India Market Strategy

Earnings recovery elusive. For how long?

Equity Strategy

India

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Earnings recovery key to markets performance, when will they recover?

Positive surprise on rates cycle, lower oil prices and reforms newsflow helped Indian markets over the last 1 year. Hereon, actual earnings and macro data points will matter increasingly. The reality of a slow growth recovery is now being acknowledged and earnings estimates for FY15/16 have been cut 6-7% over last 6 months – recovery is yet elusive. Street forecasts are building in margins recovery, near past peaks, for FY16/17. Topline growth forecasts though appear conservative, at 8%/14% for FY16/17, vs. our forecast nominal GDP growth of 12.8%/13.3%. We continue to expect a mild recovery in FY16 (20bps acceleration in GDP growth) and a sharper recovery only in FY17. Our top-down earnings growth forecast for the Nifty is 10%/18% for FY16/17, post likely 7% growth in FY15. This implies likely further cuts to earnings growth estimates by the street/analysts. 4QFY15 will likely be weak but markets may be arguably already expecting that, based on our discussions with investors.

WPI ignored given focus on CPI – topline surprised negatively

We have been expecting negative GDP growth surprise but positive inflation surprise (ex crude oil) over the last 1 year. Yet earnings disappointed even our top-down expectations for FY15. Earnings cuts and disappointments have been driven more by lower sales growth while margins have broadly gone up, only a bit below earlier expectations. As per our analysis, markets (and us) were focused on CPI as the key inflation metric, given RBI's focus on this as the policy driver. WPI is arguably more relevant for topline growth for companies and the sharper than expected decline in this was ignored. The commodities/oil deflation globally in 2H 2014 has led to WPI printing in negative zone over last 5 months. This also played a role in adversely affecting topline growth for Nifty.

Portfolio sector positioning – OW Banks, Pharma; UW Auto 2Ws, Staples, IT

Earnings forecasts by street and UBS analysts are building in growth acceleration for Consumers, Autos, Banks, Infra/Cap Goods and building in deceleration in IT Services. We reiterate OW Banks as we believe the rate cycle will be a bigger driver for these stocks (through lower NPLs, and bond book gains) rather than credit growth near-term. We are also OW Coal, Oil & Gas/Petchem, Pharma and Telecom & Media. We reiterate UW on Auto 2Ws and Consumer Staples to reflect our concerns on rural growth. We are also UW on IT Services and Real Estate. We are Neutral on Auto 4Ws, Consumer Discretionary, Infra/Cap Goods, Power Utilities and Midcaps.

Nifty Dec-2015 target cut to 9,200 from 9,600. Most/least preferred stocks

We cut our Nifty target for Dec-2015 to 9,200, to reflect earnings cuts. We now use a higher multiple of 17x one-year forward PE (vs. 16x earlier) as we expect current multiples to likely sustain. The revised target also reflects our view of the growth recovery being slower than expected, as is playing out in quarterly corporate results. It does reflect possibility of near-term consolidation and even profit-taking, given limited absolute upside from current levels near-term. We remain positive directionally and expect the rates cycle to continue surprising the markets positively. India remains OW from Asia and EM perspective. Our most preferred stocks are Bharti Airtel, Coal India, HDFC Bank, ITC, JSW Energy, LIC Housing Finance, Maruti, ONGC, Reliance Industries, SBI and Sun Pharma. Our least preferred stocks are Bajaj Auto, BHEL, Hero MotoCorp, Hindustan Unilever, Infosys and Jubilant FoodWorks. Our top midcap picks are MCX, Info Edge, Cholamandalam and Kajaria Ceramics.

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Figure 1: UBS India alpha preferences (most and least preferred stocks) and top midcap picks

Company Name	Rating	M cap ($m)	Current market price (Rs)	Price target (Rs)	% upside	P/E (x) FY16E	P/E (x) FY17E	P/B (x) FY16E	P/B (x) FY17E	EV/EBITDA FY16E	RoAE FY16E	Net Debt/Equity FY16E	EPS CAGR FY15-17E
Most Preferred													
Bharti Airtel	Buy	26,792	417	480	15.0%	22.3	18.1	2.3	2.1	7.0	11.0%	126.8	26.3%
Coal India	Buy	38,850	383	470	22.7%	14.7	13.3	5.7	5.4	12.0	39.1%	(145.5)	10.9%
HDFC Bank	Buy	38,576	1,029	1,300	26.3%	19.2	15.4	3.6	3.0	-	20.2%	-	27.4%
LIC Housing Finance	Buy	3,660	452	600	32.9%	12.8	10.1	2.3	1.9	-	19.1%	-	27.2%
ITC	Buy	44,523	350	430	22.9%	24.0	20.0	7.8	6.8	16.6	35.0%	(46.0)	17.7%
JSW Energy	Buy	3,021	115	144	25.7%	10.8	9.5	2.2	1.9	6.5	21.7%	66.7	16.1%
Maruti Suzuki India	Buy	17,801	3,669	4,200	14.5%	20.3	15.6	4.1	3.4	11.1	21.6%	(14.7)	41.9%
Oil & Natural Gas	Buy	45,002	328	400	22.1%	9.8	9.0	1.3	1.2	5.2	14.4%	18.4	11.3%
Reliance Industries	Buy	43,835	927	1,315	41.8%	10.8	9.5	1.1	1.0	8.4	11.0%	36.9	11.3%
State Bank of India	Buy	34,948	291	400	37.2%	12.8	10.2	1.5	1.4	-	12.7%	-	29.3%
Sun Pharma	Buy	42,237	1,090	1,260	15.6%	30.2	24.4	5.2	4.4	22.3	18.5%	(21.3)	22.7%
Least Preferred													
Bajaj Auto	Sell	9,698	2,087	2,300	10.2%	14.8	13.3	4.5	3.9	9.3	32.4%	(31.3)	12.0%
BHEL	Sell	9,124	232	202	-13.0%	21.8	23.4	1.6	1.5	14.5	7.5%	(23.3)	34.4%
Hero MotoCorp	Neutral	7,790	2,429	3,000	23.5%	14.0	12.2	6.0	5.0	8.9	46.6%	(26.2)	21.7%
Hindustan Unilever	Neutral	32,370	932	1,000	7.3%	41.1	35.6	35.8	28.4	31.3	97.8%	(65.9)	19.2%
Infosys Ltd	Sell	40,294	2,191	1,475	-32.7%	19.1	17.8	4.3	3.8	13.1	23.7%	(68.6)	6.4%
Jubilant FoodWorks	Sell	1,605	1,527	1,200	-21.4%	59.7	44.0	11.8	9.3	27.7	22.0%	(3.0)	33.9%
Top Midcap picks													
Multi Commodity Exch	Buy	921	1,125	1,500	33.3%	35.6	22.5	4.9	4.6	18.8	13.8%	(19.5)	50.7%
Info Edge	Buy	1,555	887	1,000	12.7%	49.8	40.3	6.0	5.4	33.0	12.6%	(86.3)	28.9%
Cholamandalam	Buy	1,435	624	700	12.1%	16.9	12.9	2.5	2.2	-	17.0%	-	32.0%
Kajaria Ceramics	Buy	933	768	900	17.1%	24.7	19.6	6.3	5.0	13.4	28.6%	17.8	33.4%

Source: UBS Estimates

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Positive surprise on rates cycle, lower oil prices and reforms newsflow helped Indian markets over the last 1 year. Hereon, actual earnings and macro data points will matter increasingly. The reality of a slow growth recovery is now being acknowledged and earnings estimates for FY15/16 have been cut 6-7% over the last 6 months – recovery is yet elusive.

