio bottomed out in FY20 and has since risen by 270bps but is still 500-600bps lower than the previous peak seen around 2010. All the three elements of the capex cycle (Housing, Corporate Capex & Govt Capex) are now firing and hence the potential global slowdown should have limited impact on India. A combination of a strong pent-up demand for housing, above average affordability and 12-year low unsold inventory should drive a multi-year virtuous housing cycle. Ditto for corporate capex with all-time low D/E ratio for Indian corporate, along with a decade high capacity utilisation level and well capitalised banking system should drive corporate capex.

Potential Govt capex slowdown won't hurt the broader capex cycle. Strong tax collections and subdued social spending allowed the Govt to raise Capex 3x over past 5 years. Expected fiscal consolidation by 140bps over the next 2 years implies Govt Capex (15% of GFCF) could slow down but private capex (75% of GFCF) pick-up should more than offset. The approaching national elections will keep the welfare spending imperative high, and same may be visible during the 1st Feb interim budget. Post elections, there is a risk of higher taxation. Slower incremental Govt capex growth could be a near-term negative for L&T, rail and defence stocks. We move some weight from L&T to Adani Ports (privatisation beneficiary) in our model portfolio.

Foreign inflows should improve in CY24. The Indian markets have been well supported by the domestic institutional flows wherein the rise of 'SIPs' continues to create consistent liquidity pool. We do not foresee a disruption to the domestic flow particularly as fixed income has turned less attractive due to tax changes. Moreover, we believe that the FPI flows will likely improve in CY24. Key triggers for FPI flows would be 1. Peaking USD 2. May'24 elections and 3. Rising significance of India in global markets. As a matter of reference, Chinese equities saw foreign inflows of US$50bn+/year during CY17-21. While the size of the Chinese market and economy is much bigger, the global environment wasn't conducive for EM flows.

Banks - The best risk reward sector: Banking sector has benefitted from the sector rotation (into large caps) seen in Dec'23. But even beyond that near-term trade, the sector stands out as the only sector with below average multiples and possible earnings surprise if asset quality holds up. Also, more foreign flows from global mandates suit the large banks/financial theme well.

Relative valuations better, market could touch new highs. Nifty is now 20x 1-year forward - higher than the past 10-year average, but relative to EM (ex China) the premium at 67% is only somewhat higher than historical average. Also, on PEG basis, Indian market appears reasonable. Dec-24 Nifty target of 24,000 implies 12% total return and assumes current multiple to sustain helped by 12% EPS cagr and strong flows. We remain positive on domestic economy / capex and our key picks are large banks (Axis, ICICI), developers (Lodha, GPL), Power (Coal India, JSW Energy) 2 wheeler (TVS, Eicher), Telecom (Bharti) and cap goods (Adani Ports, Kajaria).

Exhibit 1 - Sectoral stance of Model portfolio

Stock/Sector	Neutral Wt.	Jefferies Wt.	Stance
Financials	26.2	31.0	OWT
IT	13.1	8.9	UWT
Energy	10.4	6.0	UWT
Telecom	2.9	4.0	OWT
Consumer Staples	8.6	5.7	UWT
Consumer Disc.	12.9	11.3	UWT
Materials	7.3	8.6	OWT
Healthcare	4.9	4.8	Neutral
Industrials	8.2	9.2	OWT
Utilities	4.4	8.1	OWT
Real Estate	1.0	2.5	OWT
Total	**100.0**	**100.0**	

Source: Jefferies

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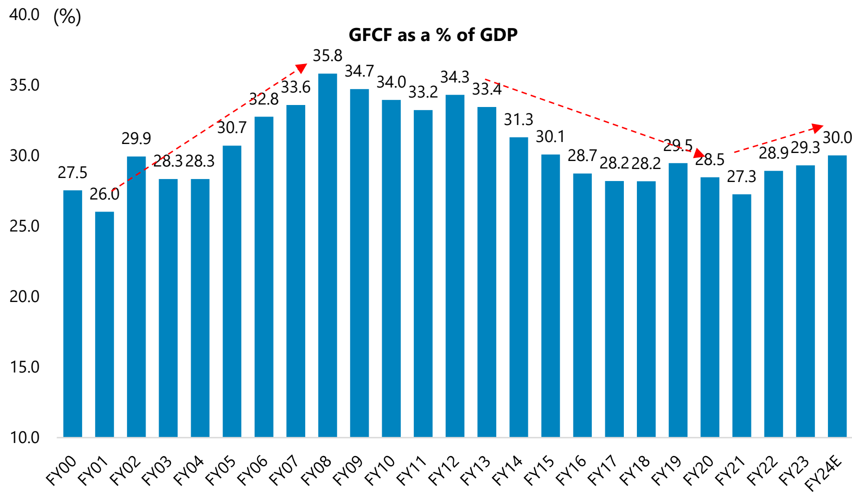
Story in charts

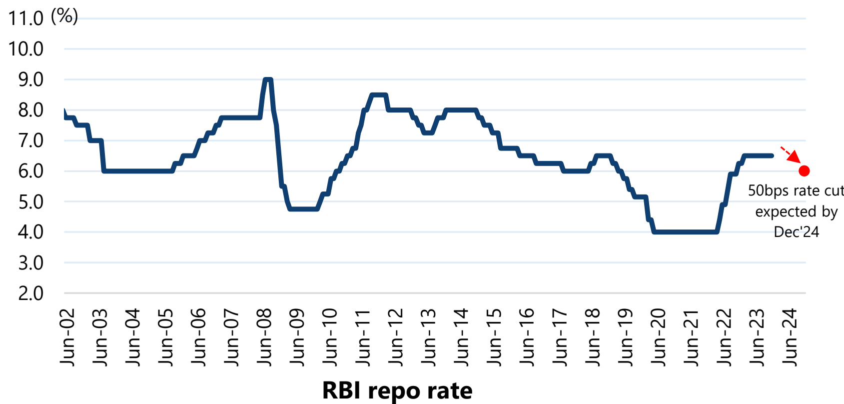
Exhibit 2 - Gross Fixed Capital Formation (GFCF - Nominal) as a % of GDP



Source: CMIE, Jefferies

India's capex cycle now clearly visible, more leg to capex upcycle before we touch previous peak of FY08.

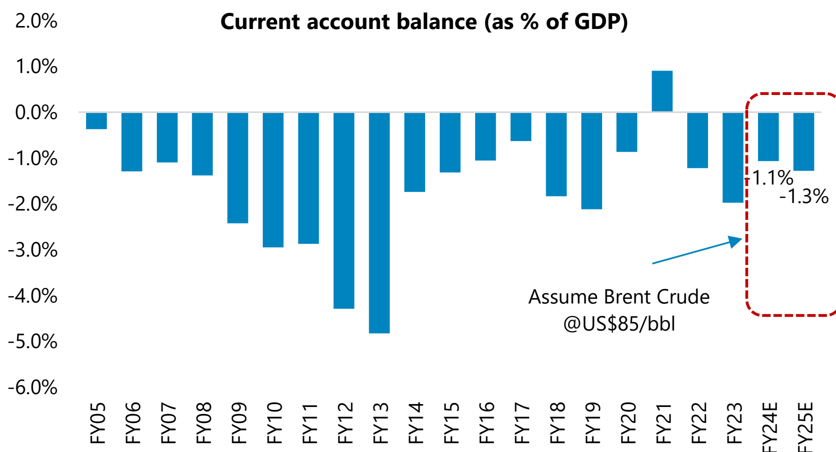
Exhibit 3 - RBI benchmark rate trend



Source: RBI, Jefferies

RBI has kept steady post its April'23 pause. We expect a 50bps rate cut by 2HCY24.

Exhibit 4 - Current account balance as % of GDP



Source: RBI, Jefferies

Current account deficit (CAD) to marginally rise to 1.3% of GDP in FY25, as surging domestic capex cycle exerts import pressure on capital goods. Overall CAD of <3% is the comfort zone.

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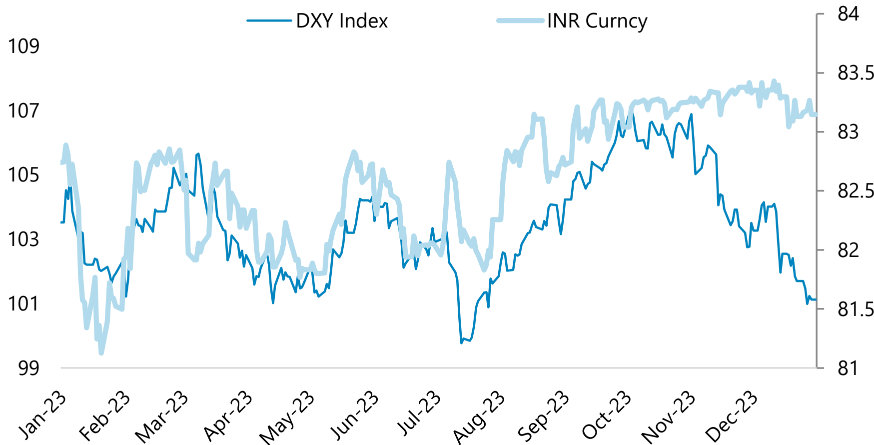
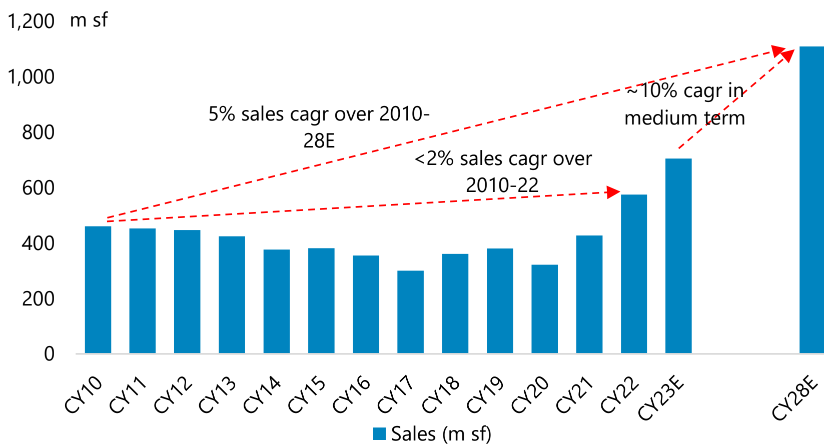
Exhibit 5 - DXY index vs INR



Source: Bloomberg, Jefferies

Despite the DXY weakness during 4QCY23, INR was stable as RBI bought USD to build FX reserves. INR could remain stable throughout CY24 as dollar peaks.

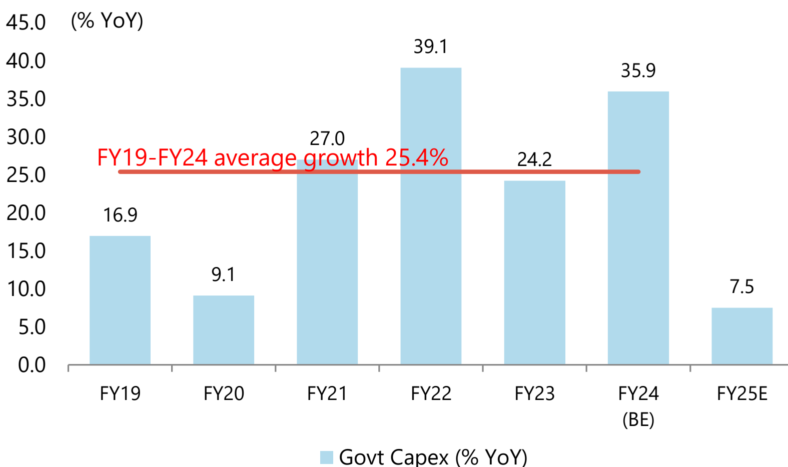
Exhibit 6 - Top-7 city housing sales



Source: Propequity, Jefferies

Property sector is witnessing a multi-year upcycle with an expected volume grow of 10% CAGR in the medium term. Value growth should be c.20%.

Exhibit 7 - Govt Capex growth (%YoY)



Source: Budget Document, Jefferies

Govt. Capex growth likely to slow in FY25e as government sticks to its fiscal consolidation plans. 25%+ capex growth would come down to single digits.

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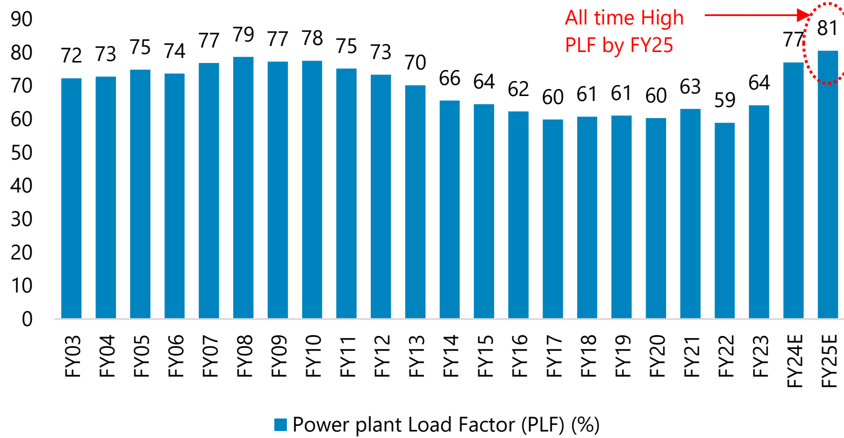
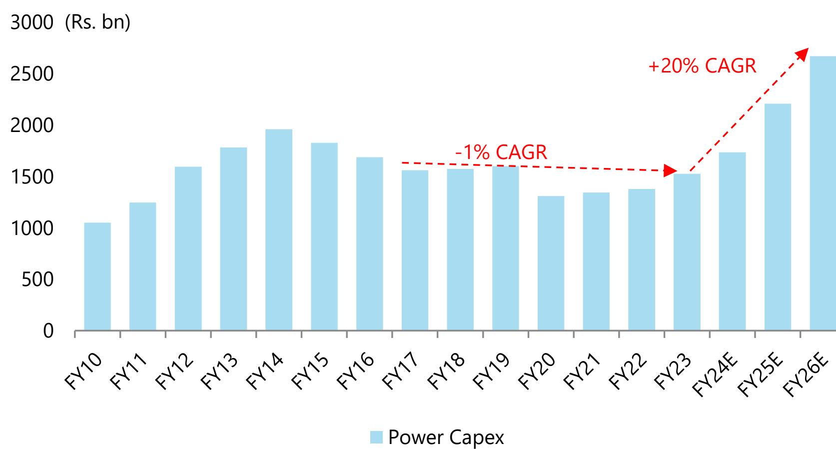
Exhibit 8 - Thermal power plant load factor



Source: Jefferies

Thermal power utilization peaking led by increasing power demand and multiple years of under investment.

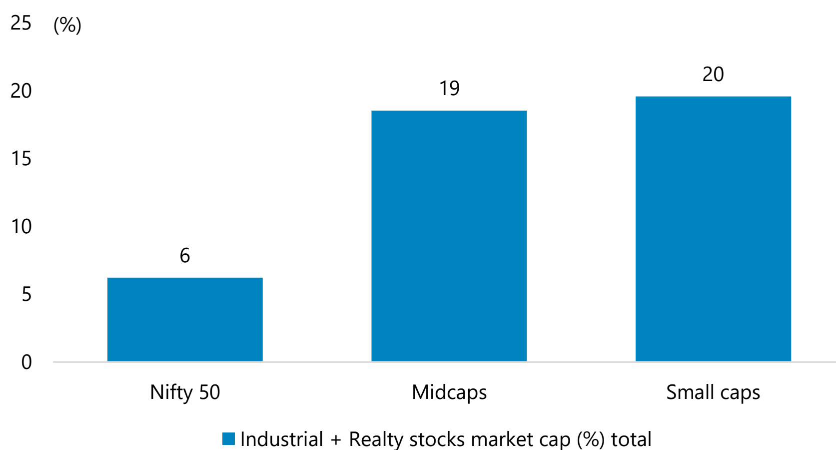
Exhibit 9 - Power Capex



Source: Company Data, Jefferies Estimate, Planning Commission

Power capacity peaking and increasing power demand is estimated to lead to 20% CAGR of power capex in next 3 years.

