# UBS Investment Research

# India – Outlook 2012

## Headwinds provide buying opportunity

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■ **Summary**

India is in the midst of a cyclical slowdown that is further complicated by stubborn inflation and a rapidly depreciating currency. Corporate earnings growth is likely to slow to about 10% YoY as earnings momentum continues to be negative. In the event of large-scale foreign institutional investment (FII) outflows, we estimate 20% further downside to Indian equity markets. However, we would view this as an attractive buying opportunity as India's structural story is strong and underpinned by demographic advantages.

■ **Inflation, policy and rates in 2012**

We expect inflation to slow to 7% by March 2012 and remain in the 6-7% range thereafter. In 2012, we expect cuts of 100bp in the official repo rate starting in the March quarter. We expect the USD-INR rate to weaken to 55 by end-2011 and appreciate in stages to 51 by end-2012 as it prices in 'inflation-stabilisation' then 'growth recovery'.

■ **Key Catalysts**

We think falling inflation followed by a loosening monetary policy that revives economic growth is likely to be the key catalyst to watch out for. Other potential catalysts include the government making progress on reforms and fiscal discipline in the February 2012 budget. Potential negative catalysts include stubborn inflation, higher crude oil prices, further rupee depreciation and continuing policy paralysis.

■ **Most & Least Preferred Stock Ideas for 2012**

Most preferred: Bharti Airtel, Coal India, Federal Bank, Idea Cellular and Mahindra & Mahindra. Least preferred: Bank of India, HCL Technologies, LIC Housing Finance and Tata Motors.

Table 1: India Most and Least Preferred List

| Company | RIC | Market Cap (US$ bn) | UBS Rating | Share Price (Rs) | Price Target (Rs) | PE 2013E (x) |
|---|---|---|---|---|---|---|
| Most Preferred | | | | | | |
| Bharti Airtel Ltd. | BHTV.BO | 27.2 | Buy | 373.5 | 530.0 | 14.2 |
| Coal India | COAL.BO | 39.1 | Buy | 322.1 | 400.0 | 12.0 |
| Federal Bank | FED.BO | 1.2 | Buy | 356.3 | 550.0 | 6.4 |
| Idea Cellular | IDEA.BO | 6.0 | Buy | 95.2 | 120.0 | 20.8 |
| Mahindra & Mahindra | MAHM.BO | 7.9 | Buy | 725.1 | 940.0 | 9.4 |
| Least Preferred | | | | | | |
| Bank of India | BOI.BO | 3.3 | Sell | 327.2 | 300.0 | 6.4 |
| HCL Technologies | HCLT.BO | 5.2 | Sell | 391.2 | 380.0 | 10.1 |
| LIC Housing Finance | LICH.BO | 2.0 | Sell | 218.8 | 200.0 | 7.4 |
| Tata Motors Ltd. | TAMO.BO | 10.9 | Sell | 177.4 | 170.0 | 5.0 |

Data as at 29 November 2011. Source: UBS estimates

# Outlook 2012 – Summary

## What is the outlook for India and our central thesis for 2012?

Market target: 6,500 for the Nifty

- **Nifty Outlook:** The Nifty is trading at about 12.5x forward PE, below the 10-year average. In the event of large scale FII outflows, we estimate 20% further downside to Indian equity markets.

  We expect earnings growth of about 10% in FY13 and about 12% in FY14. Our March 2013 target for the Nifty is 6,500, based on a 12-month forward PE of 15x and a base case FY14E EPS of Rs430.

Our target is based on a 12-month forward PE of 15x on FY14E EPS of Rs430 for the Nifty

- **Economic Outlook:** We expect real economic growth to recover to 7.3% in 2012-13 and to 7.8% in 2013-14. We expect only a moderate recovery from the slump to 6.9% growth in 2011-12 for two reasons: 1) only limited policy stimulation; and 2) the challenging global conditions.

  India is in a fairly standard-issue economic downswing, but we expect the turn to come in the March 2012 quarter (where we forecast a sub-7% growth rate). We think policy should respond in the March 2012 quarter and believe the response will matter. A heavy QE-type reply implies another cycle of vigorous economic recovery plus reaccelerating inflation. This in turn gives profits a challenging time as policymakers must later wind back the stimulus. However, we do not expect this—rather, we expect ‘stimulus-lite’. This implies a modest growth rebound and minor inflation consequences.