Nifty earnings estimates cut

In the earlier part of FY15, consensus estimates for Nifty earnings had appeared to have stabilised, but started being revised downwards since mid-Oct'15, post weak 2QFY15 results. Since then, earnings for FY15/16 have been cut by nearly 7%, led by cuts in oil & gas, metals & mining, financials, autos and infra & cap goods.

The cut in earnings has been driven by a nearly 5% cut in topline estimates for FY15 (and over 7% for FY16), led by petrochemicals, oil & gas and autos.

EBITDA margin estimates for FY15 have been revised down marginally, with estimates for metals & mining, cement, power, infra & cap goods and oil & gas being revised down the most. However, estimates for petrochemicals, telecom, pharma and autos have been revised up (and consumers too for FY16).

On a sectoral basis, earnings cuts in autos, banks and petrochemicals are reflective primarily of cuts in topline; in cement, metals & mining and infra & cap goods primarily of margins cuts; and in oil & gas and power of both.

The impact of lower commodity prices can be seen on margin estimates of sectors which use these commodities as inputs – EBITDA margin estimates have been revised up for companies such as HUL and Asian Paints in the consumer sector (though overall sector margins estimates for FY15 are still down due to revisions in

ITC). The converse impact has been seen on companies in sectors whose selling price is dependent on commodity prices, such as Coal India, Sesa Sterlite, Tata Steel and NMDC in metals & mining, and Cairn and ONGC in oil & gas.

Figure 2: Nifty FY15 and FY16 earnings revisions and drivers

	FY15					FY16				
	Earnings		Sales		EBITDA margin	Earnings		Sales		EBITDA margin
	Revision	Contribution	Revision	Contribution	Revision	Revision	Contribution	Revision	Contribution	Revision
Autos	-5.6%	-0.7%	-3.3%	-0.6%	0.14%	-3.5%	-0.4%	-4.2%	-0.8%	0.25%
Financials	-3.5%	-1.0%	-2.6%	-0.2%		-2.6%	-0.8%	-3.0%	-0.3%	
Cement	-4.9%	-0.1%	-0.4%	0.0%	-1.08%	-3.0%	-0.1%	-0.7%	0.0%	-0.51%
Consumers	-2.5%	-0.1%	-1.8%	-0.1%	-0.26%	-4.1%	-0.2%	-4.4%	-0.1%	1.91%
Infra & Capital Goods	-18.0%	-0.6%	-1.6%	-0.1%	-0.96%	-10.1%	-0.4%	-1.2%	-0.1%	-0.62%
IT Services	0.7%	0.1%	0.5%	0.0%	-0.21%	-0.2%	0.0%	1.5%	0.1%	-0.51%
Media	-4.8%	0.0%	-2.1%	0.0%	-0.10%	-10.0%	0.0%	-3.4%	0.0%	-1.43%
Metals & Mining	-20.5%	-1.6%	-2.2%	-0.3%	-1.74%	-20.0%	-1.5%	-2.8%	-0.4%	-1.86%
Oil & Gas	-22.4%	-1.7%	-11.7%	-1.4%	-0.88%	-26.3%	-2.0%	-19.8%	-2.2%	-0.11%
Petrochem	-8.5%	-0.7%	-12.2%	-1.9%	0.39%	-12.3%	-0.9%	-24.4%	-3.6%	1.95%
Pharmaceuticals	-1.1%	0.0%	-1.7%	0.0%	0.21%	0.7%	0.0%	-0.7%	0.0%	0.54%
Power	-11.4%	-0.4%	-2.6%	-0.1%	-1.03%	-7.8%	-0.3%	-1.8%	-0.1%	-0.47%
Telecom	7.6%	0.1%	-0.6%	0.0%	0.33%	-1.8%	0.0%	0.3%	0.0%	0.19%
Nifty	**-6.8%**	**-6.8%**	**-4.8%**	**-4.8%**	**-0.27%**	**-6.6%**	**-6.6%**	**-7.5%**	**-7.5%**	**0.35%**

Note: Cuts since mid Oct-15; Source: Datastream, UBS

Sharper recovery only in FY17

Street forecasts are building in margins recovery, near past peaks, for FY16/17. Topline growth forecasts though appear conservative, at 8%/14% for FY16/17, vs. our forecast nominal GDP growth of 12.8%/13.3%. We continue to expect a mild recovery in FY16 (20bps acceleration in GDP growth) and a sharper recovery only in FY17.

Our top-down earnings growth forecast for the Nifty is 10%/18% for FY16/17, post likely 7% growth in FY15. This implies likely further cuts to earnings growth estimates by the street/analysts.

Figure 3: Nifty sales, EBITDA and earnings expectations

	Sales Growth (YoY, %)						EBITDA Margin						Earnings Growth (YoY, %)					
	UBS-e			IBES-e			UBS-e			IBES-e			UBS-e			IBES-e		
	FY15E	FY16E	FY17E	FY15E	FY16E	FY17E	FY15E	FY16E	FY17E	FY15E	FY16E	FY17E	FY15E	FY16E	FY17E	FY15E	FY16E	FY17E
Nifty	5.1%	4.4%	14.0%	4.2%	7.5%	13.6%	16.7%	18.5%	18.9%	17.0%	18.4%	18.9%	7.6%	17.2%	18.8%	7.7%	17.7%	19.9%
Nifty (ex Oil & Gas)	6.5%	4.9%	14.7%	5.8%	9.1%	13.9%	17.3%	19.2%	19.5%	17.5%	18.8%	19.3%	10.1%	18.1%	19.4%	10.6%	18.5%	20.3%
Nifty (ex global comms)	10.5%	12.4%	15.1%	11.3%	14.6%	15.4%	20.6%	21.3%	21.6%	20.7%	21.2%	21.4%	12.5%	19.1%	20.0%	13.2%	19.7%	20.0%

Note: Global commodities include oil & gas/petchem and metals & mining; Source: Datastream, Bloomberg, UBS

Nifty 4QFY15 expectations

4QFY15 will likely be weak but markets may be arguably already expecting that, based on our discussions with investors. Street/analyst estimates for Nifty companies suggest that overall profits are expected to decline, with negative yoy earnings growth in sectors such as oil & gas, metals & mining, cement and infra & cap goods. Ex global commodities, earnings are expected to grow modestly at 5%.

Revenue growth is expected to be similarly slow, with growth in 4Q being lower in most sectors than the past 9MFY15 (ex pharma and power). EBITDA margins are expected to improve vs. the past 9MFY15, with some benefits expected from the decline in commodity prices (e.g. autos, consumers).