Exhibit 10 - Capex play (industrial + realty) market cap shares



Source: Bloomberg, Jefferies

SMID cap offers more opportunity to play the Capex upcycle theme with about 20% of their market cap focussed towards Industrial and realty sector.

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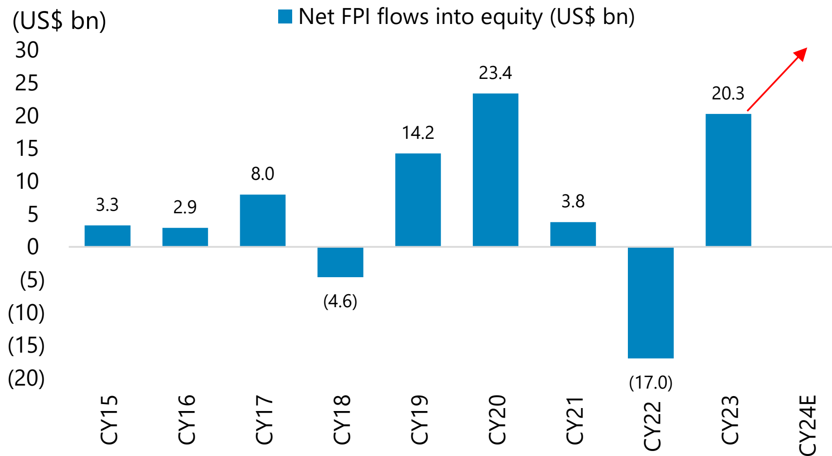
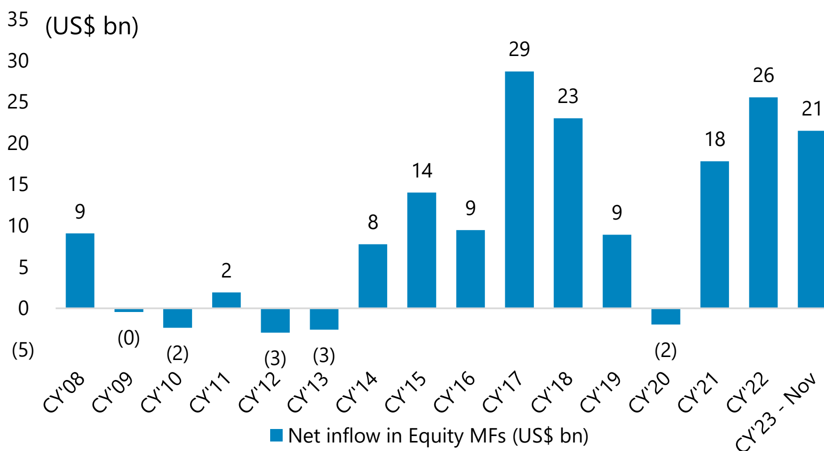
Exhibit 11 - Net FPI flows (US$bn)



Source: NSDL, Jefferies

FPI flows into equity to increase in CY24 as we expect more global mandates participation in Indian equity markets going forward. Also, currently EM funds only marginally OWT on India.

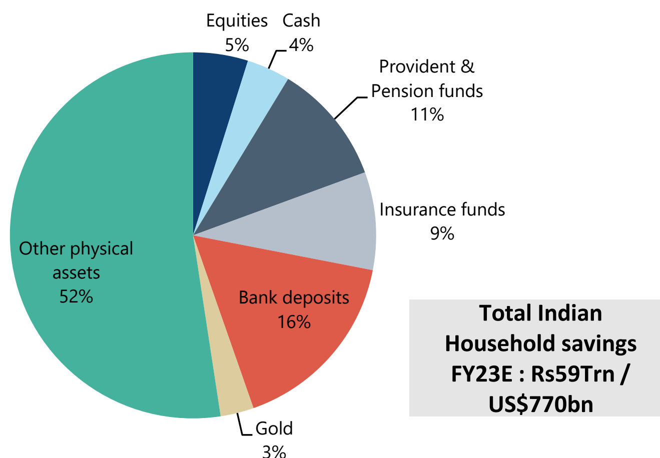
Exhibit 12 - Net inflows in domestic equity MFs



Source: AMFI, Jefferies

Domestic flows should continue to support the market

Exhibit 13 - India household asset



Source: RBI, AMFI, Jefferies

Equities accounts for only 5% of India's household assets. Also, annual household savings is US$700bn+ and these should support domestic flows into equities

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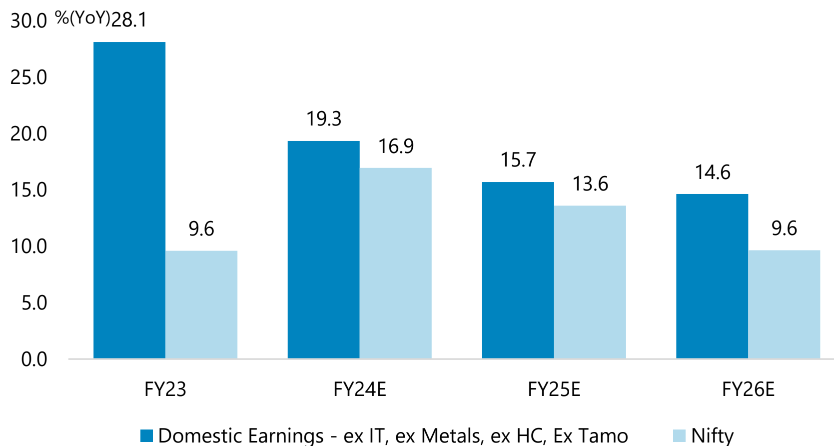
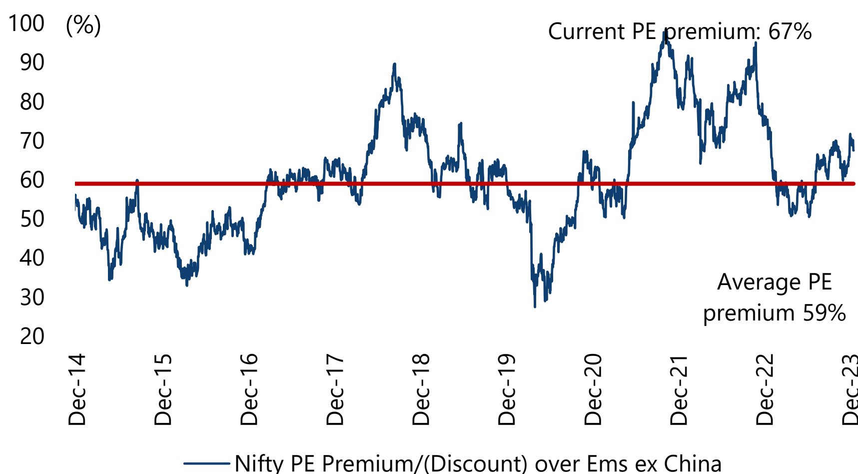
Exhibit 14 - Nifty vs Domestic earnings growth (%YoY)



Source: Bloomberg, Jefferies

Domestic earnings should grow tad faster than Nifty at 16%, on top of a 19% growth during FY24

Exhibit 15 - Nifty PE premium over EM ex-China



Source: Bloomberg, Jefferies

Nifty PE premium over EM ex-China benchmark at 67% - above average but significantly below previous peak seen in Oct'22 .

Exhibit 16 - PEG ratio of global markets

Countries	PE	EPS Growth(%) (CY24)	PEG Ratio
China	9.2	15.7	0.58
Indonesia	8.7	10.8	0.81
Brazil	8.3	9.7	0.85
Taiwan	16.0	17.8	0.90
Malaysia	13.6	13.3	1.02
Thailand	16.5	15.1	1.09
India	**22.3**	**17.0**	**1.31**
Korea	11.5	7.7	1.50
Canada	13.8	8.7	1.58
US	19.9	12.1	1.64
Japan	13.7	7.8	1.77
Euro	12.8	4.9	2.62
Mexico	13.3	4.8	2.78
Australia	16.5	4.1	4.00
UK	10.8	2.4	4.50

Source: Bloomberg, Jefferies

India's valuation looks reasonable in the context of higher growth.

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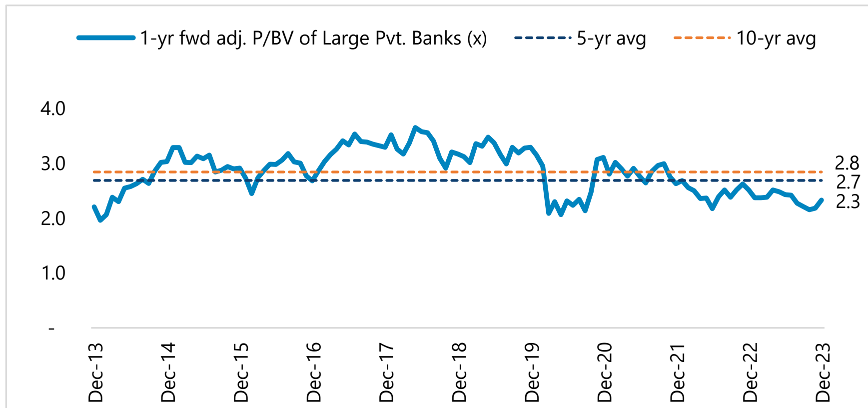
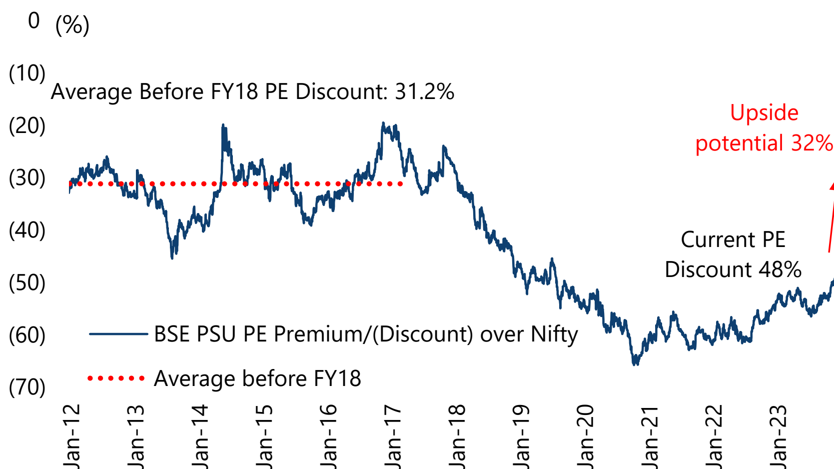
Exhibit 17 - Aggregated 1yr forward P/B of banks under coverage



Source: Jefferies

Valuation of Bank stocks under our coverage looks very attractive with 1yr forward P/B at just 2.3x, well below 5/10yr average. One of the two sectors where current valuation at a discount to historical averages...

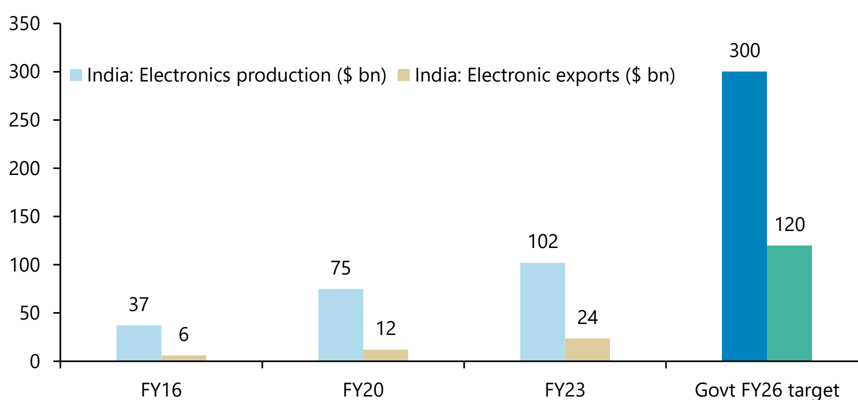
Exhibit 18 - BSE PSU index 1yr fwd preimum over Nifty PE



Source: Bloomberg, Jefferies

...the other being PSUs (or SOEs)

Exhibit 19 - India Electronics Production vs Export



Source: Govt of India, Avalon, Jefferies

Electronics to play a major part in India's China +1 strategy with strong jump in production and exports by FY26

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Exhibit 20 - Jefferies India Model Portfolio*

Stock/Sector	Neutral Wt.	Jefferies Wt.	Stance
Financials	**26.1**	**30.8**	**OWT**
Axis Bank	2.6	6.8	
ICICI Bank	5.2	7.5	
HDFC Bank	4.9	6.0	
SBI	1.2	4.5	
IndusInd Bank	0.0	2.8	
Cholamandalam Fin	0.5	1.4	
ICICI PruLife	0.2	1.8	
IT	**12.9**	**8.8**	**UWT**
Infosys	5.2	6.4	
TCS	3.5	2.4	
Energy	**10.4**	**5.9**	**UWT**
RIL	8.0	5.9	
Telecom	**2.9**	**4.1**	**OWT**
Bharti Airtel	2.4	4.1	
Consumer Staples	**8.8**	**5.7**	**UWT**
Godrej Consumer	0.5	2.0	
Honasa Consumer	0.0	2.3	
ITC	1.4	1.4	
Consumer Disc.	**13.0**	**11.5**	**UWT**
Eicher Motors	0.6	3.6	
Tata Motors	1.3	3.3	
TVS Motors	0.5	4.7	
Materials	**7.3**	**8.9**	**OWT**
Tata Steel	1.0	2.9	
Hindalco	0.8	3.0	
Ultratech Cement	1.2	3.0	
Healthcare	**4.9**	**4.8**	**Neutral**
Max Healthcare	0.5	3.0	
Sun Pharma	1.2	1.7	
Industrials	**8.2**	**8.9**	**OWT**
Larsen & Toubro	2.4	2.4	
Kajaria Ceramics Ltd	0.0	3.0	
Adani Ports	0.5	3.4	
Power/Utilities	**4.4**	**8.1**	**OWT**
Coal India	0.6	3.0	
NTPC	1.4	2.8	
JSW Energy	0.0	2.3	
Real Estate	**1.0**	**2.6**	**OWT**
Godrej Properties	0.3	1.2	
Lodha	0.3	1.4	
Total	**100.0**	**100.0**	

Source: Bloomberg, Jefferies, *Neutral weights are based on MSCI India

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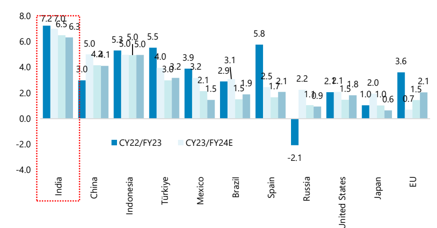
India - one of the few bright spots globally

While global growth is expected to slow down in CY24, we expect India's GDP growth to be a strong 7.0% in FY24 and a further 6.5% in FY25. Similarly, we expect corporate earnings growth to be a strong c.15% in FY24 and FY25. For the domestic cyclical sectors, strong earnings growth should continue well into FY26 also. As against this, several large markets will likely witness earnings growth deceleration into CY24 and CY25. This coupled with favorable geopolitics should raise investor interest in Indian equity markets.

India stands out on GDP growth outlook... Driven by renewed capex cycle, well capitalized banking system, robust credit growth, upturn in housing sector, robust domestic consumption & growing Services exports, India has been the fastest growing large economy globally over the last 2 years. GDP has grown at a strong 7.7% in 1HFY24, much ahead of consensus estimates. The long dormant capex cycle, both in housing and corporate, has just started picking up and should be a significant growth driver over the remainder of the decade. IMF estimates India to contribute 7-8% of the world's incremental GDP over 2024-2028, as the growth momentum sustains over the next several years.

Exhibit 21 - Real GDP growth



Source: IMF, Jefferies estimate for India (FY)

...and also corporate earnings growth outlook. Nifty earnings have risen at a 21% cagr over FY20-24E, matching pace with the Nifty 50 index rising by 77% during the past 4 years. Earnings outlook is still robust for FY25/CY24 as rising corporate spending and strong bank balance sheets anchor earnings growth in mid-teen over the medium term. Compared with the other EMs/major economies, India has shown more robust and consistent earnings performance. Visibility of India's cyclical upturn, full-blown capex cycle, robust demand and expected interest rate easing in 2HCY24 gives us enough confidence in Indian companies to deliver 15%+ earnings growth next year.

