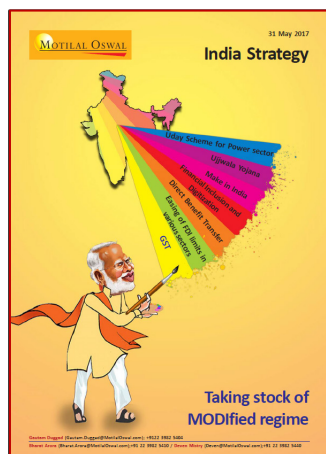


Latest Strategy Report: Taking stock of MODified regime



Sensex reconstitution; EPS downgrade of 1.5%

Weight of Financials to rise 250bp; Tech weight to hit near-decade low

- The S&P BSE Sensex composition is all set for a reshuffle on Monday, 19 June 2017. Kotak Mahindra Bank (KMB) will replace GAIL India, and Tata Motors Differential Voting Rights (DVR) will be included as an additional stock in the benchmark.
- In this report, we will analyze how these changes will (i) impact the earnings for the benchmark and (ii) alter the weights of various sectors.

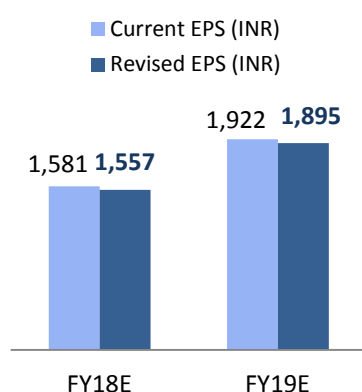
Sensex reconstitution: BFSI will have 36% weight (+250bp)

- KMB will be included in the benchmark with 3.5% weight, and thus, will be among the top-10 stocks by weight. Tata Motors DVR will enter with 0.5% weight, helping maintain the weight of Auto sector in the benchmark.
- With the exit of GAIL (weight: 0.8%), Oil & Gas stands to lose the most in terms of weight (-110bp to 9%). Other losers include Consumer (-40bp), Technology (-40bp), NBFCs (-30bp), Healthcare (-20bp) and Capital Goods (-20bp).
- Least impacted sectors would be Utilities, PSU Banks, Telecom and Metals.
- BFSI will have a weight of 36.1% (+250bp) post the reshuffle, which will be almost equivalent to the combined weights of Consumer, IT and Auto.

Of the top-10 stocks to be most impacted, four are from Financials

- Aggregate weight of the existing 29 Sensex stocks will decline by 320bp.
- Top-10 stocks to be most impacted (in terms of weight) by the reshuffle: HDFC Bank (-40bp), HDFC (-30bp), ITC (-30bp), Reliance Inds (-30bp), Infosys (-20bp), ICICI Bank (-20bp), L&T (-20bp), TCS (-20bp), Maruti (-10bp) and SBI (-10bp).

Sensex EPS to see downgrade of 1.5%/1.4% for FY18/FY19



Sensex EPS for FY18/FY19 to see downgrade of 1.5%/1.4%

- Sensex EPS for FY18/FY19 will see a downgrade of 1.5%/1.4%, primarily due to a higher increase in free float market cap of 2.7% compared to a rise of 1.1%/1.3% in free float PAT for FY18/FY19.
- Notably, Kotak Mahindra Bank's free float market cap is 4.4x of GAIL India.
- We now estimate Sensex EPS at INR1,557 for FY18 (+15.4%) and ~INR1,895 for FY19 (+21.7%).
- We have recently downgraded GAIL India to **Sell** (refer our detailed report – [A case for lower PE; US contracts pose threat of losses](#)).
- Sensex trades at a P/E of 19.7x on FY18E earnings based on current composition; this will expand to P/E of 20x post the reshuffle.