Figure 4: Nifty 4QFY15 expectations vs 9m growth and FY15, 16 estimates

	Revenue growth				EBITDA margin				Net Profit growth			
	4Q15	9M15	FY15	FY16	4Q15	9M15	FY15	FY16	4Q15	9M15	FY15	FY16
Nifty	-1.3%	6.4%	5.1%	4.4%	19.1%	17.6%	16.7%	18.5%	-4.3%	9.1%	7.6%	17.2%
Nifty (ex oil & gas)	-0.2%	7.4%	6.5%	4.9%	20.4%	18.6%	17.3%	19.2%	0.4%	11.2%	10.1%	18.1%
Nifty (ex global commodities)	8.0%	11.1%	10.5%	12.4%	21.4%	20.7%	20.6%	21.3%	5.3%	14.6%	12.5%	19.1%
Sectors												
Autos	4.3%	12.7%	8.0%	7.4%	16.8%	15.9%	15.3%	16.3%	11.7%	13.7%	16.2%	12.3%
Financials	11.7%	15.2%	15.7%	16.5%					13.5%	13.9%	13.5%	25.0%
Cement	5.3%	13.2%	13.4%	15.1%	16.7%	15.2%	16.8%	19.2%	-38.6%	3.6%	9.5%	31.8%
Consumers	12.4%	12.5%	13.3%	15.6%	29.1%	28.6%	28.9%	29.0%	16.9%	11.2%	13.7%	17.6%
Infra/Cap goods	4.3%	4.7%	4.0%	17.2%	13.1%	11.3%	11.8%	12.4%	-36.4%	7.2%	-17.7%	25.0%
IT Services	11.7%	11.5%	11.6%	13.0%	25.8%	26.2%	26.1%	25.5%	6.5%	17.4%	13.4%	10.3%
Media	7.8%	9.3%	8.9%	16.8%	27.3%	27.6%	27.5%	28.0%	27.9%	10.1%	14.4%	24.5%
Metals & Mining	-4.1%	11.5%	5.6%	6.7%	22.5%	25.3%	14.7%	15.2%	-37.8%	-5.9%	-6.7%	16.4%
Oil & Gas	-8.9%	-0.5%	-5.2%	0.3%	9.9%	10.6%	12.4%	13.5%	-51.3%	-15.0%	-17.8%	5.0%
Petrochem	-32.2%	-7.4%	-6.5%	-27.0%	13.4%	8.4%	9.2%	14.6%	2.6%	0.8%	3.6%	8.6%
Pharmaceuticals	11.8%	10.3%	28.6%	14.3%	26.8%	26.5%	27.2%	28.6%	16.0%	21.3%	16.6%	23.5%
Power	9.3%	2.2%	3.6%	9.5%	34.1%	29.7%	30.9%	31.5%	18.5%	-2.1%	-7.6%	12.7%
Telecom	10.3%	10.8%	10.7%	12.5%	33.8%	33.6%	34.5%	35.5%	40.0%	96.3%	87.3%	22.1%

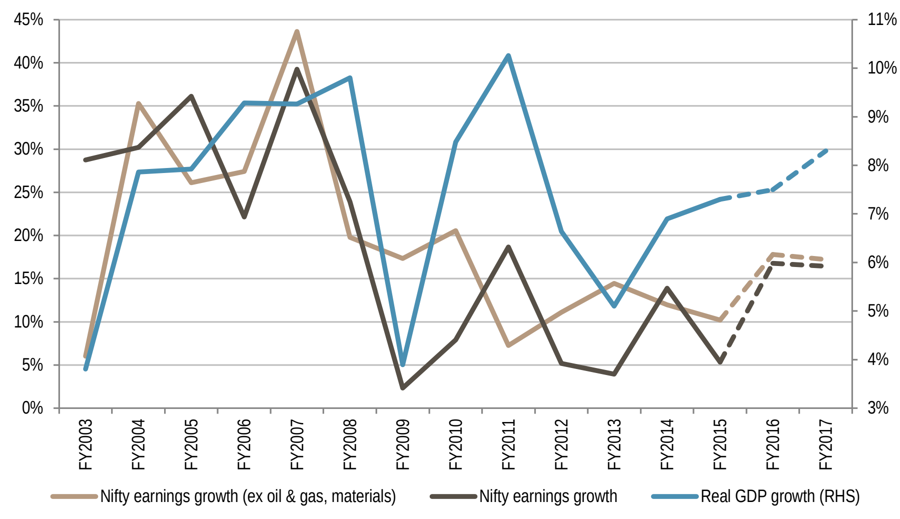
Note: Jump in pharma sales is due to Sun-Ranbaxy merger; Cement and Metals & Mining are consensus forecasts; Source: Datastream, Bloomberg, UBS

WPI ignored given focus on CPI – topline surprised negatively

We have been expecting negative GDP growth surprise but positive inflation surprise (ex crude oil) over the last 1 year. Yet earnings disappointed even our top-down expectations for FY15.

A lower growth environment is reflected in the decline in earnings growth rates over the past few years. Real GDP growth recovery over the next two years should help drive some pick-up in earnings growth (bottom up analyst forecasts imply a pick-up from single digit growth levels to 15%+), though we expect acceleration only in FY17, not FY16.

Figure 5: Nifty earnings growth vs real GDP growth

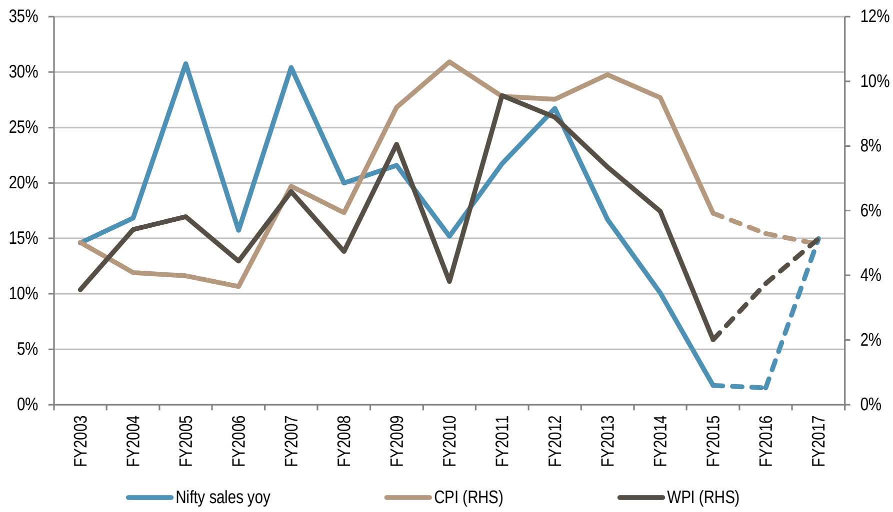


Note: Real GDP is based on 2011-12 market prices (new series); FY12 and earlier is using previous series; Nifty earnings based on current constituents, for which data goes back to FY02; analysis is FF adjusted, ex-banks; Source: CEIC, Capitaline, Datastream, Bloomberg, UBS

Earnings cuts and disappointments have been driven more by lower sales growth while margins have broadly gone up, only a bit below earlier expectations.

As per our analysis, markets (and us) were focused on CPI as the key inflation metric, given RBI's focus on this as the policy driver. WPI is arguably more relevant for topline growth for companies and the sharper than expected decline in this was ignored. CPI is dominated by food (weight of food & beverages is more than 45%) and thus not directly reflective of Nifty topline drivers. Sharp decline in WPI inflation has thus had a dampening impact on nominal sales in FY15. The commodities/oil deflation globally in 2H 2014 has led to WPI printing in negative zone over last 5 months. This also played a role in adversely affecting topline growth for Nifty.