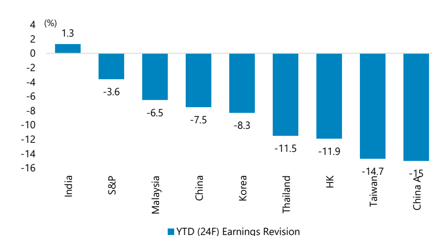
Exhibit 22 - Corporate Earnings growth

Countries	CY22/21% Growth	CY23/22% Growth	CY24/23% Growth
Taiwan	6.2	-28.2	17.8
India	**16.0**	**12.0**	**17.0**
China	-11.4	0.8	15.7
Thailand	13.2	-8.5	15.1
Malaysia	-1.7	-5.5	13.3
US	5.3	-0.2	12.1
Indonesia	41.2	-8.3	10.8
Brazil	16.1	-21.4	9.7
Canada	19.6	-11.7	8.7
Japan	-4.3	20.2	7.8
Korea	-11.3	-38.6	7.7
Euro	18.4	0.8	4.9
Mexico	15.6	20.6	4.8
Australia	15.4	-11.3	4.1
UK	32.3	-9.8	2.4

Source: MSCI, Bloomberg, Jefferies

India's earnings revised upwards for CY24: The earnings estimates for Indian cos are also proving resilient, as the better than expected GDP growth creates strong demand conditions. India is among the only major markets to see its EPS revised upwards for 24F, in 2023 whereas all the other major EM economies as well as US saw earnings revised downwards. Empirically it has been seen that upwards revision in earnings correlates with strong price performance. With cyclical story still playing out in India there is strong potential for further upside reversion in earnings and in turn in market performance for next year.

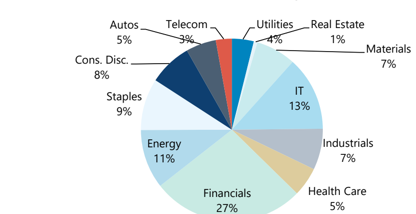
Exhibit 23 - Global market - 24F earnings revision over Jan-Dec'23



Source: Jefferies

Indian markets well diversified in terms of sectors: The India growth story is domestic driven and not concentrated in few segments, with the private sector playing the major role. The same is reflected as diversification that the Indian equity market offers in terms of sectoral split, as compared to the other EM indices. Top 3 sector contribute ~50% of MSCI India index compared to more than 60% for other regions. India market offers exposures to a well diversified sector base with some high quality companies which are reasonably liquid.

Exhibit 24 - MSCI India Sector weight



Source: Bloomberg, Jefferies

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Full blown capex cycle visible after 10 years

India's capex upcycle is visible across the two largest segments viz. housing and corporate capex now, which contribute c.75% to total capex. This is over and above the strong trend seen in Govt capex over the last 5 years. The housing upcycle is in the 3rd year of upcycle and should still have 5+ years to go. For the corporate segment, overall capacity utilisation is near 12-yr high with examples being cement & power. Even if govt. / infra capex spends cool off under budgetary pressure in 2024, we believe the large housing and corporate spending will drive the capex levels higher. Any potential correction in capex plays post budget would then become a good buying opportunity.

Capex surges. More to go. Capex (or GFCF) has risen by a sharp 11.0%/9.5% YoY in 2Q/1HFY24. The broad basing of India's rising investment cycle is well evident, but there is significant headroom here. The capex as % nominal GDP should rise to a near decade high of 30% in FY24. We believe though, there is a long way to go in the capex cycle. From the capex cycle peak of GFCF being at 35% of GDP, the investment share in the economy declined to a low of 27% in FY21. The GFCF has 3 major contributors (households, govt., and corporate). The uptick in the housing cycle (since early 2021) and government/infra capex have been more visible. Recently, data related to corporate capex (new orders & proj. announcements, financing, utilisation levels, etc.) point to the beginning of a private corporate spending upturn.

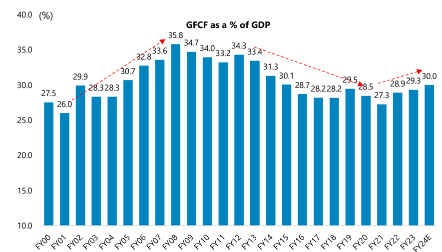
Capacity utilization levels run high Capacity utilization across sectors is trending higher and at 74.6% (Tr-4Q) in Jun23, near a 10-year high. Rising utilisation levels (e.g. cement at 10-year high, thermal power at 81% in FY25E, 8-yr high), alongside Power capex growth at a 20% cagr over FY23-26E vs. -1% over last 5 years. Bottom-up analysis shows steel and cement projected capex over FY24-25E should average 2x the past 5 years' run-rate for both sectors. Railways have emerged as a large capex driver too, with govt. spending from its budget doubled over FY21-24E.

Multiple large drivers to lead Capex. Supply chain diversification, alongside Production Linked Incentive (PLI) schemes, is driving optimism across industries. New project announcement data shows a surge in the chemicals industry - a key beneficiary of the supply chain split. The order flow with the cap goods majors (L&T, Siemens, ABB, Thermax) has risen by an average (Tr-4Q) of 28% YoY for the last 6 qtrs and up at a high 63% YoY in 2QFY24. In Housing, supply is now rising with data from Propequity showing that the new launch pace is now at all time high, up 20% YoY. The housing construction spurt bodes well for a long supply chain of building materials, electricals, cement, tile cos, etc.

Govt Capex to see limited upside, but its a small contributor: With National Election due in about 5-6 months, Government spending is expected to turn populous. The recent state elections showed that income transfer policies and other welfare schemes have been key to campaigns; and even BJP has been matching some of these poll promises. The central govt. Capex has surged by 3x over past 5-years; incremental growth from here could turn limited. However, we note that while a govt. capex surge has been a visible part of the capex cycle, its contribution to the overall capex is low at 25%. As such, any potential slowdown in govt. infra capex spends should not be material to the direction of overall capex spends in the economy.

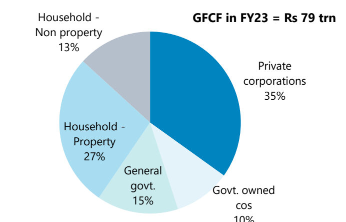
Remain capex play buyers. The recent upturns in corporate spending & housing cycle have 5+ years to go; and at 75% of capex, are its major drivers. Any potential dip in capex plays on declining confidence in govt. capex would then especially be a buying opportunity. L&T, SBI, Lodha, God Prop, Ultratech, Thermax, Polycab, KEI, Kajaria, JSW Energy, Coal are the preferred capex cycle plays.

Exhibit 25 - Gross Fixed Capital Formation (GFCF - Nominal) as a % of GDP



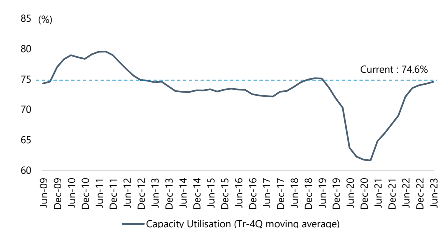
Source: CMIE, Jefferies

Exhibit 26 - GFCF brekup by institution



Source: MOSPI, Jefferies

Exhibit 27 - Capacity Utilization



Source: CMIE, Jefferies

Exhibit 28 - Order flows of L&T, Siemens, Thermax, & ABB

Source: Company report, Jefferies

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RBI rate cuts should follow the Fed with rate cuts in 2HCY24

Delayed impact of rate hikes should be visible with the expected US GDP growth slowdown in CY24. Consensus expectations are of 110bps slowdown in the GDP growth to 1.3%, Jefferies economist expects a sharper deceleration. This should pave the way for the fed rate cuts. Consensus expects 150 bps rate cut by the fed during CY24. We expect the RBI to follow suit with a lag and expect 50bps rate cut in India in 2HCY24. This should augur well for rate sensitives - property, NBFCs and capex plays.

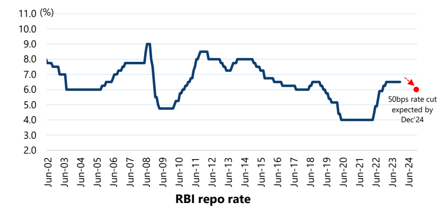
Global growth slowdown in CY24 : The impact of synchronized global rate tightening is likely to drag down Global GDP growth to a 4-year low of 2.9% in 2024, as per IMF's projections. US GDP growth is projected to decline by 0.6ppt to 1.5%, though an improvement in Eurozone from a low base will keep the overall Advanced economy growth decline contained at 0.1ppt YoY to 1.4%. Jefferies US economics team is relatively more bearish on growth, anticipating a mild recession (-0.1%).

Fed rate cuts of 150bps expected : Dec23 policy of the US Fed projected interest rate cuts of 75bps over 2024, with the Fed chair expressing comfort with inflation and as such returning to a more normalized interest rates. The consensus, however, is pricing in ~150bps of rate cuts during CY24. Chris Woods ascribes three plausible explanations for the change of commentary by the Fed. The first is that the Fed is aware of data not yet published which has caused governors to become more concerned about the economy. The second is that the Fed chairman risked losing the support of the committee and, in the spirit of maintaining a collective consensus, decided to side more with the majority opinion. The third explanation is that Powell's change of language is driven by the presidential election cycle and the significant ongoing slump in Joe Biden's approval rating.

USD has peaked : Following a largely flat year for the USD (DXY -1%), there could be a downward pressure on the USD vs. the EM currencies in 2024. DXY has actually declined by 5% from the 2023 peak. EM currency reaction was varied during the year with the INR holding up flat, and the RMB down 3%. The US rate cut / weak USD cycle is seen positively for the EM assets and FPI flows to EMs/ India should ideally pick-up in 2024. The expectations of a peaking USD / DXY would also likely give confidence to the RBI on the potential rate cuts in India.

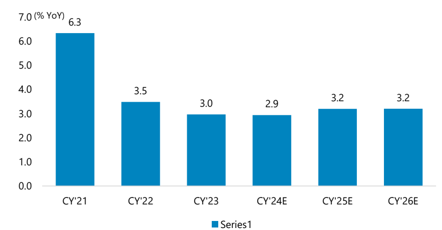
RBI rate cuts expected in 2HCY24 : The RBI has been on a rate pause since its Mar23 policy. The governor has also clarified that the central bank CPI target is actually 4% firmly. Current CPI projections from the RBI project inflation reaching the 4.0% level by mid'24. While India did not have a high inflation jump, unlike the Developed world, RBI rate hike was partly driven to support the INR as the US tightened. With US expected to cut rates in 2024, and inflation outlook benign, the RBI may consider rate cuts during the year. We expect timing for the same to be likely in 2H, as the impact of budget post elections and monsoon forecasts get factored in by that time. Our favourite rate sensitive is the property sector with Lodha developers and GPL as our top picks. We also like other housing sector plays with Kajaria, Polycab, KEI.

Exhibit 29 - RBI benchmark rate trend



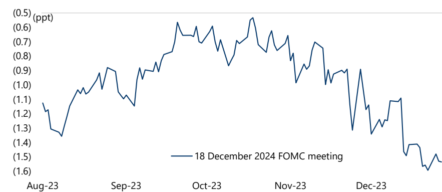
Source: RBI, Jefferies

Exhibit 30 - Global Real GDP growth



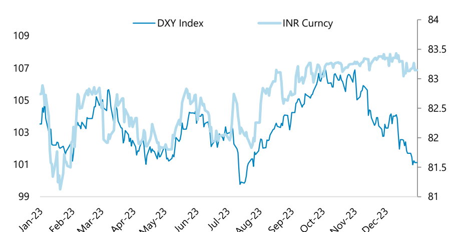
Source: IMF, Jefferies

Exhibit 31 - Implied US rate cut by Dec'24



Source: Bloomberg, Jefferies

Exhibit 32 - DXY index vs INR



Source: Bloomberg, Jefferies

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INR should hold steady in 2024

The INR has been remarkably stable during 2023 against the USD, and another year of stability appears likely. We expect current account deficit (CAD) to marginally rise to 1.3% of GDP in FY25, as surging domestic capex cycle exerts import pressure on capital goods. BoP (Balance of Payment) is expected to stay close to neutral, with India's inclusion in the global bond indices driving ~US$20bn foreign flows in debt. A declining US Fed rate scenario, alongside India's FX reserves at a 21-mth high, gives RBI headroom to manage volatility as well.

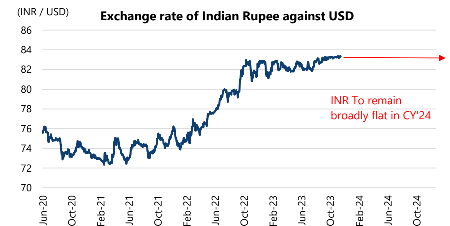
INR well managed in 2023, CAD stability to keep it that way. 2023 was a largely flat year for the USD (DXY -1%), though it has declined by 5% from the 2023 peak. EM currency reaction was varied with the INR holding up flat (among the better performing currencies), and the RMB down 3%. The RBI spent the year rebuilding FX reserves. Trade deficit has declined by 9% in 8MFY24 which has helped to reduce CAD by ~1ppt in FY24E. We build in oil@ USD85/bbl in FY25, flattish YoY. Though we expect imports to rise by ~6% YoY, essentially driven by the capex led GDP growth. Exports growth is expected to be moderate at ~4% during FY25, on weak external demand. Overall, trade deficit should expand ~9% YoY in FY25. However, India's large invisible surplus of US$207bn (>US$150bn of services exports & >US $100bn in remittances), would still grow by 3-5%. We estimate that the CAD should rise ~20bps YoY to 1.3%, fairly manageable.

Bond index inclusion to drive flows into debt. India will be included in the JPM EM Bond index from Jun-24, which could drive US$20bn inflows via the passive route. Indeed, the FPI buying of Indian debt has already ramped up in anticipation / build-up to the inclusion. If the same move is replicated by Bloomberg and FTSE, total inflows could be US$40-45bn over the next 2-3 years. Potentially higher FPI debt inflows via bond index inclusion could also drive a 'crowding in' of FX flows into other Indian assets such as equity and / or property. Earlier, years with high Debt FPI flows (FY15, FY18) have seen relatively strong INR performance (-1.1%, +4.1% respectively vs. -3.7% annual average depreciation over past decade); and as such bond index inclusion should be INR positive.

BoP at breakeven levels. We expect a US$56bn of CAD to be met from Capital account surplus of similar amount in FY25. A sharp decline in FDI flows, inline with global trends, is visible in FY24 (US$5bn in 1H, -77% YoY). FDI flows should likely improve in FY25 as the decline in developed market interest rates drive PE/VC activity higher. Strong performance of the Indian equity markets has attracted ~US $20bn of FPI inflows in equities during 2023. While we do not build in any FPI inflows in equity in our FY25 forecast, the debt markets are likely to receive US$20bn of net inflows (as above), helping drive BoP to neutral levels.

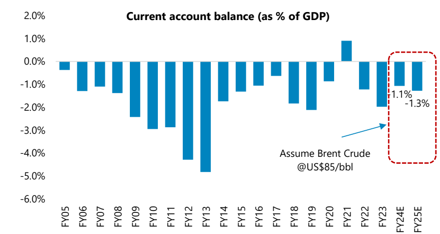
Comfortable situation for the RBI likely on INR. The INR is flat vs. the USD during CY23. Even as BoP turned positive during the year, the RBI has utilized the same to build up its FX reserves (+US$58bn). The FX reserves provide an ~11mth cover to imports, and are thus fairly comfortable. We expect that the fed rates to see cuts during late 1Q/2QCY24, which would provide further support to the INR. With RBI unlikely to cut rates in 1H24 (elections during 2Q, CPI forecast still >4%); the INR should remain well-supported during the year. Any excess FX flows could then be utilized to support domestic liquidity requirements.