Expect higher activity in the reshuffled stocks

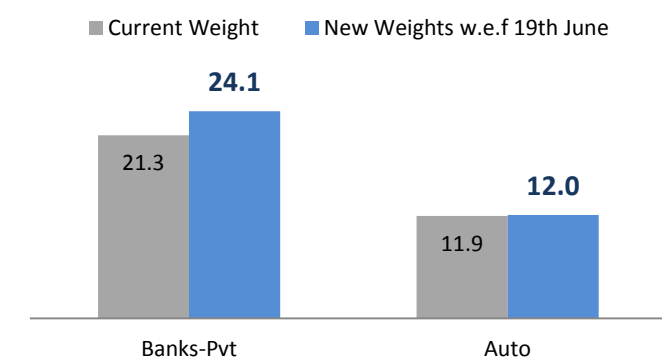
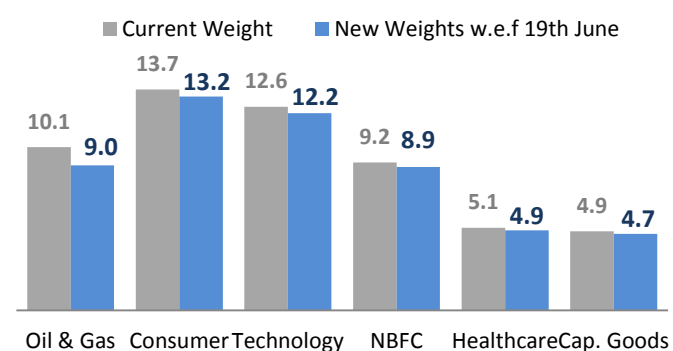
- Domestic MFs currently hold 0.8% of their total AUM in GAIL, which is in line with the weight of the current benchmark. However, domestic MFs are under-owned in Kotak Mahindra Bank at 1.7% of total AUM.
- DIIs hold 7.8% (-0.6% QoQ in Mar 2017) and FIIs hold 38.6% (+1.7% QoQ in March 2017) in Kotak Mahindra Bank.
- Out of top-20 domestic MFs, 15 have exposure of less than 2% of their AUM to Kotak Mahindra Bank.

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Exhibit 1: Pvt banks will see an increase in weight; Auto weight to be unchanged due to addition of Tata Motor-DVR**Exhibit 2: Oil & Gas, Consumer, Technology – biggest losers due to the reshuffle**

Source: BSE, MOSL

Interesting observations from sectoral weight changes in the past decade: Financials, Autos at all-time high; Capital Goods, Telecom at new lows

- **Weight of Financials has kept rising.** It will touch a new high of 36.1% (+1.8x in 10 years) with the inclusion of Kotak Mahindra Bank .
- **Auto about to overtake IT:** Auto has bridged the gap versus Technology, especially over the last two years. The gap between Auto and Technology has come off from 610bp in FY16 to virtually zero now. Post the reshuffle, Auto weight will be at a new high of 12%.
- **Healthcare weight is down significantly** due to the underperformance over the last two years.
- **Weights of Capital Goods and Telecom are now at an all-time low** of 4.7% and 1.6%, respectively. Notably, Telecom weight is down from ~10% in FY07. Both the sectors will now have representation of only one stock in the benchmark (L&T and Bharti Airtel).
- **Consumer weight has remained stable** over the last four years, but has increased significantly (+570bp) over the last 10 years given its sharp outperformance v/s the index.
- Real Estate and Cement have no representation in Sensex.
- **Metals weight has bounced off its lows** of sub-1% in FY16, but it is far off from the peak of 7.2% in FY10.

Exhibit 3: Trend in Sensex sectoral weight (%) – Financials, Autos at all-time high

Sector	FY07	FY10	FY13	FY16	FY17	Current	New w.e.f 19th June	Avg Weight FY07-17	Chg. New vs. Avg Weight (pp)
Auto	4.0	6.4	9.4	10.8	11.4	11.9	12.0	8.1	3.9
Banking/ Finance	21.1	23.0	26.2	28.9	32.0	33.6	36.1	25.5	10.5
Capital Goods	7.3	9.7	5.6	4.8	4.7	4.9	4.7	7.2	-2.5
Cement	4.2	2.2						3.1	-3.1
Consumer	7.5	7.2	13.8	12.5	13.0	13.7	13.2	10.4	2.8
Health Care	3.6	1.1	4.7	8.3	6.3	5.1	4.9	3.9	1.0
Infrastructure		1.3		1.0	1.1	1.1	1.1	1.1	0.0
Metals	3.6	7.2	3.9	0.9	1.2	1.2	1.2	4.1	-3.0
Oil & Gas	16.0	16.8	13.7	10.0	10.8	10.1	9.0	14.5	-5.6
Real Estate		1.0						0.9	-0.9
Technology	19.9	14.6	16.2	17.9	13.5	12.6	12.2	15.6	-3.4
Telecom	9.7	4.1	2.4	2.1	1.7	1.7	1.6	4.3	-2.7
Utilities	3.3	5.4	4.0	2.8	4.5	4.1	4.0	4.1	-0.2
SENSEX	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	
Private	88.1	86.4	87.4	91.6	89.4	90.3	91.4	87.7	3.7
PSU	11.9	13.7	12.6	8.4	10.6	9.7	8.6	12.3	-3.7

