

## Equities

2 December 2011 | 9 pages

# India Equity Strategy

## 2012 Outlook: Structural Pain In, Cyclical Gain Not

### ■ Equities

- **Structural snags...** — India's 'secular investment story' has taken several twists over the year. The 'democratic government' has become directionless, the 'fortune at the bottom of the pyramid' has turned into a structural inflation infuser, the 'capital inflow window' has tipped into a currency crunch, and India's much feted 'entrepreneurial energy' has become more of a corporate governance quagmire. Yes, a lot has changed in a year – including GDP growth expectations sliding from 8% to 7% – but it is the -30% YTD currency-adjusted market swing that is now most dominating the mood.
- **...and cyclical stress – but cycles do turn** — Inflation and interest rates are high, government activity is low, oil is rising, capital is not coming, confidence is waning and earnings growth is falling. But there is another way of looking at this way: Inflation is statistically set to go down, interest rates will not continue to rise as demand falls (and aggressive policy could well bring about rate cuts), and the government has recently done more than in 2 years. And valuations are relatively attractive (and meaningfully so for any inbound M&A activity – businesses are 30-40% cheaper than a year ago) and earnings growth has been cut almost as sharply as in 2008. Cycles can be deep, but by definition they turn...sometime.
- **Economy increasingly vulnerable to markets – Needs some luck** — India's high dependence on excess external capital – for corporate/ investment growth, filling its current account gap and keeping interest rates low – has only increased as the economy has grown. What can be a virtuous circle has turned vicious – India is more vulnerable now than at higher market and Rupee levels. The economy needs support from the markets for the circle to revert to being virtuous: Risk on, easing inflation, falling oil, falling commodities or other global market drivers/events.
- **Upsides, likely to be front-loaded** — We set a 18,400 Dec 12 Sensex target (5520 on Nifty), at a 1-year Fwd PE of 14x (a 10% discount to the long-term average as India has fundamentally de-rated). We expect positive market movements to be more upfront than back-ended (cyclical gains with structural caps from slower growth and FX vulnerability), and have tweaked our model portfolio to continue to position relatively aggressively. Overweight on Banks and Autos, in addition to the relatively defensive telecom sector and pharma businesses. And underweight in Materials, IT, Utilities and Consumer.
- **Top picks for 2012** — Our top buys for 2012 side are Axis Bank, SBI, Tata Motors, Jindal Steel & Power and Dr Reddy.

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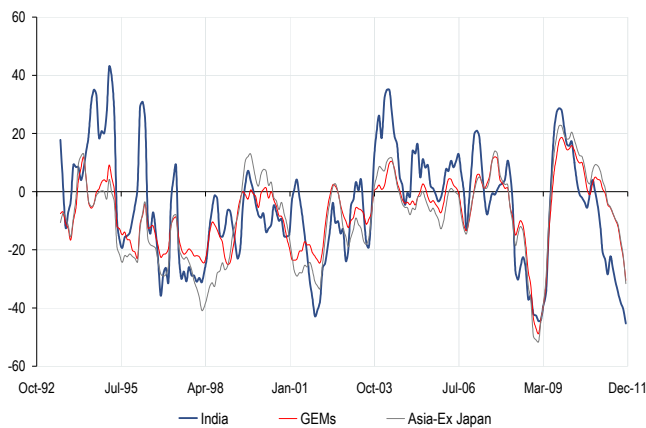
# 2012: Structural Pain In, Cyclical Gain Not

Figure 1. Top Buys for 2012

	Ticker	Rating	Price (Dec 01)	Target Price	Yield (%)	ETR (%)	P/E	FY13E P/BV	ROE (%)
<b>AXIS Bank</b>	AXBK.BO	1	972	1,400	1.7	45.7	8.70	1.54	19.8
<i>Healthy growth/ return profile, strong deposit franchise and a relatively well diversified loan book with modest exposure to sensitive sectors.</i>									
<b>Tata Motors</b>	TAMO.BO	1	183	215	1.6	18.6	6.35	1.64	30.4
<i>Volume growth in the domestic CV segment remains strong despite macro headwinds. Evoque to buoy JLR volumes while greater proportion of China sales to aid margins.</i>									
<b>Jindal Steel</b>	JNSP.BO	1	522	645	0.5	23.9	9.54	2.15	25.2
<i>Well-integrated steel business/ flexible product mix; low cost power producer, power expansion (2400 MW) has been cleared.</i>									
<b>Dr Reddy</b>	REDY.BO	1	1,545	1,835	0.7	19.5	15.59	3.64	26.0
<i>Best placed to capture generics and emerging biosimilars opportunities. Strong US pipeline with niche opportunities and well established biz in Russia/ CIS.</i>									
<b>SBI</b>	SBI.BO	1	1,819	2,250	1.8	25.3	8.00	1.35	18.1
<i>SBI is operationally stabilizing and underlying biz momentum is picking with – strong uptick in margins, healthy funding franchise and healthy growth. Valuations are attractive.</i>									

