MOTILAL OSWAL

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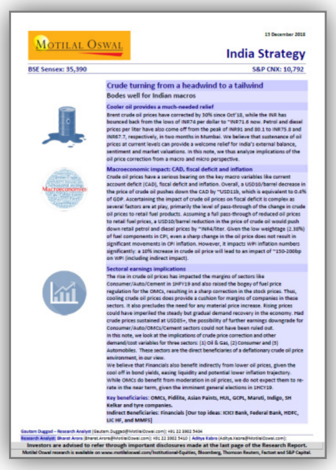
India Strategy

BSE Sensex: 36,195 **Nifty-50: 10,850**

Refer our latest India Strategy report on Crude turning from a headwind to a tailwind



Corporate profit to GDP: Analyzing growth across cycles

2018 mirroring 2003 bottom

As part of our continued effort to provide a broad and informative perspective of the market and the economy, we, in this note, take a close look at the corporate profit contribution of various sectors/companies in Nifty-500 to GDP. As a lot has changed over the last 15 years, we step back and analyze trends in retrospect to come up with some interesting observations.

Interpreting the corporate profits to GDP metrics over 2003-18

- India's corporate profit to GDP ratio dropped from 7.8% to 3% over 2008-18. For the Nifty-500 universe, the ratio has declined from 5.5% to 2.8% – a-15 year low – over the same period. Earnings have lacked resilience over the last decade due to a multitude of macro-micro factors. In this note, we analyze 'corporate earnings as a percentage of GDP' in greater detail. We use Nifty-500 as a proxy for corporate earnings as it contributes 93% of India's market-cap.
- Notably, the corporate profit to GDP ratio has been on a downward spiral since 2010, barring 2017, when profits of global cyclicals like Metals and O&G had rebounded and losses at PSU Banks had reduced over the preceding year.
- However, we expect the trend in corporate profits/GDP to turn better, led by normalization of profits at Corporate Banks and gradually improving trends in the capex cycle. Even Telecom and Utilities – the two sectors that have witnessed huge investments over the years without any commensurate returns – should start contributing to earnings over the next five years, in our view.
- In our analysis, we look at the 2003-18 period in two parts: [1] 2003-08 and [2] 2008-18.

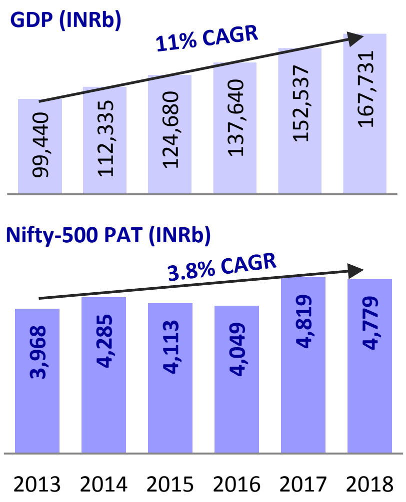
2003-08: The Golden Phase…

- The corporate profit to GDP ratio doubled from 2.8% to 5.5% over 2003-08, with Nifty-500 profits growing at a substantial 31%, 2x the pace of underlying GDP growth (CAGR of 14.5%).
- This surge was driven by the export-, investment- and capex-oriented sectors. Over 2003-08, the global economy was growing at a faster clip, helping the export-oriented players. Capacity investment across sectors was also significant as investment cycle took off.
- Of the 2.7% improvement in the profits/GDP ratio over this period, 1.6% was contributed by Metals, Telecom, Technology, Capital Goods and Cement.

2008-18: …that lost luster

- Over the last decade, the corporate earnings distress in India has translated into corrosion in the Nifty-500 profit/GDP ratio from 5.5% to 2.8%.

Profits have been stagnant



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- Similar to 2003-08, the movement in the ratio over 2008-18 was driven by a few sectors – 88% of the fall was driven by PSU Banks (36%), Oil & Gas (19%), Metals (18%) and Telecom (15%).
- Private Banks, NBFC, Autos and Technology were the only sectors witnessing an improvement in the profit/GDP ratio over the last decade.

2003-18: Wild swings in fortunes

- Sectors that have been most stable and rising to prominence over these 15 years are Technology, NBFCs, Private Financials, Autos and Metals. Profits of these sectors as a percentage of GDP has increased by 3-4x over 2003-18.
- Profit contribution to GDP of NBFCs is at a new high, while that of PSU Banks is at a new low. Auto has seen a 3.5x jump in profit to GDP over 2003-18.
- Consumer's contribution has been quite stable, underscoring the resilient nature of the sector.
- O&G's contribution has come off from 1.05% to 0.66% over 2003-18, but is still significant, given the preponderance of large PSU players in both upstream and downstream in the sectoral profit pool.
- Capital Goods' contribution tripled from 0.09% to 0.28% in five years from 2003-08. However, it thereafter declined by more than half over 2008-18.
- Similarly, after moving up 8x from 0.1% in 2003 to 0.8% in 2008, Metals' profits as a percentage of GDP declined steeply to 0.2% before bottoming out in 2016 (now at 0.3%).
- Telecom has gyrated between losses and profits over 2003-18.

Value migration toward Private Corporates at play

- We analyzed India's corporate profit to GDP distribution over the last 15 years in three categories: PSUs, MNCs and Private Corporates.
- PSUs' corporate profit to GDP is down from 1.8% in 2003 to 0.4% now, given the significant value migration away from public to private in sectors like Banking, Telecom and Airlines, even as PSU heavy sectors like Oil & Gas and Utilities underperformed on profit growth versus underlying GDP growth.
- Losses of PSUs have been gains for the Indian Private Corporate sector, with the latter's profit/GDP ratio rising from 0.8% in 2003 to 2.2% in 2018.

The bottom yet?

- We expect the corporate profit to GDP trend to improve FY19 onward, even as we do not foresee acceleration like 2003-08.
- Corporate Banks (both PSU Private) – one of the biggest contributors to the downtrend in corporate profit to GDP – are expected to drive the expansion as asset quality bottoms, fresh slippage generation moderates, provisioning cost normalizes and loan growth recovers.
- In Capital Goods and Cements, we expect the private capex cycle to recover gradually. Incipient signs of capex spending in select sectors (Refining, Steel and Cement) offer some confidence in their contribution to aggregates.
- Telecom and Utilities, which have seen significant capex investments and balance sheet expansion (rising capital employed) without commensurate returns, may have troughed, in our view, and can contribute to this cycle over the next few years. Rising competitive intensity and entry of a deep-pocketed new operator necessitated capex investments, weakening ARPUs and driving

Exhibit data is sourced from Capitaline, RBI, Companies, and MOSL database

down profits and return ratios. However, as telecom players repair their balance sheets (de-leveraging, asset monetization) and competitive intensity peaks out, we expect profitability in this sector to see gradual improvement.

- We expect sectors like Consumer, Auto and Private Banks (especially Retail) to stay stable as far as their contribution as a percentage of GDP is concerned.
- We note that in every cycle, new sectors evolve and contribute to the profit to GDP metrics. This is a reflection of the change in the underlying economy. In the earlier upcycle of 2003-08, sectors like Infrastructure, Cement, Capital Goods and Construction evolved, even as investments— as proportion of GDP – galloped. A few sectors that were not listed a decade back are now listed and growing well. They also have a strong long-term growth path ahead of them, given the under-penetration in their respective segments. For example, Consumption and Financials have seen relatively good performance vis-à-vis investment-oriented sectors. Over the last few years, Insurance (Life and General), Asset Management Companies, Organized Retail, Lifestyle Consumption, etc., have scaled up and been gaining traction. We expect their contribution in the profit to GDP equation to inch up further.

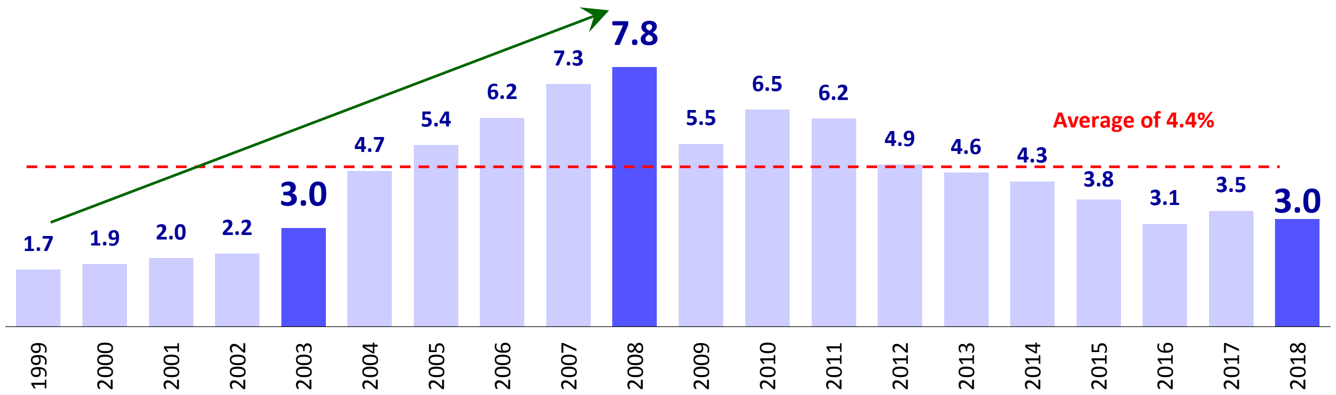
Exhibit 1: Sectoral Corporate profit to GDP for Nifty-500 (%) – NBFCs at all-time high; Banks at new low

