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## India Market Strategy

### Not the bottom yet

Despite the underperformance, MSCI India still trades at 15% premium to MSCI Asia leaving room for downside. On the positive, at 11.9x FY13CL earnings, Indian market now trades at 10% away from the Mar'09 lows which should limit downside, implying a range bound market. Our recent field trips make us more cautious on consumer discretionary demand outlook and we remove 3 ppts from our model portfolio. We also reduce 2.5ppts and 1 ppt each from banks and industrials to maintain UWT stance and add it to IT services to close the UWT there, primarily attributable to weaker INR outlook.

#### India premium has come down, but still a premium

- Indian stock market (Sensex) is now trading at 11.9x FY13CL earnings or 27% discount to the last five year average and 17% discount to the 10 year average.
- Over the last five years, Indian markets have traded at a 25% premium over Asian peers – which also stands corrected to 17% now. Indian market has traded at lower premium only during the GFC, when India traded at a discount.
- While the GFC type of situation cannot be ruled out now, India is only 10% away with Mar-09 low multiples and valuation support should restrict the downside.

#### Governance a drag but several negatives now built-in

- With a near roll back of FDI in retail, the Government inaction is once again in the forefront. The possibilities of agitation by Mr Anna Hazare, on the 'Lokpal bill' remains an outstanding issue. But the 'Government paralysis' is not really new.
- Many of the government facing industries viz. infrastructure /property stocks have already corrected by c.50% over the last one year and earnings lowered by 20-50%. While more damage can happen but we believe downside is limited.
- 33% of stocks (30% of mcap) of stocks under CLSA India coverage universe are already trading below Mar-09 PE multiples.

#### Consumer demand slowing

- Our recent field trips to the Northern state of Punjab and channel check by On The Road confirm signs of a consumer slowdown spreading. We temper our enthusiasm on consumer discretionary by slashing a 1 ppt each from Mahindra, Bajaj and Jet.
- We do see downside risks to some expensive staples names viz. HUL, Nestle, Colgate etc owing to the triple impact of a small slowdown in demand growth, margin pressure due to the INR depreciation and high valuations. Our key picks here include ITC, Godrej Consumer and Jubilant.
- We add 1 ppt to ITC by taking away 1 ppt from United Spirits to take into account the impact of higher ENA prices and a steep duty hike in West Bengal.

#### Weights lowered in discretionary and banks; added to IT services

- Underperformance by the banking sector has reduced our UWT to only 2ppts. We reinstate our 4.5ppts UWT on banks by removing SBI (-1.5ppts) and 1 ppt from ICICI Bank. We continue to be worried about the growth slowdown and asset quality concerns for the sector. Similarly, we also take out 1 ppt from Jaiprakash to maintain our small UWT on industrials. The near-term risk to our UWT on banks would be a potential rate cut by the RBI in January'12.
- We add these 6.5ppts to IT services sector to close our UWT position in the sector. While the companies will likely disappoint on US\$ growth numbers, the reported performance, due to weaker INR, will drive street upgrades to earnings.
- Our portfolio now has a 57% active bet reflecting our view that bottom-up stock picking would be crucial for outperformance.
- Our top picks for the market are ITC, Dr Reddy's, M&M and ICICI Bank. ITC and Dr Reddy's appear good on earnings visibility. M&M's volume sales have been robust so far and we expect similar trend to continue. Core auto business now trades at 10x. ICICI at 1.2x in line with PSU banks and already builds in asset quality risks.

At 11.9x FY13CL earnings or 27% discount to the last five year average and 17% discount to the 10 year average