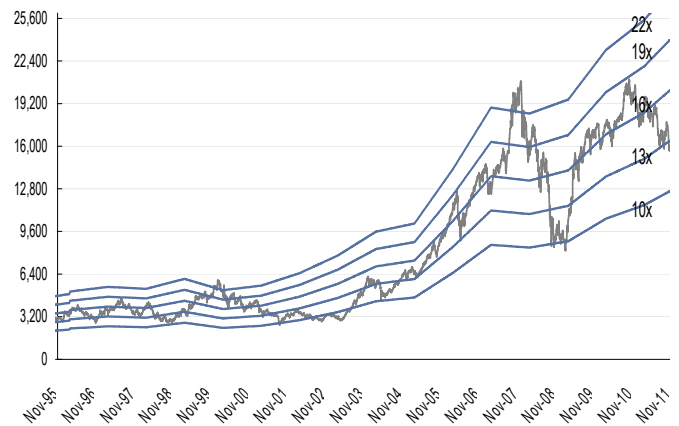
Source: Citi Investment Research and Analysis

Figure 2. Earnings revision index: Have earnings bottomed?



Source: IBES, Factset

Figure 3. Sensex rolling 1-Yr Fwd PE band : Moderate



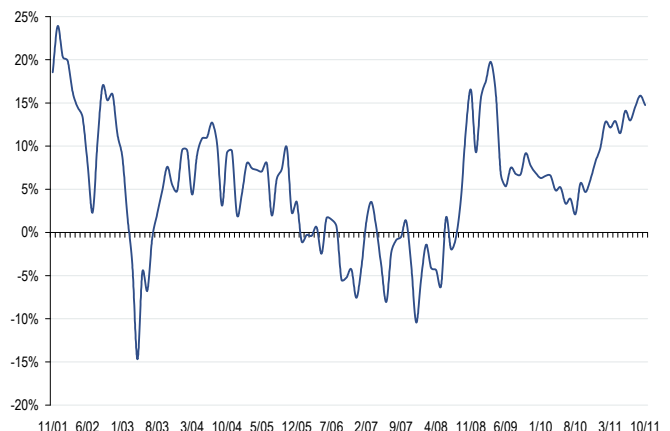
Source: Citi Investment Research and Analysis

Figure 4. Beta of MSCI India - Falling, but does it deserve to?



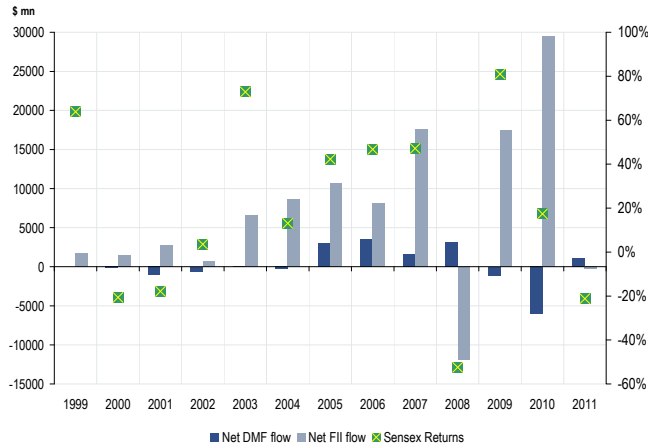
Source: Datastream

Figure 5. Small/mid cap discount (P/E) relative to large caps; Getting big



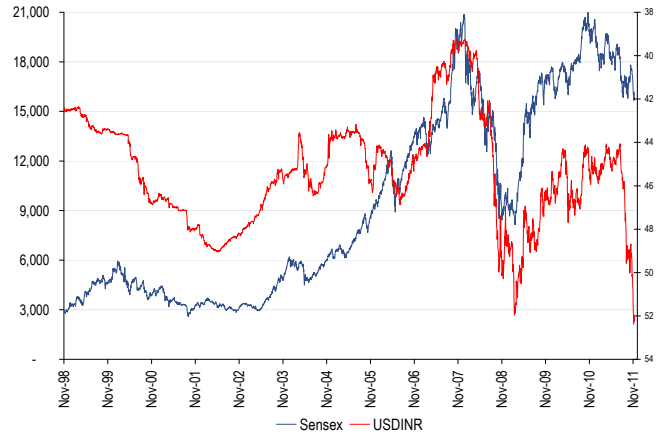
Source: Factset, CIRA

Figure 6. Equity flows and the market – It needs inflows



Source: Bloomberg

Figure 7. Sensex vs. USD/ INR: Going down together – coming up?