  The implications of the above for equity investors are: 1) the recovery is going to depend on profits benefitting from lower cost inflation rather than a straight interest rate cyclical story; and 2) capex should remain relatively weak and then recover. In the interim, we believe the consumption story will play a bigger role than the infrastructure side. Fresh reform moves are also likely, in our view. They could boost the retail sector and the investment in the logistics, transportation and storage sectors that India badly needs.

  From the global angle, India’s growth is increasingly synchronised to the G7 economies via trade and foreign capital. The gap in the growth rate between India and the G7 has narrowed 1% after the global financial crisis to approximately 6%. Balance of payments data also tell us that even at today’s yawning interest rate differentials India’s ability to draw in foreign capital is much reduced. India must reduce inflation, companies must improve efficiency, and the government must improve regulatory clarity and stability if India is to continue to attract sufficient foreign funds.

- **Earnings Outlook:** Our bottom-up earnings analysis of Nifty constituents suggests earnings growth of over 14% in FY13 (see the table below for more details). We believe there could be further downward revisions to earnings forecasts as the economic outlook for FY13 becomes clearer over the course of the year. We forecast earnings growth of 10% in FY13.

Macro events on the global front can have an impact on the outlook for India. Our global equity strategy team's view on the global macro economy is that growth is weak and appears unlikely to rebound sharply given ongoing de-leveraging, austerity plans, and heightened uncertainty. 'Sovereign stress' also threatens periodic shocks to markets given the role of politics and challenging growth.

Table 2: Nifty earnings estimates

| | FF adj. Earnings (UBS-e) | | FF adj. Earnings (IBES-e) | | Earnings Growth UBS-e (YoY, %) | | Earnings Growth IBES-e (YoY, %) | | Sector contribution to UBS-e (YoY, %) | | Sector contribution to IBES-e (YoY, %) | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | FY12E | FY13E | FY12E | FY13E | FY12E | FY13E | FY12E | FY13E | FY12E | FY13E | FY12E | FY13E |
| Autos | 131,533 | 147,692 | 117,529 | 133,764 | 18.7% | 12.3% | 6.0% | 13.8% | 2.2% | 1.5% | 0.7% | 1.5% |
| Financials | 250,695 | 308,951 | 268,826 | 321,118 | 15.8% | 23.2% | 12.3% | 19.5% | 3.6% | 5.4% | 3.0% | 4.8% |
| Cement | 29,867 | 33,650 | 28,119 | 30,830 | 17.2% | 12.7% | 10.3% | 9.6% | 0.5% | 0.4% | 0.3% | 0.2% |
| Consumers | 54,711 | 64,764 | 53,678 | 62,735 | 23.3% | 18.4% | 20.9% | 16.9% | 1.1% | 0.9% | 1.0% | 0.8% |
| Infra/Cap goods | 74,672 | 86,597 | 72,427 | 82,215 | 17.7% | 16.0% | 14.1% | 13.5% | 1.2% | 1.1% | 0.9% | 0.9% |
| IT Services | 118,106 | 136,315 | 114,213 | 131,216 | 22.5% | 15.4% | 18.4% | 14.9% | 2.3% | 1.7% | 1.8% | 1.6% |
| Materials | 121,944 | 133,794 | 135,477 | 158,197 | -6.4% | 9.7% | 4.0% | 16.8% | -0.9% | 1.1% | 0.5% | 2.1% |
| Oil & Gas | 75,372 | 77,028 | 78,035 | 85,245 | 11.5% | 2.2% | 15.4% | 9.2% | 0.8% | 0.2% | 1.1% | 0.7% |
| Petrochem | 114,084 | 104,256 | 118,182 | 126,306 | 14.8% | -8.6% | 18.9% | 6.9% | 1.5% | -0.9% | 1.9% | 0.7% |
| Pharmaceuticals | 28,741 | 40,754 | 28,646 | 34,434 | 7.2% | 41.8% | 6.8% | 20.2% | 0.2% | 1.1% | 0.2% | 0.5% |
| Power | 46,253 | 51,895 | 48,319 | 54,668 | 4.0% | 12.2% | 8.7% | 13.1% | 0.2% | 0.5% | 0.4% | 0.6% |
| Real Estate | 3,885 | 4,613 | 3,552 | 4,199 | 10.9% | 18.7% | 1.4% | 18.2% | 0.0% | 0.1% | 0.0% | 0.1% |
| Telecom | 20,166 | 36,132 | 22,656 | 35,823 | -17.1% | 79.2% | -6.9% | 58.1% | -0.4% | 1.5% | -0.2% | 1.2% |
| Nifty | 1,070,031 | 1,226,439 | 1,089,658 | 1,260,750 | 12.2% | 14.6% | 11.6% | 15.7% | 12.2% | 14.6% | 11.6% | 15.7% |
| Nifty (ex Oil & Gas) | 994,659 | 1,149,412 | 1,011,623 | 1,175,505 | 12.3% | 15.6% | 11.3% | 16.2% | | | | |
| Nifty (ex global commodities) | 758,630 | 911,361 | 757,964 | 891,002 | 15.6% | 20.1% | 11.6% | 17.6% | | | | |
| Nifty EPS | 352 | 404 | 359 | 415 | 12.2% | 14.6% | 11.6% | 15.7% | | | | |

