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Equity Strategy

UBS Investment Research

Asian Equity Strategy: India to neutral

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From underweight on improved valuations

■ SENSEX down 14% from high, YTD 2nd worst performer

We are upgrading India from underweight to neutral for 4 reasons. 1. Valuations - premium on P/ BV vs ROE has dropped to just 5%, the lowest since Sep 2004. 2. Dropped out of the expensive 4 club. 3. Strong consensus EPS upgrades on a strong base of EPS growth. 4. Approaching the average EMBI sell-off of 23 trading days.

■ India's premium 5%, the lowest since Sep 2004

While historic PE at 16.2x is still some 10% above the historical average (see chart below to the right), India's premium to the region has dropped from 31% at end Oct 06 to 5% currently. The premium has dropped as the SENSEX is YTD the 2nd worst performer (SENSEX -8.5% US$ vs -1.6% for region) but consensus EPS revisions remain strong.

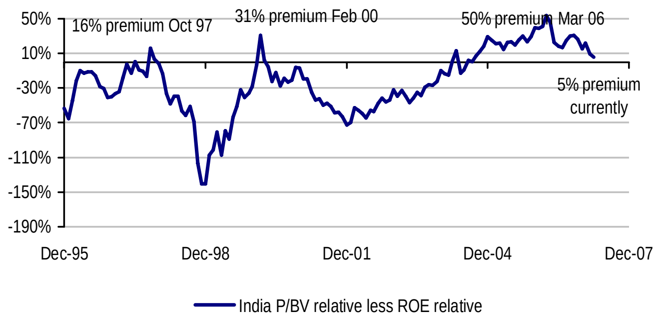
■ Strong EPS revisions on strong EPS growth

Chart 1 highlights that 2007E consensus EPS for India is up 10% since 31 Dec 2005. Significantly, there were big upgrades in recent months - Feb was +2.4%, March to date +0.6%. Some investors argue that since other markets have also seen strong EPS upgrades - Philippines +20%, Singapore +19%, Malaysia +10%.

■ 2007 bottom up is for India's EPS to grow by 26%

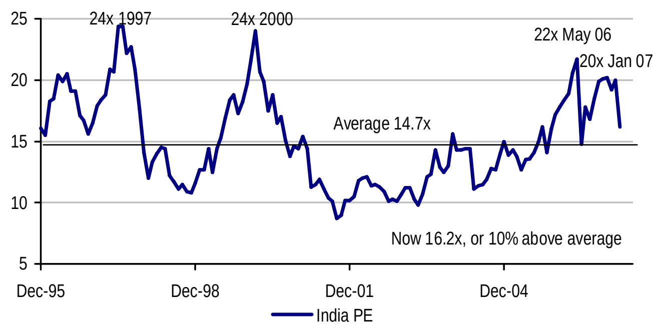
India's EPS upgrades imply 26% EPS growth in 2007 and 23% in 2008. This compares with Singapore's 6% (or 13% after one-offs), Philippines 15% and Malaysia's 17% in 2007.

India P/ BV vs ROE relative to the region



Source: UBS estimates

Chart 1: India historic PE



Source: Datastream, UBS estimates

This report has been prepared by UBS Securities Pte. Ltd.

4 reasons why we are upgrading India from Underweight to Neutral

We are upgrading India from Underweight to Neutral for 4 reasons:

1st reason – P/ BV vs ROE premium just 5%, lowest premium since Sep 2004

One, valuations – on P/ BV vs ROE relative to the region, India's premium has dropped to just 5%. This is down from a recent high of 31% at end October 2006. **The 5% premium is the lowest since September 2004**. India's premium has dropped because of the SENSEX's poor performance (for example, YTD in US$, the SENSEX is down 8.4% versus -1.6% for MSCI Asia Pacific ex Japan in US$) and continued consensus EPS upgrades (see below).

