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India
Equity Research
Investment horizon: 6–12+ months
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Research Flash

Investment Ideas

India Strategy: High volatility in Q1 to provide attractive entry opportunities

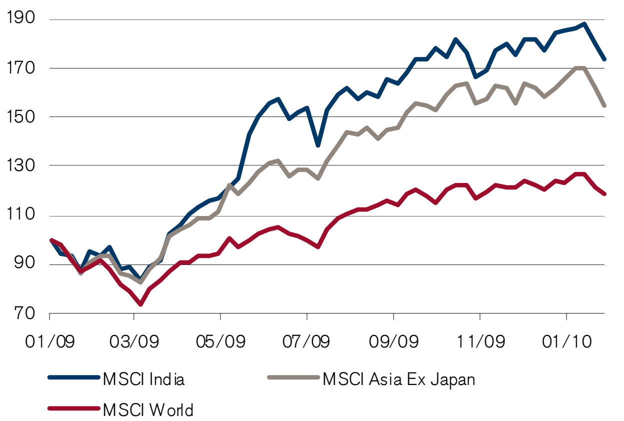
Private Banking

Stay defensively positioned for a volatile quarter

Markets commenced 2010 on a strong note, but entered into a correction mode towards mid-January, as a reversal of monetary policy in Asia and proposals for stringent banking sector regulation led to a return of risk aversion. The Sensex has seen an 8% correction from its peak of 17500. MSCI Asia and MSCI World have also witnessed a similar 8%–10% pullback (Figure 1). Post the sharp rally of 2009, we view a correction of this magnitude as quite healthy for the sustainability of the positive trend in equity markets.

As indicated in our "India Strategy: 2010 to be volatile, but positive for Indian equities," we expect the Indian equity market to remain choppy in Q1, with the domestic exit of monetary and fiscal stimulus coupled with intermittent concerns on liquidity-driven global asset bubbles to weigh on investor sentiment. The CRR hike of 75 bp by the RBI is the first step in the reversal of the monetary easing cycle in India. We expect domestic macro events to dominate the market's psyche over the next few months – the Union Budget in February, increasing inflation risks and rate hikes in March or April onwards, are events which would keep markets volatile. In addition, a strong pipeline of large primary market issuances would suck away liquidity, restricting secondary market gains. Bouts of global risk aversion, and thereby fund flow volatility, is the other key risk that equity investors have to contend with. We therefore

Figure 1
All global markets have corrected 8%–10%



Source: Bloomberg, Credit Suisse

Highlights

- Macro events – withdrawal of stimulus measures, reversal of interest rate cycle and budget – to dominate Q1 2010.
- Exit strategies, financial regulation and a reversal of economic recovery in some countries could lead to periods of global risk aversion.
- However, the government's determination to execute various reform measures can attract significant capital into the country.
- We continue to advise keeping a low beta in portfolios to ride out the volatile quarter. A bottom-up approach to stock selection during corrections will be key to generate positive returns in 2010.

Top investment ideas

We recommend a bottom-up approach to stock selection, with a focus on growth visibility at reasonable valuations.

Blue Star Ltd (industrial air-conditioning)

Gujarat Industries Power Company (utilities)

Infosys Technologies Ltd (IT)

ING Vyasa Bank Ltd (financials)

ITC Ltd (diversified)

Maruti Suzuki Ltd (automobiles)

Nestle India Ltd (consumers)

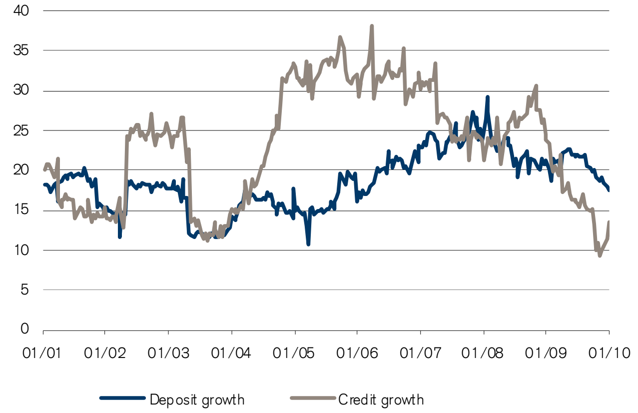
Power Finance Corporation Ltd (financials)

Tata Chemicals Ltd (fertilizer & chemicals)

Please note that trading facilities for these securities may be limited.