	Profit to GDP (%)				Change (x)		
Sector	**2003**	**2008**	**2013**	**2018**	**2003-2018**	**2008-2018**	**2003-2008**
Automobiles	0.08	0.21	0.28	0.28	3.8	1.4	2.8
Financials	0.74	1.00	1.20	0.27	0.4	0.3	1.4
Banks - PSU	0.46	0.51	0.49	-0.44	-1.0	-0.9	1.1
Banks - PVT	0.11	0.18	0.30	0.28	2.5	1.6	1.6
NBFCs	0.15	0.26	0.37	0.40	2.7	1.5	1.8
Insurance	0.02	0.05	0.04	0.04	1.8	0.7	2.5
Capital Goods	0.09	0.28	0.17	0.11	1.2	0.4	3.1
Cement	0.02	0.20	0.10	0.06	3.1	0.3	9.8
Chemicals	0.03	0.09	0.06	0.07	2.6	0.8	3.0
Consumer	0.17	0.20	0.20	0.20	1.2	1.0	1.2
Healthcare	0.08	0.16	0.17	0.16	1.9	1.0	1.9
Hotels	0.00	0.01	0.00	0.00	3.0	0.2	13.0
Infrastructure	0.01	0.04	0.01	0.01	1.0	0.1	6.7
Logistics	0.01	0.02	0.01	0.01	0.8	0.5	1.5
Media	0.01	0.01	0.02	0.02	1.7	2.2	0.8
Metals	0.10	0.78	0.19	0.31	3.2	0.4	8.1
Oil & Gas	1.05	1.17	0.60	0.66	0.6	0.6	1.1
Real Estate	0.00	0.19	0.03	0.04	9.4	0.2	40.1
Retail	0.00	0.01	0.01	0.02	10.4	2.6	4.0
Technology	0.10	0.33	0.39	0.42	4.1	1.3	3.2
Telecom	-0.04	0.24	0.05	-0.14	3.8	-0.6	-6.6
Textiles	0.01	0.01	0.02	0.02	1.6	1.5	1.1
Utilities	0.27	0.42	0.42	0.21	0.8	0.5	1.6
Misc	0.04	0.11	0.07	0.11	2.8	1.0	2.7
Nifty-500	**2.8**	**5.5**	**4.0**	**2.8**	**1.0**	**0.5**	**2.0**

Corporate profits to GDP at one-and-half decade low

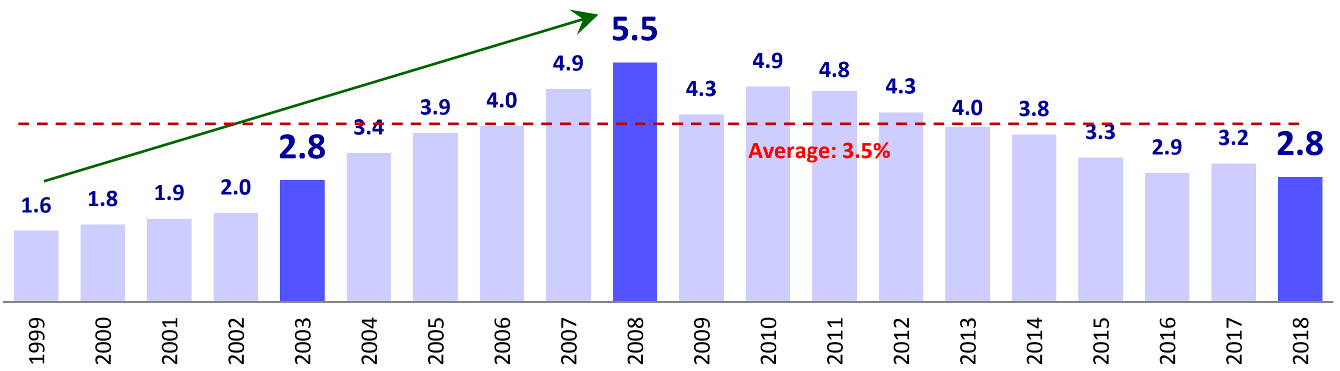
- The continued soft patch in earnings over the last decade has resulted in steady deterioration in the corporate profit to GDP ratio. Corporate profit as a percentage of GDP has dropped to 2.8% – a 15-year low – from the peak of 5.5% in 2008.
- Nifty-500 profits have remained stagnant at INR4-4.8t over the last five years, even as nominal GDP has continued to grow steadily. Over 2013-2018, profit CAGR of 3.8% has significantly lagged GDP CAGR of 11%.
- The ratio has consistently declined since 2010 (except for 2017) and is also lower than the long-period average of 3.9% (2003-2018). The 2017 aberration was owing to a rebound in profits of global cyclicals like Metals and O&G and the loss reduction in PSU Banks over FY16.
- However, we now believe that India's earnings growth has bottomed out and that the corporate profit to GDP ratio should expand hereon. Our confidence stems from the bottoming out of the asset quality cycle in PSU and Private Corporate Banks and some initial signs of green-shoots in private corporate capex. Consumption, too, remains robust.

Exhibit 2: India Inc. (Listed + Unlisted) – Trend in Corporate profit to GDP ratio



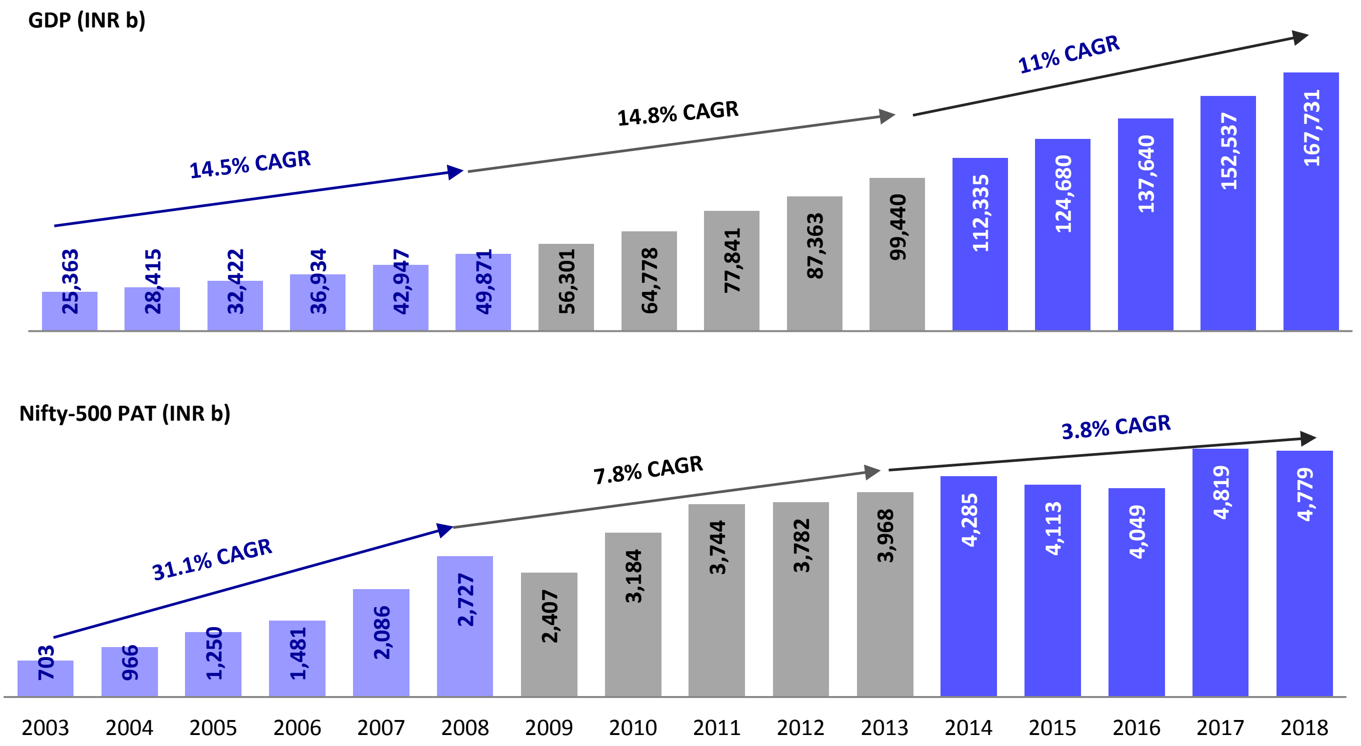
Note: Corporate profit sourced from Capitaline for listed/unlisted companies (7,500+ companies)