Above data as at 29 November. Source: Datastream, Bloomberg, UBS estimates

## Inflation, policy and rates

Inflation has been the number one issue in India's economy. The wholesale price index (WPI) rate remains at 9-10%. This dates back to Indian policy over-stimulation in 2009 and the rebound in global commodity prices. But the impact of higher global oil pricing has almost run its full course, in our view. Meanwhile, the Reserve Bank of India (RBI) has raised policy rates to 8.5% and the economy is slowing. We therefore expect headline inflation to slow to 7% by March 2012 and remain in a 6-7% range thereafter.

This inflation reprieve should allow the government to somewhat ease policies. In 2012, we expect cuts of 100bp in the official repo rate starting in the March quarter. We expect the fiscal deficit to rise by approximately 1% of GDP to 5.5% in 2011-12, and to remain at 5% in 2012-13. The wider fiscal deficit mainly reflects cyclical revenue slippage and subsidy boost. Beyond this, high inflation and bond market stresses provide little room for significant policy stimulation.

Towards end-2011, the exchange rate is vulnerable to: 1) the wider trade deficit; 2) weaker growth; and 3) larger foreign currency debt repayments. In 2012, however, we expect the exchange rate to stabilise and strengthen as inflation stabilises. We do not expect further gains until the economy recovers and official rate cuts end. We expect the USD-INR rate to weaken to 55 by end-2011 then appreciate in stages to 51 by end-2012 as it prices in 'inflation-stabilisation' and then 'growth recovery'.

## What are the likely key themes for 2012?

- **State assembly elections 2012:** State assembly elections are scheduled in seven states in 2012: Goa, Gujarat, Himachal Pradesh, Manipur, Punjab, Uttarakhand and Uttar Pradesh (UP).

  The UP election is a key event to watch, as it might have an impact on the Lok Sabha elections in 2014, since UP elects approximately 15% of Lok Sabha members. The Mayawati-led BSP has had a strong hold on the UP electorate but has recently faced significant criticism about corruption. The Congress Party has chosen Rahul Gandhi as its representative to take advantage of the declining support for the BSP.

  The other key states are Gujarat and Punjab, where the BJP-led National Democratic Alliance (a major opposition party at the national level) is in power. The performance of the Congress Party in these state elections will provide an insight into how the electorate views the Congress-led UPA government's term in power at the national level so far.

  The recent election results in Bihar, Tamil Nadu, West Bengal and Kerala indicate that voters have begun to reward good governance and penalise bad governance. We therefore believe the run-up to state elections is likely to witness increased government policy/reform/incentive/subsidy announcements at the state and national levels, to create positive sentiment among voters.

- **Reforms:** Given the recent clamour about policy paralysis, we expect reforms by the government to be a key driver for markets in 2012. Over the past several months, there have been positive steps including cabinet approval of mandatory digitisation, a promising draft National Telecom Policy (NTP) 2011 and petrol price deregulation etc. Reforms that we think could occur in 2012 include:

  - **GST:** The Goods and Services Tax (GST) is a value-added tax, which is generally expected to be implemented by October 2012. It will replace all indirect taxes on goods and services by Central and State governments. It is likely to help in the progress towards a more comprehensive tax structure and is expected to lower the tax rate and broaden the tax base. It should be a positive move towards reducing tax evasion and promoting economic growth.