Figure 2

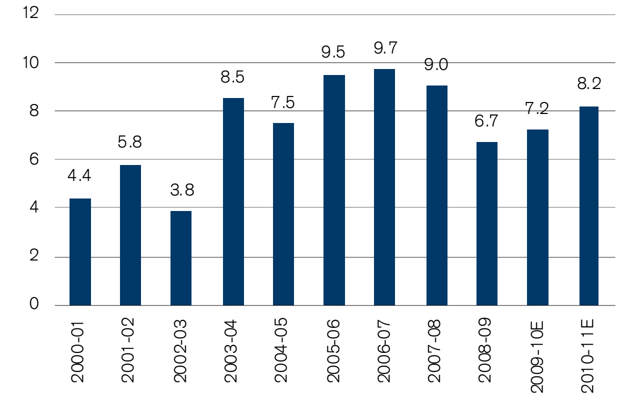
Bank lending showing signs of a pick-up



Source: Credit Suisse IB

Figure 3

Accelerating GDP growth



Source: Bloomberg, Credit Suisse

advise investors to maintain a low beta in their portfolios to ride out the volatile quarter.

Macro factors to drive market direction and fund flows

Sustainable long-term factors driving the direction of the market in India in 2010 would be a) continuing economic and earnings growth momentum and b) the government's ability to drive major reform and take firm steps towards fiscal consolidation. Early indications of all these parameters are encouraging.

Economic growth momentum is picking up: Economic data has surprised positively for the past few months. Bank credit growth, which had decelerated to a low of 10%, is showing signs of bottoming out (Figure 2). The RBI has revised upwards its GDP growth forecast for 2009 (FY ending March 2010) from 6% to 7.5%. In its forecast, the RBI has assumed near zero growth in agricultural production and a continued recovery in industrial and service sector activity. Our macro team estimates India GDP growth at 7.2% for 2009 and 8.2% for 2010 (Figure 3).

No significant negative surprise in Q3 earnings season: Q3 earnings have been mixed. A few large capital goods and cement players reported numbers below expectations. On the other hand, results of automobile, IT, telecom and consumer companies exceeded expectations. We do not see any risk to our below consensus estimate of 20% YoY Sensex earnings growth in FY 2010 (ending March 2011). Even so, the period of sharp earnings upgrades is now almost over (Figure 4), with margin pressures to rise going forward as commodity costs move higher.

Divestment and privatization agenda on track: The government has drawn up plans to divest over 95 unlisted profitable public sector enterprises (PSEs) and has also proposed to raise the minimum public shareholding in listed entities to 10%, which would mean additional divestment in a few listed PSEs. It has also drawn up a list of loss-making PSEs with sizeable real estate assets which could be monetized. NHPC and Oil India issues have been concluded, NTPC and REC follow-on issues are slated for February and another 4–5 new or follow-on issues are in the pipeline over the coming months. This clearly shows the government's serious intention to proceed with its disinvestment agenda.

Roadmap to fiscal consolidation awaited in the budget: Financial investors now keenly await to see how the government approaches its most challenging task of bringing down the ballooning fiscal situation. The current high level of fiscal deficit is clearly unsustainable and it is crucial that some of the transitory fiscal easing undertaken during the crisis period be reversed. We expect the government to selectively withdraw the significant excise reductions provided to industry and outline an indicative plan to achieve the targeted 1%–1.5% p.a. deficit reduction. While reversal measures would have a short-term negative impact on the market, we would see these steps as a directionally positive move in improving India's longer-term fiscal position and are likely to be appreciated by the global investment community. Oil deregulation, telecom 3G auctions, financial sector reform and the introduction of a common goods and service tax would be other key macro events to be watched for in 2010.