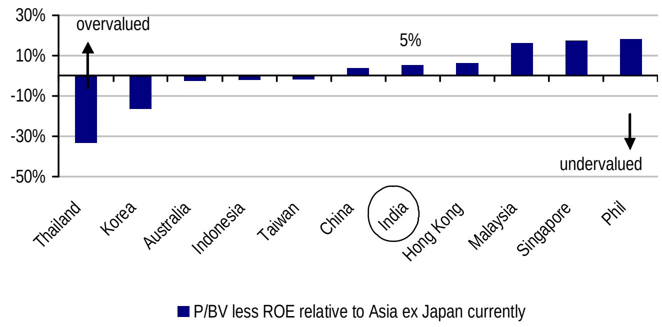
2nd reason – India has dropped out of the expensive 4 club

Two, India has dropped out of the expensive 4 club. Chart 1 highlights that India is no longer amongst the four most overvalued markets on P/ BV vs ROE relative to the region. The last time this occurred was in June 2006.

3rd reason – approaching the average EMBI sell-off

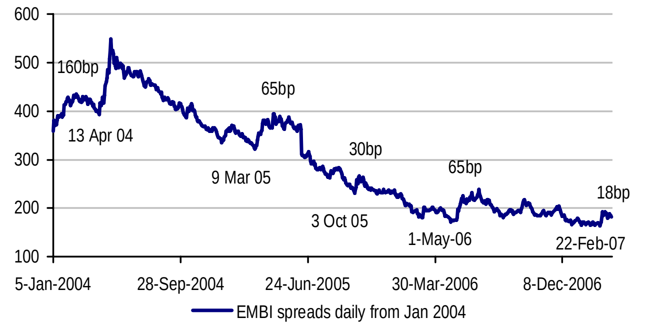
Three, with the SENSEX being a EMBI driven market, chart 2 and Table 1 highlight that the **EMBI sell-off now in its 17th day is fast approaching the average sell-off of 23 trading days.**

Chart 1: Countries on P/ BV vs ROE relative to the region



Source: UBS estimates

Chart 2: EMBI spreads



Source: J P Morgan, Bloomberg, UBS estimates

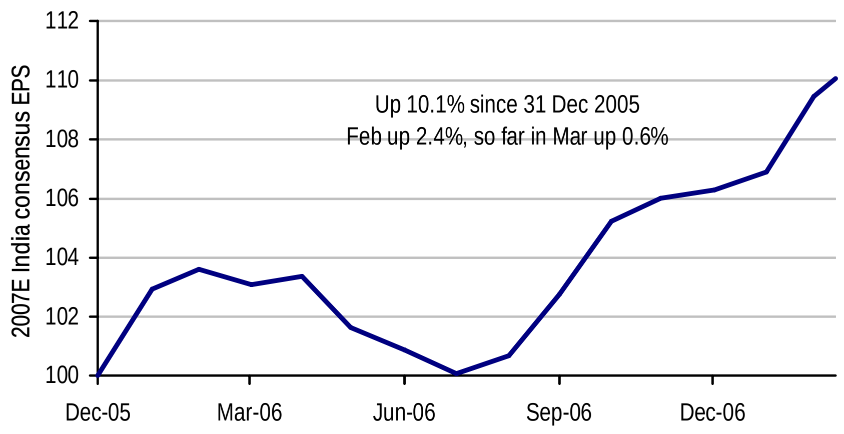
Table 1: Last 4 sell-offs in EMBI spreads

Low in EMBI	High in EMBI	Rise in EMBI	Length of sell-off
13-Apr-04	10-May-04	160bp	17 trading days
8-Mar-05	18-Apr-05	65bp	27 trading days
3-Oct-05	14-Oct-05	30bp	7 trading days
1-May-06	27-Jun-06	65bp	40 trading days
Average		80bp	23 trading days
22-Feb-07		18bp to date	17 trading days to date