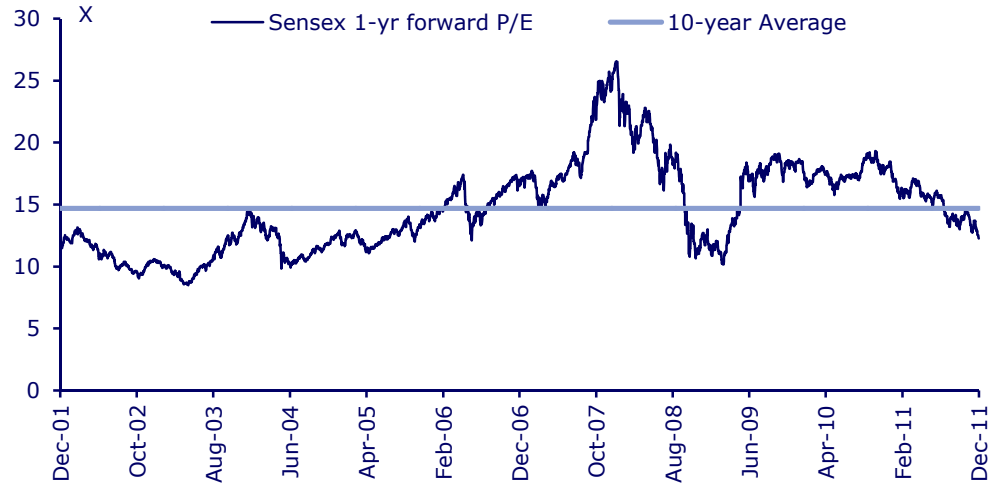
India's premium vis-à-vis other Asian countries has compressed

Indian now cheaper than many other Asian markets

**Markets now 17% discount to 10-year average**

Figure 1

**Sensex 1-year forward P/E trend**

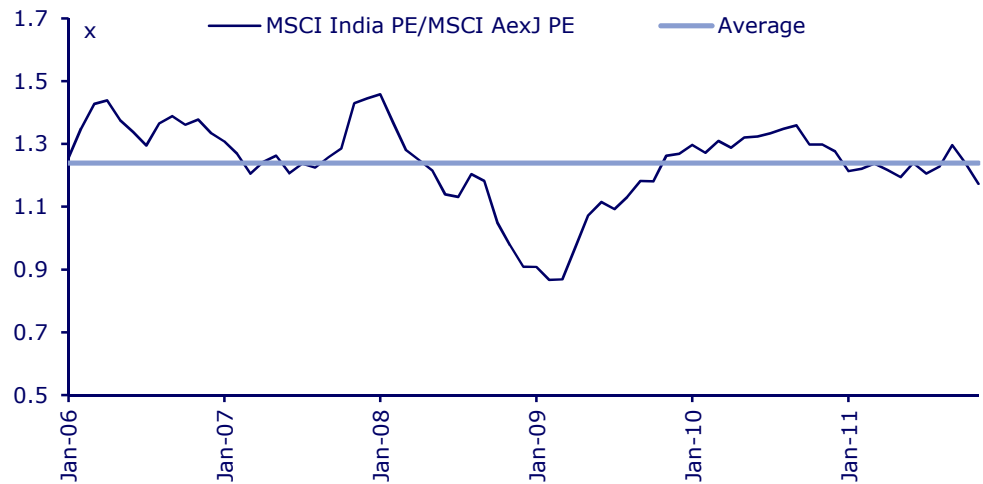


Source: CLSA Asia-Pacific Markets

**Indian market's valuation premium over peers has come off**

Figure 2

**Trend in ratio of MSCI India PE/MSCI Asia-ex-J PE**



Source: MSCI, CLSA Asia-Pacific Markets

Figure3

**Valuation of Indian markets vis-à-vis other markets**

Country	Index	P/E (x)		Erg growth (%)
		Current yr	Next yr	
China	CSI 300	11.0	9.1	21.2
Hongkong	HSI	10.0	9.2	8.8
<b>India</b>	<b>Sensex</b>	<b>13.6</b>	<b>11.8</b>	<b>15.2</b>
Indonesia	JCI	15.1	12.7	18.9
Malaysia	Bursa Malaysia	14.3	13.5	5.9
Philippines	PSEi	14.4	13.0	11.3
Singapore	Straits	12.7	11.9	6.6
S Korea	KOSPI	10.1	8.8	14.4
Taiwan	Taiex	14.4	12.2	18.8
Thailand	SET50	12.4	10.9	13.5

Source: Bloomberg, CLSA Asia-Pacific Markets

From valuation support point of view, we like **BHEL, Cairn, HT Media, Jain irrigation, JPA, Power Grid, Sterlite and United Spirits**