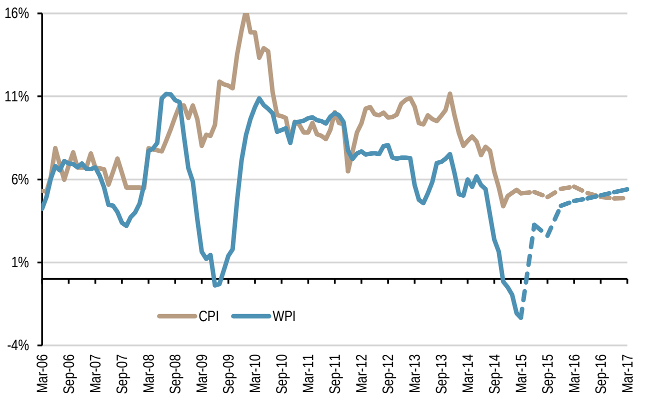
Figure 6: Nifty sales growth vs inflation



Note: Nifty sales based on current constituents, for which data goes back to FY02; analysis is FF adjusted, ex-banks and metals & mining; Source: Capitaline, Datastream, Bloomberg, UBS

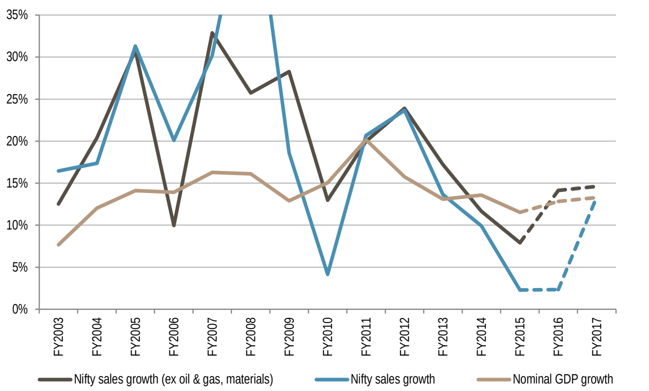
Sales growth is expected to recover from single digit levels going forward, but analysts are not building in a strong recovery in sales. In a more conducive environment, sales growth has some potential to surprise on the upside. Sales growth has been higher than nominal GDP growth in the past. Some uptick in the WPI inflation ahead supports the expectation of sales growth recovery.

Figure 7: Inflation trajectory and UBS forecasts



Note: Quarterly forecasts; Source: CEIC, MoSPI, UBS

Figure 8: Nifty sales growth vs nominal GDP growth



Note: Nifty sales based on current constituents, for which data goes back to FY02; analysis is FF adjusted, ex-banks; Source: Capitaline, Datastream, Bloomberg, UBS

Margins have been historically correlated with global commodity price movements and WPI inflation trajectory. The environment of benign global commodity prices and domestic inflation can be supportive of margin expansion.

Figure 9: Nifty EBITDA margin vs CRB index

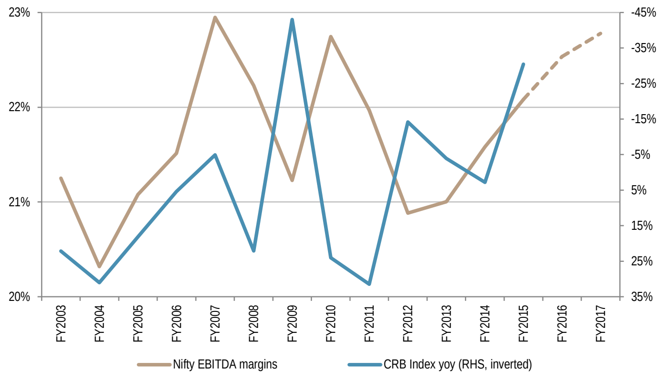
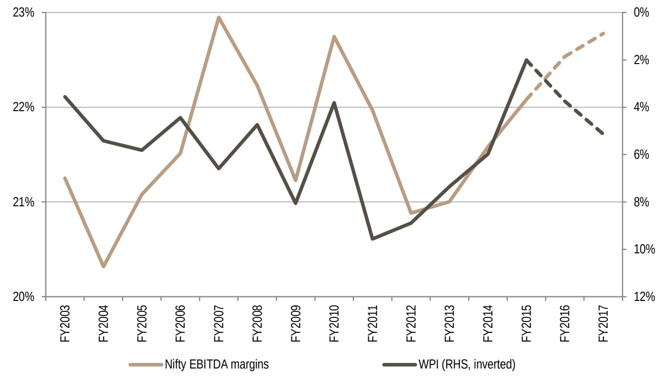


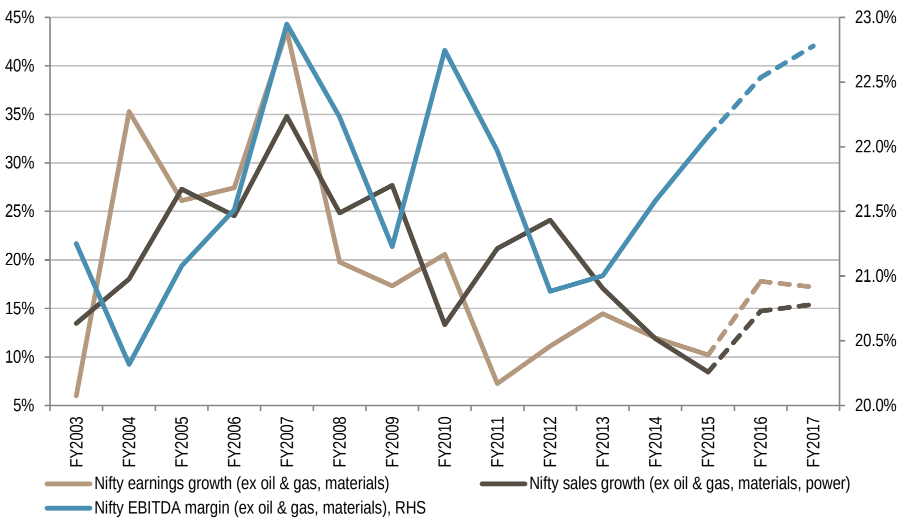
Figure 10: Nifty EBITDA margin vs WPI inflation



Note: Nifty margins based on current constituents, for which data goes back to FY02; analysis is FF adjusted, ex-banks, oil & gas and materials; Source: Capitaline, Datastream, Bloomberg, UBS

Current forecasts for the Nifty suggest that analysts are building in a much greater impact of operating leverage and EBITDA margins (ex oil & gas/materials) are forecast to improve to past peaks. We do not think that the current moderate expectations for sales recovery are enough to drive such an improvement in margins and thus the expected rise in earnings. If topline growth is actually in-line with the conservative estimates, margins could disappoint as operating leverage may not play out completely (as has been the case in FY15). Only if sales forecasts are beaten, can margins meet expectations, and earnings growth recovery be stronger.

Figure 11: Nifty earnings growth, sales growth and EBITDA margins



Note: Nifty earnings, sales and EBITDA margins based on current constituents, for which data goes back to FY02; analysis is FF adjusted, ex-banks; Source: Capitaline, Datastream, Bloomberg, UBS

Earnings forecast by street and UBS analysts are building in growth acceleration for Consumers, Autos, Banks, Infra/Cap Goods and building in deceleration in IT Services.