Exhibit 3: Nifty-500 - Corporate profit to GDP ratio has touched a 15-year low



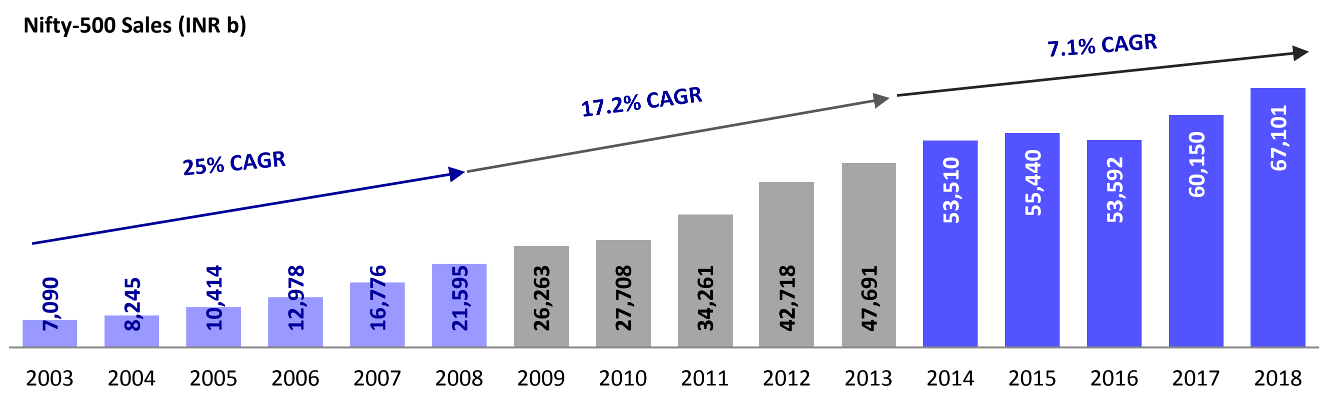
- As we can infer from exhibit 3, Nifty-500's profits have broadly flat-lined around INR 4-4.8t over the last five years, the period when asset quality problems of corporate banks (PSUs and Private) emerged, resulting in a sharp jump in provisioning requirements.
- Meanwhile, Nominal GDP, aided by Consumption, maintained a healthy pace of 11% CAGR over 2013-18

Exhibit 4: Contrast between corporate PAT growth and GDP growth



- Moderation in the top-line CAGR of Nifty-500 is due to a combination of correction in commodity prices and some softening in the top-line growth of Consumer-oriented sectors.

Exhibit 5: Trend in Nifty-500 Sales (INR b)



- As shown in Exhibits 6 and 7, the operating margins of the Nifty-500 Universe inched up over 2015-18 after being range-bound over 2012-15 – a reflection of softening in commodity prices and operating leverage in a few sectors. However, the PAT margin did not reflect a similar improvement over 2015-18 due to higher provisioning costs of Corporate Banks. In fact, it shrank 30bp over 2015-18 and still well below the peak of 12.6% reached in 2008.
- Operating margins of Nifty-500 ex Financials broadly hovered in the 13-13.5% range over 2012-15, before breaking into the 14-15% band post commodity price correction over 2015-16. However, it is still far away from the peak of 16.6% clocked in 2005. Similarly, the PAT margin collapsed from the peak of 11% in 2008 to 5.6% in 2015. Thereon, it steadily climbed to 7.3%, largely as a flow-through of the improvement in the operating margins (while operating margins expanded 190bp, PAT margins expanded 170bp over 2015-18).

Exhibit 6: Nifty-500 EBDITA Margin (%)

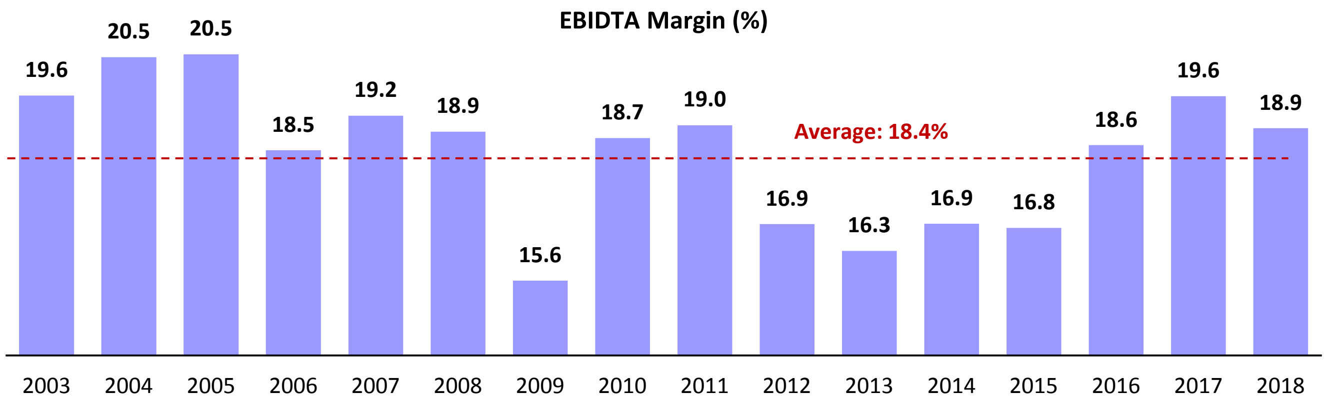
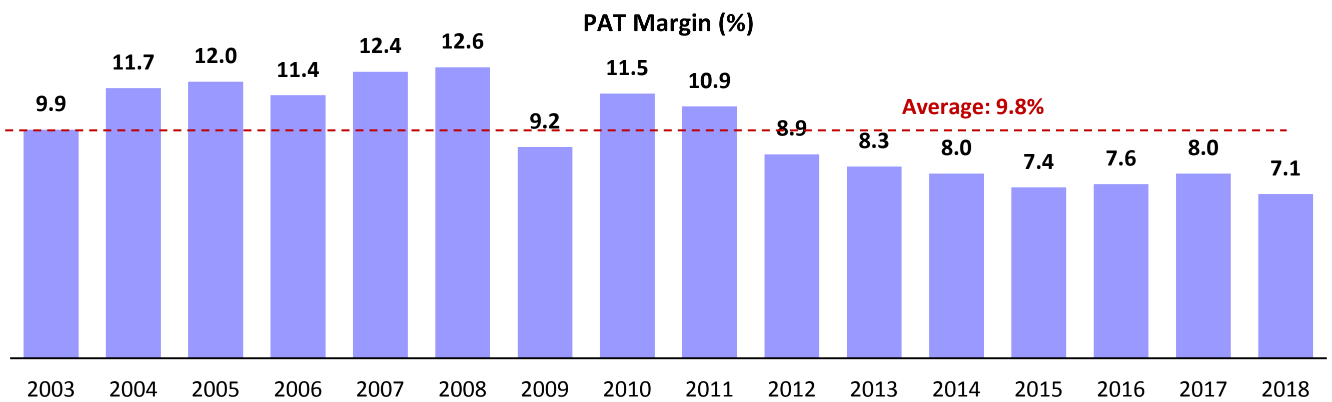


Exhibit 7: Nifty-500 PAT Margin (%)



Corporate profit to GDP doubled over 2003-08…

- Over 2003-08, the corporate profit to GDP ratio doubled from 2.8% to 5.5%, with Nifty-500 profits growing at 31%, 2x the pace of underlying GDP growth (14.5% CAGR).
- This surge was driven by the export-, investment- and capex-oriented sectors. Over 2003-08, the global economy was growing at a faster clip, helping the export-oriented players. Capacity investment across sectors was also significant as investment cycle took off.
- Of the 2.7% improvement in the profits/GDP ratio over this period, 1.6% was contributed by **Metals**, **Telecom**, **Technology**, **Capital Goods** and **Cement**.
- The **Telecom** sector saw a sharp upswing as India embarked on unprecedented subscriber addition and density improvement.
- **Technology** sector benefited from global growth and the inflexion point of Indian IT, when it build scale and took rapid strides.
- Top five contributors to the profit delta during this period were RIL, Tata Steel, SAIL, DLF, Bharti Airtel and RCom.