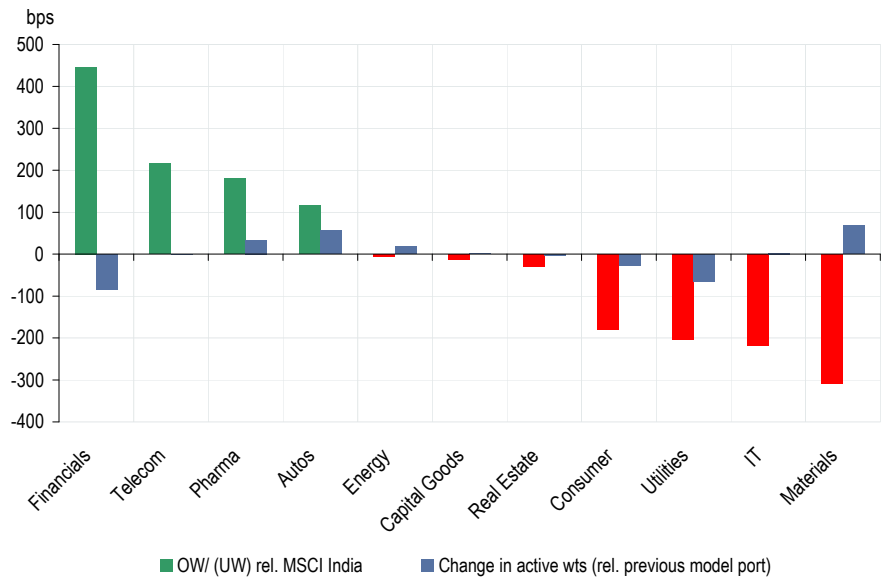


Source: Bloomberg

### Our Portfolio

We remain aggressive with our model portfolio: Banks and Autos the big OWs, though we cut some exposure in the banks. Remain UW on materials and IT, though increase the UW on Utilities and Consumers. We continue to position for a domestic businesses led rally, and keep the risk and the cyclicality of the portfolio relatively high. Our stock selection is also geared to a little more risk, albeit to the relatively larger stocks, rather than the small/mid-cap, or leveraged ones.