Figure 12: Nifty sales, EBITDA and earnings expectations

	Sales Growth (YoY, %)						EBITDA Margin						Earnings Growth (YoY, %)					
	UBS-e			IBES-e			UBS-e			IBES-e			UBS-e			IBES-e		
	FY15E	FY16E	FY17E	FY15E	FY16E	FY17E	FY15E	FY16E	FY17E	FY15E	FY16E	FY17E	FY15E	FY16E	FY17E	FY15E	FY16E	FY17E
Autos	8.0%	7.4%	15.6%	10.4%	15.2%	15.6%	15.3%	16.3%	16.7%	15.3%	15.5%	15.8%	16.2%	12.3%	24.8%	16.4%	21.5%	20.3%
Financials	15.7%	16.5%	17.0%	15.0%	16.4%	17.9%							13.5%	25.0%	22.0%	14.6%	21.9%	22.5%
Cement	13.4%	15.1%	15.4%	13.4%	15.1%	15.4%	16.8%	19.2%	21.4%	16.8%	19.2%	21.4%	9.5%	31.8%	32.7%	9.5%	31.8%	32.7%
Consumers	13.3%	15.6%	16.3%	13.1%	11.9%	16.6%	28.9%	29.0%	29.7%	29.3%	32.0%	29.3%	13.7%	17.6%	18.9%	11.4%	14.6%	15.5%
Infra/Cap goods	4.0%	17.2%	19.7%	5.0%	16.4%	18.2%	11.8%	12.4%	12.8%	11.8%	12.7%	13.1%	-17.7%	25.0%	30.9%	-14.9%	34.7%	26.5%
IT Services	11.6%	13.0%	11.2%	11.6%	14.4%	13.8%	26.1%	25.5%	24.8%	26.1%	25.9%	25.8%	13.4%	10.3%	8.9%	13.6%	12.6%	13.9%
Metals & Mining	5.6%	6.7%	7.5%	5.6%	6.7%	7.0%	14.7%	15.2%	15.8%	14.8%	15.3%	15.9%	-6.7%	16.4%	17.3%	-6.7%	17.9%	17.3%
Media	8.9%	16.8%	19.4%	7.8%	15.6%	17.6%	27.5%	28.0%	28.9%	27.1%	27.3%	28.9%	14.4%	24.5%	21.7%	2.3%	16.1%	24.8%
Oil & Gas	-5.2%	0.3%	8.1%	-7.4%	-5.1%	10.9%	12.4%	13.5%	13.9%	13.4%	15.0%	15.5%	-17.8%	5.0%	9.9%	-21.6%	5.5%	14.0%
Petrochem	-6.5%	-27.0%	23.0%	-12.2%	-11.3%	14.8%	9.2%	14.6%	14.6%	9.8%	12.5%	14.1%	3.6%	8.6%	14.1%	3.0%	7.1%	26.3%
Pharmaceuticals	28.6%	14.3%	13.2%	30.3%	14.7%	14.7%	27.2%	28.6%	29.8%	26.7%	27.4%	28.2%	16.6%	23.5%	21.2%	16.9%	19.8%	21.1%
Power	3.6%	9.5%	8.1%	2.8%	8.7%	8.3%	30.9%	31.5%	32.0%	31.1%	32.4%	33.3%	-7.6%	12.7%	12.7%	-0.2%	17.8%	13.8%
Telecom	10.7%	12.5%	12.4%	10.9%	10.9%	10.5%	34.5%	35.5%	36.4%	33.6%	34.1%	34.6%	87.3%	22.1%	17.1%	84.3%	12.2%	14.7%
Nifty	**5.1%**	**4.4%**	**14.0%**	**4.2%**	**7.5%**	**13.6%**	**16.7%**	**18.5%**	**18.9%**	**17.0%**	**18.4%**	**18.9%**	**7.6%**	**17.2%**	**18.8%**	**7.7%**	**17.7%**	**19.9%**
Nifty (ex Oil & Gas)	**6.5%**	**4.9%**	**14.7%**	**5.8%**	**9.1%**	**13.9%**	**17.3%**	**19.2%**	**19.5%**	**17.5%**	**18.8%**	**19.3%**	**10.1%**	**18.1%**	**19.4%**	**10.6%**	**18.5%**	**20.3%**
Nifty (ex global comms)	**10.5%**	**12.4%**	**15.1%**	**11.3%**	**14.6%**	**15.4%**	**20.6%**	**21.3%**	**21.6%**	**20.7%**	**21.2%**	**21.4%**	**12.5%**	**19.1%**	**20.0%**	**13.2%**	**19.7%**	**20.0%**

Note: Cement and Metals & Mining are consensus forecasts; Source: Datastream, Bloomberg, UBS

Portfolio sector positioning – OW Banks, Pharma; UW Auto 2Ws, Staples, IT

We reiterate OW Banks as we believe the rate cycle will be a bigger driver for these stocks (through lower NPLs, and through bond book gains) rather than credit growth near-term. We are OW Oil & Gas/Petrochemicals, Pharma and Telecom/Media. We are also OW Coal, with our sector analyst's recent initiation on Coal India – he believes Coal India is at a turning point with positive implications for top-line growth and operational leverage that have not yet been priced in by the market.

We reiterate UW on Auto 2Ws and Consumer Staples to reflect our concerns on rural growth. We are also UW on IT Services and Real Estate.

We are Neutral on Auto 4Ws, Consumer Discretionary, Infra/Cap Goods, Power Utilities and Midcaps.

Figure 13: UBS India sector positioning

Overweight	Neutral	Underweight
Banks & FIs - Private and SOE	Autos 4W	Autos 2W
Coal	Consumer Discretionary	Consumer Staples
Oil & Gas/Petrochemicals	Infrastructure & Capital Goods	IT Services
Pharmaceuticals	Power Utilities	Real Estate
Telecom & Media	SMID (small and midcaps)	

Source: UBS

Nifty Dec-2015 target cut to 9,200 from 9,600

We cut our Nifty target for Dec-2015 to 9,200, to reflect earnings cuts.

Our earlier Nifty target of 9,600 for Dec-2015 was based on assumptions of 12%/15%/18% growth in FY15/16/17 earnings and a one-year forward PE multiple of 16x. FY15 earnings have disappointed and are likely to be closer to 7%. We now assume a more moderate 10% growth in earnings in FY16, and a pick-up to 18% in FY17, and thus arrive at a lower one-year forward EPS for Dec-15 vs. earlier. Markets have rerated and have recently traded at higher multiples, closer to 17x one-year forward PE, despite the cut in earnings. We expect current multiples to likely sustain, and thus apply a 17x PE multiple to the derived EPS, which gives us a Nifty value lower than our earlier target.

Figure 14: Nifty value matrix

Scenarios	FY15E growth	FY15E EPS	FY16E growth	FY16E EPS	FY17E growth	FY17E EPS	1 year fwd	14x	15x	16x	16.5x	17x	17.5x	18x
Scenario 1 - UBS bottom-up	7.6%	434	17.2%	508	18.8%	603	579	8,113	8,692	9,272	9,561	9,851	10,141	10,431
Scenario 2 - IBES bottom-up	7.7%	433	17.7%	509	19.9%	611	585	8,194	8,779	9,365	9,657	9,950	10,243	10,535
Scenario 3 - pessimistic	7.0%	431	8.0%	466	15.0%	535	518	7,252	7,770	8,288	8,547	8,806	9,065	9,324
Scenario 4 - Base case	**7.0%**	**431**	**10.0%**	**474**	**18.0%**	**560**	**538**	**7,535**	**8,074**	**8,612**	**8,881**	**9,150**	**9,419**	**9,688**

Source: Datastream, Bloomberg, UBS estimates

The revised target also reflects our view of the growth recovery being slower than expected, as is playing out in quarterly corporate results. It does reflect possibility of near-term consolidation and even profit-taking, given limited absolute upside from current levels near-term. We remain positive directionally and expect the rates cycle to continue surprising the markets positively. India remains OW from Asia and EM perspective.

