

India Market Strategy

Mixed data, recovery gradual. Rural complacency?

Equity Strategy

India

High frequency data signals mixed; gradual recovery likely. Disappointment?

High frequency data (economic, corporate, surveys) continues to give mixed signals. Some segments which picked up post elections last year have started to moderate – passenger autos especially 2Ws, Jobs index released by Naukri.com and cement production trends a bit. Some of the data shows signs of recovery in the last 3-4 months, like goods vehicles. Power availability (as proxy for production) continues to sustain robust growth rates in high single digits, despite the IIP (Index of Industrial Production, composite) being muted (3m moving average has slowed to <1% over the last few months vs. 3%+ in May-July). While rail freight activity appears to be robust, if we strip out coal (which is linked to robust power production), the numbers are actually declining yoy. Real GDP growth slowed to 5.3% yoy in the September quarter, from 5.7% in June, but is better than the 4.5% and 4.7% of FY13 and FY14. We continue to expect a mild and gradual recovery in growth with our forecast for real GDP growth at 5.5%/5.8% in FY15/16. This remains below consensus and could be an area of some disappointment near-term. Will markets react negatively? They didn't, in October, when festive season disappointed and seem to be ignoring that in 2015 too!

Business sentiment improvement sustains; uptick in new capex data, finally

Most sentiment indicators saw an uptick, also supported by corporate management commentary. The purchasing managers' index (PMI), has been above 50 (denoting expansion), driven more by manufacturing recently, though the services index has also been robust. This indicates a divergence from the IIP prints, which could be due to statistical volatility (more prevalent in measures of actual activity) in the IIP. We would put more weight on the elevated PMI than the depressed IIP. The RBI industrial outlook index also improved over the last 2 quarters. New capex announcement in the Dec'14 quarter was the highest since 2010 (up 170% yoy and 55% qoq), though the new capex in CY2014 is still lower than the annual run rate in 2006-10). The Cabinet Committee on Investments (CCI) has cleared a lot of stuck projects – 190+ projects, worth Rs6.5trn (over 5% of GDP), out of the 490 accepted for consideration.

Rural slowdown clearly evident. -ve impact for HUL, Hero MotoCorp, MMFS

Our thesis of CPI inflation moderation continues to play out, positively surprising markets (latest prints around 5% levels). The collateral negative of this is slower rural growth. This is manifesting itself in real rural wage growth now in negative territory. There are other tell-tale signs of this: 1) Tractor sales averaging a decline of 15% in last 3m 2) HUL 3Q volume growth at 3% 3) 2W sales growth (ex scooters, which is urban dominated arguably) coming off sharply (last 3m avg at -4%) 4) MMFS reporting pressure on asset quality and weak growth in 3Q, with decline in disbursements as rural demand remained weak across all product segments. We sense some complacency amongst investors around this rural slowdown theme. We reiterate UW Consumer Staples and Auto 2Ws. HUL, Hero MotoCorp and UNSP remain Least Preferred stocks.

Interest rates may yet be a +ve surprise, OW Banks. Nifty 2015 target 9,600

RBI's rate cut has made lower interest rates a widely-held view now amongst investors but we believe that it may yet surprise markets positively. We reiterate our forecast of 10-year government yields to fall to 6.5% by end FY16. Banks remain the key OW for us. The markets will look for tangible indicators like earnings or macro parameters into 2015, beyond just headlines of hope from future reforms by the govt, and we would keep a watch on these high frequency data for signs of a sustainable recovery. We remain positive on Indian equities for 2015 as the economic growth recovery underway will support valuations. Based on our top-down 15%/18% earnings growth forecasts for FY16/FY17 and 16x one-year forward PE, our Nifty target for end-2015 is 9,600.