Exhibit 33 - INR trajectory



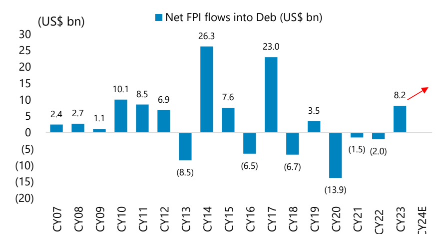
Source: Factset, Jefferies

Exhibit 34 - Current account balance as % of GDP



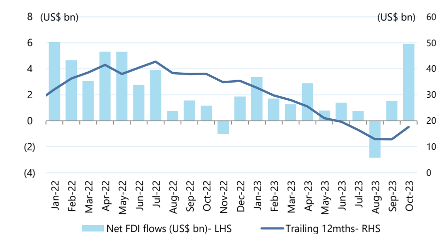
Source: RBI, Jefferies

Exhibit 35 - Net FPI flows into debt (US$ bn)



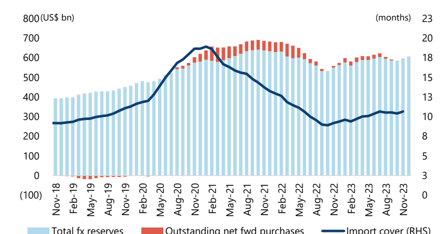
Source: NSDL, Jefferies

Exhibit 36 - Net FDI ($bn)



Source: MOSPI, Jefferies

Exhibit 37 - RBI's fx reserves + outstanding net fwd purchases



Source: RBI, Jefferies

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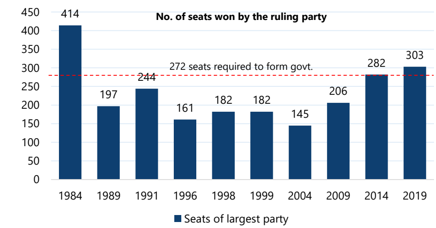
Elections 2024 - Potential political continuity would be a positive

2024 will see PM Narendra Modi contesting for his 3rd term in national election to be held in April-May 2024. With BJP performing much better than expected in the recent state elections, consensus expectations of a Modi win 2024 national elections gets reinforced. There now appears a greater likelihood of 300+seats (out of a total of 543 seats) for the BJP. A potential strong win for the incumbent would be a positive for the market sentiments due to ensuing political stability and continuity. Domestic cyclical would get a leg up.

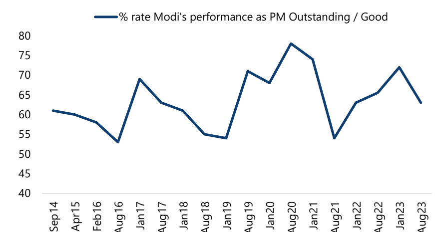
Exhibit 38 - No. of seats won by the single largest party



Source: ECI, Jefferies

BJP on strong footing for national election 2024: The high popularity enjoyed by PM Modi (approval rating at 60-70% thru his tenure) remains a major contributing factor to BJP's performance, and will likely play an important role in 2024 elections. The recent state govt. polls show that party remains fairly popular in the core Central/West/North part of India. We believe that the BJP is likely to win back the 200+ seats it has won consecutively in 2014 & 2019 from the 7- large states (UP, MP, Rajasthan, Gujarat, Maharashtra, Bihar, Karnataka). The party can also secure another 90-100 seats (96 in 2019) out of 170 other smaller contributing states which include Chattisgarh, Telangana, Delhi, Jharkhand, Assam, West Bengal etc. As such, we believe a repeat of 300+ seats is now a possibility.

Exhibit 39 - PM Modi's performance rating



Source: India Today, Jefferies

Anti-BJP alliance still fragmented: The anti-BJP opposition alliance 'I.N.D.I.A.' was not active in the recent state elections. The parties under alliance have not been able to yet formulate seat sharing plan for the national elections. It was expected that Congress' performance in the state polls will likely form the basis for INDIA alliance seat negotiations for 2024. Loss of Congress party in the 3 major states of Rajasthan, Madhya Pradesh and Chhattisgarh will reduce its bargaining power in the Bloc resulting in a weak opposition. Our seat-by-seat vote-share analysis of 2019 national elections show that the alliance could win 20 more out of 543 national seats if alliance formation is efficient.

Exhibit 40 - Update from "INDIA" Alliance party leaders

Leaders	Party	Comment
Nitish Kumar	JD(U)	Congress busy with polls, INDIA Alliance not moving
Omar Abdullah	National Conference	All is not well with INDIA alliance
Akhilesh Yadav	SP	Congress party not trust worthy
Saamna "Publication"	Shiv Sena	The misuse of power has to be stopped and democracy has to be restored and for that Congress needs to win elections
Arvind Kejriwal	AAP	"India Alliance" is for national elections and not state elections, Give us one chance, Madhya Pradesh, you will also forget BJP and Congress governments

Source: Media Articles, Jefferies

Poll Promises turns populous, more in budget ahead: Both BJP & Congress tried to woo the voters in the recent state elections by providing freebies particularly to Below Poverty Line (BPL) people. Some common promises include income transfer to married women (Rs10k/annum in Rajasthan by Congress, Rs1,250/mth in MP by BJP) & landless-farmers (Rs10k/annum by both BJP & Congress in Chattisgarh), farm loan waivers (all states by Congress, interest waiver in MP by BJP), subsidy on cooking-fuel (Rs300-500/cylinder by all parties) & electricity bills (100-200 units/mth free), one-time grants (10gm Gold on marriage) etc costing about 1.5%-2% of State GDP.

Exhibit 41 - Major welfare policies ahead of national elections

Election	Party	Policy
2009	Cong	National farm-loan waiver scheme
		Rural employment guarantee expansion
2014	Cong	National food security Act
		Land acquisition law changes
2019	BJP	Farmer basic income scheme
		Higher MSP increase
2024E	BJP	Not Yet Known/Announced

Source: Jefferies

BJP's strong performance in state polls notwithstanding, we believe that the tilt to welfare policies should gain momentum in run up to Apr-May24 polls. The upcoming budget may have some large new welfare scheme announcements, similar to the farmers direct income transfer announced before 2019 polls.

The market outlook. Out of the last 4 national elections, the previous two elections results were more on the expected lines but yet the Indian market outperformed MSCI AxJ during the election results period (10 days incl results impact) by 5-9ppts. In the previous 6 months leading up to the election week India outperformed before 2014 elections but was inline for 2019 elections. With a strong win by BJP in 3 key state elections in the state of MP, Rajasthan and Chhattisgarh; we believe that political continuity is the most likely outcome, though the margin of victory could be narrower. We therefore OWT on capex recovery plays including banks, industrial, power and property

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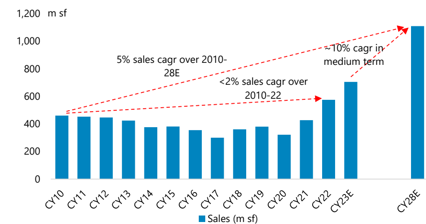
Housing cycle upturn in its 3rd year, easily 5 more years to go

The Indian housing cycle started an upswing in late'2020, following a 7+ year long consolidation. Housing sales have since doubled, and supplies are still only catching up; though the long consolidation means that we still have ~5 years in the upcycle. Huge pent-up demand, 12-year low inventories, stable mortgage rates and mid-cycle affordability should support a resi vol rise 10%+ in 2024 and for the next 5 years, with upsides possible if mortgage rate cuts and / or govt. policy support. Developers have delivered strong growth, amid disciplined spending, driver of higher multiples. Godrej Properties & Macrotech are our top picks.

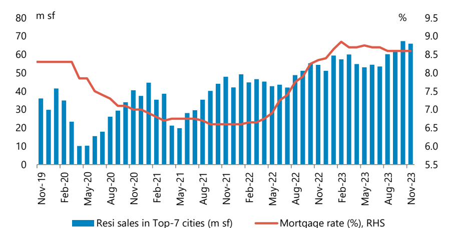
Exhibit 42 - Top-7 city housing sales



Source: Propequity, Jefferies

Residential demand staying resilient. The Indian housing market has seen volumes surge ~25% YoY in 2023, doubling in 3-years and topping the levels of previous cycle peak already. We expect the upturn to enter its 4th year in 2024, though with vols having already moved up significantly, vols growth should cool to ~10%. Mortgage rates have risen by ~225bps from their 2020-21 lows, though stable since Mar23 and back to pre-COVID levels. Our volume forecast builds in flat mortgage rates, and any cut could be a tailwind to vols, particularly at the affordable end of the market.

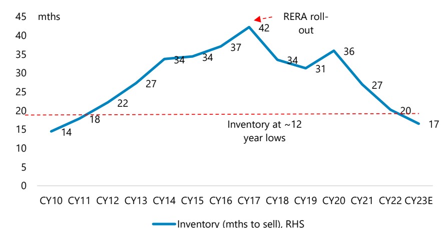
Exhibit 43 - Residential sales vs. mortgage rate trend



Source: Propequity, SBI, Jefferies

Price hikes to continue, limited regulatory risk. Housing supply has started matching demand in 2023, though in sales velocity terms, supply is down to near all time lows of ~16-17 months. Pricing has kept rising thru 2023, with ~12% average YoY increase. However, rise is much more in NCR (25%+, doubling in 3-yrs) and Bangalore (+15% in 2023) vs. MMR (<10%). Price hikes are following local inventory trends, with low NCR inventory driving sharp pricing gains. We believe price hikes of 5-10% are likely in 2024, though gains could be front ended as potentially rising supply, caution around elections and some impact on affordability to be felt. Much higher price hikes may also risk attracting regulatory action, with for example, RBI recently tightening consumer lending regulations a case in point.

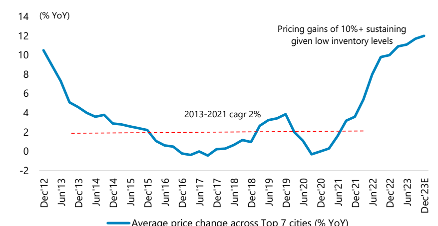
Exhibit 44 - Residential inventory in Top-7 cities (Tr-12 mths)



Source: Propequity, Jefferies

Developers in expansion mode as consolidation is still on. Geographic expansion is part of a strategy to take advantage of underlying consolidation in the real estate space. 2023 has seen the listed developer space increase its risk appetite with Oberoi (NCR), DLF (MMR), Lodha (Bangalore) expanding beyond their home turfs after a very long time. Some of these initial new project additions have been via partnership models, but we believe as deal competition rises, balance sheets will need to be deployed. Given the limited pool of capital outside the one available to large, listed developers; the consolidation in the sector is unlikely to unwind in 2024.

Exhibit 45 - Residential pricing trend in Top-7 cities



Source: Cushman & Wakefield, Propequity, Jefferies

Strong rally builds potential rate cut gains. Broad basing beyond luxury likely. The Nifty realty index has O-PFed the market by 60ppt in 2023, marking a strong turn since RBI paused on rate hikes in Mar23. A potential rate cut in 2024, as global rates likely head down, would be seen positively for developers; though the strong rally in stocks does build in some of these gains. We also note that while property sales have favored premium & luxury housing in this upturn so far; a potential rate cut could actually help the affordable housing segment more. Moreover, the government is reviving its interest subvention scheme for affordable housing, which was wound down in FY22. We favor developers with a broader range of products, instead of just at the top end which includes Godrej Prop and Macrotech.

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Budget to signal Govt capex spend growth slowdown

The central govt. has committed to a path of fiscal consolidation to bring down fiscal deficit to 4.5% of GDP by FY26. This implies FY25E expenditure growth could be limited to about 7-8% YoY. Strong tax collections and subdued social spending allowed the Govt to raise Capex 3x over past 5 years. Incremental Govt capex growth would be likely in single-digits. The approaching national elections imply welfare spending imperative is high as the PM campaigns on 'Modi's guarantees' and same may be visible during the 1st Feb interim budget. Post elections, we see a risk of higher taxation & a disinvestment push too as deficit reduction gains focus.

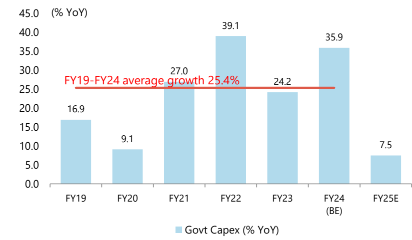
Fiscal consolidation limits spending headroom. The fiscal deficit jumped to a high of 9.2% in FY21, vs. a pre-COVID level of 4%. A process of fiscal consolidation was laid out subsequently under which, government's commitment is to cut fiscal deficit by 1.4ppt over FY24-26E to 4.5%. As such, we estimate FY25E fiscal deficit target at 5.2% of GDP. Assuming the tax revenue growth at ~12.5% (similar to FY24E, driven by 11% nominal GDP and 15% corporate earnings growth); the total expenditure growth would have to be limited to ~7% (vs. 9% in FY24E). The current Government is known to be a fiscally prudent Government, and we do not believe that the FY26 fiscal deficit target of 4.5% would be tinkered around. As it is, 4.5% is higher than pre-covid (FY19) fiscal deficit of 3.4%.

Welfare spending pressures high in an election year. The recent state elections showed that income transfer policies and other welfare schemes have been key to campaigns; and even BJP has been matching some of these promises. The est. cost of such schemes has been around 150-200bps of GDP at the state levels. Prior to the 2019 elections also the budget had carried large welfare scheme in the form of income transfers to farmers. Ahead of 2024 polls, while a large new scheme is possible, some popular schemes of BJP may also get expansion / extra resources to boost implementation rates such as Housing for all, health insurance etc. Government's farmer's cash transfer scheme of Rs6000/ farmer/year may see an increase. Overall, we expect the social spending of govt. (ex subsidies) to rise by ~7-8% in FY25E against a c.3% increase in FY24E.

Govt Capex growth headroom is limited. The central govt. Capex has surged by 3x over the past 5-years, taking the govt. capex to GDP ratio to all-time-high 3.3% of GDP in FY24. The incremental growth from here could turn limited, at least in FY25, as welfare spending pressures & budget consolidation takes a toll. We expect only about 7-8% growth in govt. capex budget for FY25E. This low number might disappoint the market; and stocks exposed to the Government capex program may see some correction. That's the reason why we have lowered L&T's weight in our model portfolio to neutral and transferred the same to Adani Ports. Some stocks exposed to railway and defence capex program may also be subdued. But we do not believe that this will derail the whole capex cycle as 75% of the capex in the economy is housing and private corporate related which has a multi-year upside ahead.

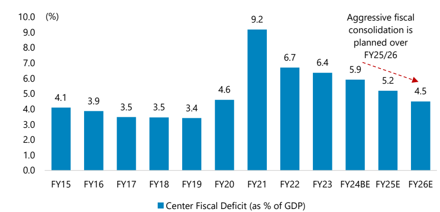
Disinvestment pressure to rise, taxation increase cannot be ruled out post elections. The pressure to raise welfare spending amidst a consolidating fiscal would imply a search for revenues. While we do not expect an immediate tax hike, considering elections, some post election measures such as higher capital gains tax are possible during the year. Disinvestment may also get ramped up post elections, partly as the government capitalizes on the sharp run in PSU stocks in sectors such as railways, defence etc.

Exhibit 46 - Govt Capex growth (%YoY)



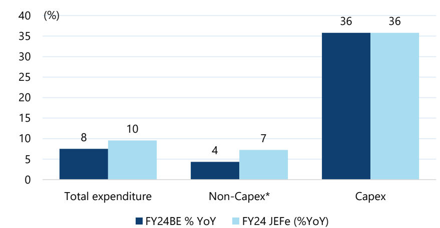
Source: Budget Document, Jefferies

Exhibit 47 - Central government fiscal deficit to GDP trend



Source: Budget documents, Jefferies

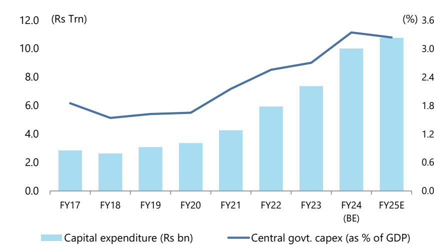
Exhibit 48 - Central Govt expenditure estimates



Source: Ministry of Finance, Jefferies

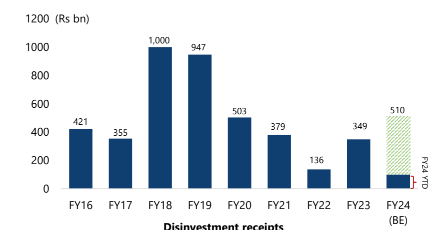
* Expenditure, including state tax transfer ex interest and subsidies and Capex.