Bottom-up Nifty implied scenarios

Our top-down Nifty target of 9,200 for end-2015 implies a 5-6% upside from current levels. Using bottom-up UBS analyst price targets for individual Nifty stocks, we arrive at a bottom-up Nifty expectation of close to 9,900, which reflects a 14% upside, albeit over a year (assuming price targets largely reflect price expectations a year out). This is expected to be driven by banks, petrochem, pharma, consumers, oil & gas and autos. Consensus bottom-up price targets indicate a 9% upside.

We also looked at the projections for price targets for Nifty stocks in upside and downside scenarios – which indicate a 32% return and a 17% decline respectively.

The delta between the base case and upside scenario comes from sectors such as banks, infrastructure, IT Services, oil & gas and petrochemicals, which are expected to do much better in a rosy scenario. The delta between the base case and downside scenario comes from banks, pharmaceuticals and IT Services.

Figure 15: Nifty bottom up vs top down expectation, upside-downside scenarios

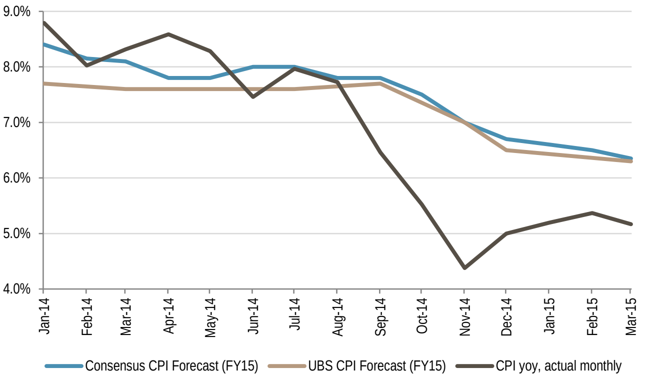
		UBS expectations				Consensus
	Current	Top down	Bottom up base case	Upside scenario	Downside scenario	Bottom up
Nifty value	8,707	9,200	9,888	11,457	7,257	9,483
% upside		5.7%	13.6%	31.6%	-16.7%	8.9%

Source: Bloomberg, UBS

Appendix

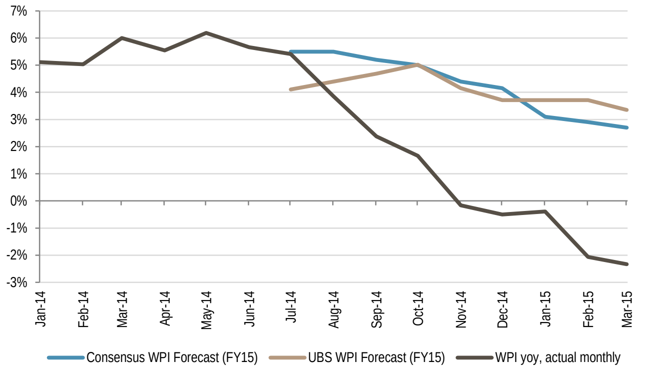
Inflation moderation vs. forecasts

Figure 16: FY15 CPI downward trajectory led to estimate cuts for FY15 – UBS was below consensus initially



Source: Bloomberg, UBS

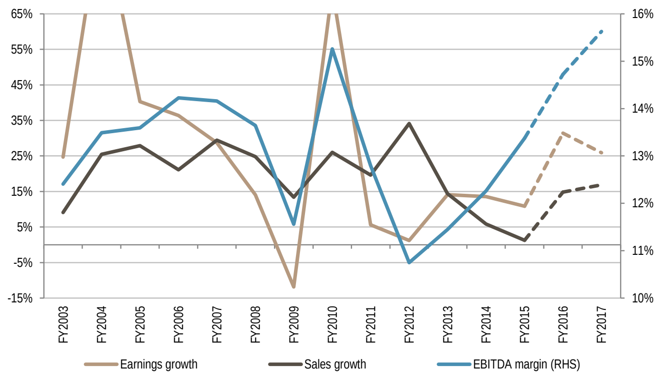
Figure 17: FY15 WPI downward trajectory led to estimate cuts for FY15 – WPI inflation moderation surprised



Source: Bloomberg, UBS

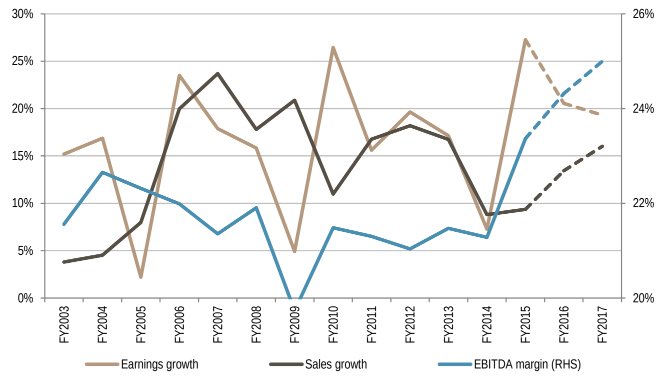
Nifty historical sectoral earnings trends and forecasts

Figure 18: Autos – historicals and forecasts



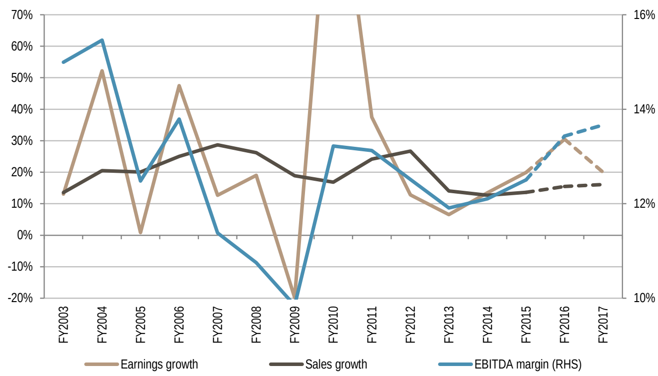
Note: For Nifty companies; Source: Capitaline, Bloomberg, UBS

Figure 19: Consumer staples – historicals and forecasts



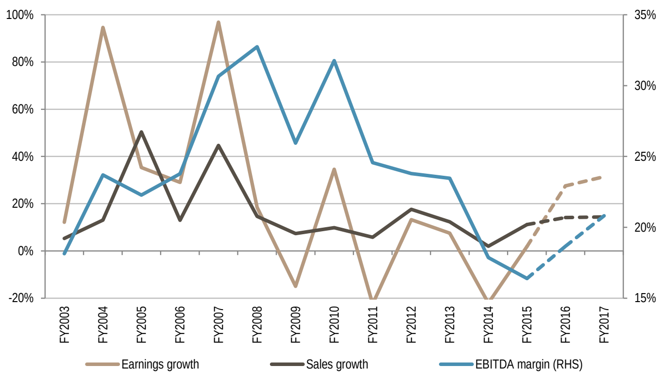
Note: For UBS coverage companies; Source: Capitaline, Bloomberg, UBS