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Figure 1: Summary of activity/sentiment data

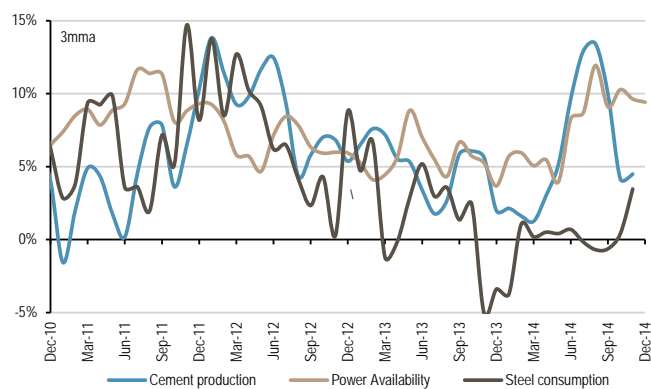
	Nov-13	Dec-13	Jan-14	Feb-14	Mar-14	Apr-14	May-14	Jun-14	Jul-14	Aug-14	Sep-14	Oct-14	Nov-14	Dec-14
Consumption activity														
Auto volumes – passenger (domestic)	-12.8%	-12.1%	-12.3%	-6.3%	-7.9%	-9.1%	4.0%	12.4%	8.6%	13.7%	6.3%	-5.4%	4.8%	16.9%
2W volumes (domestic)	5.6%	2.3%	8.9%	9.7%	21.2%	11.7%	16.3%	13.0%	13.7%	19.2%	23.8%	-3.6%	4.9%	4.3%
2W volumes (domestic, ex scooters)	0.4%	-4.8%	3.8%	4.5%	14.9%	7.5%	11.2%	9.3%	6.4%	15.5%	19.1%	-7.9%	-2.2%	-2.7%
2W volumes (export)	16.7%	14.0%	11.3%	6.7%	19.9%	24.7%	43.8%	20.6%	42.0%	18.1%	22.3%	21.1%	28.6%	13.0%
Tractor volumes	12.5%	13.0%	16.5%	15.2%	5.4%	-10.7%	0.1%	5.5%	-5.9%	-4.5%	7.0%	-12.3%	-32.3%	-3.4%
Consumer staples revenue growth		10.7%			5.7%			12.2%			10.2%			
Consumer Durables Index (2004-05=100)	235.8	229.1	261.6	261.2	274.4	255.4	262.7	211.9	220.9	218.8	241.3	191.8	201.7	
Consumer Durables growth	-21.7%	-16.4%	-8.3%	-9.8%	-11.8%	-7.7%	3.6%	-23.3%	-20.4%	-15.0%	-11.2%	-35.2%	-14.5%	
Air traffic – passengers	4.0%	4.5%	1.5%	2.1%	2.9%	4.6%	5.6%	11.8%	8.1%	8.9%	23.5%	16.5%	16.8%	
Business activity														
Cement production	3.9%	1.1%	1.4%	2.3%	0.0%	6.7%	8.7%	13.5%	16.4%	10.3%	3.2%	-1.1%	11.3%	
Steel consumption – long	9.1%	23.5%	14.3%	-0.9%	-6.4%	-3.3%	-1.9%	5.4%	45.5%	0.4%	6.6%	10.8%	0.9%	
Steel consumption – flat	-18.0%	-27.0%	-11.9%	2.8%	3.4%	6.8%	5.2%	-3.1%	-16.2%	-0.7%	0.9%	-5.2%	20.2%	
Steel consumption – total	-13.7%	2.8%	-0.3%	0.7%	0.2%	0.7%	0.4%	1.0%	-1.9%	-1.2%	1.2%	1.2%	8.0%	
Power availability	5.8%	4.1%	7.2%	6.6%	1.4%	8.5%	2.0%	14.4%	9.6%	11.8%	5.8%	13.2%	9.9%	5.2%
Auto volumes – goods (domestic)	-25.9%	-22.0%	-19.6%	-26.6%	-22.3%	-21.8%	-13.3%	-6.5%	-9.7%	-1.9%	9.8%	-2.5%	10.0%	5.2%
Auto volumes – passenger + goods (exports)	-12.1%	2.7%	2.3%	8.4%	10.9%	-9.5%	7.0%	7.5%	13.2%	8.9%	2.4%	13.6%	39.9%	24.9%
Diesel consumption	0.6%	-2.3%	-2.6%	0.1%	-1.9%	-3.5%	1.3%	3.3%	6.3%	1.4%	-0.2%	-3.0%	3.0%	2.8%
Petrol consumption	10.2%	7.8%	6.4%	8.2%	3.8%	18.3%	-0.7%	13.8%	5.3%	7.8%	21.6%	10.5%	3.6%	12.1%
Air (domestic) cargo volume	5.5%	10.4%	11.9%	10.3%	14.2%	12.2%	24.8%	22.5%	22.6%	20.7%	24.3%	9.1%	23.8%	