Brief snapshot of key sector weights vis-à-vis sector earnings growth and valuation trends over the last decade

Exhibit 4: Auto weight has gone up consistently

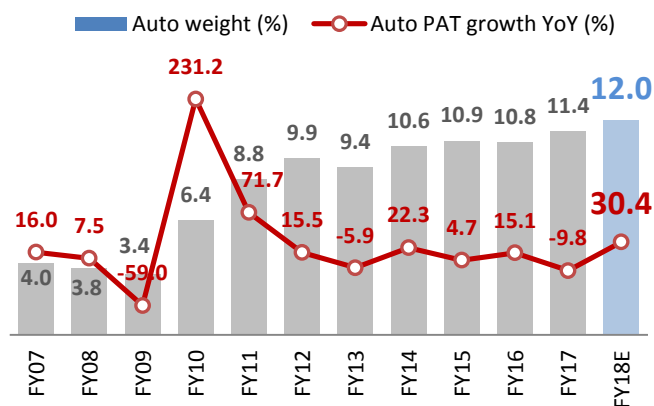


Exhibit 5: ...and valuations have expanded too

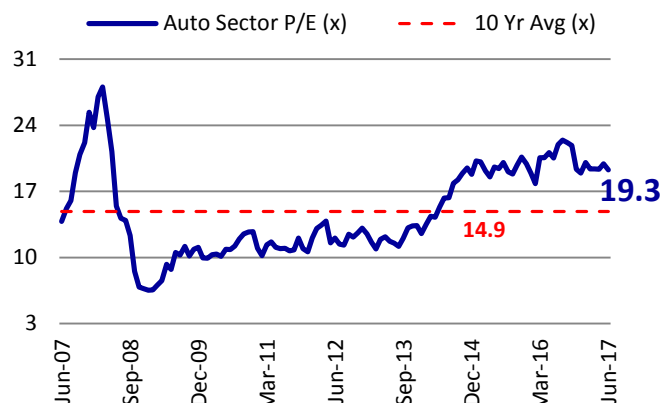


Exhibit 6: Consumer weight has been steady of late

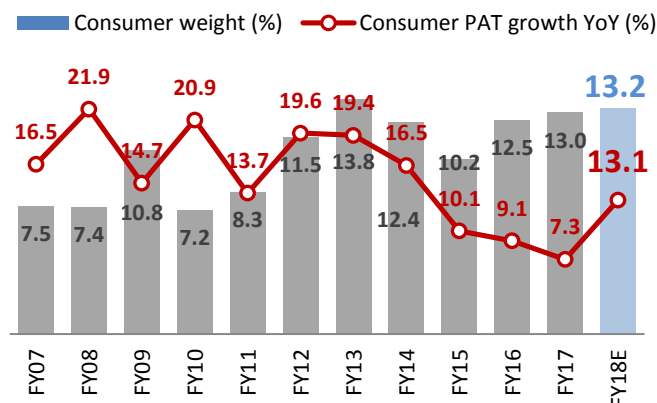


Exhibit 7: ...but valuations are at decadal high

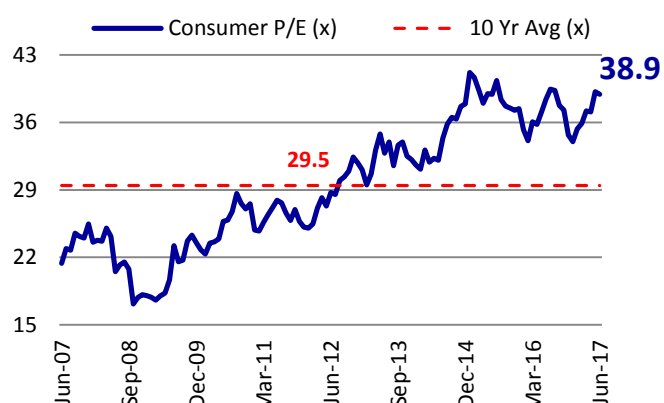


Exhibit 8: Financials weight in Sensex up 1.8x in a decade..