## Stocks trading at lower than Mar-09 PE

Figure4

### Stocks trading at P/E lower than Mar-09 levels

Name	Estimated 12-m Forward P/E	
	Mar 09	Now
ACC Ltd	18.1	16.8
Ashok Leyland	11.1	10.2
Bharat Heavy Electricals	14.5	8.3
Bharat Petroleum	12.2	6.5
Cairn India	27.0	8.3
CESC	6.4	5.4
DLF	20.7	17.6
Educomp Solutions Ltd	9.5	4.5
Gujarat State Petronet Ltd	12.6	12.1
Hindustan Petroleum	13.5	5.1
Housing Development & Infrastructure	8.1	3.4
HT Media Ltd	25.9	12.4
Indian Oil Corporation	9.7	6.6
Jagran Prakashan Ltd	17.5	13.1
Jain Irrigation Systems	10.7	6.6
Jaiprakash Associates Ltd	11.9	8.2
Larsen & Toubro	12.5	11.1
Maruti Suzuki India	13.3	12.7
NTPC Ltd	18.0	12.1
Oil and Natural Gas Corporation Limited	7.0	6.8
Power Grid	19.3	12.7
Sesa Goa Ltd	4.4	4.2
Sintex Industries Limited	3.5	3.2
State Bank of India	6.7	6.1
Steel Authority of India	10.2	7.8
Sterlite Industries	7.5	5.2
Sun TV Network Ltd	16.0	11.8
Tata Motors Ltd	14.6	6.2
Unitech Ltd	13.7	8.6
United Spirits Ltd	16.0	14.4

Source: CLSA Asia-Pacific Markets

Figure5

### Key model portfolio changes

ppts	Addition	Deletion
Bajaj Auto		1
M&M		1
Jet Airways		1
SBI		1.5
ICICI Bank		1
JPA		1
United Spirits		1
ITC	1	
Infosys	4.5	
TCS	2	

Source: CLSA Asia-Pacific Markets

Reducing weight in consumer discretionary and adding to IT

Figure 6

**CLSA India model portfolio**

	<b>CMP (Rs)</b>	<b>Market Cap (US\$m)</b>	<b>Avg. Daily Turnover (US\$m)</b>	<b>CLSA Rec Wt (%)</b>	<b>Stance</b>	<b>FY11-13 EPS Cagr (%)</b>	<b>FY12 P/E (x)</b>	<b>FY11 div yield (%)</b>	<b>3m Perf. (%)</b>	<b>CLSA Rec</b>
<b>Consumer discretionary</b>				<b>10.0</b>	<b>O-WT</b>					
M&M	651	7,614	27	4.0		17.9	13.9	1.5	(20.0)	BUY
Bajaj Auto	1,604	8,875	14	2.0		13.0	14.8	2.5	(1.4)	U-PF
Zee	119	2,209	7	3.0		13.2	19.0	2.0	0.9	BUY
Jet Airways	177	291	4	1.0			(1.3)	-	(37.0)	O-PF
<b>Financials</b>				<b>19.5</b>	<b>U-WT</b>					
HDFC Bank	414	18,464	42	7.5		24.4	19.0	0.8	(15.7)	BUY
BOB	640	4,753	8	1.0		10.4	5.6	2.6	(16.9)	O-PF
ICICI Bank	652	14,271	87	8.0		20.1	12.2	2.1	(26.1)	BUY
IDFC	101	2,808	25	3.0		7.5	10.2	2.0	(12.2)	BUY
<b>Energy</b>				<b>15.0</b>	<b>O-WT</b>					
Reliance	714	44,515	91	9.0		13.0	9.7	1.1	(16.2)	O-PF
Cairn India	310	11,212	58	3.0		5.4	8.1	0.0	1.7	O-PF
ONGC	253	41,270	34	3.0		19.2	6.8	3.5	(3.2)	BUY
<b>Consumer staples</b>				<b>10.0</b>	<b>O-WT</b>					
ITC	200	29,613	31	5.0		17.8	25.7	2.2	0.6	O-PF
United Spirits	604	1,505	5	1.0		10.4	18.2	0.4	(23.7)	O-PF
Godrej Consumer	390	2,401	2	2.0		17.7	22.5	1.2	(8.1)	O-PF
Jubilant	711	890	9	2.0		46.3	43.7	-	(22.2)	O-PF
<b>Industrials</b>				<b>5.0</b>	<b>U-WT</b>					
Jain Irrigation	76	560	7	2.0		24.3	9.4	-	(55.0)	BUY
Jaiprakash	53	2,137	21	1.0		0.3	11.1	1.5	(26.3)	BUY
BHEL	229	10,626	32	2.0		6.6	9.0	2.1	(30.4)	O-PF
<b>Health care</b>				<b>8.0</b>	<b>O-WT</b>					
Dr Reddy's	1,571	5,070	13	4.0		22.8	20.0	0.7	2.1	BUY
Torrent Pharma	520	835	1	2.0		21.4	12.8	1.5	(12.0)	BUY
Lupin	427	3,631	10	2.0		17.1	19.5	0.7	(11.6)	O-PF
<b>Infotech</b>				<b>18.5</b>	<b>Neutral</b>					
Infosys	2,667	29,179	102	10.5		17.6	18.4	2.6	9.4	U-PF
TCS	1,133	42,250	5	8.0		20.0	20.6	1.4	7.1	U-PF
<b>Materials</b>				<b>7.0</b>	<b>U-WT</b>					
Tata Steel	344	6,290	48	3.0		(12.9)	8.4	3.5	(25.3)	O-PF
Coal India	302	36,215	31	2.0		19.3	12.3	1.3	(20.2)	O-PF
JSPL	479	8,536	16	2.0		12.0	10.8	0.3	(13.7)	O-PF
<b>Utilities</b>				<b>5.0</b>	<b>U-WT</b>					
PowerGrid	97	8,541	9	3.0		12.0	15.0	2.3	(1.6)	O-PF
Tata Power	82	3,689	7	2.0		(1.2)	8.1	1.5	(18.2)	O-PF
<b>Telecoms</b>				<b>-</b>	<b>U-WT</b>					
<b>Property</b>				<b>2.0</b>	<b>O-WT</b>					
Oberoi Realty	213	1,327	0.2	2.0		2.4	14.3	-	(5.3)	BUY
<b>Total</b>				<b>100.0</b>						