Rail cargo volume	3.1%	4.2%	4.1%	4.0%	2.2%	6.1%	4.0%	2.6%	4.3%	6.0%	2.2%	8.4%	8.5%	3.9%
Rail cargo (ex coal) volume	8.5%	8.7%	7.3%	7.1%	7.3%	11.8%	7.6%	6.9%	7.1%	2.0%	-1.9%	-3.3%	-1.5%	-2.0%
Visitor arrivals	4.7%	9.1%	0.0%	7.2%	4.6%	11.9%	0.8%	9.0%	12.9%	17.0%	9.1%	9.7%	2.2%	6.7%
Credit														
Overall bank credit	13.9%	14.2%	15.7%	15.7%	16.7%	13.9%	12.5%	12.8%	12.8%	10.4%	9.4%	12.2%	11.3%	10.5%
Non-farm credit	14.9%	15.0%	14.8%	14.6%	14.4%	14.1%	12.5%	12.2%	11.6%	9.1%	7.3%	9.9%	9.7%	
Investment														
Capex (new) - private project no.		208			208			207			288			207
Capex (new) - govt project no.		224			203			136			292			134
Capex (new) - govt. projects %		51.9%			49.4%			39.7%			50.3%			39.3%
Capex - new (Rs bn)		1,476			1,140			861			2,569			4,019
Capex - new (yoy)		118.8%			12.7%			-51.2%			128.8%			172.3%
Capex - outstanding (Rs bn)		148,053			148,288			147,377			149,915			156,155
Capex - under implementation (Rs bn)		82,002			83,576			82,555			84,848			86,282
Capex - completed (Rs bn)		530			1,472			1,108			556			646
Business sentiment indicators (index)														
Purchasing managers' index - composite	48.5	48.1	49.6	50.3	48.9	49.5	50.7	53.8	53.0	51.6	51.8	51.0	53.6	52.9
Purchasing managers' index - manufacturing	51.3	50.7	51.4	52.5	51.3	51.3	51.4	51.5	53.0	52.4	51.0	51.6	53.3	54.5
Purchasing managers' index - services	47.2	46.7	48.3	48.8	47.5	48.5	50.2	54.4	52.2	50.6	51.6	50.0	52.6	51.1
Business confidence index (NCAER)		122.3			127.0			143.5			142.5			
D&B Business optimism		134.9			157.2			154.5			145.5			138
RBI Industrial Outlook		25.7			31.5			27.4			37.0			39.7
Jobspeak Index (July-08=1000)	1299	1296	1466	1502	1475	1589	1600	1570	1649	1478	1518	1241	1471	1425
Jobspeak Index yoy growth	16.0%	12.7%	15.3%	13.9%	13.1%	16.2%	21.5%	27.6%	24.6%	22.6%	22.6%	-3.4%	13.2%	10.0%
Macro Indicators														
UBS India LEI	1.8%	2.5%	2.4%	2.1%	2.0%	2.7%	3.4%	3.4%	4.7%	3.5%	3.5%	3.2%	3.6%	3.0%
Industrial production														
IIP - composite	-1.3%	0.1%	1.1%	-2.0%	-0.5%	3.7%	5.6%	4.3%	0.9%	0.5%	2.8%	-4.2%	3.8%	
IIP - mining	1.6%	2.6%	2.7%	2.3%	0.5%	1.7%	2.5%	4.8%	0.1%	1.2%	0.3%	4.9%	3.4%	
IIP - manufacturing	-2.6%	-1.1%	0.3%	-3.9%	-1.3%	3.0%	5.9%	2.9%	-0.3%	-1.1%	2.9%	-7.4%	3.0%	
IIP - electricity	6.3%	7.5%	6.5%	11.5%	5.4%	11.9%	6.7%	15.7%	11.7%	12.9%	3.9%	13.3%	10.0%	