Figure 20: Consumer discretionary – historicals and forecasts



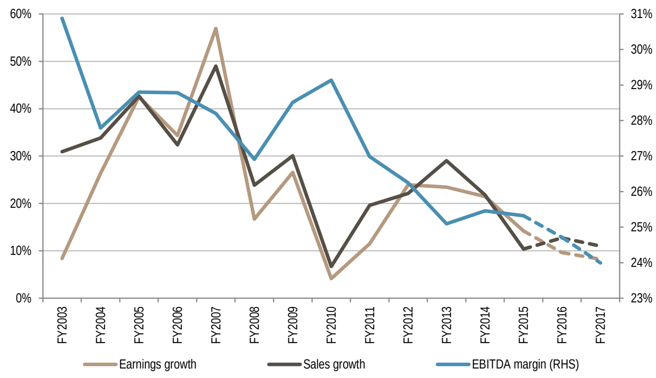
Note: For UBS coverage companies; Source: Capitaline, Bloomberg, UBS

Figure 21: Cement – historicals and forecasts



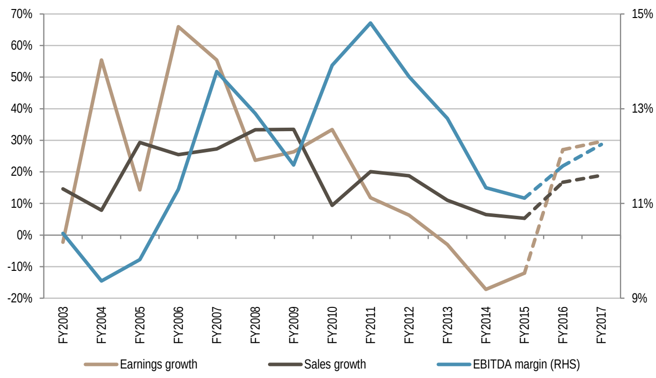
Note: For Nifty companies; consensus forecasts; Source: Capitaline, Datastream, Bloomberg, UBS

Figure 22: IT Services – historicals and forecasts



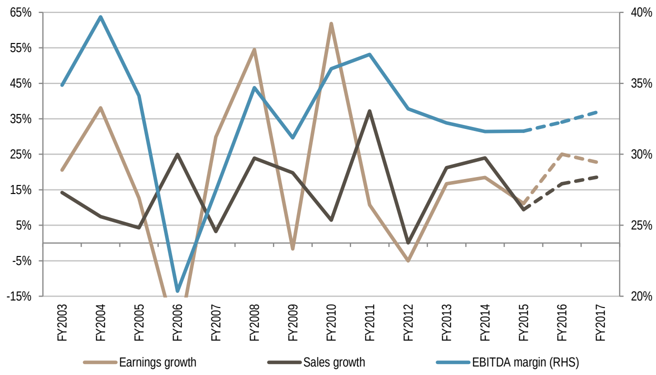
Note: For Nifty companies; Source: Capitaline, Bloomberg, UBS

Figure 23: Infra/cap goods – historicals and forecasts



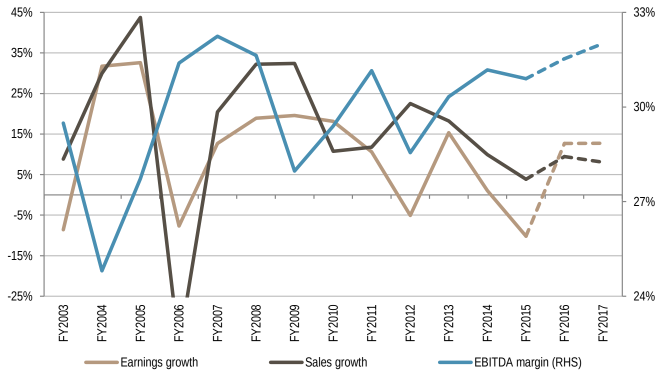
Note: For coverage companies; Source: Capitaline, Bloomberg, UBS

Figure 24: Media – historicals and forecasts



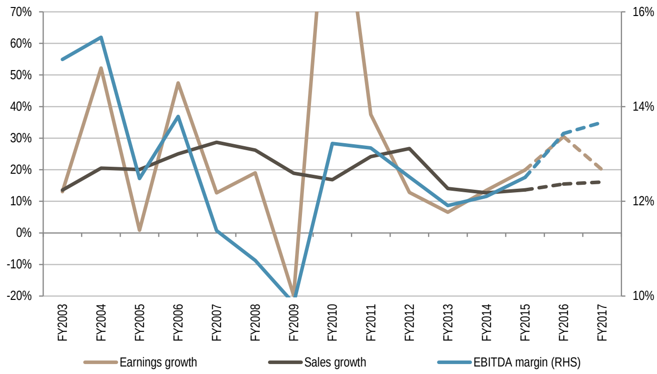
Note: For coverage companies; Source: Capitaline, Bloomberg, UBS

Figure 25: Power – historicals and forecasts



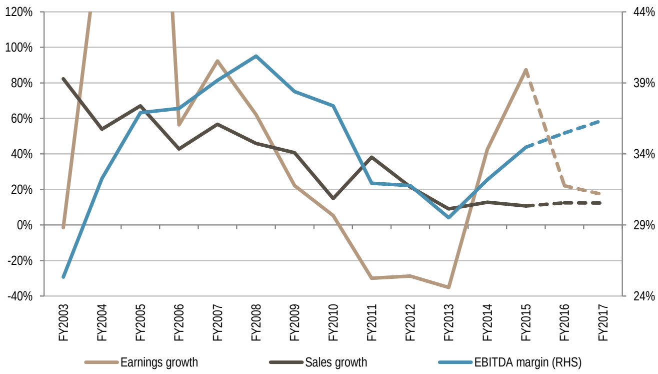
Note: For Nifty companies; Source: Capitaline, Bloomberg, UBS

Figure 26: Pharma – historicals and forecasts



Note: For Nifty companies; Source: Capitaline, Bloomberg, UBS

Figure 27: Telecom – historicals and forecasts



Note: For Nifty companies; Source: Capitaline, Bloomberg, UBS

Figure 28: Banks' GNPLs and slippages (% of loans)

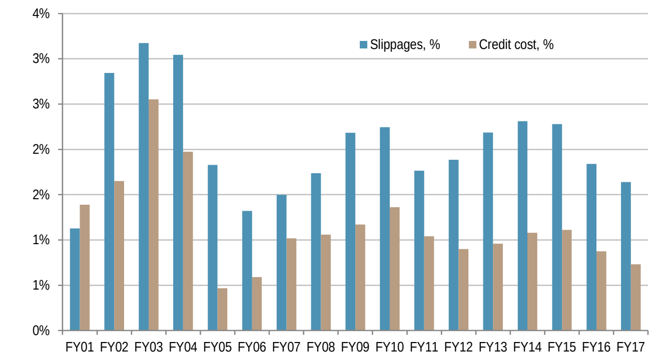


Figure 29: Banks' credit cost (% of loans)