Source: J P Morgan, Bloomberg, UBS estimates

Four, consensus EPS revisions remain strong and uniquely off a high base of EPS growth. As discussed in our AES of 2 March *India Underweight*, the trend in consensus EPS revisions remain strong. Chart 3 highlights that 2007E consensus EPS has been upgraded by 10.1% since 31 December 2005. **More importantly, recent months have continued to be strong – with an upgrade of 2.4% in February alone and a further 0.6% upgrade so far in March.**

Chart 3: India 2007E consensus EPS

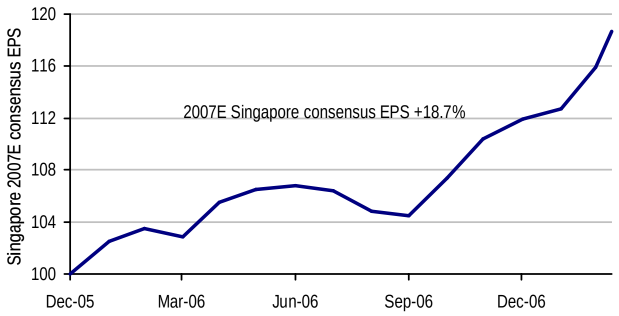


Source: IBES, UBS estimates

4th reason – strong consensus EPS upgrades

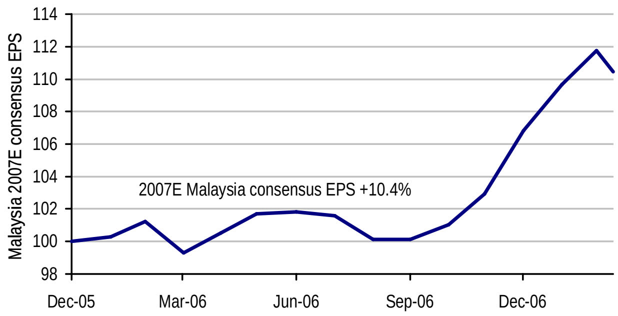
However, investors point out that strong consensus EPS upgrades are not unique to India. There are many other markets – such as China, Philippines, Singapore and Malaysia – which are also associated with strong consensus EPS upgrades. Chart 3-4 highlight that 2007 consensus EPS estimates since 31 December 2005 have been revised up by almost 19% in Singapore and by 10% in Malaysia.

Chart 2: 2007E consensus EPS - Singapore



Source: IBES, UBS estimates

Chart 3: 2007E consensus EPS - Malaysia



Source: IBES, UBS estimates

The key point for us though is while other markets are also associated with a strong uptrend in consensus EPS revisions, only India has a strong uptrend from a high EPS growth number in the first place.

UBS bottom up EPS growth in India for 2007E is 26% vs 6% for Singapore, 17% for Malaysia and 15% for the Philippines

Table 2 highlights that UBS bottom up estimates are for Indian EPS growth of 26% in 2007 and 23% in 2008. Singapore maybe associated with a strong uptrend but off a low base – just 6% EPS growth in 2007E. Even if we adjust for one-offs, Singapore's EPS growth in 2007 is estimated to be between 13-14%.

We are funding the India upgrade from Singapore.