	Nov-13	Dec-13	Jan-14	Feb-14	Mar-14	Apr-14	May-14	Jun-14	Jul-14	Aug-14	Sep-14	Oct-14	Nov-14	Dec-14
Macro Economy														
GDP														
Real GDP (Rs tm)		14.8			15.4			14.4			14.4			
Real GDP		4.6%			4.6%			5.7%			5.3%			
Agriculture - % of GDP		17.0%			13.9%			13.4%			10.8%			
Industry - % of GDP		25.3%			26.1%			26.2%			25.9%			
Services - % of GDP		57.7%			60.0%			60.4%			63.3%			
Agriculture - contribution		0.6%			0.9%			0.5%			0.4%			
Industry - contribution		-0.1%			-0.1%			1.1%			0.6%			
Services - contribution		4.0%			3.8%			4.1%			4.4%			
Consumption		2.9%			6.8%			6.2%			6.4%			
Investment		-3.2%			-2.2%			3.4%			-1.5%			
Inflation														
CPI	11.2%	9.9%	8.8%	8.0%	8.3%	8.6%	8.3%	7.5%	8.0%	7.7%	6.5%	5.5%	4.4%	5.0%
CPI - Food	14.5%	12.0%	9.9%	8.6%	9.2%	9.6%	9.2%	8.0%	9.1%	9.1%	7.6%	5.7%	3.6%	5.1%
CPI - AL	13.4%	11.2%	9.1%	8.1%	8.4%	8.4%	8.1%	7.7%	8.0%	7.2%	6.9%	6.1%	4.6%	
CPI - IW	11.5%	9.1%	7.2%	6.7%	6.7%	7.1%	7.0%	6.5%	7.2%	6.8%	6.3%	5.0%	4.1%	
CPI - RL	13.3%	11.2%	9.2%	8.3%	8.5%	8.7%	8.3%	7.8%	8.1%	7.6%	7.1%	6.4%	5.0%	
WPI	7.5%	6.4%	5.1%	5.0%	6.0%	5.5%	6.2%	5.7%	5.4%	3.9%	2.4%	1.7%	0.0%	0.1%
WPI - food	19.7%	13.7%	8.8%	7.9%	9.6%	8.7%	9.6%	8.3%	8.5%	5.1%	3.7%	2.7%	0.6%	5.2%
WPI - core	3.0%	3.3%	3.3%	3.8%	4.0%	3.9%	4.0%	4.1%	4.0%	3.6%	3.1%	2.6%	2.2%	1.5%
WPI - manufactured	2.9%	3.0%	3.0%	3.4%	3.7%	3.7%	3.9%	3.9%	4.1%	3.7%	3.0%	2.5%	2.0%	1.6%
WPI - fuel	11.1%	10.9%	9.8%	8.7%	11.8%	9.3%	10.5%	9.0%	7.4%	4.5%	1.3%	0.5%	-4.9%	-7.8%
Nominal rural wages	17.3%	15.8%	13.6%	13.3%	11.7%	11.6%	10.6%	9.7%	7.7%	5.7%	5.6%	5.6%	3.9%	
Real rural wages	4.0%	4.6%	4.4%	5.0%	3.2%	2.9%	2.2%	1.9%	-0.4%	-1.8%	-1.5%	-0.8%	-1.1%	
Balance of Payments														
Exports	4.1%	3.7%	4.0%	-5.7%	-0.7%	3.2%	10.1%	8.9%	3.7%	1.0%	0.9%	-7.9%	7.3%	-3.8%
Imports	-16.5%	-15.0%	-18.9%	-17.9%	0.8%	-13.8%	-11.2%	8.6%	4.7%	1.4%	25.4%	3.3%	26.8%	-4.8%
Services (US\$ bn)		18.1			19.6			17.1			19.0			
Transfers and Income (US\$ bn)		10.9			9.7			9.7			9.5			
Current account (US\$ bn)		-4.1			-1.3			-7.9			-10.1			
FDI (US\$ bn)		6.1			0.9			8.2			8.0			
Portfolio investment (US\$ bn)		2.4			9.3			12.4			9.8			
ECB & loans (US\$ bn)		3.0			1.6			1.9			2.2			
All other foreign capital (US\$ bn)		12.3			-2.6			-2.6			-1.3			
BoP (US\$ bn)		19.1			7.1			11.2			6.9			