Exhibit 8: Contributors to the rise in corporate profit to GDP (FY03-08)

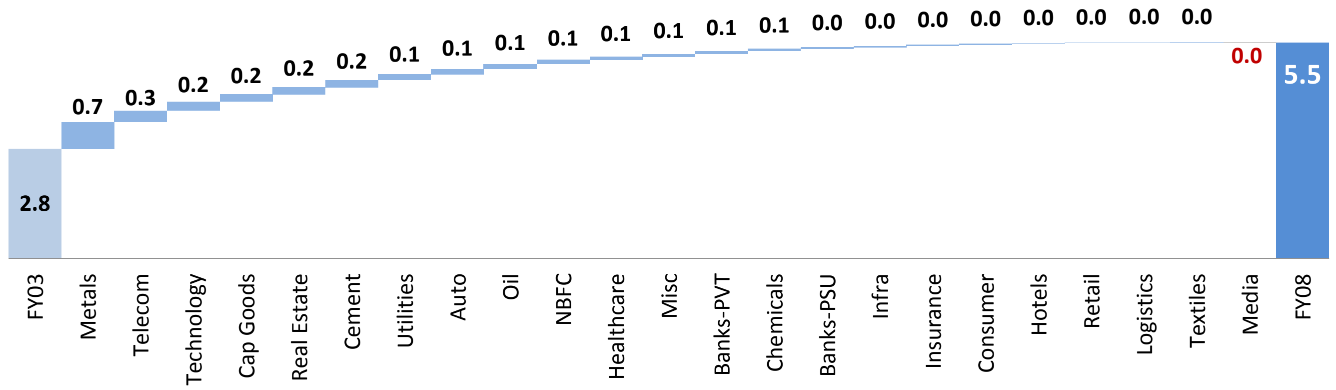


Exhibit 9: Stocks with positive contribution to change

		Contributor to change (FY03-08)	
Company	**Sector**	**pp**	**%**
Reliance Inds.	Oil & Gas	0.23	8.7
Tata Steel	Metals	0.21	7.7
S A I L	Metals	0.17	6.3
DLF	Real Estate	0.15	5.7
Bharti Airtel	Telecom	0.14	5.1
Rel. Comm.	Telecom	0.11	4.0
TCS	Technology	0.10	3.7
Coal India	Utilities	0.10	3.5
Hind.Zinc	Metals	0.08	3.1
Infosys	Technology	0.06	2.1
NMDC	Metals	0.05	2.0
Grasim Inds	Cement	0.05	1.7
M R P L	Oil & Gas	0.04	1.5
B H E L	Capital Goods	0.04	1.5
JSW Steel	Metals	0.04	1.4

Exhibit 10: Stocks with negative contribution to change

		Contributor to change (FY03-08)	
Company	**Sector**	**pp**	**%**
I O C L	Oil & Gas	-0.10	-3.7
H P C L	Oil & Gas	-0.03	-1.1
Hind. Unilever	Consumer	-0.03	-1.1
B P C L	Oil & Gas	-0.03	-1.0
NLC India	Utilities	-0.02	-0.9
Power Fin.Corp	NBFCs	-0.02	-0.8
O N G C	Oil & Gas	-0.01	-0.5
Oriental Bank	Banks - PSU	-0.01	-0.4
Bajaj Holdings	NBFCs	-0.01	-0.4
Natl.Fertilizer	Chemicals	-0.01	-0.3
GAIL (India)	Oil & Gas	-0.01	-0.3
Dish TV	Media	-0.01	-0.3
J & K Bank	Banks - PVT	-0.01	-0.2
TVS Motor Co.	Automobiles	-0.01	-0.2
Dr Reddy's Labs	Healthcare	-0.01	-0.2

Corporate profit to GDP 2003-2008: This surge was driven by the export, investment and capex-oriented sectors

Exhibit 11: Nifty-500 profits expanded at 31% CAGR over 2003-08

	PAT (INR b)		Change		Profit to GDP (%)	
Sector	**2003**	**2008**	**(x)**	**CAGR**	**2003**	**2008**
Automobiles	19	104	5.4	40	0.1	0.2
Banks - PSU	117	254	2.2	17	0.5	0.5
Banks - PVT	28	88	3.2	26	0.1	0.2
NBFCs	37	131	3.5	29	0.1	0.3
Insurance	5	25	4.8	37	0.0	0.1
Capital Goods	23	138	6.1	43	0.1	0.3
Cement	5	101	19.2	81	0.0	0.2
Chemicals	7	43	6.0	43	0.0	0.1
Consumer	43	98	2.3	18	0.2	0.2
Healthcare	21	80	3.8	30	0.1	0.2
Hotels	0	7	25.5	91	0.0	0.0
Infrastructure	1	19	13.1	67	0.0	0.0
Logistics	3	8	3.0	24	0.0	0.0
Media	3	5	1.5	9	0.0	0.0
Metals	25	391	15.9	74	0.1	0.8
Oil & Gas	266	583	2.2	17	1.1	1.2
Real Estate	1	93	78.9	140	0.0	0.2
Retail	1	4	7.8	51	0.0	0.0
Technology	26	164	6.4	45	0.1	0.3
Telecom	-9	122	-12.9	LP	0.0	0.2
Textiles	3	7	2.2	17	0.0	0.0
Utilities	68	207	3.1	25	0.3	0.4
Misc	10	56	5.4	40	0.0	0.1
Nifty-500	**703**	**2,727**	**3.9**	**31**	**2.8**	**5.5**

...and then halved over 2008-18

- Over the last decade, the corporate earnings distress in India has translated into corrosion in the profit/GDP ratio from 5.5% to 2.8%.
- Just like the 2003-08 period, the movement in the profits/GDP ratio over 2008-18 was driven by a few sectors. We note **that 88% of the fall in the ratio from 5.5% in 2008 to 2.8% in 2018 was driven by just four sectors: PSU Banks (36%), Oil & Gas (19%), Metals (18%) and Telecom (15%).**
- Private Banks, NBFC, Autos and Technology were the only sectors witnessing an improvement in the profit/GDP ratio over the last decade.
- **PSU Banks** have been impacted by rising NPAs (especially in corporate-oriented banks), higher provisions, higher slippages and lower loan growth – all combining to drive meaningful deterioration in profitability and return ratios. However, we believe that the asset quality cycle has now bottomed out and the contribution of PSBs' profits to GDP should improve significantly over FY19-21.
- **Metals** have seen significant swings in profitability post 2008. It went down from 0.8% in 2008 to 0.2% in 2013 and bottomed out in 2016. The fortunes of sectoral profitability are inextricably linked to underlying commodity prices and have swung in line with prices. Post 2016, the sector has seen massive profitability jump owing to rising commodity prices and a phase of de-leveraging in a few big companies. In fact, MOSL Metals Universe profits have grown 3x from INR130b in 2016 to INR470b in 2018.
- **Telecom's** profitability nosedived due to elevated competitive intensity post the entry of Reliance Jio. This, coupled with rising capex intensity and lower operating margins, has pushed the sector toward losses.
- NBFCs meanwhile have delivered a solid performance over the last decade, with consistent market share gains and rising penetration in several segments (home/vehicle finance, etc.) due to the underlying stress in PSU Banks. The profit to GDP ratio of NBFCs has expanded consistently over the last decade. In fact, the MOSL NBFC Universe PAT has delivered 20% CAGR over 2008-18.
- Key stocks contributing to the fall in the profit to GDP ratio over 2008-18 are ONGC (-10%), RCom (-10%), SBI (-8%), RIL (-7%) and Tata Steel (-6%).

Exhibit 12: Contributors to the fall in the corporate profit to GDP ratio (FY08-18) (pp)

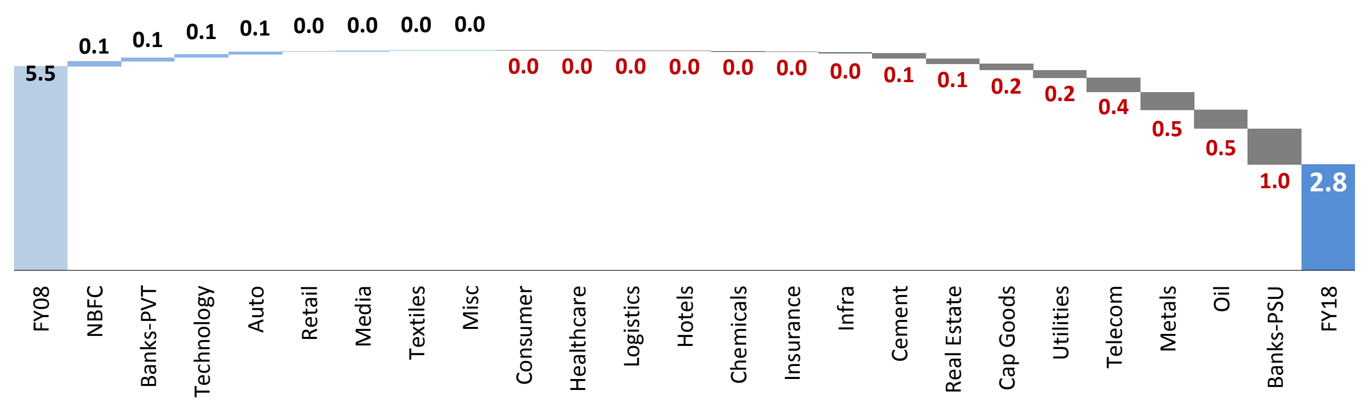


Exhibit 13: Stocks with positive contribution to change

		Contributor to change (FY08-18)	
Company	Sector	pp	%
HDFC Bank	Banks - PVT	0.08	3.0
TCS	Technology	0.05	2.0
H D F C	NBFCs	0.04	1.6
Thomas Cook (I)	Misc	0.03	1.3
HCL Technologies	Technology	0.03	1.2
Vedanta	Metals	0.03	1.2
Piramal Enterp.	Healthcare	0.02	0.9
Indiabulls Hous.	NBFCs	0.02	0.9
Yes Bank	Banks - PVT	0.02	0.8
IndusInd Bank	Banks - PVT	0.02	0.8
Power Grid Corpn	Utilities	0.02	0.8
B P C L	Oil & Gas	0.02	0.7
Interglobe Aviat	Misc	0.02	0.7
Adani Ports	Misc	0.02	0.7
Kotak Mah. Bank	Banks - PVT	0.02	0.7