Exhibit 49 - Central government capital spending trend



Source: Budget documents, Jefferies

Exhibit 50 - Disinvestment receipts



Source: Budget documents, DIPAM, Jefferies

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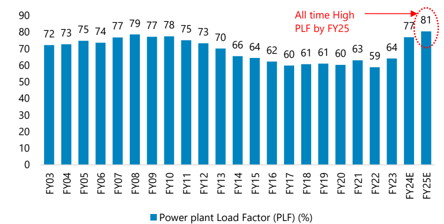
Power – An attractive 3-5 year story

With power demand likely to grow 7% cagr, we expect thermal power plant operating rates (PLF) should reach an all time high of 80%+ in FY25E. This tight demand supply should sustain for the next 2-3 years if not longer. Growth in power sector (generation and T&D) capex is expected to jump 10x during FY24E-30E vs FY17-23. NTPC, Power Grid, Coal India and JSW Energy are our top picks from the perspective of the multiple rerating. Coal India could possibly surprise on the volume growth leading to EPS surprise on the positive.

Decade of underinvestment to drive growth ahead: Our power demand estimates of 7% CAGR in FY23-30E factors residential and manufacturing-linked demand, data centres, and other industries witnessing similar demand to that of FY04-10, which was the last capex upcycle. Thermal plants are running at 75-78% PLF annually on an average, below potential peak levels of 80-85%. However, peak deficit periods are on the rise, with current thermal utilisation close to all-time high of 80%+. Capacity addition acceleration is critical for ensuring regular deficit periods do not begin FY26E onwards. The government's 450 GW Renewable Energy (RE) capacity target by 2030 should see India setting up at least 308 GW RE by then.

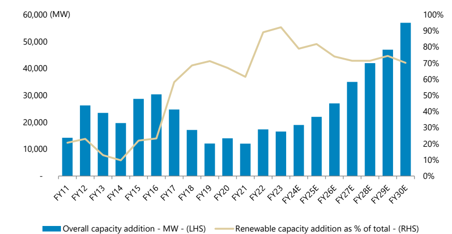
Exhibit 51 - Thermal power plant load factor



Source: Jefferies

Thermal capacity addition to move to c.15 GW annually from 2-5 GW run-rate since FY18: RE plants operate at less than 30% utilisation and are at their peak in the day. Thermal is needed for baseload generation to supply at night and also back-up RE if there is generation volatility. Our power demand estimates factor 7% CAGR in FY23-30E as capex drives GDP growth, similar to FY04-10. All-India power generation capacity needs to move to 665 GW by FY30 from 416 GW in FY23 to avoid regular power deficit and should drive Thermal capex. Thermal power capex is key to enhancing baseload power supply in the evenings and the night when solar is not active. India has ample coal reserves but the mining activity needs a step up to meet the demand. Last 3 years volume growth for Coal India was c.10% cagr. If the same thing gets repeated over the next 2, it would be a positive surprise.

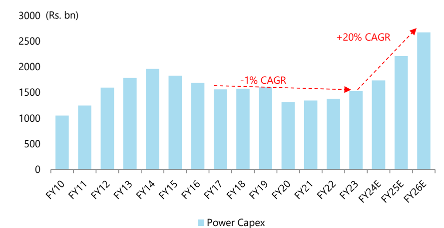
Exhibit 52 - Power Capacity addition



Source: Jefferies

Power Transmission bid pipeline up more than 3x YoY: FY23 transmission pipeline was less than Rs100 bn. Power Grid on its call mentioned that Rs597 bn bids are in tendering stage and another Rs670 bn is expected to be added. Power Ministry simplifying approval processes is helping speed up awards. A material share for this is linked to green energy corridors to support RE addition. We expect the earnings growth for Power Grid and NTPC, however, will stay subdued over the next 2 years. NTPC's earnings growth should revive beyond FY26.

Exhibit 53 - Power Capex



Source: Company Data, Jefferies Estimate, Planning Commission

Return discipline important for capacity addition to translate to growth: We believe the current backdrop increases probability of regulated ROE being stable or 50 bps cut at most. Any ROE reduction reduces available equity cash flows for investment. 10-year G-sec rates are 7.2% vs 7.8% when the previous regulated ROE document was published. This augurs well for NTPC (Buy) and Power Grid (Buy) on a regulated business. On competitive bidding, given access to lowest rates, they are in a better position to generate profitable growth. JSW Energy (Buy) should benefit from timely commissioning of 700 MW merchant power plant and renewables rising to 81% of capacity from 52% over the next 5-7 years.

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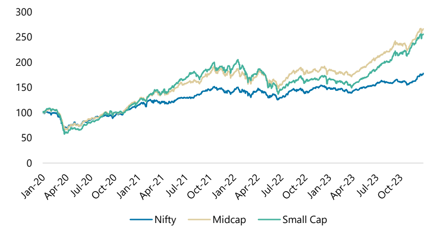
Large cap catch-up to continue in early 2024

After a 25-35ppt Outperformance, by Mid/Small cap indices, 2024 could start with a bias rotation towards larger caps. A reason for SMID outperformance has been the lack of capex plays among the large caps. SMID caps offer a bunch of options to play the industrial recovery. Early rotation signs in December has seen large caps outperforming midcaps. Positioning in Financials is light with domestic OWT near multi-year lows. A potential budget disappointment on capex could cause a sector rotation early in 2024. Among the larger caps, we prefer banks to IT & staples, to play the rotation.

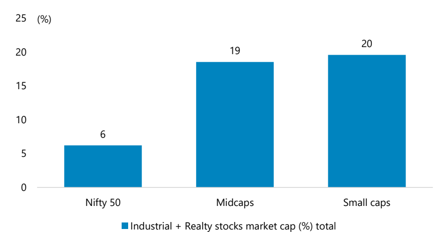
Exhibit 54 - Mid&Small cap index performance compared to Nifty



Source: Bloomberg, Jefferies

SMID Outperformance reflects capex cycle uptick... The Domestic capex cycle recovery is a key theme driving SMID cap outperformance. The capex plays are important portfolio weights for the medium to long term investors. However, there is a dearth of such ideas among large caps with only 3 Nifty-50 components/5% market cap belonging to this direct capex play (industrial & realty) group. However, 18-20% of SMID market cap is spread over the industrial & realty cos; necessitating the reach among the lower mid cap names to play the cyclical story.

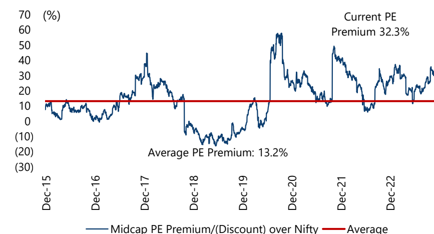
Exhibit 55 - Capex play (industrial + realty) market cap shares



Source: Bloomberg, Jefferies

....valuations, budget headwinds can drive rotation to large caps. The sharp outperformance of SMIDs during 2023 has led to valuations becoming a challenge now. At 27x 1-yr fwd PE, the Nifty Midcap100 index trades at 35% premium to its average valuations, vs. a <20% premium for the Nifty 50. This makes the SMIDs susceptible to a sharp sell-off. We believe that the budget / approaching elections may disappoint on govt. capex, creating a possible trigger for sell-off in parts of SMID universe, particularly among industrials, select PSUs etc.

Exhibit 56 - Midcap 100 PE premium/discount over Nifty Index



Source: Bloomberg, Jefferies

Sector positioning, valuations hint at possible 2024 rotations. Dec23 has seen a 8% rise in the large cap Nifty50, leading the Midcaps by 2ppt. Large cap banks have OPFed Nifty. Some positive shift has been seen into IT (US rate declines) and RIL. Staples haven't seen any benefit from the rotation trade.

Valuation check of the Top100 stocks shows that while only about 1/3rd of the stocks are below their 10-yr average on valuations; the bucket is dominated by financials and select SOEs. We also note from our BSE500 shareholding analysis that Financials positioning has significantly lightened with the domestic OWT on the sector at a multi-year low of 1.2ppt, much below the peak 4.9ppt OWT seen in Mar22.

On the other hand the IT UWT at 0.3ppt, is among the lowest for domestics in the same period and the IT cos are trading at premium to their average valuations, despite a weak revenue cycle.

Exhibit 57 - Domestic MFs weight & positioning compared to benchmark as of Q2FY24

Sector	DMF WT	DMF OWT/UWT
Consumer Staples	6.7	(2.7)
Energy	6.1	(1.7)
Materials	9.1	(0.8)
Information Technology	9.6	(0.3)
Utilities	3.7	(0.1)
Real Estate	1.0	0.1
Industrials	10.6	0.6
Communication Services	3.5	0.6
Financials	30.9	1.2
Health Care	6.8	1.4
Consumer Discretionary	12.0	1.7

Source: Ace Equity, Jefferies

Benchmark is BSE 500 index for neutral weight

Large cap banks preferred space. We believe that a sell-off in SMID space and/or a budget driven scare in capex spends can drive a shift to the large caps early in 2024. Within the large caps, we have a large OWT position on Financials, primarily banks. The NSE Bank index has UPFed the Nifty by 5ppt in 2023, and valuations are much more inline with longer term averages. The banks also offer superior growth trajectory with loan growth at 15%+ and balance sheets strong with historically low NPL ratios and high capitalisation levels.

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Exhibit 58 - Nifty 100 index stocks PE/PB premium/discount to its 5/10yr avg

Company	Current PE/PB	Premium/Discount to 5yr avg. (%)	Premium/Discount to 10yr* avg. (%)
Indus Towers Ltd	8.6	(31.5)	(53.6)
Bandhan Bank Ltd	1.5	(44.3)	(49.4)
SBI Cards & Payment Services Ltd	24.0	(36.3)	(36.3)
Hindustan Petroleum Corp Ltd	5.2	(20.0)	(34.7)
Bharat Petroleum Corp Ltd	6.8	(25.0)	(32.8)
Petronet LNG Ltd	9.3	(19.2)	(31.2)
IndusInd Bank Ltd	1.8	2.9	(29.5)
Kotak Mahindra Bank Ltd	3.4	(26.3)	(29.1)
Oil & Natural Gas Corp Ltd	5.2	(4.1)	(28.0)
Piramal Enterprises Ltd	0.7	(4.2)	(28.0)
Indraprastha Gas Ltd	14.5	(33.9)	(27.3)
HDFC Bank Ltd	2.6	(16.5)	(22.6)
HDFC Life Insurance Co Ltd	9.1	(16.6)	(21.8)
Indian Oil Corp Ltd	6.2	(2.4)	(21.0)
ICIC Lombard General	5.3	(20.4)	(20.3)
GIC	1.0	6.5	(17.0)
Dr Reddy's Laboratories Ltd	17.9	(17.6)	(16.7)
Biocon Ltd	26.6	(17.9)	(14.3)
Motherson Sumi Systems Ltd	17.0	(13.9)	(13.8)
UPL Ltd	11.3	(7.1)	(13.5)
ACC Ltd	20.1	(2.7)	(10.9)
Eicher Motors Ltd	25.8	(2.3)	(10.7)
Coal India Ltd	8.5	30.1	(10.2)
Maruti Suzuki India Ltd	23.0	(19.9)	(9.6)
GAIL India Ltd	10.0	9.4	(9.6)
Avenue Supermarts Ltd	78.4	(11.3)	(8.4)
HDFC Asset Management Co Ltd	9.4	(6.6)	(7.0)
ICIC Pru Life	6.3	(4.2)	(6.5)
Berger Paints India Ltd	48.5	(20.5)	(3.7)
Bajaj Finance Ltd	5.5	(19.0)	(1.8)
Cadila Healthcare Ltd	20.4	3.6	(1.4)
United Spirits Ltd	54.7	10.3	(1.3)
Cipla Ltd/India	23.4	0.7	(0.9)
Bajaj Finserv Ltd	3.5	(18.3)	1.4
Axis Bank Ltd	2.1	9.4	5.5
Hindustan Unilever Ltd	51.1	(6.6)	5.9
SBI Life Insurance Co Ltd	8.8	6.6	6.1
Info Edge India Ltd	72.1	(19.6)	6.4
Dabur India Ltd	43.5	(6.7)	6.5
Marico Ltd	42.0	(0.8)	6.7
ITC Ltd	25.0	26.1	9.5
Asian Paints Ltd	56.2	(7.5)	9.5
Muthoot Finance Ltd	2.2	(6.8)	9.5
Hero MotoCorp Ltd	18.1	16.1	11.1
Adani Transmission Ltd	95.2	11.5	11.5

Source: Bloomberg, Jefferies

Exhibit 59 - Nifty 100 index stocks PE/PB premium/discount to their 5/10yr avg

Company	Current PE/PB	Premium/Discount to 5yr avg. (%)	Premium/Discount to 10yr* avg. (%)
Wipro Ltd	18.8	1.5	13.1
UltraTech Cement Ltd	32.3	12.3	15.1
InterGlobe Aviation Ltd	22.6	(11.9)	16.3
Sun Pharmaceutical Industries Ltd	28.4	20.4	16.7
Britannia Industries Ltd	50.5	6.5	17.0
State Bank of India	1.4	15.3	17.0
Lupin Ltd	28.8	10.1	17.3
Siemens Ltd	59.3	20.7	18.2
Adani Ports	22.6	21.0	19.0
Godrej Consumer Products Ltd	46.2	11.4	19.2
Tata Consultancy Services Ltd	27.5	4.5	20.0
Infosys Ltd	23.5	3.7	20.3
Pidilite Industries Ltd	62.5	(2.8)	21.3
Container Corp Of India Ltd	32.7	14.5	22.0
Aurobindo Pharma Ltd	17.6	37.4	22.8
Havells India Ltd	52.2	1.6	23.7
Colgate-Palmolive India Ltd	48.5	21.2	24.6
Shree Cement Ltd	42.2	9.2	24.9
Mahindra & Mahindra Ltd	3.4	43.7	26.0
Nestle India Ltd	70.1	9.8	27.8
ICICI Bank Ltd	2.8	10.9	29.8
Bajaj Auto Ltd	23.1	27.9	30.0
Bank of Baroda	1.0	55.8	30.1
Ambuja Cements Ltd	29.4	36.9	30.7
Power Grid Corp of India Ltd	2.2	35.6	33.3
Hindalco Industries Ltd	1.1	22.3	33.6
NMDC Ltd	8.6	60.6	36.6
Larsen & Toubro Infotech Ltd	32.0	19.1	37.1
Grasim Industries Ltd	2.7	43.3	37.8
Tata Steel Ltd	1.4	49.2	38.1
Larsen & Toubro Ltd	29.9	48.9	38.5
Titan Co Ltd	71.7	11.2	39.3
Alkem Laboratories Ltd	31.5	37.6	39.4
Reliance Industries Ltd	21.0	12.7	40.0
JSW Steel Ltd	2.4	26.2	40.2
Torrent Pharmaceuticals Ltd	37.4	15.2	40.3
HCL Technologies Ltd	22.8	32.5	45.0
NTPC Ltd	14.6	72.0	45.3
Punjab National Bank	0.9	67.0	46.1
Tech Mahindra Ltd	22.8	37.2	48.4
Divi's Laboratories Ltd	45.8	20.8	52.8
Tata Consumer Products Ltd	55.9	21.7	67.4
Bharti Airtel Ltd	5.1	30.9	71.0
Power Finance Corp Ltd	1.4	135.9	104.2
Hindustan Zinc Ltd	6.8	78.5	130.8
DLF Ltd	4.0	108.8	174.7

Source: Bloomberg, Jefferies

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Foreign flows to improve in CY24

India's rising prominence in the global economy and global capital markets is likely to trigger higher FPI (Foreign Portfolio Investor) flows in CY24 and in the medium term, in our view. 2023 FPI net buying of US$20bn, comes after two weak years for foreign flows. India's relative positioning is still light in EM portfolios. Rising size is making Indian markets much more relevant for global mandated funds. Meanwhile, structural positives such as the expected political stability, rising investment cycle provide multi-year growth visibility and peaking USD; is an ideal conditions for higher foreign flows.