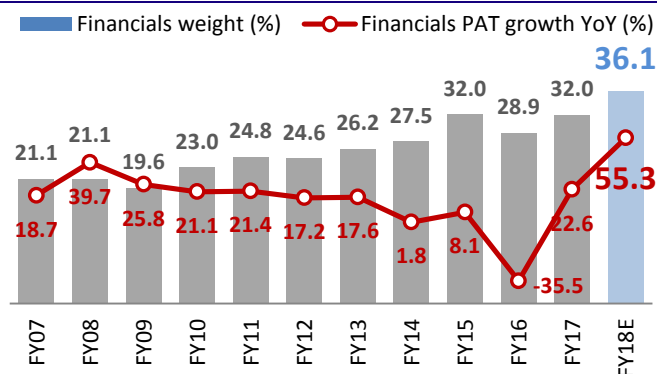
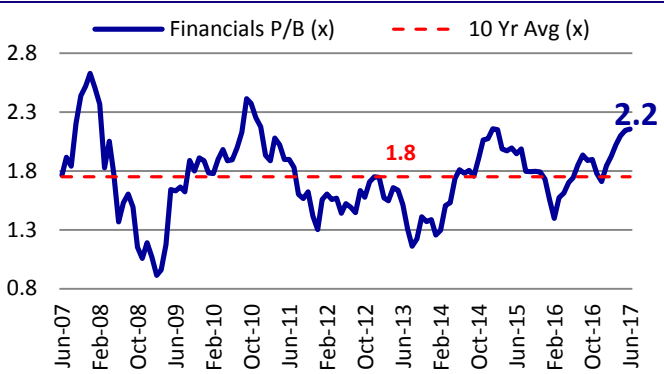
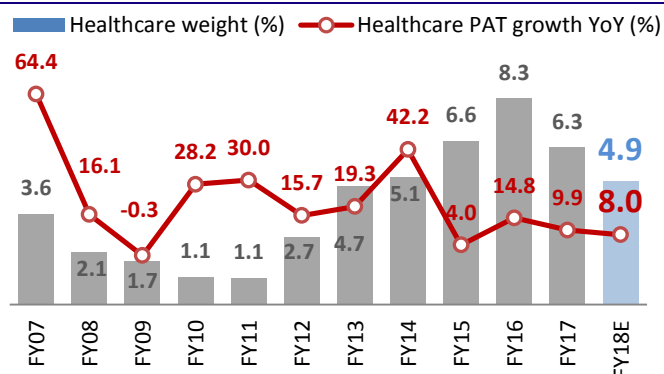
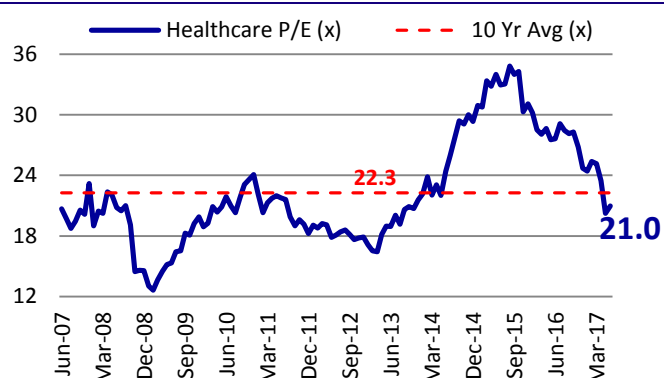
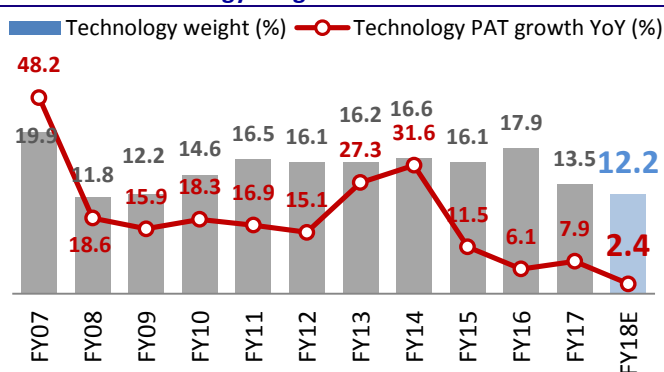
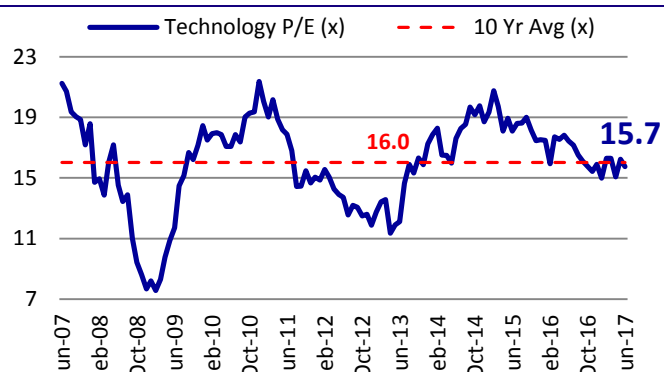