- **DTC:** The Direct Tax Code is likely to come into effect in 2012 and will replace the existing Income Tax Act. A number of amendments to the current regulations are proposed, such as raising the tax exemption limit for men, women and seniors, removal of surcharge/cess from corporate tax and raising the amount allowed to be allocated to tax-free investments, and the impact should be largely positive on sentiment if implemented.

- **Insurance:** A hike in the FDI limit from 26% to 49%, which has been under discussion for some time, would be positive for the banking sector as companies would be able to access more capital. Stocks such as HDFC and Aditya Birla Nuvo (ABNL) are likely to benefit from this, in our view.

- **New banking licences:** The RBI is likely to issue new banking licences to non-banking finance companies (NBFCs) and industrial houses. This could be positive for small, private sector banks, which would be M&A candidates.

- **SEB reforms:** State Electricity Boards (SEBs), which are presently recording operating losses, could be given a lease of life by reforming SEB structures (unbundling, privatising, consistent tariff revisions etc). This would be beneficial for growth and profitability of the Power Finance Corporation (PFC), Rural Electrification Corporation (REC), and public sector banks.

- **DoT’s views on TRAI recommendations:** Over the past 12-18 months, the Telecom Regulatory Authority of India (TRAI) has come out with several recommendations on spectrum management, pricing, licensing and M&A guidelines. We expect the Department of Telecommunications (DoT) to take a view on these recommendations in H112 in the course of drafting the new telecom policy. Among the recommendations, the TRAI’s latest recommendations on M&A and spectrum sharing are path breaking as the new M&A guidelines should enable meaningful consolidation in the sector. On the issue of 2G spectrum charges (excess spectrum and renewal of licenses), though we believe existing operators will have to pay market prices, the DoT view remains to be seen.

- **Faster clearance and smooth development of coal blocks:** We expect new initiatives from the Prime Minister’s Office (PMO) to result in better coordination among the power ministry, the coal ministry and other related government departments. This could improve domestic coal availability for power projects.

- **Support in power project execution:** Power projects currently experience numerous delays in matters such as land acquisition and environmental and forest approvals. The government appears to be prioritising faster execution of power projects and we expect processing and approvals/clearances to become faster and more efficient.

- **Duty on imported Chinese equipment:** There has been very strong newsflow on the likelihood of a 14% duty on imported Chinese equipment. This is likely to be beneficial for Bharat Heavy Electricals (BHEL), L&T, Thermax and other domestic equipment suppliers. We have also spoken with management of some power companies, who think that though power generation companies would fight the measure hard, it looks very likely (perhaps as soon as January/February). However, pricing is not the only issue here, as power generation companies are also concerned with delivery schedule and financing.

- **FDI in multi-brand retail:** The Cabinet has recently permitted 51% foreign direct investment (FDI) in multi-brand retail. Once implemented, we expect FDI in multi-brand retail to benefit: 1) major consumer staples companies, especially those that have dominant market shares, as retailers will require their support to expand; 2) backend logistics, as 50% of the investment has to be earmarked for the back end; 3) consumer durables, as funds required for expansion will be easily available in an industry with significant scope for growth; and 4) retailers, which could be acquired or become JV partners for MNCs.

- **Consumer growth to remain strong:** Despite high food inflation the underlying trends in the consumer sector seem to suggest strong growth in volumes and uptrading to better quality products. This should provide momentum in consumer spending. Private consumption contributed 58% of FY11 GDP.

- **Emergence of pricing power in telecom:** We believe India's mobile sector is going through a paradigm shift, with the leading companies (Bharti Airtel, Idea Cellular, Vodafone and Reliance Communications) increasing tariffs as the current pricing is not sustainable. We believe that price increases mark a turning point in the sector's competitive dynamics. The emergence of pricing power over the next year is likely to lead to better financial performance and further re-rating of the sector, in our view.

- **Mining pick up:** We expect timely environmental approvals/forest clearances for various coal blocks/other mines that are pending at various stages, as the government realises these are needed to promote coal output that is required for India's economy. We believe any such speedy action by the government could be a positive for companies such as Coal India, Hindalco Industries and Sterlite Industries.

  Additionally, resolution of the mining ban in Karnataka, which is widely expected by early 2012 (at least to meet the requirements of domestic steel producers, though exports might still not be allowed) would be a positive for mining companies like Sesa Goa and steel companies like JSW Steel, in addition to the general benefits of the positive impact on employment in the region, contribution to state and central government taxes and Index of Industrial Production (IIP) and GDP.