Figure 8. Model Portfolio OW/ UWs



Source: Citi Investment Research and Analysis

Figure 9. CIRA India Model Portfolio

	Price 1-Dec-11 (Rs)	YTD Perf. (%)	RIC	MSCI Weight (%)	Portfolio Weight*	OW/ UW/Rel. MSCI (bps)	FY12			ROE (%)
							PE (x)	EPS Growth (%)	PB (x)	
<b>Automobiles and Components</b>				<b>7.83</b>	<b>9.0</b>	<b>117</b>				
M&M	729.8	-6.1%	MAHM.BO		2.5	O/W	17	2.4%	3.4	23.4%
Maruti	962.0	-32.3%	MRTI.BO		3.0	O/W	15	-23.3%	1.8	12.4%
Tata Motors	182.9	-30.0%	TAMO.BO		3.5	O/W	7	-8.4%	2.2	37.1%
<b>Banks &amp; Diversified Financials</b>				<b>26.44</b>	<b>30.9</b>	<b>446</b>				
AXIS Bank	972.1	-28.0%	AXBK.BO		5.0	O/W	11	14.5%	1.8	19.3%
IDFC	110.7	-39.2%	IDFC.BO		1.0	M/W	12	4.1%	1.4	11.7%
HDFC Bank	453.5	-3.4%	HDBK.BO		5.0	U/W	21	26.9%	3.5	18.1%
ICICI Bank	762.5	-33.4%	ICBK.BO		9.0	O/W	14	24.5%	1.5	11.1%
State Bank of India	1819.3	-35.3%	SBI.BO		3.0	O/W	10	34.2%	1.6	16.0%
Yes Bank	279.3	-10.7%	YESB.BO		1.0	O/W	10	31.7%	2.1	22.7%
Kotak Mahindra	478.2	5.7%	KTKM.BO		1.0	U/W	19	17.4%	2.7	15.9%
<b>Capital Goods</b>				<b>6.64</b>	<b>6.5</b>	<b>-14</b>				
Larsen & Toubro	1294.7	-34.6%	LART.BO		4.5	O/W	20	10.1%	3.2	17.4%
Crompton Greaves	128.0	-58.8%	CROM.BO		1.0	O/W	14	-34.9%	2.2	17.2%
Mundra Ports	126.2	-12.2%	MPSE.BO		1.0	O/W	18	44.2%	4.7	28.5%
<b>Energy</b>				<b>13.06</b>	<b>13.0</b>	<b>-6</b>				
Coal India	330.6	5.1%	COAL.BO		2.0	O/W	14	34.8%	4.7	37.6%
Gujrat State Petronet	90.2	-23.5%	GSPT.BO		1.0	O/W	10	1.1%	2.1	22.9%
Reliance Industries	798.5	-24.5%	RELI.BO		10.0	O/W	11	13.4%	1.5	14.3%
<b>Consumer</b>				<b>9.00</b>	<b>7.2</b>	<b>-180</b>				
Dish TV	65.5	-7.9%	DSTV.BO		1.0	O/W	nm	-58.2%	nm	
ITC	203.6	16.7%	ITC.BO		4.0	O/W	26	21.0%	9.4	36.9%
United Spirits	703.8	-51.8%	UNSP.BO		1.5	M/W	20	57.1%	1.9	10.4%
Asian Paints	2799.4	-2.6%	ASPN.BO		0.7	M/W	28	12.0%	10.0	38.7%
<b>Materials</b>				<b>9.09</b>	<b>6.0</b>	<b>-309</b>				
Hindalco	131.2	-46.7%	HALC.BO		2.0	O/W	9	10.2%	0.8	9.0%
Jindal Steel & Power	522.1	-26.8%	JNSP.BO		2.5	O/W	12	8.9%	2.7	25.7%
Grasim	2427.0	3.7%	GRAS.BO		1.5	O/W	9	8.7%	1.3	15.8%
<b>Pharmaceuticals, Biotechnology, Agrochem</b>				<b>4.70</b>	<b>6.5</b>	<b>180</b>				
Ranbaxy	444.1	-25.8%	RANB.BO		1.5	O/W	24	113.5%	2.1	38.7%
Dr Reddy	1545.4	-7.0%	REDY.BO		3.0	O/W	20	23.9%	4.6	25.9%
Lupin	466.1	-3.0%	LUPN.BO		2.0	O/W	20	20.7%	5.1	28.2%
<b>Software &amp; Services</b>				<b>16.67</b>	<b>14.5</b>	<b>-217</b>				
Infosys Technologies	2652.8	-23.0%	INFY.BO		7.0	U/W	18	20.7%	4.7	27.6%
Tata Consultancy Services	1134.8	-2.6%	TCS.BO		3.0	U/W	21	22.6%	6.7	36.4%
Wipro	386.1	-21.2%	WIPR.BO		2.5	O/W	17	4.9%	3.4	21.6%
HCL Technologies	401.8	-11.9%	HCLT.BO		2.0	O/W	14	32.9%	2.9	22.9%
<b>Telecom Services</b>				<b>0.33</b>	<b>2.5</b>	<b>217</b>				
Bharti Airtel	379.0	5.7%	BRTI.BO		1.5	O/W	22	-8.0%	2.6	12.5%
Idea	92.3	33.0%	IDEA.BO		1.0	O/W	49	-31.7%	2.4	4.9%
<b>Utilities</b>				<b>4.93</b>	<b>2.9</b>	<b>-203</b>				
Tata Power	92.9	-32.0%	TTPW.BO		0.9	O/W	24	11.9%	2.0	8.2%
Power Grid Corp	99.9	1.7%	PGRD.BO		2.0	O/W	16	15.0%	2.0	13.1%
<b>Real Estate</b>				<b>1.30</b>	<b>1.0</b>	<b>-30</b>				
DLF	218.2	-25.3%	DLF.BO		1.0	O/W	22	4.1%	1.5	6.8%
<b>Total</b>				<b>100.0</b>	<b>100.0</b>					

Source: Citi Investment Research and Analysis, MSCI; \* Weights may not add up to 100 due to legal restrictions

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