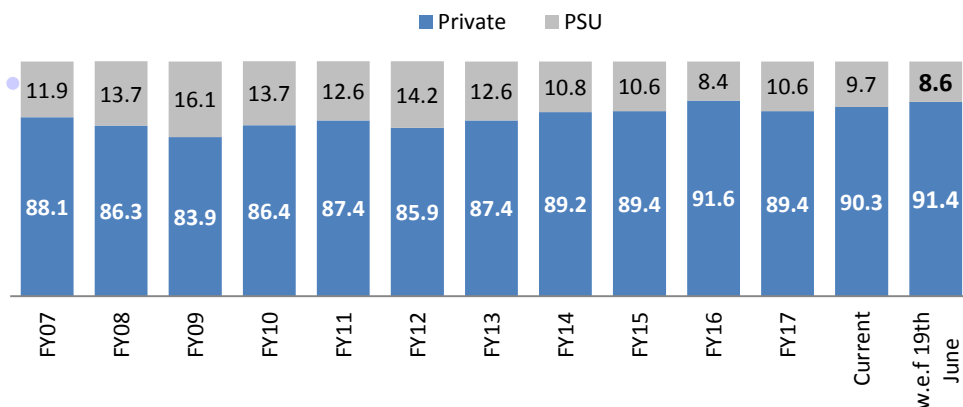
Exhibit 9: ...valuations still off from peak but it's a story of two halves – Private v/s PSU



Note: Weights for FY18E represent pro forma weight to be effective from 19th June.

Exhibit 10: Healthcare weight has come off drastically since FY16...**Exhibit 11: ...and valuations at discount to LPA****Exhibit 12: Technology weight at near-decade low****Exhibit 13: ...valuations at LPA****Exhibit 14: Private v/s PSU weights in Sensex (%)**

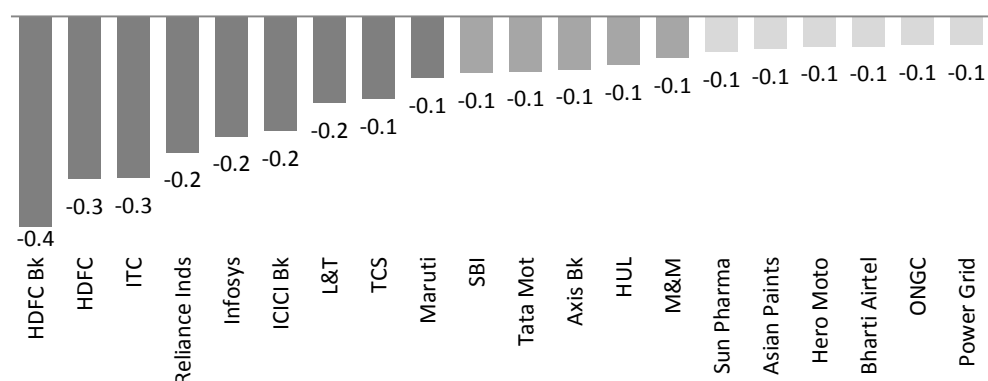
PSU weights in Sensex to be in single-digits