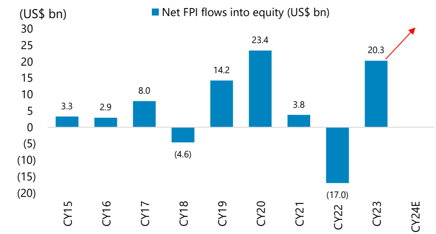
FPI flows rise, but India positioning is light. After an outflow of US$33bn from 2H21-1H22, the FPI flows reversed course and are seeing the highest inflows in last 11-years. Part of the higher flows to India are an outcome of India's rising weight in EMs wherein neutral weight in benchmark MSCI EM has increased by 3.5ppt over the past 6-quarters. Our analysis of large EM active funds though indicates that India relative positions are actually much closer to neutral now, than an average OWT of >2ppt. As such, headroom for FPIs to take a larger OWT position could become an important flow driver.

Global funds can provide next stream of capital. Indian stocks, have lagged their Chinese / North Asian peers usually in global active stock mandates, which touch ~US$5Trn in AUM. The Indian m.cap crossing US$4Trn, makes the country among the largest globally. India's weight is also rising in global benchmark indices, which alongside strong performance could attract significant discretionary flows. Already, India is an important geography for Sovereign Wealth Funds with >US$100bn invested. We note that during CY17-21 (5 years), China's northbound stock connect program drove US$235bn of foreign inflows into China A/B shares. Even during the lull years of CY22 and CY23, China A/B shares still attracted net foreign inflows. We note, therefore, that the potential for foreign inflows into Indian equities remains large.

EM flows should be stronger as US rates head down. 2024 should see a cut in US benchmark rates of 75-150bps, which is usually associated with a weak US Dollar performance and associated with incremental flows in Emerging Markets. With India's weight in EM indices at an all time high, passive / active flows into EM funds could in turn drive significant foreign buying.

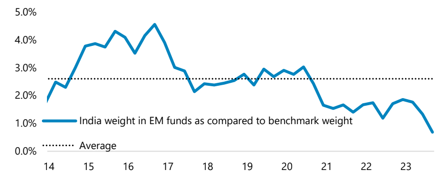
Structural positives favor India holdings. India has enjoyed political stability with a majority, reform oriented govt. in place for past 10-years and same is likely to conitinue for another 5-years, as per recent state elections and opinion polls. Internationally also, India is seen to be more closely integrating in the Western directed international supply chains. The rising capex cycle, likely still has 5+ years to go, with both housing and private corporate capex on the upswing. We believe such conditions provide ideal backdrop for patient global capital inflows into India.

Exhibit 60 - Net FPI flows (US$bn)



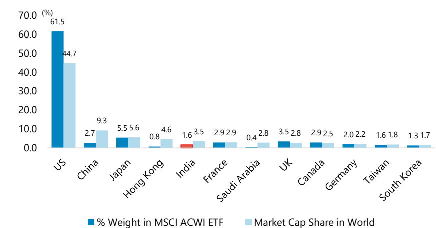
Source: NSDL, Jefferies

Exhibit 61 - India weight in Global EM funds vs in MSCI India



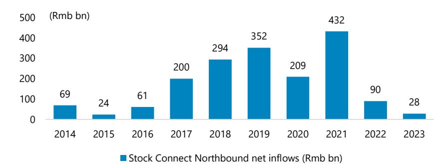
Source: Bloomberg, Jefferies

Exhibit 62 - India Weight in Ishare MSCI AC World ETF



Source: Ishare, Jefferies

Exhibit 63 - Stock connect Northbound netflows (Rmb bn)



Source: Bloomberg, Jefferies

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Strong domestic flows to act as a cushion

Domestic investors have emerged as a big support for Indian equity markets and appears sustainable. We estimate that the steady state domestic annual flows would be US$30-35bn - 2/3rd of which is in the form of a stable inflows into domestic equity mutual funds through systematic investment plan (SIP) and the balance by way of pension funds and insurance flows. We believe that the domestic flows are sustainable given only 5% of household assets in equities and Indian households save US $750-800bn annually.

Strong SIP performance, rising pension / insurance flows - a structural positive.

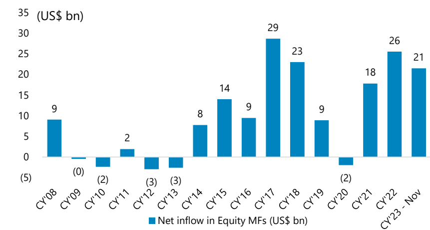
We estimate the structural flows from retail to the equity markets at ~US$30-35bn/ annum. The participation of retail via MFs has seen the monthly investing (SIP) accounts rise 23% YoY to 73m and monthly flows at US$2.1bn, +31% YoY. The SIP flows account for ~60% of the structural domestic equity flows. Insurance, and pension fund (EPFO + NPS) inflows are also large (US$10bn+/annum) and rising. Govt. mandates that 15% of the annual gross inflows in the pension scheme (EPFO) must invest in equity markets, drawing net inflows of ~US$5bn/annum. The equity allocation by insurance cos adds another ~US$5bn.

Equity still a small chunk of overall investment pie. Our proprietary analysis of India's household savings data shows that equity holdings and flows as a % of household assets and annual savings is less than 5%. Indeed, just reallocation within the savings pie is enough to sustain retail flows in the market e.g. SIPs are just ~10% of annual incremental bank deposits; and given the longer-term benefits of the former, can gain further share.

Only 4-5% of incremental savings going into equities. Indian household savings rate is about 23% of GDP and in absolute terms, Indian household savings have been growing by 10% cagr over the last 10 years. In USD terms, expected household savings (gross) during FY24 (current financial year) would be about US$855bn. Thus, the US$30-35bn of flows mentioned in the para above refer to only 3.5%-4% of the annual household savings and appear sustainable. We, therefore, believe that the equity culture amongst the Indian households is at the initial stage and can sustain and grow meaningfully from hereon. This can provide a strong cushion to the foreign flows.

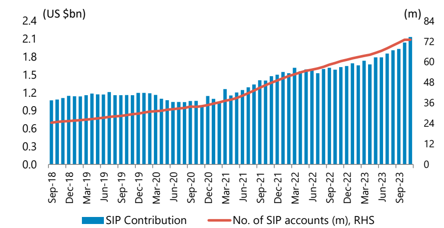
Direct retail flows still not elevated. The post-COVID surge in direct retail activity has normalized as evident in the non-institutional share of market vols which is off 12ppt from peak. Data on 'active' accounts from NSE shows an 8% decline in these accounts by Nov'23 from the mid'22 peak. Also, while the past few months has seen mid-cap stock vols rise; they are still to reach levels associated with mid-cap index peaks. Additionally, history suggests that periods of low market volatility, such as now, usually drive higher lumpsum flows. We therefore believe that the domestic investor activity is not at the previous peak level yet and given the rising financial literacy and income levels, the numbers can easily surpass the previous peaks like what seen in the SIP account trend. The number of unique accounts is about 4-5m or about 1% of the working population.

Exhibit 64 - Net inflows in domestic equity MFs



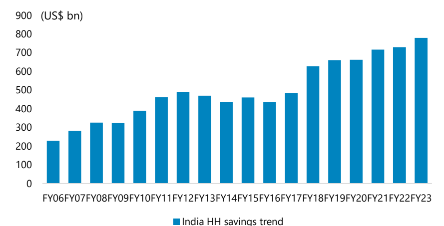
Source: AMFI, Jefferies

Exhibit 65 - SIP flows into India Equities



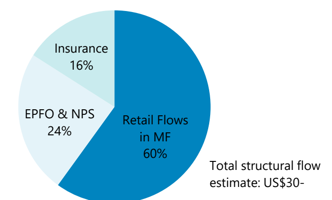
Source: AMFI, Jefferies

Exhibit 66 - Indian household (HH) savings trend



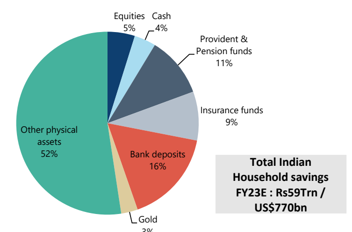
Source: RBI, Jefferies

Exhibit 67 - Structural Domestic Flows



Source: AMFI, Jefferies

Exhibit 68 - India household asset



Source: RBI, AMFI, Jefferies

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EPS growth to remain strong at 14% for FY25

Consensus Nifty earnings growth projections at 14% for FY25 appear realistic given the strong investment driven economic upcycle underway, and possibility of interest rates heading lower. Domestic earnings should grow tad faster at 16%, on top of a 19% growth during FY24. Earnings growth will be broad based across sectors with 10-15% growth projected for Financials, IT & consumer. Industrials should grow at 20%+. Margin expansion has supported earnings in FY24, and some more is likely in FY25 as stable commodity and energy costs benefits accrue during the year. Industrials, Bharti, Bajaj Finance, Tata Steel - stand outs for FY25 on earnings performance. Upside risk to banks EPS if credit costs stay low.

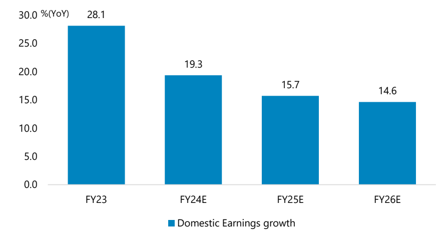
Resilient earnings growth in FY25. Over FY19-24E period, Nifty EPS has compounded at 13% cagr despite the Covid impact. Nifty consensus earnings growth, ex of the commodities (Energy and Materials sector) is estimated to grow at 15% in FY25, similar to the 16% growth forecasted for FY24. Earnings have proven resilient thus far in FY24, with downgrades of <2% seen. A robust capex spending uptick is underway which has driven GDP growth >7% in 1HFY24, supporting the earnings growth as well. Indeed, past cycle analysis and current corporate profitability levels still being below long prior peaks suggest that 12-15% earnings growth over the next few years is likely.

Margins support to earnings. Jefferies' coverage universe (ex-Energy, ex-metals) margins are projected to improve by 0.5ppt in FY25, on top of a similar 0.5ppt increase in FY24. The margin growth will clearly remain an improtant driver of the ~15% earnings growth expectations for the Nifty / domestic cos. Easing of the commodity cost pressures over past few quarters, alongside strong domestic demand and / or op. leverage are driving higher margins. Sectors which can see >50bps margin improvement in FY25 include the cyclicals (industrials, property), consumer staples, cement, chemicals and exporters (IT, pharma).

Earnings growth diversified. Upside / downside risks. Financials earnings growth is expected by consensus to decline from 20% in FY24, to 15% in FY25, but still contribute 5ppt to overall Nifty earnings growth. Upside risk to earnings is possible credit cost stays low. Capex upcycle can keep system loan growth elevated (c.15%+) and strong asset quality can drive upsides here. Among domestic cos, a high base in autos is expected to lead to earnings growth to slow from 20%+ to ~12%. While industrials are likely to enjoy the benefits of a cyclical uptick and continue with 20%+ growth. The consensus expectations for earnings growth from IT cos is for low-teens; though this can be at risk if the revenue growth recovery takes longer than estimated. Margins are supportive here now.

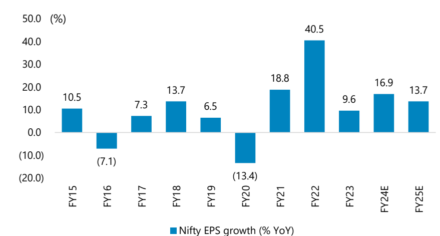
Large stocks with earnings impact. Among the Nifty cos with large earnings impact are L&T (3rd consecutive year of 20%+ earnings growth), RIL (~15% earnings growth expected); Bharti (+70% YoY, expect tariff hikes) and Tata Steel (100%+, improved pricing + low base). Significant growth slowdown is expected from Asia Paints (rising competition), Maruti (slowing PV demand) and BPCL (reduction in marketing margins).

Exhibit 69 - Domestic Earnings expectation



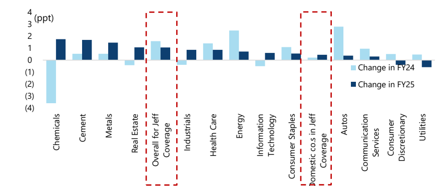
Source: Bloomberg, Jefferies

Exhibit 70 - Nifty consensus earnings growth



Source: Bloomberg, Jefferies

Exhibit 71 - Ebitda margin change (sectoral - Jeff coverage)



Source: Jefferies

Exhibit 72 - Credit Cost trend in coverage banks

Credit cost (%)	FY23	FY24E	FY25E	FY26E
HDFCB	0.8%	0.6%	0.5%	0.6%
ICICIBC	0.6%	0.4%	0.4%	0.5%
Axis	0.4%	0.5%	0.5%	0.6%
Kotak	0.2%	0.5%	0.5%	0.6%
IIB	1.6%	1.3%	1.3%	1.3%
SBI	0.4%	0.3%	0.5%	0.5%

Source: Jefferies

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Exhibit 73 - Consensus Earnings estimate

Companies	FY22% y/y	FY23% y/y	FY24% y/y	FY25% y/y	FY26% y/y
NSE Nifty 50 Index	**40.5**	**9.6**	**16.9**	**13.6**	**9.6**
Financials	**39.0**	**31.4**	**20.5**	**14.6**	**15.7**
Axis Bank Ltd	96.2	(23.4)	122.0	13.8	17.5
Bajaj Finance Ltd	59.0	63.7	25.8	27.7	27.6
Bajaj Finserv Ltd	1.9	40.8	27.7	26.3	10.3
HDFC Bank Ltd	19.5	20.9	29.8	22.4	18.9
HDFC Life Insurance Co Ltd	(2.5)	3.1	20.0	18.5	12.5
ICICI Bank Ltd	36.6	35.5	12.3	10.2	15.7
IndusInd Bank Ltd	64.0	54.9	21.5	18.7	18.1
Kotak Mahindra Bank Ltd	21.0	23.5	(13.3)	10.7	13.1
SBI Life Insurance Co Ltd	3.4	14.2	20.8	15.7	21.7
State Bank of India	57.9	57.3	6.0	4.7	8.3
Information Technology	**15.4**	**6.1**	**4.4**	**13.6**	**10.9**
HCL Technologies Ltd	7.9	10.3	6.0	12.5	10.9
Infosys Ltd	14.3	9.0	2.7	13.2	10.9
Tata Consultancy Services Ltd	18.2	10.0	10.1	11.2	9.9
Tech Mahindra Ltd	25.7	(13.2)	(30.0)	59.2	20.8
Wipro Ltd	13.2	(7.1)	(0.5)	12.2	10.8
LTIMindtree Ltd	103.9	11.7	10.8	19.5	16.5
Energy	**43.4**	**(2.1)**	**26.8**	**1.0**	**7.1**
Bharat Petroleum Corp Ltd	(27.7)	(81.8)	856.4	(46.8)	(0.1)
Coal India Ltd	36.7	62.3	(6.0)	(2.5)	5.5
Oil & Natural Gas Corp Ltd	179.2	(22.1)	31.8	(0.1)	1.4
Reliance Industries Ltd	23.6	9.9	11.4	16.1	11.5
Consumer Staples	**10.6**	**22.7**	**7.9**	**12.5**	**9.6**
Britannia Industries Ltd	(18.2)	52.3	(7.4)	13.6	11.6
Hindustan Unilever Ltd	11.1	14.0	6.1	12.3	10.8
ITC Ltd	15.8	25.9	7.8	11.6	9.8
Nestle India Ltd	1.7	12.8	26.3	15.4	0.0
Tata Consumer Products Ltd	9.2	28.6	18.4	19.0	15.7
Consumer Discretionary	**32.8**	**45.8**	**23.6**	**11.6**	**11.1**
Asian Paints Ltd	(3.5)	35.5	29.9	6.9	10.0
Bajaj Auto Ltd	26.9	(1.7)	16.9	14.5	12.4
Eicher Motors Ltd	24.5	73.8	31.5	10.1	10.9
Hero MotoCorp Ltd	(20.6)	21.3	38.5	12.1	9.5
Mahindra & Mahindra Ltd	262.9	56.3	(1.5)	7.8	7.2
Maruti Suzuki India Ltd	(11.6)	111.7	51.8	11.8	11.0
Tata Motors Ltd	nm	nm	651.5	17.1	22.6
Titan Co Ltd	123.3	49.6	16.3	23.6	21.7
Health Care	**30.0**	**51.5**	**13.6**	**15.9**	**12.5**
Cipla Ltd/India	4.7	11.3	39.2	12.2	10.8
Divi's Laboratories Ltd	49.2	(38.4)	(6.5)	28.5	24.1
Dr Reddy's Laboratories Ltd	23.1	91.2	11.5	5.1	2.4
Sun Pharmaceutical Industries	12.7	158.9	9.9	17.1	12.7
Industrials	**(18.1)**	**27.4**	**34.5**	**22.0**	**20.0**
Adani Ports & Special Economic	(2.2)	8.7	54.4	19.4	17.4
Adani Enterprises Ltd	(15.8)	218.4	20.0	20.0	20.0
Larsen & Toubro Ltd	(25.2)	20.8	27.7	24.0	21.6
Utilities	**25.6**	**(3.5)**	**5.5**	**8.1**	**4.4**
NTPC Ltd	13.9	1.4	10.6	9.9	5.2
Power Grid Corp of India Ltd	39.8	(8.4)	(0.1)	5.9	3.5
Materials	**nm**	**(58.8)**	**6.8**	**38.9**	**13.0**
Grasim Industries Ltd	75.4	(9.6)	(74.3)	10.5	1.5
Hindalco Industries Ltd	294.2	(26.5)	1.4	10.3	9.4
JSW Steel Ltd	161.2	(79.9)	173.9	37.1	10.2
Tata Steel Ltd	436.1	(78.2)	(21.9)	113.5	19.2
UltraTech Cement Ltd	34.4	(31.0)	53.5	20.6	14.7
UPL Ltd	26.3	(5.3)	(12.8)	37.2	12.5
Communication Services	**nm**	**96.1**	**41.3**	**73.2**	**30.9**
Bharti Airtel Ltd	nm	96.1	41.3	73.2	30.9
*ex of Tata Motors					3.1