Exhibit 14: Stocks with negative contribution to change

		Contributor to change (FY08-18)	
Company	Sector	pp	%
O N G C	Oil & Gas	-0.27	-10.2
Rel. Comm.	Telecom	-0.25	-9.6
St Bk of India	Banks - PSU	-0.21	-7.9
Reliance Inds.	Oil & Gas	-0.18	-6.7
Tata Steel	Metals	-0.17	-6.4
S A I L	Metals	-0.15	-5.9
DLF	Real Estate	-0.13	-5.0
Bharti Airtel	Telecom	-0.12	-4.6
PNB	Banks - PSU	-0.12	-4.4
NTPC	Utilities	-0.09	-3.3
Bank of India	Banks - PSU	-0.07	-2.9
IDBI Bank	Banks - PSU	-0.06	-2.4
Coal India	Utilities	-0.06	-2.4
I O B	Banks - PSU	-0.06	-2.4
Canara Bank	Banks - PSU	-0.06	-2.3

Corporate profit to GDP 2008-2018: Fall from 5.5% in 2008 to 2.8% was driven by just four sectors

Exhibit 15: Just 6% CAGR in profits over 2008-18

	PAT (INR b)		Change		Profit to GDP (%)	
Sector	2008	2018	(x)	CAGR	2008	2018
Automobiles	104	477	4.6	16	0.2	0.3
Banks - PSU	254	-745	-2.9	PL	0.5	-0.4
Banks - PVT	88	463	5.2	18	0.2	0.3
NBFCs	131	674	5.1	18	0.3	0.4
Insurance	25	62	2.5	10	0.1	0.0
Capital Goods	138	180	1.3	3	0.3	0.1
Cement	101	108	1.1	1	0.2	0.1
Chemicals	43	123	2.9	11	0.1	0.1
Consumer	98	329	3.3	13	0.2	0.2
Healthcare	80	263	3.3	13	0.2	0.2
Hotels	7	6	0.8	-2	0.0	0.0
Infrastructure	19	9	0.5	-7	0.0	0.0
Logistics	8	14	1.7	6	0.0	0.0
Media	5	36	7.4	22	0.0	0.0
Metals	391	521	1.3	3	0.8	0.3
Oil & Gas	583	1,114	1.9	7	1.2	0.7
Real Estate	93	73	0.8	-2	0.2	0.0
Retail	4	36	8.8	24	0.0	0.0
Technology	164	701	4.3	16	0.3	0.4
Telecom	122	-240	-2.0	PL	0.2	-0.1
Textiles	7	32	4.9	17	0.0	0.0
Utilities	207	354	1.7	6	0.4	0.2
Misc	56	190	3.4	13	0.1	0.1
Nifty-500	**2,727**	**4,779**	**1.8**	**6**	**5.5**	**2.8**

Interesting observations over the last 15 years

- Sectors that have been most stable and rising to prominence over these 15 years are Technology, NBFCs, Private Financials, Autos and Metals. Profits of these sectors as a percentage of GDP have increased by 3-4x over 2003-18.
- Healthcare (1.9x) and Insurance (1.8x) have also seen an increase.
- Profit contribution to GDP of NBFCs is at a new high, while that of PSU Banks is at a new low. NBFC has seen the most consistent improvement in the profits to GDP metric. Moreover, it has been the only sector to exhibit an improvement in every five-year block over 2003-18.
- PSU Banks has been the only laggard, with a significant swing toward losses. While its profit to GDP hovered in a narrow range over 2003-13, asset quality clean-up and peaking of corporate stress have resulted in a significant deterioration over 2013-18.
- Auto has seen a 3.8x jump in profit to GDP over 2003-18, as the sector's profitability increased in consonance with its penetration across segments.
- Consumer's contribution has been quite stable, even as the economy underwent multiple swings. This underscores the resilient nature of the sector.
- O&G's contribution has come off from 1.05% to 0.66% over 2003-18, but is still significant, given the preponderance of large PSU players in both upstream and downstream in the sectoral profit pool.
- Capital Goods' contribution has undergone a roller-coaster ride. It first tripled from 0.09% to 0.28% over 2003-08 and then fell by more than half in the subsequent 10 years. This is a clear reflection of the pain that domestic private capex cycle has gone through over the last decade.
- Metals, given the cyclicality associated with the underlying business, saw its profits as a percentage of GDP move up 8x from 0.1% in 2003 to 0.8% in 2008 (second largest in pecking order after O&G in 2008). However, its contribution declined all the way to 0.2% before bottoming out in 2016 (now at 0.3%).
- Telecom has gyrated between losses and profits over 2003-18. It was one of the key contributors to the improvement in the profit to GDP ratio over 2003-08. However, the sector's fortunes have consistently deteriorated post 2008 with rising competitive pressures and sharp elevation in capex intensity, resulting in both P&L and balance sheet stress.

Exhibit 16: Sectoral Corporate profit to GDP for Nifty-500 (%) – NBFCs at all-time high; Banks at new low

	Profit to GDP (%)				Change (x)		
Sector	**2003**	**2008**	**2013**	**2018**	**2003-2018**	**2008-2018**	**2003-2008**
Automobiles	0.08	0.21	0.28	0.28	3.8	1.4	2.8
Financials	0.74	1.00	1.20	0.27	0.4	0.3	1.4
Banks - PSU	0.46	0.51	0.49	-0.44	-1.0	-0.9	1.1
Banks - PVT	0.11	0.18	0.30	0.28	2.5	1.6	1.6
NBFCs	0.15	0.26	0.37	0.40	2.7	1.5	1.8
Insurance	0.02	0.05	0.04	0.04	1.8	0.7	2.5
Capital Goods	0.09	0.28	0.17	0.11	1.2	0.4	3.1
Cement	0.02	0.20	0.10	0.06	3.1	0.3	9.8
Chemicals	0.03	0.09	0.06	0.07	2.6	0.8	3.0
Consumer	0.17	0.20	0.20	0.20	1.2	1.0	1.2
Healthcare	0.08	0.16	0.17	0.16	1.9	1.0	1.9
Hotels	0.00	0.01	0.00	0.00	3.0	0.2	13.0
Infrastructure	0.01	0.04	0.01	0.01	1.0	0.1	6.7
Logistics	0.01	0.02	0.01	0.01	0.8	0.5	1.5
Media	0.01	0.01	0.02	0.02	1.7	2.2	0.8
Metals	0.10	0.78	0.19	0.31	3.2	0.4	8.1
Oil & Gas	1.05	1.17	0.60	0.66	0.6	0.6	1.1
Real Estate	0.00	0.19	0.03	0.04	9.4	0.2	40.1
Retail	0.00	0.01	0.01	0.02	10.4	2.6	4.0
Technology	0.10	0.33	0.39	0.42	4.1	1.3	3.2
Telecom	-0.04	0.24	0.05	-0.14	3.8	-0.6	-6.6
Textiles	0.01	0.01	0.02	0.02	1.6	1.5	1.1
Utilities	0.27	0.42	0.42	0.21	0.8	0.5	1.6
Misc	0.04	0.11	0.07	0.11	2.8	1.0	2.7
Nifty-500	**2.8**	**5.5**	**4.0**	**2.8**	**1.0**	**0.5**	**2.0**

Divergence between corporate profit and GDP growth

- Although real GDP growth has grown faster than corporate profits, the divergence can be easily explained – consumption has replaced investments as the key driver of GDP growth. Since consumption is a more scattered activity than investments (and thus, less representative of the listed space), Nifty-500 is unlikely to mirror GDP growth.
- Not surprisingly then, while Nifty-500 profits have fallen, the contribution of consumption-oriented sectors like Auto, Consumer and Retail has increased over the recent period.
- We expect these sectors to continue benefiting from the continued strong consumption trends, even as investment activity gradually picks up.