Source: BSE, MOSL

Aggregate weight of existing 29 Sensex stocks to see a decline of 320bp

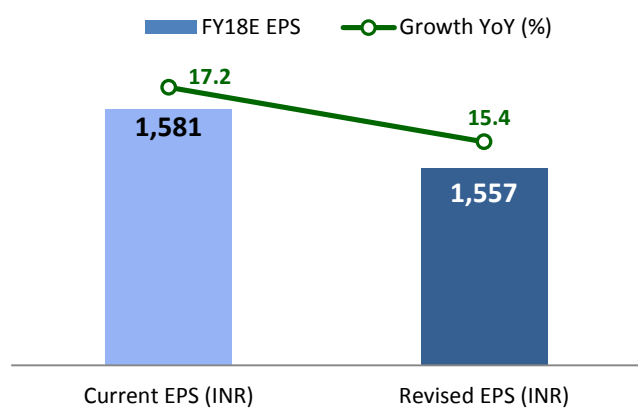
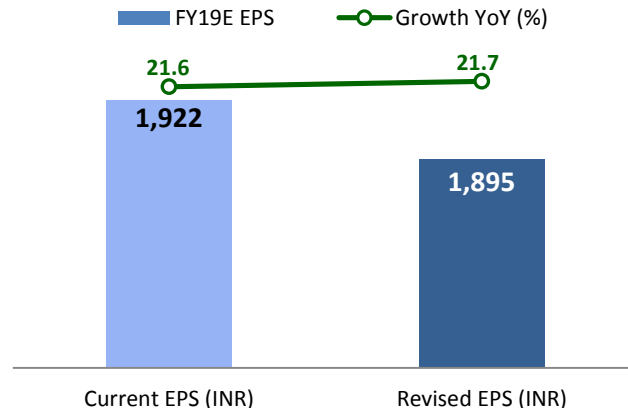
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- The top-10 stocks to get most impacted by the reshuffle are HDFC Bank (-40bp), HDFC (-30bp), ITC (-30bp), Reliance Inds (-30bp), Infosys (-20bp), ICICI Bank (-20bp), L&T (-20bp), TCS (-20bp), Maruti (-10bp) and SBI (-10bp).

Exhibit 15: Existing stocks weight change (pp)

Source: BSE, MOSL

Sensex EPS to see downgrade by ~1.5% for FY18/FY19

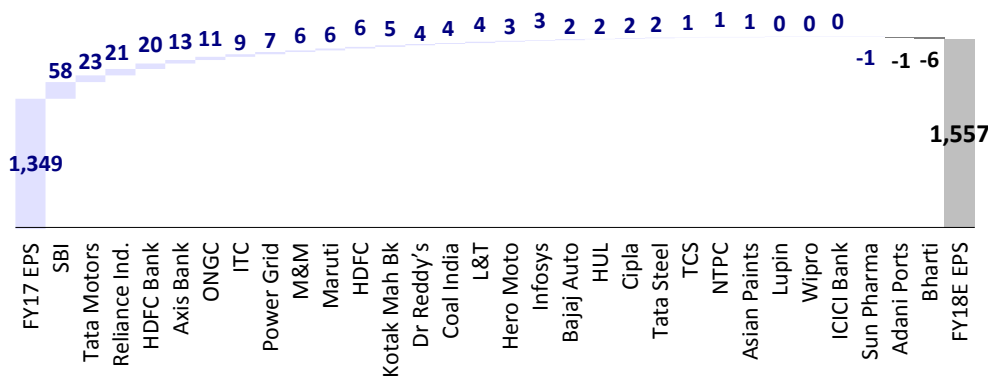
- Notably, Sensex EPS will see a downgrade in estimates by 1.5%/1.4% for FY18/FY19. This is because free float market cap will increase by 2.7% v/s rise of 1.1%/1.3% in free float PAT for FY18/FY19.
- Kotak Mahindra Bank's free float market cap is 4.4x of GAIL India.
- We now estimate Sensex EPS at INR1,557 for FY18 (+15.4%) and ~INR1,895 for FY19 (+21.7%).
- Sensex trades at a P/E 19.7x on FY18E earnings based on current composition; will expand and trade at 20x post the reshuffle.