Source: Bloomberg, Jefferies

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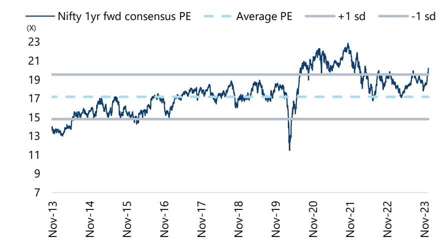
Valuations appear steep, but can sustain, given growth and expected flows

Nifty was up 20.0% during CY23, outperforming MSCI EM by 11.0 ppts (in USD terms) during CY23. But excluding China, the India's performed inline with the region. Nifty is now 20.5x 1-year forward - higher than the past 10-year average of 17.5x, but relative to EM (excluding China) the premium at 67% is somewhat higher than historical average. Current market multiples can sustain given the strong domestic flows and our expectations of improved foreign inflows during CY24. Our Dec-24 Nifty target of 24,000 offers 12% total return. Aside from the global risk-off, key risk to the equity markets can come from a possible increase in the capital gains tax rate and a possible unstable Govt after the upcoming national elections.

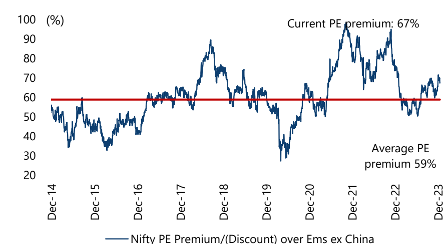
Exhibit 74 - Nifty 1yr fwd Consensus PE



Source: Bloomberg, Jefferies

Absolute valuations near the upper end on most parameters: The Nifty, post the 20.0% rally in CY23, is trading at 20.5x 1-yr forward PE; slightly above +1stdev on a 10-yr basis. 1yr forward PB is also at +1stdev of 2.9x. Our preferred yield-gap parameter (10-yr bond yields less 1/Nifty PE) shows the yield gap at 231bps at its previous peak seen in Oct'22. But we note that the yield gap is at an elevated level in all global markets. However, given that RBI is expected to cut rates by 2HFY25 and Consensus estimates building low earnings growth for FY26. Risk to the earnings estimate is on the upside for banks and potentially industrial stocks.

Exhibit 75 - Nifty PE premium over EM ex-China



Source: Bloomberg, Jefferies

Relative valuations ex-China, PEG basis appear reasonable. India has done well against the EM benchmarks, though part of the same is on account of China's weakness, even as many other EMs have held up well in 2023. Although Nifty's absolute valuation appears to be stretched, relative to EM (excluding China) the premium at 67% is somewhat above the historical average of 59%. The Indian markets have enjoyed PE premiums historically due to a less cyclical profile of its cos (more domestic stories) and the same is getting reinforced with a strong domestic cycle. On a PEG basis, we find the Indian earnings growth multiples to be more inline with Thailand and Korea, and ahead of the developed world, which also makes Indian markets appear reasonable.

Exhibit 76 - PEG ratio of global markets

Countries	PE	EPS Growth(%) (CY24)	PEG Ratio
China	9.2	15.7	0.58
Indonesia	8.7	10.8	0.81
Brazil	8.3	9.7	0.85
Taiwan	16.0	17.8	0.90
Malaysia	13.6	13.3	1.02
Thailand	16.5	15.1	1.09
India	**22.3**	**17.0**	**1.31**
Korea	11.5	7.7	1.50
Canada	13.8	8.7	1.58
US	19.9	12.1	1.64
Japan	13.7	7.8	1.77
Euro	12.8	4.9	2.62
Mexico	13.3	4.8	2.78
Australia	16.5	4.1	4.00
UK	10.8	2.4	4.50

Source: Bloomberg, Jefferies

Flows support to valuations. The Indian markets have been well supported by the domestic institutional flows wherein the rise of 'SIPs' continues to create consistent liquidity pool for equity buying. We do not see a disruption to positive domestic flow support in 2024 on a durable basis, particularly as fixed income has turned less attractive. Moreover, we believe that the FPI flows will likely improve in CY24. Key triggers for FPI flows would be 1. weaker USD which augurs well for EM flows in general 2. Political uncertainty will go away in Apr-May'24 3. FPI positioning on India is light as explained earlier. As a matter of reference, Chinese equities saw foreign inclowd of US$50bn+/ year during CY17-21. While the size of the Chinese market and economy is much bigger, the global environment wasn't conducive for EM flows and particularly towards China during those years. Any potential dips in the market would be a buying opportunity.

Dec-24 Nifty target at 24,000. Notwithstanding any big external shock, the current market multiples can sustain given the strong domestic flows, potential for rate cuts and a likely stable political environment over the medium term. Our Nifty target of 24,000 offers 12% total return and is set at 20.5x fwd PE from current multiples. Even as India is at the initial stages of a full blown capex cycle, the GDP growth has started to beat estimates and earnings have been remarkably stable. Aside from the global risk-off, key risk to the equity markets can come from a possible increase in the capital gains tax rate and a possible unstable Govt after the upcoming national elections.

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Banking - The best large-cap sector

Indian banks UPFed during CY23 despite strong earnings performance due to concerns on NIM compression, large banking facing leadership transition among other things. But the sector stands out as the only sector with below average multiples and possible earnings surprise if asset quality holds up. Also, one of our core market theme for CY24 is more foreign flows with global mandates and large banks suit that theme the best. In 2024, Indian banks should continue their 15-16% loan growth path. We prefer leading private banks & IndusInd Bank. NBFCs performance should become much more selective in 2024 especially as regulatory risks are playing out.

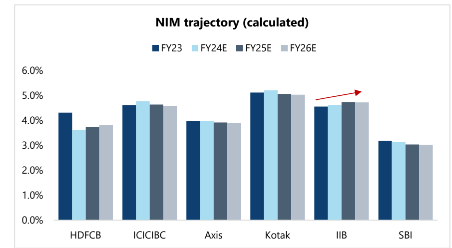
Bank credit growth to broadly hold, small decline for NBFCs. India's economic has held-up well and will continue to support growth in credit. We are also seeing signs of pick-up in capex activity with peaking capacity utilisation, housing capex & pick-up in power capex. However, with RBI pointing for need to caution on unsecured personal loans, banks will adopt a more cautious approach to lending in retail segment. Also, rising funding costs will push them to select & price credit appropriately to defend margins. We see banks having 15-16% growth in credit over FY24-26 and scope for private banks to gain share will be less than in the past. With a higher exposure to consumer unsecured lending, loan growth at NBFCs should moderate slightly (1-2ppt) but still growth should be healthy at 16-17%.

Chase for deposit growth to impact margins. With sector loan/ deposit ratio at 77% now and limited room to lower Liquidity Coverage Ratio (LCR), banks will continue to chase deposit growth to meet credit demand. While banks are offering higher rates & adding branches, they are also adopting divergent strategies to mobilise deposits. We see deposit growth to improve towards 13% over FY24-26, but expect rates to stay high and be a drag on margins. For NBFCs, a further rise in bank borrowing costs due to higher risk weights can push out margin trough to 1HCY24.

Asset quality to hold-up better for banks. One area where banks continue to deliver well is on underwriting of new loans and recovery from older corporate stressed loans. Even as we build normalisation of credit costs from FY25, it is still reasonably higher than current levels and offers scope to surprise positively on earnings. Among banks, private banks have been more cautious on lending in unsecured segments than PSU banks so will watch out for divergence there. NBFCs have seen delinquencies in unsecured loan products like personal loans (mainly small ticket), cards rising (17-40 bps in Sept Q), though not much concerning.

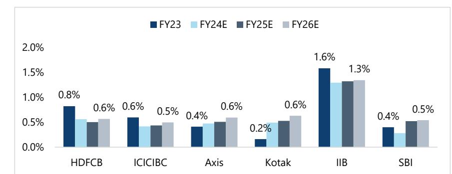
Valuations attractive for banks. Indian banking index has UPFed the Nifty by 7ppt in 2023 despite strong loan growth, partly reflecting concerns on margins & challenges with heavy-weight banks. We feel valuations are attractive near the longer-term average in context of growth and returns. We prefer leading private banks and IndusInd Bank in sector. NBFCs, meanwhile, saw broad based outperformance vs. the Nifty and same should become much more selective in 2024. We believe quality NBFCs with strong growth and returns outlook like BAF, CIFC and potential re-rating plays like SHFL should outperform.

Exhibit 77 - NIM projections for different large banks



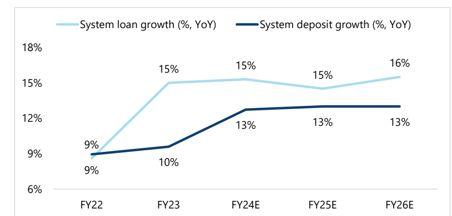
Source: Jefferies

Exhibit 78 - Credit Cost trend in banks under coverage



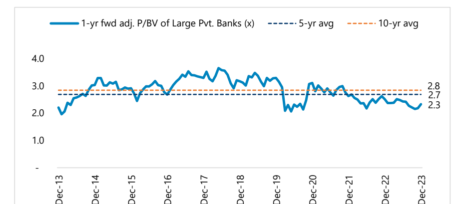
Source: Jefferies

Exhibit 79 - Loan & deposit growth for Indian Banks



Source: Jefferies

Exhibit 80 - Aggregated 1yr forward P/B of banks under coverage



Source: Jefferies

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Elusive rural recovery should be visible in 2024

India's post COVID recovery has been relatively urban / higher-income skewed, with a positive rural turn remaining elusive. We are surprised that the recovery is not visible yet, given the construction upturn should aid rural incomes. Recent 2-wheeler data offers some hope but no conclusive turnaround as yet. A large jump in housing starts to record levels, alongside rising private capex, should drive labor demand. Meanwhile, govt. spending focus may also turn welfare focussed which can improve investor sentiments. We prefer 2W stocks (Hero, Eicher, TVS) and select consumer staples GCPL, Marico play the potential recovery.

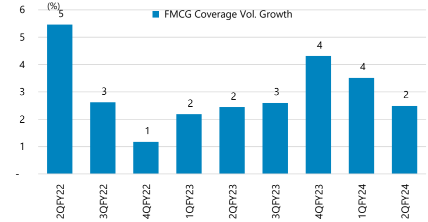
Some signs of hope, but not conclusive. The data indicators associated with rural economy saw a green shoot in late'23 as the 2W sales during the Oct-Nov festive season grew by 21% YoY, ahead of the 10% growth for PVs. 2W sales will still end 2023, 26% below the peak sales seen in 2018. FMCG / staple cos are also seeing market share shifts to unorganized / smaller competitors, after many years, which hints at demand growing faster at lower end. Data on rural indicators is not consistently positive though with tractor sales weak, demand under rural employment guarantee scheme high and rural wage growth trend in the 5-6% range for last 2 years.

Rising construction activity to propel transfer economy. A major driver of rural economy is the jobs in construction sector, as after agriculture, they are the largest employer of unskilled / low-skilled labor. These laborers then boost the rural income transfer economy. 2023 has seen a ~50% YoY jump in housing starts (Tr-12-mth), taking them near all-time-highs. Outlook on housing sales / construction is robust over the medium term. Central government's capex is also up 30% YTD, and moreover the large private corporate capex is also seeing a rise in capex commitments. The rise in construction activity is in strong growth in steel consumption (+14% in 11M23) and cement demand (+10% YoY in 10M23).

Government social spend to rise. Some support to the rural / agri economy has come through in 2023, in the form of higher farm purchase prices wherein govt. gave 5-year high increases in purchase prices for both the rice and wheat crops. 2024 will be the national election year and the trend over the last 3 election cycles suggests large rural / eco. weaker section supportive schemes see a push. E.g. ahead of the 2019 elections, the Modi govt had launched the Rs800bn minimum basic income scheme for small farmers. The 2023 state elections show again that BJP is not averse to large income transfer schemes such as monthly income transfers for women, landless laborers etc.

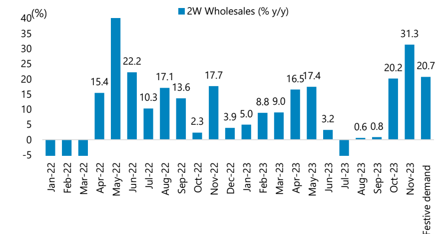
Plays on the theme. The stocks with a higher proportion of rural sales include consumer staples and select discretionary such as autos. In our model portfolio, we have an Overweight position on 2 Whlrs and like Hero, Eicher and TVS on the theme. Among consumer, GCPL and Marico are our preferred plays.

Exhibit 81 - Aggregate FMCG volumes for Jefferies coverage universe



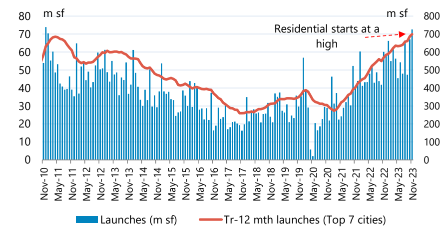
Source: Jefferies

Exhibit 82 - 2W wholesale volume (%y/y)



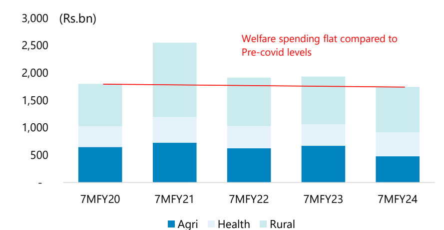
Source: SIAM, Jefferies

Exhibit 83 - New residential launch trend in Top-7 cities



Source: Propequity, Jefferies

Exhibit 84 - Government Social Spending



Source: Ministry of Finance, Jefferies

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More steam left in SoEs particularly in Coal, Power & Banks

PSU (Public Sector Undertakings or SOE) index was up 60% during CY23 outperforming Nifty by 40ppt, however the index is still trading at 10.6x 1yr forward PE which is at 47% discount to Nifty PE leaving more room for further upside. Prior to the recent period of disinvestment through ETF route which led to derating, PSU stocks used to trade at c.30% discount to Nifty. A potential mean reversion here implies a 30%+ upside. PSU power stocks are the biggest beneficiary of the visible power shortage. Defence & Railway stocks might take some breather as Govt capex growth cools and also the current rally provides strong divestment opportunities for government to meet fiscal targets. Our top Picks are Coal India, SBI and NTPC.