  However, ongoing mining investigations (related to illegal mining/environmental damages) remain a key event risk for metals and mining companies in India.

## What may surprise on the upside or downside?

- On the upside, if the government is able to successfully carry out reforms planned for 2012, it should be positive for the market.
- Encouraging data on inflation, industrial production, GDP and quarterly earnings growth could also be positive for sentiment.
- On the downside, global events such as commodity price increases or worsening conditions in the Euro-zone could have a negative effect.

## What are the likely key catalysts in 2012?

- Falling inflation followed by a loosening monetary policy that revives economic growth is likely to be the key catalyst to watch out for.
- Successful progress on reforms by the government in 2012 could be a catalyst for the market.
- The demonstration of fiscal discipline in the Union Budget announcement in February 2012 could also be a key driver.
- Negative catalysts include stubborn inflation, higher crude prices, further rupee depreciation and continued policy paralysis.

## What are our most non-consensus country calls?

**Negative on IT services:** We are negative on the sector and expect vendors to become more cautious on their outlook by early 2012. Our key concerns include: 1) slower demand growth over the medium term in large sectors such as banking and financial services and telecom; 2) aggressive competition from lower margin vendors; 3) rising supply costs; and 4) near-term cyclical demand weakness. We expect the near-term cyclical weakness to result in weaker-than-expected IT services budgets in 2012, which should impact newsflow and share prices by late December 2011, or early January 2012.

We expect Infosys Technologies (Infosys) and Tata Consultancy Services (TCS) to be relatively defensive in a prolonged sector downturn due to their high quality management, strong balance sheets and potential earnings benefits from currency depreciation.

## Most & Least Preferred Ideas

Our most preferred ideas are Bharti Airtel (Bharti), Coal India, Federal Bank, Idea Cellular (Idea) and Mahindra & Mahindra (M&M), while our least preferred ideas are Bank of India, HCL Tech, LIC Housing Finance and Tata Motors.

# India Most & Least Preferred

In this section we present our company list and commentary for the Most & Least Preferred stocks in India for 2012.

Table 3: India Most and Least Preferred

| Stock | Rating | Price Target (Rs) | Overview |
|---|---|---|---|
| Most Preferred | | | |
| Bharti Airtel | Buy | 530.00 | We see increasing evidence of an improving regulatory and pricing environment in the telecom sector and expect Bharti to emerge as one of the beneficiaries of the improving outlook. |
| Coal India | Buy | 400.00 | We believe Coal India's structural theme is intact and concerns like a proposed mining tax, wage negotiations etc. would not impact the structural positives such as strong domestic coal demand, low earnings volatility and low costs. |
| Federal Bank | Buy | 550.00 | We believe Federal Bank is at the brink of an operational turnaround brought about by a change in leadership and a structural improvement in asset quality. |
| Idea Cellular | Buy | 120.00 | We expect Idea to benefit the most from the improving pricing environment and regulatory outlook in the telecom sector given it is a pure play on the Indian mobile sector. |
| Mahindra & Mahindra | Buy | 940.00 | We believe M&M, given its high exposure to the rural segment, will continue to benefit from the strong government focus on improving rural infrastructure and income levels. |
| Least Preferred | | | |
| Bank of India | Sell | 300.00 | We are cautious on Bank of India as the bank's exposure to potential stressed sectors is high compared to other banks under our coverage. |
| HCL Technologies | Sell | 380.00 | We remain negative on HCL Tech as we expect the stock to be less defensive in a downturn given the lower margin resilience and relatively weaker balance sheet compared to its peers. |
| LIC Housing Finance | Sell | 200.00 | We are cautious on LIC Housing Finance as rising risks do not seem to be priced in at current valuations. |
| Tata Motors | Sell | 170.00 | We remain negative on the growth outlook for medium and heavy commercial vehicles (MHCV) given weak industrial growth and view Tata Motor's risk-reward profile as unfavourable |

Data as at 29 November 2011. Source: UBS estimates

We summarise the investment case into 2012, current valuation and likely catalysts for each of the stocks in our Most & Least Preferred List below:

## Most Preferred

### Bharti Airtel

**Investment case:** Bharti is the leading mobile operator in India in terms of both revenue and subscriber market share. It is one of our preferred stocks in the sector as: 1) we remain positive on the outlook for the sector as we see increasing evidence of an improving regulatory and pricing environment. Given its dominant position in the sector, we expect Bharti to emerge as one of the beneficiaries of the improving outlook; 2) we believe India is at an inflexion point of mobile data growth post the 3G launch, and we expect the company to benefit from uptake of data usage. We expect to see some evidence of data pick-up in 2012; and 3) we think the Zain acquisition is likely to be positive in the medium term. We expect the transaction to be EPS-accretive from FY13.