Exhibit 17: Consumer sector PAT contribution has increased over the years

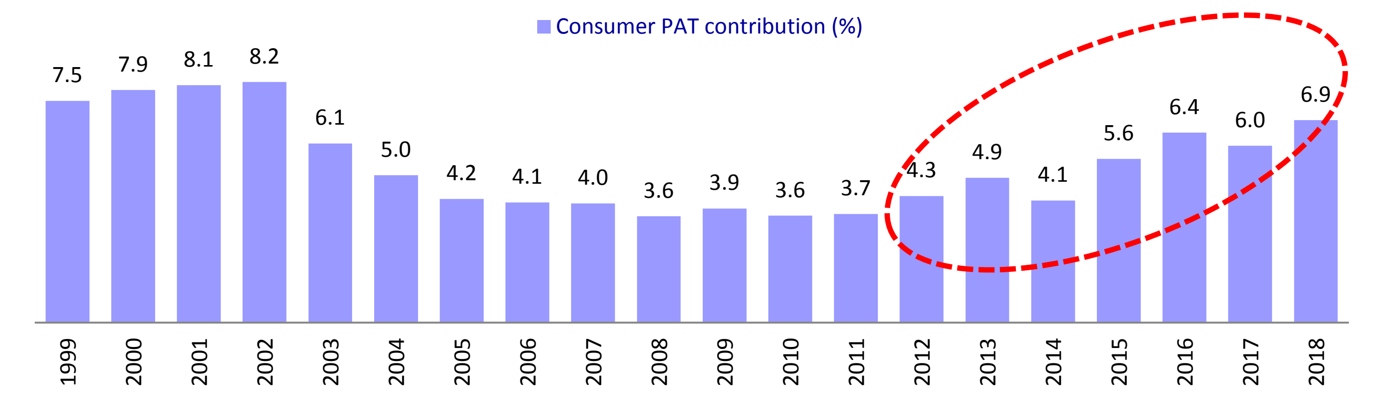
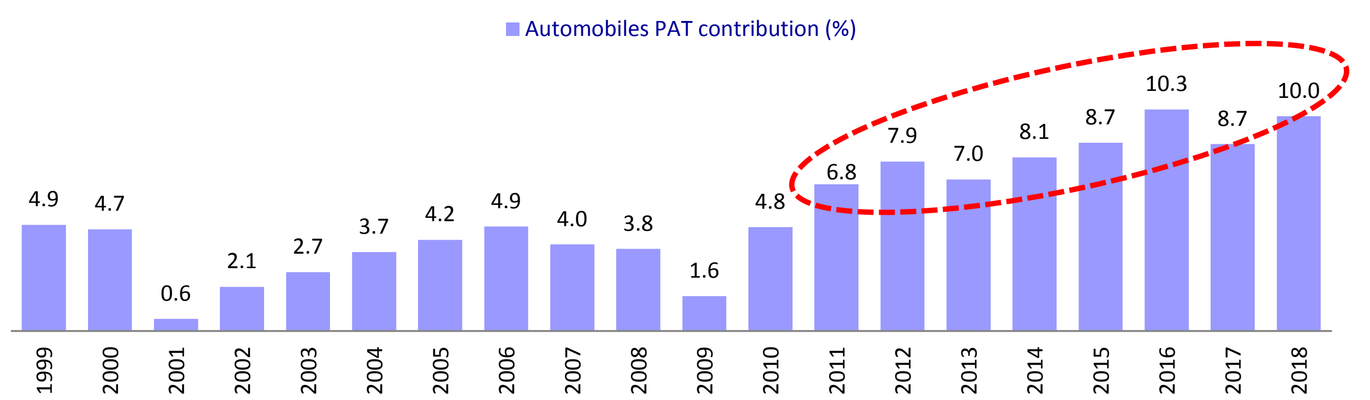
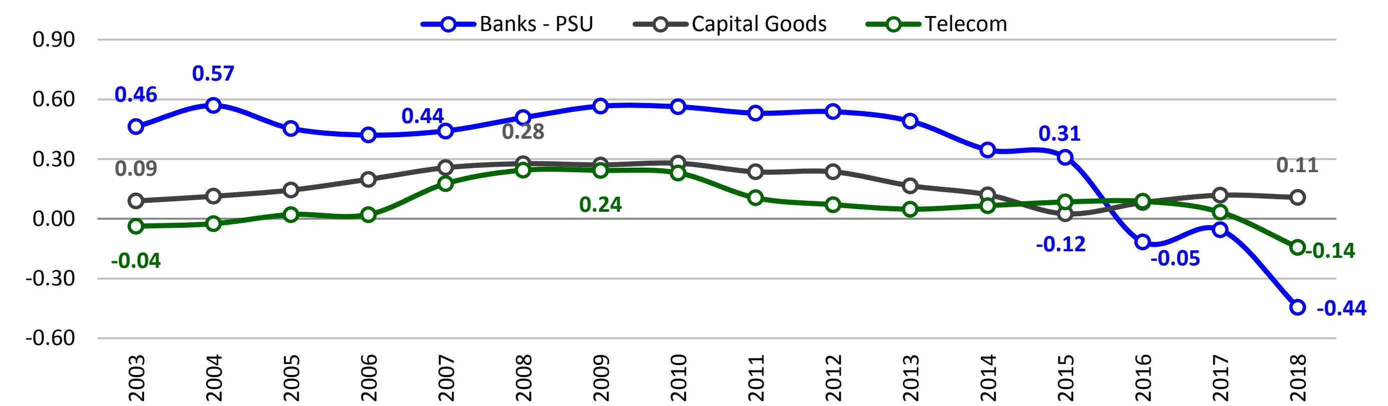


Exhibit 18: ..same is the case for Automobiles



- On the other hand, the contribution of Capital Goods (lack of private capex spending), PSBs (stress in asset quality and NPAs impacted profitability) and Telecom (sharp reversal in the fortunes of this sector post the entry of Reliance Jio in 2016) has been quite disappointing as discussed in the earlier section. We, nevertheless, expect normalization in this space, going forward.

Exhibit 19: PSU Banks, Telecom and Capital Goods have dragged corporate profit growth (Corporate profit to GDP %)

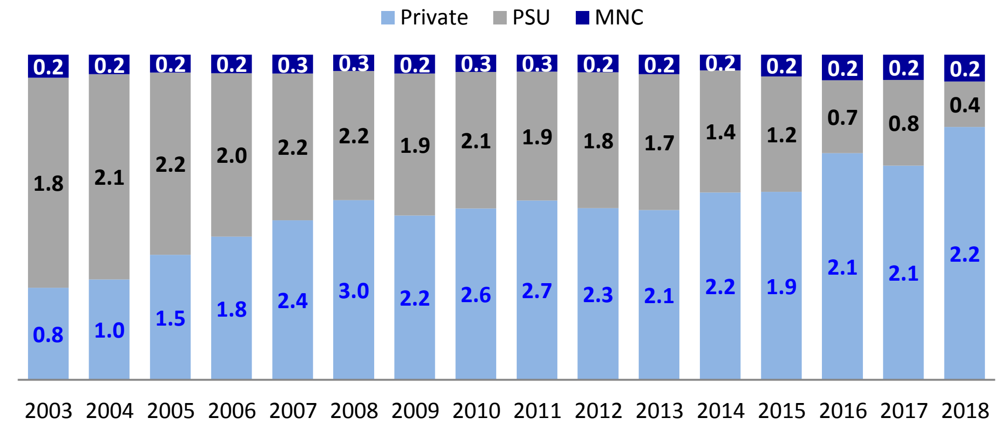


Private v/s PSUs: Private sector's profit to GDP expands ~3x over 2003-18

- We analyzed India's corporate profit to GDP distribution over the last 15 years in three categories: PSUs, MNCs and Private Corporates.
- PSUs' corporate profit to GDP is down from 1.8% in 2003 to 0.4% now, given the significant value migration away from public to private in sectors like Banking, Telecom, Airlines, even as PSU heavy sectors like Oil & Gas and Utilities have underperformed on profit growth versus underlying GDP growth.
- The losses of PSU have been gains for the Indian Private Corporates, with the latter's corporate profit to GDP ratio rising from 0.8% in 2003 to 2.2% in 2018.
- MNCs' contribution has remained stable over the years.
- We expect the structural trend of shift from public to private in the share of corporate profit to GDP to continue, given the eroding competitive advantage of the PSUs in several sectors like Banking and Insurance. While the monopolistic businesses like upstream and downstream Oil & Gas and Utilities players do enjoy a certain size in terms of absolute profits, growth has been a perennial issue for them.

Exhibit 20: Corporate profit to GDP (%) – by business group

Clear and continuous migration from PSUs to private entrepreneurs



Have we seen the bottom of corporate profit to GDP?

- We expect the corporate profit to GDP trends to improve FY19 onward, even as we do not foresee acceleration like 2003-08.
- Corporate Banks (both PSU Private) – one of the biggest contributors to the downtrend in corporate profit to GDP – are expected to drive the expansion as asset quality bottoms, fresh slippage generation moderates, provisioning cost normalizes and loan growth recovers.
- In Capital Goods and Cement, we expect the private capex cycle to recover gradually. Incipient signs of capex spending in select sectors (Refining, Steel and Cement) offer some confidence in their contribution to aggregates.
- Telecom and Utilities, which have seen significant capex investments and balance sheet expansion (rising capital employed) without any commensurate returns may have troughed in our view, and can contribute in this cycle over the next few years as Telecom players repair balance sheets (de-leveraging, asset monetization) and competitive intensity peaks out We expect profitability of this sector to see gradual improvement.
- We expect sectors like Consumer, Auto and Private Banks (especially Retail) to stay stable as far as their contribution as a percentage of GDP is concerned.
- Overall, we estimate Nifty profits to grow 13% in FY19 and 24% in FY20 – a decent pick-up – led by Financials (expected to account for ~58% of incremental earnings of the Nifty in FY20).
- For the MOSL Universe, we expect profits to grow 17%/28% in FY19/20, again led by Financials.