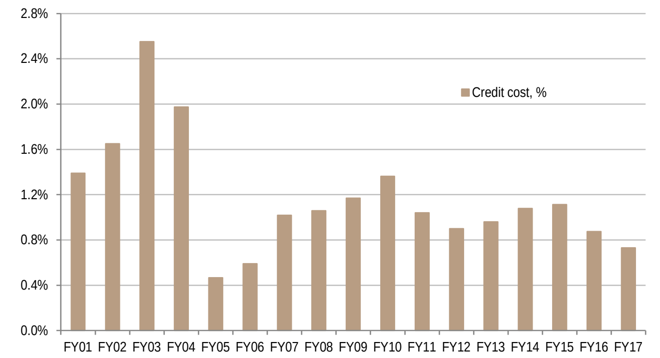


Figure 30: Banks' ROE and ROA

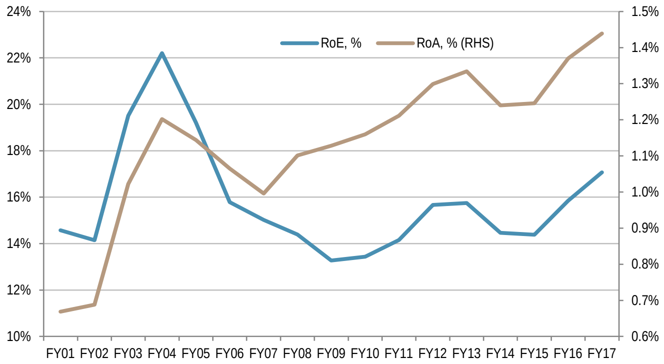
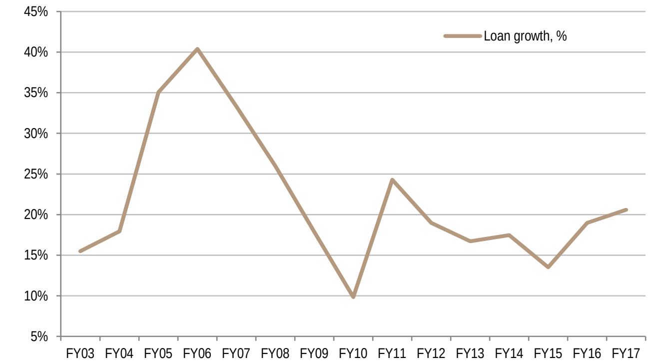


Figure 31: Banks' loan growth



Note: For coverage banks; FY15/16/17 are estimates; Source: Company reports, UBS

Figure 32: Sectoral comparison of current expectations with 2003-07 cycle

Sector	2003-07 cycle	2015-17 cycle bottom-up expectations
Autos	The jump in earnings growth was accompanied by an increase in sales growth, and some improvement in EBITDA margins. Net interest (% of PBT) declined.	Earnings growth is expected to pick up, along with an increase in sales growth. The improvement in EBITDA margins is expected to be stronger, with some increase in gross margins too. Net interest (% of PBT) is expected to decline, but from high levels, and would remain near 5 year averages.
Consumer Staples	Earnings growth dipped in FY05, led by HUL, driven partly by slow sales growth and some contraction in EBITDA margins. Net interest expenses increased.	Earnings growth is expected to pick up for the large caps (some moderation due to base effect of mid-caps), with higher sales growth and some margin improvement.
Consumer Discretionary	Sales growth improved, accompanied by a decline in margins, and earnings growth trend was mixed (base effects of some larger companies played a role). Interest costs declined for some, while others became net interest payers, from receivers.	Earnings growth is expected to remain decently strong, with sales growth rising and margins picking up. Interest expenses to moderate.
Infra/Cap goods	Sales and earnings trends were mixed, and EBITDA margins took a while to improve. Interest expenses declined significantly.	Earnings growth is expected to improve from negative levels, along with an improvement in sales growth from low/negative levels. Margins are expected to improve, but interest costs to remain high.
IT Services	Earnings growth picked up with high sales growth, but lower margins.	Earnings growth is expected to slow, with margin contraction, and sales growth likely to be moderate.
Media	Sales growth declined initially but then picked up, while earnings trend was mixed. EBITDA margin jumped up with sales decline, but then contracted.	Both earnings and sales growth are expected to pick-up along with a moderate improvement in margins.
Pharma	Earnings growth picked-up only later, along with higher sales growth and a recovery in EBITDA margins, which initially contracted.	Earnings growth pick-up to be driven largely by margin expansion, and sales growth is expected to moderate.
Power	Sales and earnings growth shot up, followed by a decline in FY06 (led by Tata Power). Margins contracted at first but then picked up (led by NTPC). Interest expenses continued to remain very high.	Earnings growth is expected to come back to positive levels, from a no growth-decline situation in the past 2 years, along with an improvement in sales growth (though still moderate). EBITDA margins expected to improve somewhat. Interest expense to remain high.
Telecom	Sales growth was strong, margins improved, but interest expenses were high. Turnaround from being loss-making companies to profit-making led the earnings growth.	Sales growth should pick-up moderately and margin expansion expected. But earnings growth expected to decline. Net interest expense (% of PBT) expected to rise.

Source: Capitaline, Datastream, Bloomberg, UBS

We would like to thank Devendra Alhat, an employee of Cognizant, for his assistance in preparing this research report. Cognizant staff provides research support services to UBS.

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) are an economic slowdown, a weakening currency, global economic events, and government policy changes.

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Buy	FSR is > 6% above the MRA.	45%	37%
Neutral	FSR is between -6% and 6% of the MRA.	43%	33%
Sell	FSR is > 6% below the MRA.	12%	20%
Short-Term Rating	**Definition**	**Coverage[3]**	**IB Services[4]**
Buy	Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.	less than 1%	less than 1%
Sell	Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event.	less than 1%	less than 1%

Source: UBS. Rating allocations are as of 31 March 2015.
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.
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Company Disclosures

Company Name	Reuters	12-month rating	Short-term rating	Price	Price date
Bajaj Auto[8]	BAJA.BO	Sell	N/A	Rs2,086.70	16 Apr 2015
Bharat Heavy Electricals Limited	BHEL.BO	Sell	N/A	Rs232.10	16 Apr 2015
Bharti Airtel Ltd.[3, 4]	BRTI.BO	Buy	N/A	Rs417.30	16 Apr 2015
Cholamandalam Investment & Finance	CHLA.BO	Buy	N/A	Rs624.40	16 Apr 2015
Coal India	COAL.BO	Buy	N/A	Rs382.95	16 Apr 2015
HDFC Bank[2, 4, 5, 6, 16]	HDBK.BO	Buy	N/A	Rs1,029.10	16 Apr 2015
Hero MotoCorp	HROM.BO	Neutral	N/A	Rs2,428.85	16 Apr 2015
Hindustan Unilever	HLL.BO	Neutral	N/A	Rs931.90	16 Apr 2015
Info Edge (India)	INED.BO	Buy	N/A	Rs887.00	16 Apr 2015
Infosys Ltd[16]	INFY.BO	Sell	N/A	Rs2,191.10	16 Apr 2015
ITC	ITC.BO	Buy	N/A	Rs349.95	16 Apr 2015
JSW Energy	JSWE.BO	Buy	N/A	Rs114.70	16 Apr 2015
Jubilant FoodWorks	JUBI.BO	Sell	N/A	Rs1,527.45	16 Apr 2015
Kajaria Ceramics	KAJR.BO	Buy	N/A	Rs768.25	16 Apr 2015
LIC Housing Finance[13]	LICH.BO	Buy	N/A	Rs451.55	16 Apr 2015
Maruti Suzuki India	MRTI.BO	Buy	N/A	Rs3,669.05	16 Apr 2015
Multi Commodity Exchange of India	MCEI.BO	Buy	N/A	Rs1,124.95	16 Apr 2015
Oil & Natural Gas Corporation[1, 5]	ONGC.BO	Buy	N/A	Rs327.50	16 Apr 2015
Reliance Industries	RELI.BO	Buy	N/A	Rs927.45	16 Apr 2015
State Bank of India[4]	SBI.BO	Buy	N/A	Rs291.45	16 Apr 2015
Sun Pharmaceuticals Industries Limited	SUN.BO	Buy	N/A	Rs1,089.55	16 Apr 2015

Source: UBS. All prices as of local market close.
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