Sector: Wireless Communications

Rating: Buy

PT: Rs530.00

Analyst: Suresh A Mahadevan

**Valuation:** Our price target of Rs530.00 is SOTP-based. We value India/South Africa operations at Rs453, Bharti Infratel at Rs45, the stake in Indus Towers at Rs54 and Africa operations at Rs10. We also incorporate a charge of Rs32 towards one time spectrum fees, spectrum renewal fees and savings from uniform license fees. We used a WACC of 10.7% in our DCF to value Bharti's India/South Africa operations.

**2012 Catalysts:** 1) The new telecom policy (NTP 2011) is likely to be announced during the year; 2) broadband wireless access (BWA) companies are likely to launch data services in H112; 3) strong operating performance in Bharti's Africa operations; and 4) clarity likely to emerge on issues pertaining to 2G spectrum pricing and allocation.

## Coal India

Sector: Mining

Rating: Buy

PT: Rs400.00

Analyst: Navin Gupta

**Investment case:** We have a Buy rating on Coal India (CIL), because we believe the recent share price correction is overdone. We believe the correction has been led by negative newsflow on: 1) the proposed mining tax; 2) concerns about wage negotiations; 3) a production miss in H1 FY12; and 4) concerns over delays in getting environmental/forest clearances and approvals needed to drive volume growth. However, we believe the structural theme is intact and that these concerns do not impact the structural positives, ie: 1) strong domestic coal demand; 2) a virtual monopoly; 3) ASPs significantly below global prices—leaving the potential for price hikes; 4) low earnings volatility; and 4) the company's status as one of the lowest cost producers globally.

**Valuation:** Our FY13 PAT estimate of Rs169bn is marginally above the consensus estimate. We continue to value CIL on 15x FY13E PE. We have a Buy rating on the stock with a price target of Rs400.00.

**2012 Catalysts:** We believe markets have reconciled themselves to the fact that CIL will struggle to meet its production/despatch targets. We believe expectations on the stock are currently very low. We believe key triggers would be: 1) any favourable buy back scheme by CIL; 2) environmental and forest clearances for the new mines; 3) progress in ordering activity for washeries; and 4) if e-auction volumes remain approximately 11% of total volumes.

## Federal Bank

Sector: Banks

Rating: Buy

PT: Rs550.00

Analyst: Vishal Goyal

**Investment case:** We like Federal Bank as we believe it is at the brink of an operational turnaround brought about by a change in leadership and a structural improvement in asset quality. Under the new management we expect the bank to focus on improving the contribution of fee-based income (which is one of the lowest in the industry) to offset the cyclical decline in NIMs, while we expect pickup in asset growth and a decline in credit costs to support earnings growth of 27% over FY11-13E, which is one of the highest rates in the industry.

**Valuation:** We derive our price target using a residual income model which implies 1.5x FY13E book and 10x FY13E earnings. At 0.9x FY13E book and 6.4x FY13E earnings, FB is one of the cheapest private sector banks in India with the potential to re-rate to new generation private sector bank peers, in our view.

**2012 Catalysts:** We expect a fall in slippages to a sustainable level to lead to a decline in credit costs; coupled with growth in fee income this should result in ROE expansion from the current 12% to 16% in FY13.

### Idea Cellular

Sector: Wireless Communications

Rating: Buy

PT: Rs120.00

Analyst: Suresh A Mahadevan

**Investment case:** Idea is one of our top picks in the telecom sector as: 1) we expect the company to benefit the most from the improving pricing environment and regulatory outlook since it is a pure play on the Indian mobile sector; 2) the company continues to outperform its peers in terms of revenue and earnings growth and we expect the outperformance to continue given its high operating leverage; and 3) Idea management has demonstrated its ability to run an efficient mobile business harnessing its spectrum advantage. Given its strong 900 Mhz footprint, we think Idea could also be an M&A candidate as and when consolidation plays out in the sector.