Exhibit 21: Expect Nifty ex corporate lenders PAT CAGR of 12% over FY18-20

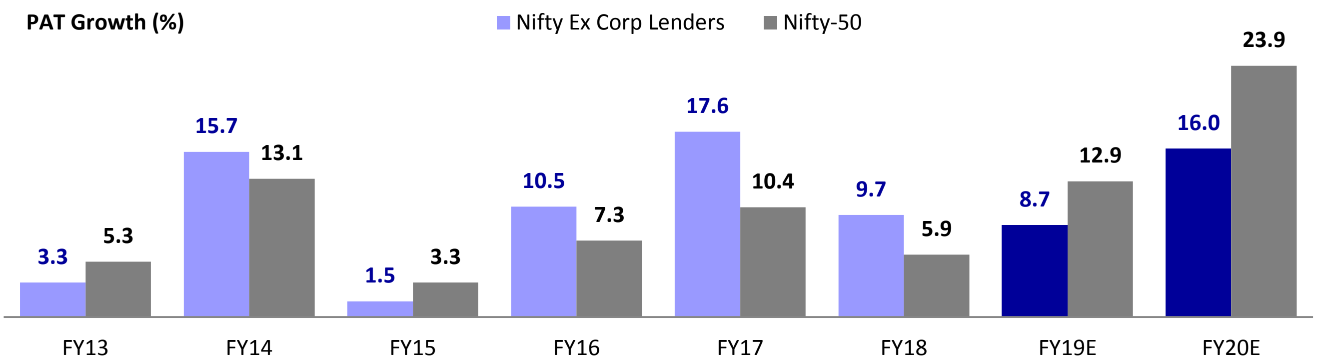


Exhibit 22: Nifty EPS – 5% CAGR over FY08-18; expect 19% CAGR over FY18-20

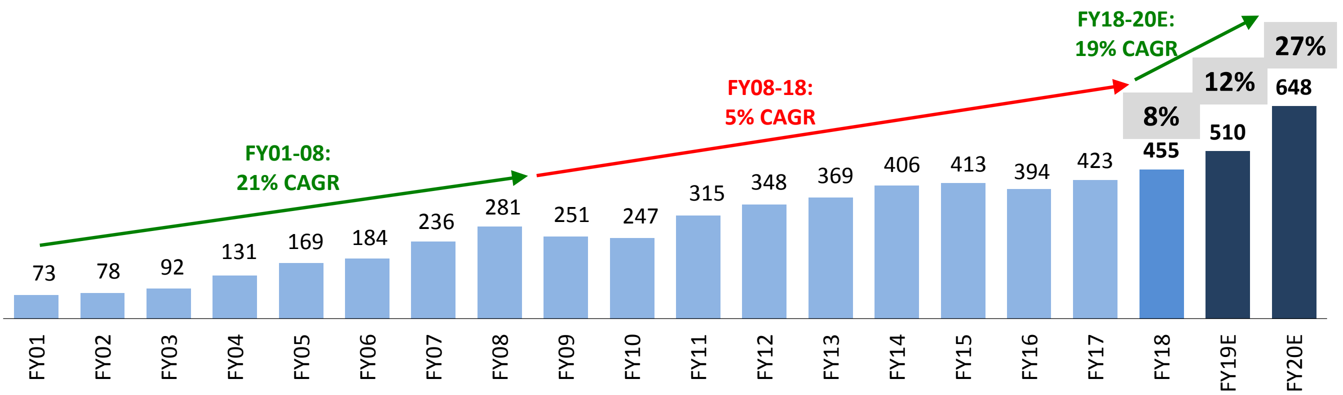


Exhibit 23: Financials would drive earnings growth in FY19

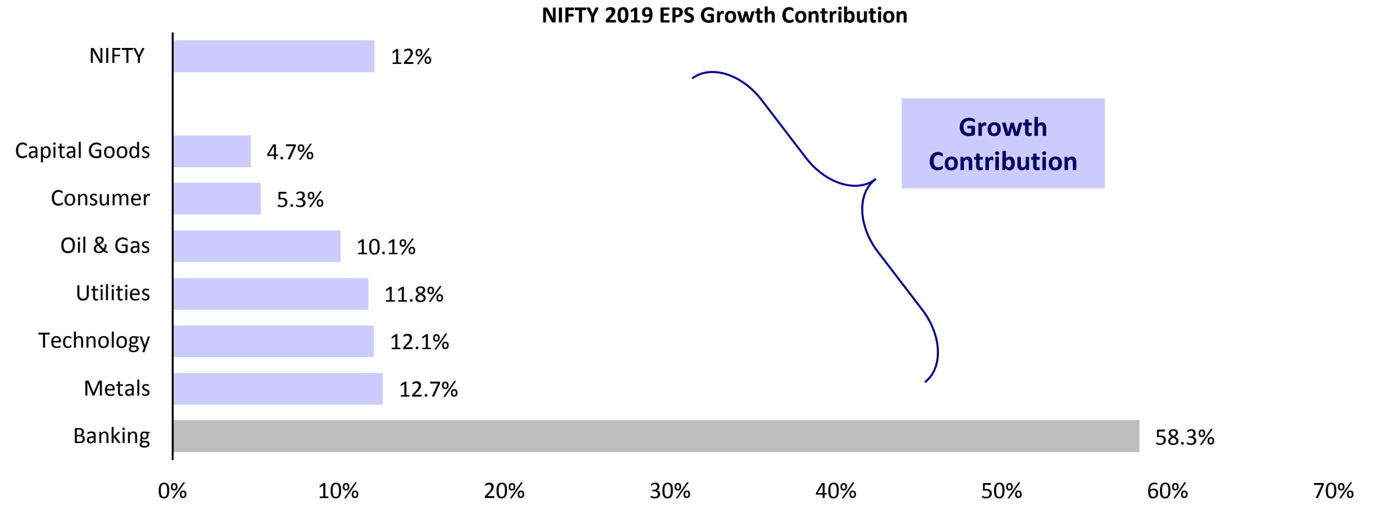
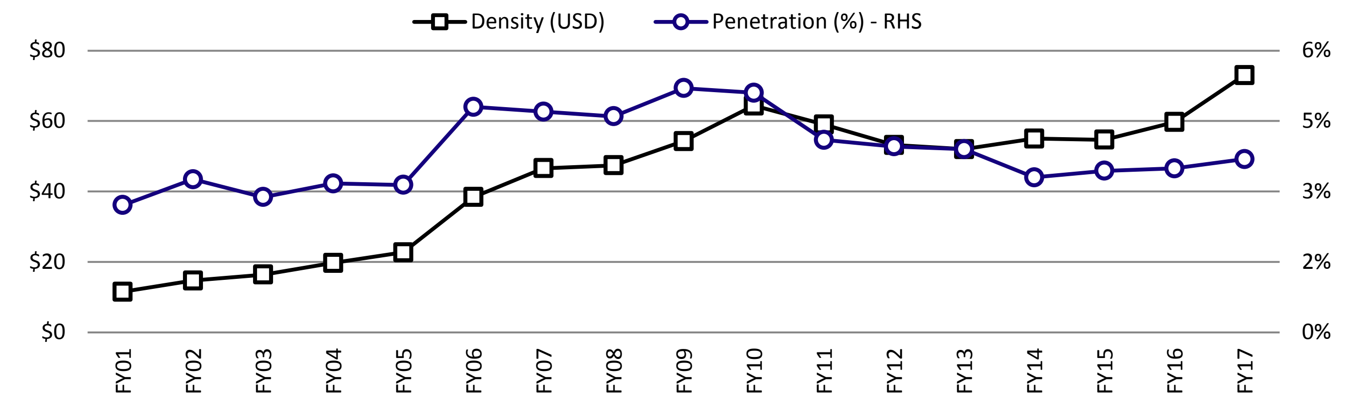


Exhibit 24: MOSL Universe profit pool (INR b)