Exhibit 16: FY18E Sensex EPS to see 1.5% downgrade**Exhibit 17: FY19E Sensex EPS to see 1.4% downgrade**

Source: Company, MOSL

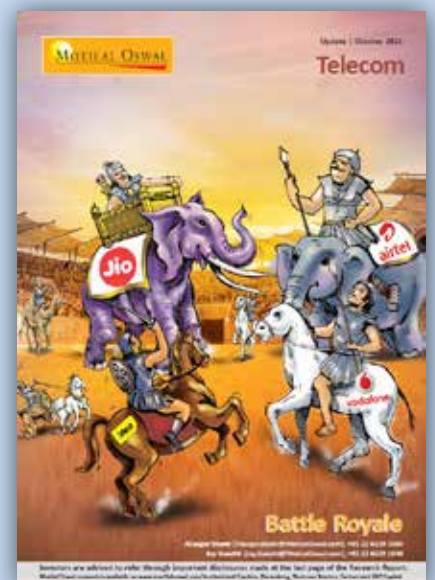
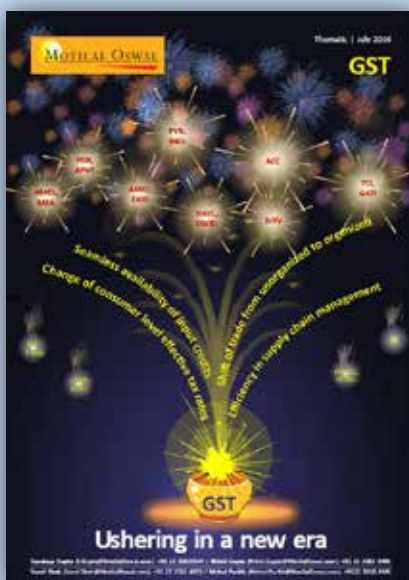
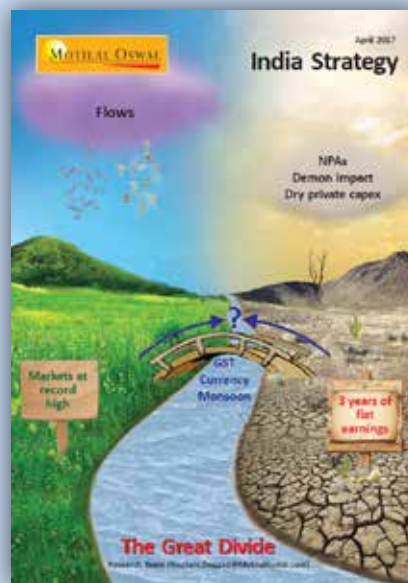
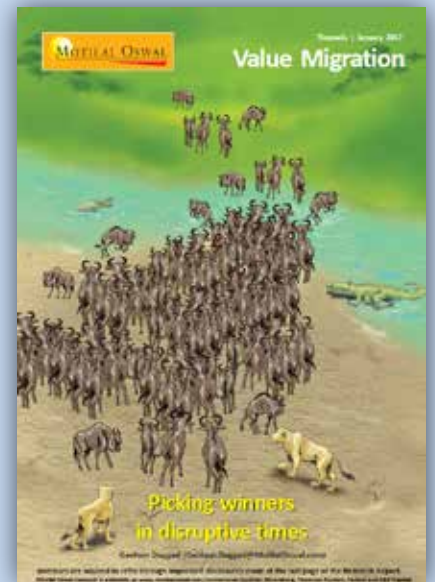
Exhibit 18: Stock-wise contribution to growth in FY18E Sensex EPS (INR)

Top 5 stocks to contribute 65% of earnings growth in FY18



Source: MOSL

THEMATIC/STRATEGY RESEARCH GALLERY



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India Inc on Call

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FUND FOLIO

Indian Mutual Fund Tracker

Equity follows record and highest since June 2013



Month	Inflows (Cr. ₹)
Jan 15	100,000
Feb 15	80,000
Mar 15	70,000
Apr 15	60,000
May 15	50,000
Jun 15	40,000
Jul 15	30,000
Aug 15	20,000
Sep 15	10,000
Oct 15	10,000
Nov 15	10,000
Dec 15	10,000
Jan 16	10,000
Feb 16	10,000
Mar 16	10,000
Apr 16	100,000
May 16	80,000

INR 19.3t

Net inflows in April up 57% MoM

Source: Inside at the last page of the Research Report

May 2016

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