**Valuation:** Our price target is SOTP based. We value Idea at Rs123 and its share in Indus at Rs20, we also incorporate a charge of Rs23 towards one time spectrum fees, spectrum renewal fees and savings from uniform licence fees. We use a WACC of 11.0% in our DCF to value Idea.

**2012 Catalysts:** 1) The NTP 2011 is likely to be announced in 2012; 2) BWA companies are likely to launch data services during H112; and 3) greater clarity on issues pertaining to 2G spectrum pricing and allocation.

### Mahindra & Mahindra

Sector: Automobile Manufacturers

Rating: Buy

PT: Rs940.00

Analyst: Sonal Gupta

**Investment case:** Given its high exposure to the rural segment, we believe M&M will continue to benefit from the strong government focus on improving rural income levels and rural infrastructure. The stock remains one of our preferred picks in the Indian auto sector.

**Valuation:** We have a Buy rating, based on a sum-of-the-parts methodology. We value the standalone business at Rs732 per share, based on 8x 2013E EV/EBITDA, and its subsidiaries (including Ssangyong) at Rs208 per share.

**2012 Catalysts:** New product launches including Rexton and Korando from Ssangyong in the India market by mid-2012 and a compact model of the Verito to be launched in the next six to eight months. Additional levies on diesel could act as a negative catalyst as M&M has an all-diesel product line-up that has benefited from the increasing cost differential between petrol and diesel.

## Least Preferred

### Bank of India

Sector: Banks

Rating: Sell

PT: Rs300.00

Analyst: Ajitesh Nair

**Investment case:** We are cautious on Bank of India as the bank's exposure to potentially stressed sectors is high compared to the other banks under our coverage. Its volatile loan recovery trends and provisioning coverage of around 59% do not provide comfort on its ability to manage the potential stress ahead. We expect loan loss provisioning to increase from 66bp in FY11 to 95bp in FY12-13. We forecast an earnings CAGR of 5.6% in FY11-13.

**Valuation:** We value the stock using a residual income method. Our price target implies 0.9x FY12E book and 6.7x FY12E earnings.

**2012 Catalysts:** We believe a sustained economic slowdown and higher loan restructuring could pose further downside risk to the share price.

## HCL Technologies

Sector: Diversified Technology Services

Rating: Sell

PT: Rs380.00

Analyst: Diviya Nagarajan

**Investment case:** We remain negative on HCL Tech as we expect the stock to be less defensive in a downturn given its lower margin resilience and relatively weaker balance sheet compared to peers. In addition, we expect a period of potential sluggishness in demand by early 2012, which could cause downgrades to FY13 outlook. We expect HCL Tech's operating margin to remain low, with the senior management indicating increased expenditure on sales and marketing in the next few quarters. We think the company needs to consistently spend more on sales and marketing in order to sustain revenue growth. We remain cautious given our concern about a potential tradeoff between margins and revenue growth.

**Valuation:** We derive our price target from a DCF-based methodology and explicitly forecast long-term valuation drivers using UBS's VCAM tool, assuming a WACC of 12.4% and a terminal growth rate of 3%. Our price target implies a one-year forward PE multiple of 15.7x, which we believe is reasonable given the lower margin profile.

**2012 Catalysts:** 1) Increased investment in client-facing activities that will manifest itself in the form of higher SG&A is likely to impact margins; and 2) continuing negative newsflow in developed economies is likely to impair 2012 IT services budgets and pose significant downside risk in the near term.

## LIC Housing Finance

Sector: Diversified Financials

Rating: Sell

PT: Rs200.00

Analyst: Ajitesh Nair

**Investment case:** We are cautious on LIC Housing Finance (LICHF) as rising risks do not seem to be priced in at 2.2x FY12E book. We think risks include: 1) a slowdown in mortgage volumes due to the slowing economy, high interest rates and high real estate prices; 2) likely pressure on NIMs as competition from banks will remain high; 3) falling interest rates will not necessary benefit LICHF as asset yields would also re-price downwards; and 4) continued regulatory risks as capital requirements for housing finance companies remain more benign compared to other NBFCs; LICHF has a low tier-1 capital at 9%, with leverage at 12x.

**Valuation:** We value the stock using a residual income method. Our price target implies 1.9x FY12E book and 8x FY12E earnings.