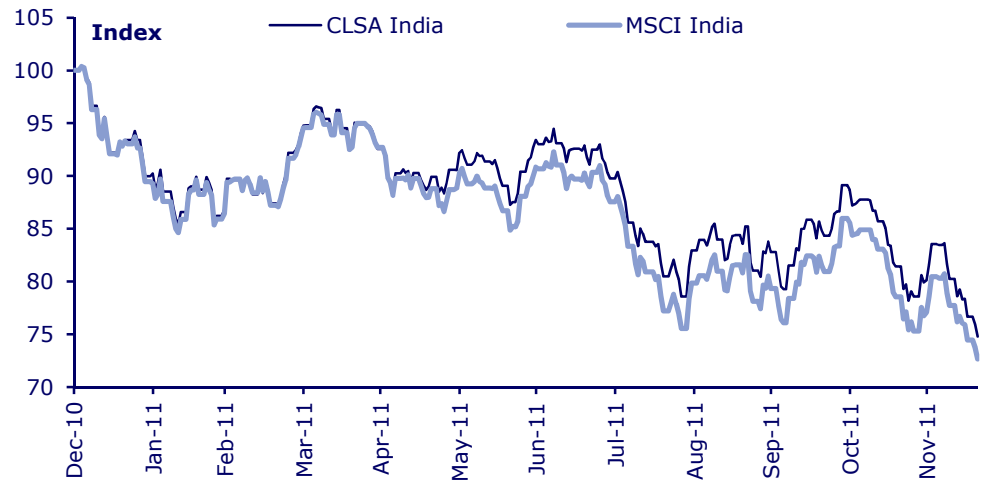
Source: CLSA Asia-Pacific Markets

**Absolute performance of the CLSA India model portfolio:**

**3ms: -12.2%**  
**6ms: -14.6%**  
**YTD: -25.2%**

Figure 7

**Performance of CLSA India model portfolio vis-à-vis MSCI India**



Source: CLSA Asia-Pacific Markets

**Key to CLSA investment rankings:** **BUY** = Expected to outperform the local market by >10%; **O-PF** = Expected to outperform the local market by 0-10%; **U-PF** = Expected to underperform the local market by 0-10%; **SELL** = Expected to underperform the local market by >10%. Performance is defined as 12-month total return (including dividends).

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**Note: In the interests of timeliness, this document has not been edited.**

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