Inflation will be the dominating worry near term

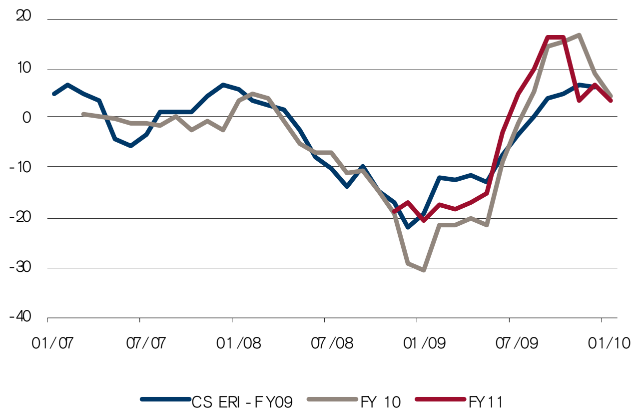
Food price inflation is at a multi-year high and has been a major concern. With improving growth momentum and the rebound in global commodity prices, capacity constraints would reinforce supply side inflationary pressures. The RBI has increased its inflation projection sharply from 6.5% to 8.5% by March 2010. The-higher-than expected CRR hike of 75 bp announced by the RBI is an endeavor to maintain price stability and anchor inflation expectations. We expect a gradual tightening of monetary policy with 125 bp of repo rate hikes in 2010 starting from March/April. However, if inflation goes beyond the RBI's comfort level, the risk of a more aggressive tightening stance would increase.

Global markets to face bouts of risk aversion

Fears of liquidity withdrawal are likely to keep financial markets jittery as investors keep close watch over exit strategies in various countries and their impact on the recovery. Signs of faltering growth in any region, increasing trade protectionism

Figure 4

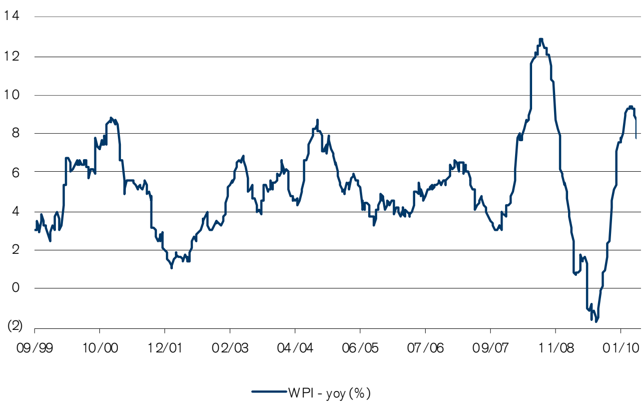
Earnings upgrade momentum flattening out



Source: Credit Suisse IB

Figure 5

Inflation is the main near-term concern



Source: Credit Suisse IB

and stringent financial sector regulations are some of the events which would cause risk aversion and high volatility. The recent correction in global markets was triggered by similar concerns – reversal of the monetary stance in key Asian nations such as China and India, curtailment of lending activities to restrict asset bubbles, and the US indicating stringent regulation of large banks which would limit high risk taking and increase capital requirements. Given the extent of equity market gains across countries, moderate corrections on profit taking are likely to occur periodically through the year. We would not be overly concerned about these, unless we see a reversal of the economic revival or emergence of a new crisis.

Corrections to provide entry opportunities

To summarize, we expect domestic macro and global liquidity worries to dominate investor sentiment in Q1. Despite the short-term concerns, the government's determination to execute various reform measures could attract significant capital into the country and drive India's growth trajectory. We believe that market corrections, such as the current one, provide an attractive entry opportunity for investors to build long-term exposure to the Indian equity market.

We continue to advocate a low beta strategy in core portfolios for Q1 2010 to ride through the volatile period. A bottom-up approach to stock selection with a focus on quality of management and balance sheet strength is important. We favor defensive stocks in the IT, pharmaceuticals, consumers and utilities sectors in the current environment. We are also positive on the outlook for selected capital goods companies, as we expect their performance to improve as industrial recovery gains momentum. We would use corrections to gradually add exposure to select cyclicals (financials, automobiles, metals and cement) at reasonable valuations. A bottom-up approach to stock selection is likely to be key to generating positive equity returns in 2010.