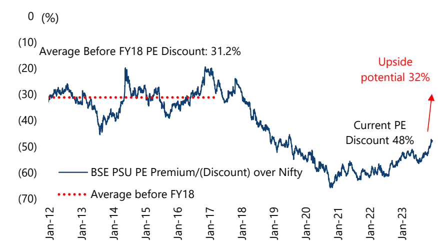
Steep rally but valuation still attractive: PSU (or SOE) Index has OPFed Nifty by 40ppts in CY23. The solid outperformance has been driven by Railways, defense plays, power utilities and Coal India. Despite this outperformance, the PSU Index PE at 10.6x is 48% discount to Nifty. Historical average has been 44% (10 year avg). However during FY18-FY21 government of India disinvested ~Rs.1200bn through ETFs which led to significant underperformance of PSU stocks during that period which led to valuation discount to reach at 70% skewing down the average. Before FY18, PSU index PE discount to Nifty PE was 31.2% on average, and catch to this Pre disinvestment average could lead to another 32% gains in the PSU basket.

Power PSUs big beneficiary of Power shortage: Indian utilities and power generation space is largely government owned and would be the biggest beneficiary of power shortage in the coming years. We believe this augurs well for NTPC (Buy) and Power Grid (Buy) on a regulated business. On competitive bidding, given access to lowest rates, they are in a better position to generate profitable growth. Also with thermal capacity addition planned, Coal India looks likely to be another major beneficiary as a coal supplier to thermal plants. India has ample coal reserves but the mining activity needs a step up to meet the demand. Last 3 years volume growth for Coal India was c.10% cagr. If the same thing gets repeated over the next 2, it would be a positive surprise.

Govt Capex growth headroom is limited, -ve for Railways and Defence. The central govt. Capex has surged by 3x over the past 5-years, taking the govt. capex to GDP ratio to all-time-high 3.3% of GDP in FY24. The incremental growth from here could turn limited, at least in FY25, as welfare spending pressures and budget consolidation takes a toll. We expect only upto 5% growth in govt. capex budget for FY25E. Railways and Defence PSU stocks which enjoyed the benefit up 80-210% of Govt Capex surge might take a breather going into FY25. The Govt budget is usually presented on the 1st Feb of every year.

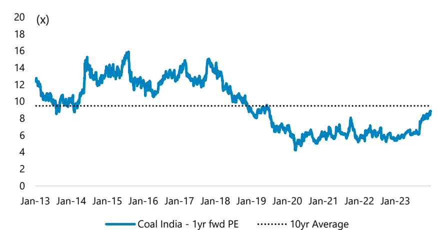
Disinvestment supply could rise. The govt. disinvestment has been low during past 6-mths at US $1.2bn. However, with national elections 5-mths away, pressure for govt. to spend will likely stay high. The govt. has a US$6bn disinvestment target for FY24. The BSE PSU index is up 60% YTD and several stocks which have seen sharp rallies and still have high govt stakes (e.g. defense and rail PSUs) have a higher likelihood of divestment.

Exhibit 85 - BSE PSU index 1yr fwd preimum over Nifty PE



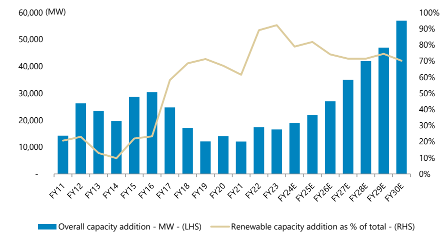
Source: Bloomberg, Jefferies

Exhibit 86 - Coal India 1yr fwd PE



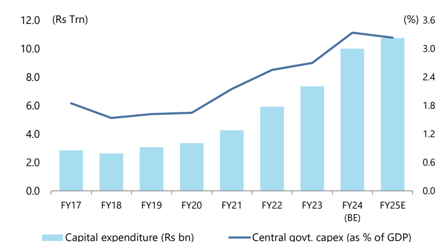
Source: Bloomberg, Jefferies

Exhibit 87 - Power Capacity addition



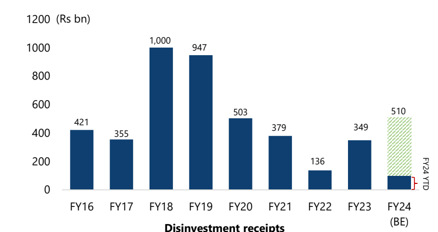
Source: Jefferies

Exhibit 88 - Central government capital spending trend



Source: Budget documents, Jefferies

Exhibit 89 - Disinvestment receipts



Source: Budget documents, DIPAM, Jefferies

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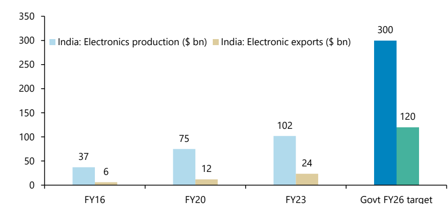
'China + 1' is a multi-year theme

China+1 has emerged as a theme in India and while the same is visible in several sectors, amongst the listed companies universe, it is visible the most amongst chemicals, tiles, cables & wires and electronics manufacturing. India is a large domestic market in these categories and potential exports opportunity adds as an advantage. Stocks as a play on this theme have moved up 50-70% in CY23 but we believe that this is a multi-year theme and more plays will emerge in these sectors. Our top picks would be Amber, Polycab, KEI, Kajaria and PI.

EMS : Recognizing the rising importance of electronics, the Indian government has embarked on a path to promote domestic manufacturing of electronics and semiconductors. The govt has launched a ~ $10bn program, providing incentives for ~50% of the project cost for chip and display fabrication, and testing facilities; certain states are offering further ~20% incentive, taking total benefit to ~70%, along with subsidized land, water and power. These incentives supplement the ~$10bn already allocated to electronics and related sectors under the PLI scheme. India is already #2 in mobile assembly, while companies such as Apple are increasing production. With an electronics assembly ecosystem in place, India is now embarking on the next step of establishing OSAT (Out-sourced Semiconductor Assembly and Testing) capabilities where US-based Micron is already setting up a facility, and companies such as Kayens and CG Power have announced plans for the same. Key beneficiaries of India indigenization and growing China 1+ strategy can be domestic incumbents such as AMBER (Buy).

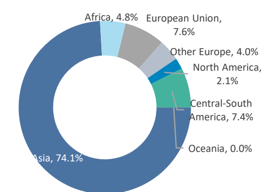
Exhibit 90 - India Electronics Production vs Export



Source: Govt of India, Avalon, Jefferies

Ceramic tiles: India's cost competitiveness is the key catalyst for flourishing exports, and India is now estimated to account for ~15% of global tile exports vs <10% pre-Covid. FY24 exports are expected to grow at +20% YoY. Key export markets include US, UK, Russia, Mexico and Kuwait. Globally, USA is a key import market for Ceramic Tiles, and in CY20 USA imposed Anti-dumping duty on Chinese tile imports. This has acted as a tailwind for strong exports from Morbi (several unorganised players based in this region). Approximately 40-45% of Morbi production goes towards exports, which helps domestic demand supply and pricing power. Kajaria Ceramics (KJC) is the market leader in India ceramic tiles industry and is a key beneficiary of housing market growth as well.

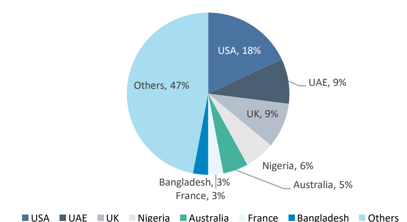
Exhibit 91 - World Production of ceramic tiles breakup



Source: Company Data, Jefferies

Cables & Wires (C&W): USA is one of the largest markets for C&W accounting for ~20% of the global imports. China's imports to USA have reduced from ~23% in 2017 to ~14% in 2022. While Mexico is one of the largest suppliers to USA geography, Indian C&W players have been ramping up exports over past three years, India currently accounts for <5% of USA imports. Polycab is the market leader in the domestic market, and its exports has sharply risen by +54% YoY in FY23, now at ~10% of its sales. While Polycab's exports are spread across 72 countries, key demand centres are developed countries such as USA, Australia, and sectors like Renewables and Oil&Gas. Polycab not only benefits from the China +1 policy but also due domestic housing, power and industrial capex growth. KEI is also a major beneficiary of these themes.

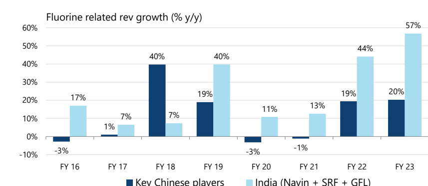
Exhibit 92 - Cables & Wires- Share of export from India by Countries (CY21)



Source: Jefferies

China's stringent policy will benefit India Chemical Industry: The significance of the European Union in agrochemical manufacturing has declined steadily over the past decade on rising environmental restrictions and higher unit cost of production. European chemical producers have been forced to cut GHG emissions and energy consumption sharply, pushing them higher up the cost curve. This has led to higher outsourcing of manufacturing of intermediates to low-cost geographies like China and India. Repeated disruptions in plant operations in China due to govt policy of discouraging industries like chemicals with high emissions along with recurring lockdowns due to Covid, have accelerated the trend of innovators diversifying sourcing outside of China. India has been among the major beneficiaries of this diversification where revenue growth of agrochem specialty chemicals majors has grown at a c.30% CAGR over FY18-23.

Exhibit 93 - Indian fluorochemical majors seeing strong growth over China



Source: Jefferies

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India model portfolio is geared towards domestic cyclicals

Our model portfolio is oriented towards domestic cyclicals & capex cycle plays with our key OWTs being financials, power, Industrials, autos, real estate & telecom. The cyclical upturn in private corporate capex has started, even as the housing upturn is now in full swing. We fund the portfolio OWTs by being UWT on staples, consumer discretionary (excl autos), energy and IT services. Within autos, we prefer two-wheelers. Within healthcare our preference is for structural story of hospitals. Metals and Tata Motors reflect our preferred plays on a potential China rebound.

Financials. The sector UPFed Nifty by 5ppt in CY23 due to concerns on NIM compression, management changes in a few banks and over-ownership. But Banks is the only sector that trades below the historical average multiples. As India attracts more foreign flows in CY24, we believe that large banks would account for a large part of the same as it would be an easy choice for several global mandates. We raise our OWT position in financials / banks by adding weights across board (Axis, ICICI, HDFCB, IIB). Potential EPS upside for banks can come through if credit costs remain low. NBFCs are seeing headwinds from the regulator as it looks to taper down risk in the consumer lending space.

Exhibit 94 - Sectoral stance of Model portfolio

Stock/Sector	Neutral Wt.	Jefferies Wt.	Stance
Financials	26.2	31.0	OWT
IT	13.1	8.9	UWT
Energy	10.4	6.0	UWT
Telecom	2.9	4.0	OWT
Consumer Staples	8.6	5.7	UWT
Consumer Disc.	12.9	11.3	UWT
Materials	7.3	8.6	OWT
Healthcare	4.9	4.8	Neutral
Industrials	8.2	9.2	OWT
Utilities	4.4	8.1	OWT
Real Estate	1.0	2.5	OWT
Total	**100.0**	**100.0**	

Source: Jefferies

Real Estate sector has been the biggest outperformer in 2023, though with a durable upcycle and consolidation underway, it remains an important OWT with a preference for pure play housing stories. We also prefer Real Estate to play any rate-cut driven upsides.

Power / Utilities OWT. Sector is seen benefiting from strong demand, as well as near peak capacity utilization levels for thermal power. Coal India looks attractive on valuations also.

Autos is our preferred **consumer discretionary** play where we prefer 2W in which demand is still to recover to pre-COVID levels. Overall, we are UWT on consumer discretionary.

Industrials The potential budget headwind (Govt capex slowdown) can be a drag on capex related plays. We have L&T as neutral, but could consider turning more constructive on any dips. Adani Ports is a key OWT, as volumes are likely to stay resilient. It can also benefit from the potential Concor disinvestment.

IT Services: Key U-WT call remains the IT sector, where demand conditions are still challenging and not adequately represented in valuations, which are still above average. A potentially strong INR could be another headwind.

Consumer staples: We have an UWT call. Low growth and high PE multiples combination is not conducive in an environment when capex cycle is unfolding. Given unfolding of the capex cycle and broadbasing of the investment ideas, hiding in the staples business would be unremunerative. Our top pick here is Honasa.

Telecom: OWT. Telecom is our preferred play on the welfare spending / defensives into elections. Peak 5G capex behind and deleveraging expected over the next 2 years. Rising ARPUs and limited competition is driving margins higher.

Materials: OWT. Metals should benefit from China stimulus and Tata Steel and Hindalco are the picks. For cement, we have a O-WT on strong demand and stable input costs.

Pharma/ Health Care: Neutral. We prefer hospitals over drug cos as the former continues to see strong structural demand.

Energy: UWT. Govt. limiting gains for refiners through windfall taxes an issue. Also, the run-up to elections could see a potential retail fuel price cuts for the Oil-Marketing majors.

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Exhibit 95 - Jefferies India Model Portfolio*

Stock/Sector	Neutral Wt.	Jefferies Wt.	Stance
Financials	**26.1**	**30.8**	**OWT**
Axis Bank	2.6	6.8	
ICICI Bank	5.2	7.5	
HDFC Bank	4.9	6.0	
SBI	1.2	4.5	
IndusInd Bank	0.0	2.8	
Cholamandalam Fin	0.5	1.4	
ICICI PruLife	0.2	1.8	
IT	**12.9**	**8.8**	**UWT**
Infosys	5.2	6.4	
TCS	3.5	2.4	
Energy	**10.4**	**5.9**	**UWT**
RIL	8.0	5.9	
Telecom	**2.9**	**4.1**	**OWT**
Bharti Airtel	2.4	4.1	
Consumer Staples	**8.8**	**5.7**	**UWT**
Godrej Consumer	0.5	2.0	
Honasa Consumer	0.0	2.3	
ITC	1.4	1.4	
Consumer Disc.	**13.0**	**11.5**	**UWT**
Eicher Motors	0.6	3.6	
Tata Motors	1.3	3.3	
TVS Motors	0.5	4.7	
Materials	**7.3**	**8.9**	**OWT**
Tata Steel	1.0	2.9	
Hindalco	0.8	3.0	
Ultratech Cement	1.2	3.0	
Healthcare	**4.9**	**4.8**	**Neutral**
Max Healthcare	0.5	3.0	
Sun Pharma	1.2	1.7	
Industrials	**8.2**	**8.9**	**OWT**
Larsen & Toubro	2.4	2.4	
Kajaria Ceramics Ltd	0.0	3.0	
Adani Ports	0.5	3.4	
Power/Utilities	**4.4**	**8.1**	**OWT**
Coal India	0.6	3.0	
NTPC	1.4	2.8	
JSW Energy	0.0	2.3	
Real Estate	**1.0**	**2.6**	**OWT**
Godrej Properties	0.3	1.2	
Lodha	0.3	1.4	
Total	**100.0**	**100.0**	

Source: Bloomberg, Jefferies, *Neutral weights are based on MSCI India

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(Article 3(1)e and Article 7 of MAR)

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- Amber Enterprises India Limited (AMBER IN: INR3,133.70, BUY)
- Apollo Hospitals Enterprise Limited (APHS IN: INR5,701.20, BUY)
- Asian Paints (APNT IN: INR3,402.10, UNDERPERFORM)
- Axis Bank (AXSB IN: INR1,102.95, BUY)
- Bajaj Auto Limited (BJAUT IN: INR6,801.00, BUY)
- Bajaj Finance Limited (BAF IN: INR7,326.90, BUY)
- Bharat Petroleum Corporation Limited (BPCL IN: INR450.55, UNDERPERFORM)

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