**2012 Catalysts:** The National Housing Bank could introduce higher provisioning for developers at 1%.

## Tata Motors

Sector: Automobile Manufacturers

Rating: Sell

PT: Rs170.00

Analyst: Sonal Gupta

**Investment case:** We remain negative on the domestic MHCV growth outlook given weak industrial growth. In addition, Tata Motors continues to invest in promotional and dealer support and expansion activities, mainly in its passenger vehicle business. We therefore expect domestic margins to remain under pressure. We see limited upside risk to JLR volume growth given the challenging global macro environment. Volume growth ex-Evoque has continued to slow. We continue to view the risk-reward profile as unfavourable.

**Valuation:** We have a Sell rating. We value the domestic business (and other subsidiaries) at 8x FY13E EV/EBITDA and JLR at 3x FY13E EV/EBITDA. We adjust our EBITDA for R&D capitalisation.

**2012 Catalysts:** IIP growth could continue to disappoint in the near term, acting as a negative catalyst for MHCV growth. Strong Evoque sales could act as a positive catalyst in early 2012.

## ■ Statement of Risk

We believe the risks to our long-term estimates (for example, for corporate earnings) and macroeconomic variables (such as GDP growth rates and inflation) arise from any economic slowdown, weakening currency, global economic events, and government policy changes.

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| UBS 12-Month Rating | Rating Category | Coverage[1] | IB Services[2] |
|---|---|---|---|
| **Buy** | **Buy** | 59% | 35% |
| **Neutral** | **Hold/Neutral** | 35% | 33% |
| **Sell** | **Sell** | 6% | 14% |
| **UBS Short-Term Rating** | **Rating Category** | **Coverage[3]** | **IB Services[4]** |
| **Buy** | **Buy** | less than 1% | 0% |
| **Sell** | **Sell** | less than 1% | 20% |

1:Percentage of companies under coverage globally within the 12-month rating category.
2:Percentage of companies within the 12-month rating category for which investment banking (IB) services were provided within the past 12 months.
3:Percentage of companies under coverage globally within the Short-Term rating category.
4:Percentage of companies within the Short-Term rating category for which investment banking (IB) services were provided within the past 12 months.

Source: UBS. Rating allocations are as of 30 September 2011.

### UBS Investment Research: Global Equity Rating Definitions

| UBS 12-Month Rating | Definition |
|---|---|
| **Buy** | FSR is > 6% above the MRA. |
| **Neutral** | FSR is between -6% and 6% of the MRA. |
| **Sell** | FSR is > 6% below the MRA. |
| **UBS Short-Term Rating** | **Definition** |
| **Buy** | Buy: Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event. |
| **Sell** | Sell: Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event. |

**KEY DEFINITIONS**

**Forecast Stock Return (FSR)** is defined as expected percentage price appreciation plus gross dividend yield over the next 12 months.

**Market Return Assumption (MRA)** is defined as the one-year local market interest rate plus 5% (a proxy for, and not a forecast of, the equity risk premium).

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**Equity Price Targets** have an investment horizon of 12 months.

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## Company Disclosures

| Company Name | Reuters | 12-mo rating | Short-term rating | Price | Price date |
|---|---|---|---|---|---|
| **Bank of India** | BOI.BO | Sell | N/A | Rs327.20 | 29 Nov 2011 |
| **Bharti Airtel Ltd.**[5] | BRTI.BO | Buy | N/A | Rs373.45 | 29 Nov 2011 |
| **Coal India** | COAL.BO | Buy | N/A | Rs322.10 | 29 Nov 2011 |
| **Federal Bank** | FED.BO | Buy | N/A | Rs356.95 | 29 Nov 2011 |
| **HCL Technologies** | HCLT.BO | Sell | N/A | Rs391.15 | 29 Nov 2011 |
| **Idea Cellular**[2] | IDEA.BO | Buy | N/A | Rs95.15 | 29 Nov 2011 |
| **LIC Housing Finance** | LICH.BO | Sell | N/A | Rs218.80 | 29 Nov 2011 |
| **Mahindra & Mahindra** | MAHM.BO | Buy | N/A | Rs725.05 | 29 Nov 2011 |
| **Tata Motors Ltd.**[16] | TAMO.BO | Sell | N/A | Rs177.35 | 29 Nov 2011 |

Source: UBS. All prices as of local market close.
Ratings in this table are the most current published ratings prior to this report. They may be more recent than the stock pricing date

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