Table 1: Pre-exceptional EPS growth

Pre-ex EPS Growth Countries	2001	2002	2003	2004	2005	2006E	2007E	2008E
China (H-shares)	-18.7%	1.9%	48.2%	48.5%	14.4%	19.7%	19.7%	12.8%
Hong Kong (HSI)	-11.3%	5.4%	9.4%	19.4%	14.6%	18.9%	13.4%	15.5%
India	11.5%	20.2%	25.0%	23.3%	24.5%	34.2%	**26.2%**	**22.9%**
Indonesia	-23.7%	-11.5%	2.7%	32.8%	-3.8%	21.1%	37.0%	13.5%
Korea	6.6%	64.4%	-6.2%	71.6%	-1.3%	-8.1%	24.4%	10.5%
Malaysia	0.8%	32.0%	18.4%	5.4%	3.7%	18.8%	**16.7%**	**9.4%**
Philippines	57.7%	-18.3%	107.8%	45.8%	23.8%	10.6%	14.8%	12.4%
Singapore	-40.1%	24.6%	28.5%	43.7%	11.0%	21.6%	**6.0%**	**15.2%**
Taiwan	-81.0%	83.2%	57.0%	59.3%	-12.0%	9.1%	21.4%	12.9%
Thailand	nm	58.7%	36.7%	55.2%	14.5%	-8.0%	9.0%	9.5%
Asia ex-JP	-17.8%	**26.2%**	**18.8%**	**40.5%**	**8.3%**	**11.0%**	**19.3%**	**14.0%**

Source: UBS estimates

■ Statement of Risk

There are many risks in upgrading India from Underweight to Neutral. One, EMBI sell-off could continue for longer than we think. Two, macro tightening by the RBI may have further to go. Three, potential supply. Four, EPS growth and ROE are forecast to slow in 2008.

■ Analyst Certification

Each research analyst primarily responsible for the content of this research report, in whole or in part, certifies that with respect to each security or issuer that the analyst covered in this report: (1) all of the views expressed accurately reflect his or her personal views about those securities or issuers; and (2) no part of his or her compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed by that research analyst in the research report.

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UBS Investment Research: Global Equity Ratings Definitions and Allocations

UBS rating	Definition	UBS rating	Definition	Rating category	Coverage[1]	IB services[2]
Buy 1	FSR is > 6% above the MRA, higher degree of predictability	**Buy 2**	FSR is > 6% above the MRA, lower degree of predictability	**Buy**	44%	36%
Neutral 1	FSR is between -6% and 6% of the MRA, higher degree of predictability	**Neutral 2**	FSR is between -6% and 6% of the MRA, lower degree of predictability	**Hold/Neutral**	43%	36%
Reduce 1	FSR is > 6% below the MRA, higher degree of predictability	**Reduce 2**	FSR is > 6% below the MRA, lower degree of predictability	**Sell**	13%	26%

1: Percentage of companies under coverage globally within this rating category.

2: Percentage of companies within this rating category for which investment banking (IB) services were provided within the past 12 months.

Source: UBS. Ratings allocations are as of 31 December 2006.

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).
Predictability Level The predictability level indicates an analyst's conviction in the FSR. A predictability level of '1' means that the analyst's estimate of FSR is in the middle of a narrower, or smaller, range of possibilities. A predictability level of '2' means that the analyst's estimate of FSR is in the middle of a broader, or larger, range of possibilities.
Under Review (UR) Stocks may be flagged as UR by the analyst, indicating that the stock's price target and/or rating are subject to possible change in the near term, usually in response to an event that may affect the investment case or valuation.

EXCEPTIONS AND SPECIAL CASES

US Closed-End Fund ratings and definitions are: Buy: Higher stability of principal and higher stability of dividends; Neutral: Potential loss of principal, stability of dividend; Reduce: High potential for loss of principal and dividend risk.
UK and European Investment Fund ratings and definitions are: Buy: Positive on factors such as structure, management, performance record, discount; Neutral: Neutral on factors such as structure, management, performance record, discount; Reduce: Negative on factors such as structure, management, performance record, discount.
Core Banding Exceptions (CBE): Exceptions to the standard +/-6% bands may be granted by the Investment Review Committee (IRC). Factors considered by the IRC include the stock's volatility and the credit spread of the respective company's debt. As a result, stocks deemed to be very high or low risk may be subject to higher or lower bands as they relate to the rating. When such exceptions apply, they will be identified in the Companies Mentioned or Company Disclosure table in the relevant research piece.

Unless otherwise indicated, please refer to the Valuation and Risk sections within the body of this report.

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