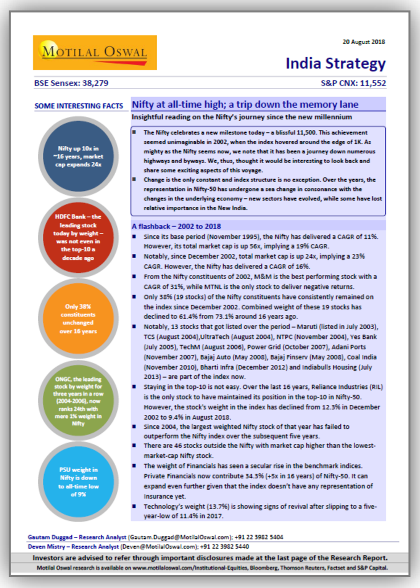
Sector	EBIDTA (INR b)					PAT (INR b)				
	FY16	FY17	FY18	FY19E	FY20E	FY16	FY17	FY18	FY19E	FY20E
Auto (16)	851	833	922	953	1,147	374	342	393	340	473
Capital Goods (16)	165	211	254	301	356	85	126	146	172	209
Cement (13)	140	172	198	220	267	88	101	103	119	155
Consumer (19)	360	384	423	489	569	243	261	289	333	389
Financials (36)	2,084	2,491	2,629	2,995	3,663	556	688	358	920	1,612
Private Banks (12)	777	932	1,010	1,162	1,458	402	415	410	504	751
PSU Banks (7)	966	1,151	1,110	1,242	1,512	-40	45	-335	70	455
Life Insurance (2)	20	17	25	22	26	25	26	27	24	28
NBFC (15)	322	392	484	569	667	169	203	256	322	378
Healthcare (20)	357	352	312	362	463	209	225	182	210	278
Infrastructure (4)	34	39	38	44	50	11	12	16	17	17
Logistics (2)	18	15	16	20	23	12	10	10	15	17
Media (8)	59	64	71	92	108	33	35	30	40	53
Metals (10)	522	808	1,050	1,262	1,271	135	229	398	476	484
Oil & Gas (14)	1,450	1,829	2,193	2,520	2,776	795	1,094	1,155	1,201	1,363
Excl. OMCs (11)	1,003	1,242	1,518	1,921	2,200	557	713	759	919	1,059
Retail (2)	12	14	21	27	33	8	9	13	17	22
Technology (15)	755	822	849	1,024	1,163	597	644	678	775	848
Telecom (4)	538	539	448	381	466	97	71	-2	-193	-204
Utilities (7)	729	731	822	955	1,122	351	323	346	417	480
Others (24)	203	225	258	274	390	87	108	129	117	174
MOSL (210)	**8,277**	**9,528**	**10,502**	**11,919**	**13,867**	**3,682**	**4,279**	**4,243**	**4,974**	**6,369**
MOSL Excl. OMCs (207)	**7,830**	**8,942**	**9,827**	**11,320**	**13,291**	**3,443**	**3,898**	**3,847**	**4,692**	**6,065**

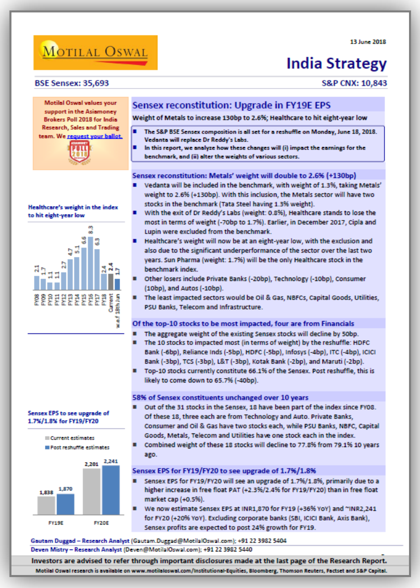
- We note that in every cycle, new sectors evolve and contribute to the profit to GDP metrics. This is a reflection of change in the underlying economy. In the earlier upcycle of 2003-08, sectors like Infrastructure, Cement, Capital Goods and Construction evolved, while Investments as proportion of GDP galloped. Few sectors that were not listed a decade ago are now listed and growing well. They also have a strong long-term growth path ahead of them given the under penetration in their respective segments. For example, Consumption and Financials have seen relatively better performance vis-à-vis investment oriented sectors. Over the last couple of years, Insurance (Life and General), Asset Management Companies, Organized Retail, Lifestyle Consumption, etc. have scaled up and are now gaining traction. We expect their contribution in the profit to GDP equation to go up further.
- Insurance is at a very nascent stage in India and its contribution to profit pool is close to zero. The sector's penetration in India declined from a peak of 5.2% in FY09 to 3.3% in FY14 and recovered marginally to 3.7% in FY17. Bulk of the decline happened during the years of major regulatory changes. With improving product offerings and macro drivers, insurance penetration in India is likely to increase over the next few years, in our view. As such, this will lead to an increased contribution of Insurance to overall corporate profitability.

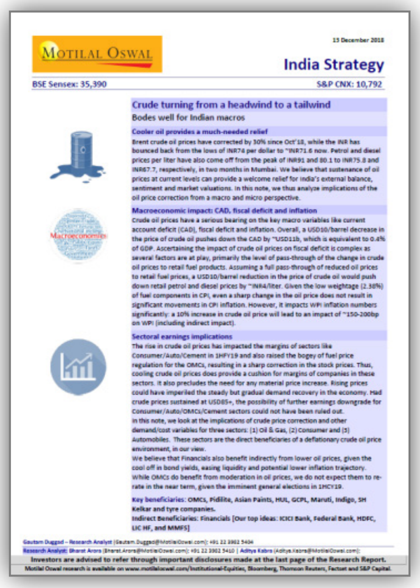
Exhibit 25: India: Insurance penetration and density trend

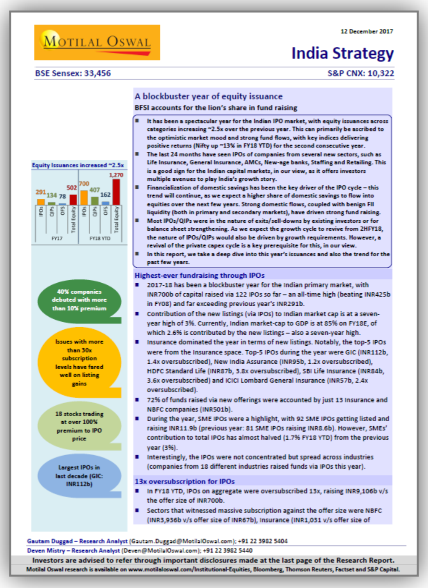


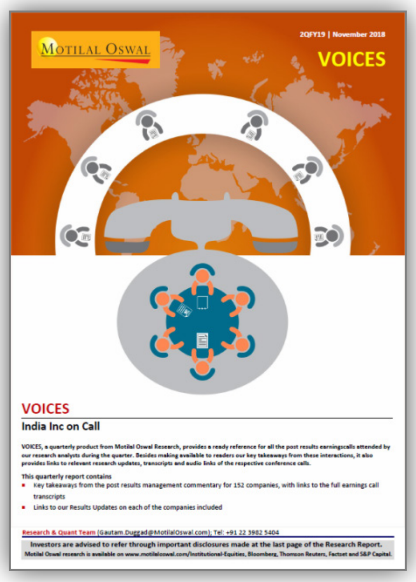
India Strategy, Thematics and Quant Research Gallery

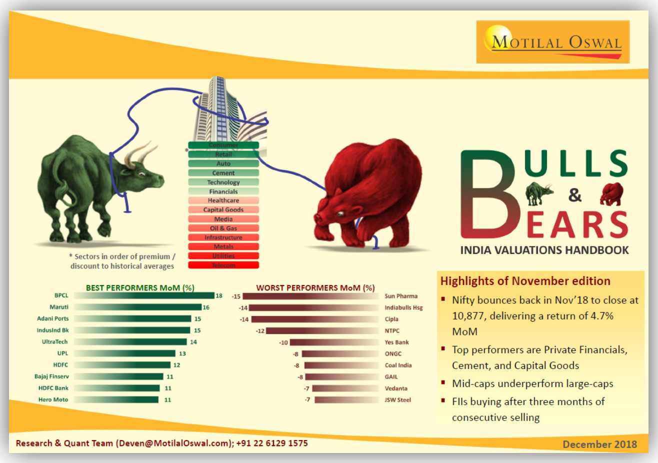


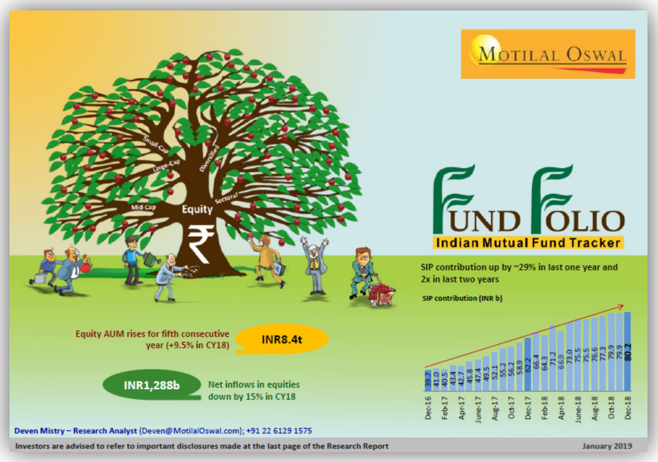












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