Table 1: Valuation snapshot (Note that trading facilities for these securities may be limited)

Stocks	Bloomberg	Currency	Mkt. cap (in INR bn.)	Rating	Closing price 29/01/2010	Target	P/E 2009E	P/E 2010E
Blue Star Ltd	BLSTR IN	INR	34	BUY	373	425	15.5	12.9
Gujarat Industries Power Co.	GIP IN	INR	16	BUY	108	141	16.1	9.3
Infosys Technologies Ltd	INFO IN	INR	1,420	BUY	2,475	2,855	22.7	19.7
ING Vyasa Bank Ltd	VYSB In	INR	30	BUY	246	331	13.7	11.4
ITC Ltd	ITC IN	INR	944	BUY	248	300	24.8	21.4
Maruti Suzuki Ltd	MSIL IN	INR	402	BUY	1,391	1,720	16.9	14.4
Nestle India Ltd	NEST IN	INR	244	BUY	2,533	2,956	34.5	27.7
Power Finance Corp Ltd	POWF IN	INR	278	BUY	242	283	13.9	11.9
Tata Chemicals Ltd	TTCH IN	INR	71	BUY	297	360	11.6	9.6

Source: Credit Suisse

Abbreviations frequently used in reports					
Abb.	**Description**	**Abb.**	**Description**	**Abb.**	**Description**
CAGR	Compound annual growth rate	EPS	Earnings per share	P/B	Price-to-book value
CFO	Cash from operations	EV	Enterprise value	P/E	Price-earnings ratio
CFROI	Cash flow return on investment	FCF	Free cash flow	PEG	P/E ratio divided by growth in EPS
DCF	Discounted cash flow	FFO	Funds from operations	ROE	Return on equity
EBITDA	Earnings before interest, taxes, depreciation and amortization	IBD	Interest-bearing debt	ROIC	Return on invested capital

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Company	**Rating**	**Date**
BLUE STAR LIMITED (BLSTR IN)	BUY	since 30/07/2009
	HOLD	since 13/07/2009
	BUY	since 19/05/2009
	BUY	since 02/02/2009
	BUY	since 01/10/2008
GUJARAT INDUSTRIES POWER COMPANY LIMITED (GIP IN)	BUY	since 02/12/2009
INFOSYS TECHNOLOGIES LIMITED (INFO IN)	BUY	since 12/01/2010
	BUY	since 22/09/2009
	HOLD	since 13/07/2009
	HOLD	since 19/01/2009
ING VYSYA BANK LIMITED (VYSB IN)	BUY	since 28/10/2009
ITC LTD (ITC IN)	BUY	since 26/10/2009
	HOLD	since 27/05/2009
	BUY	since 22/01/2009
MARUTI SUZUKI INDIA LTD (MSIL IN)	BUY	since 28/01/2010
	BUY	since 29/10/2009
	BUY	since 23/07/2009
	BUY	since 07/07/2009
	HOLD	since 27/05/2009
	BUY	since 28/04/2009
	HOLD	since 19/02/2009
	BUY	since 26/11/2008
NESTLE INDIA LIMITED (NEST IN)	BUY	since 03/11/2009
	BUY	since 03/08/2009
	BUY	since 08/07/2009
	BUY	since 05/05/2009
	BUY	since 12/03/2009
	BUY	since 03/11/2008
POWER FINANCE CORPORATION LIMITED (POWF IN)	BUY	since 29/10/2009
	BUY	since 20/07/2009
TATA CHEMICALS LIMITED (TTCH IN)	BUY	since 11/08/2009
	SELL	since 20/03/2009

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	Overall	**Investment banking interests only**
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HOLD	47.68%	47.20%
SELL	4.64%	4.81%
RESTRICTED	1.06%	1.09%

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