Note: Figures indicate yoy growth unless otherwise indicated; Consumer staples revenue growth relates to 28 companies; Passenger vehicles include MUVs; Jobspeak Index denotes jobs posted online on naukri.com as well as jobs acquired from existing clients by tele-calling team; Power Dec data is provisional; Jobspeak Index (Jul'08=1000); CPI (2010=100); Source: Company data, JPC, CapEx - CMIE, CEIC, SIAM, CRISIL, Central Electricity Authority, Petroleum planning and analysis cell, Datastream, naukri.com, CSO, RBI, Bloomberg, UBS

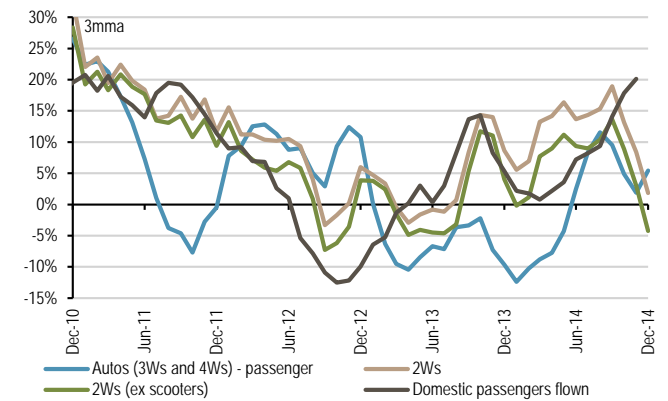
High frequency data signals mixed; gradual recovery likely

Figure 2: Steel, cement and power



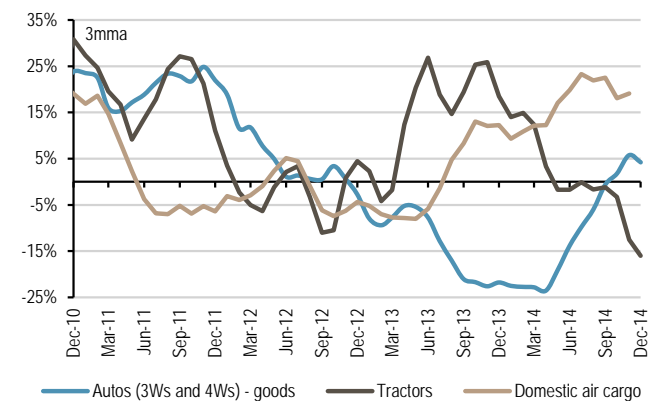
Source: CMA, CEA, JPC, UBS

Figure 3: Autos – PVs & 2Ws, domestic airline passengers



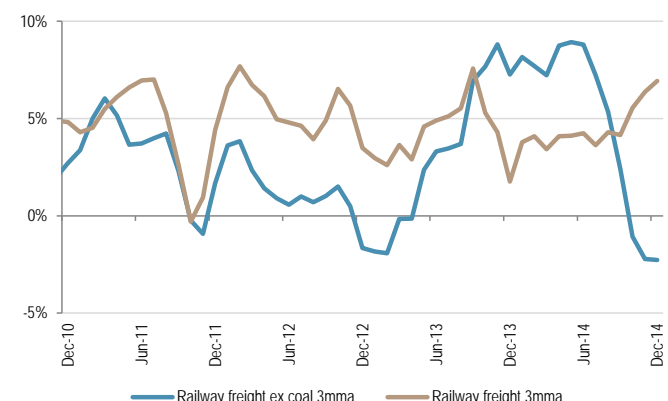
Note: Passenger includes MUVs; Source: SIAM, CEIC, UBS

Figure 4: Autos – goods, tractors and air cargo



Source: SIAM, CRISIL, CEIC, UBS

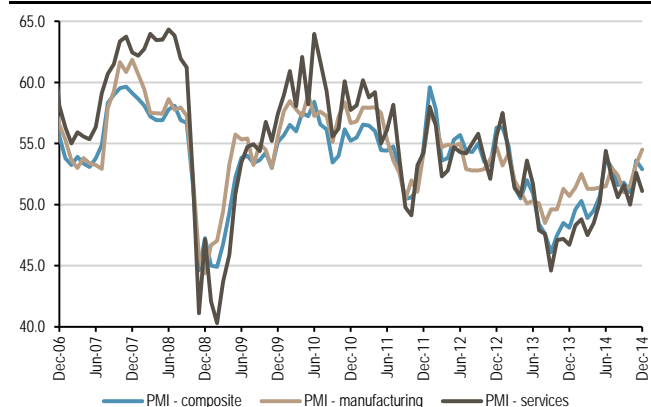
Figure 5: Railway freight



Source: CEIC, UBS

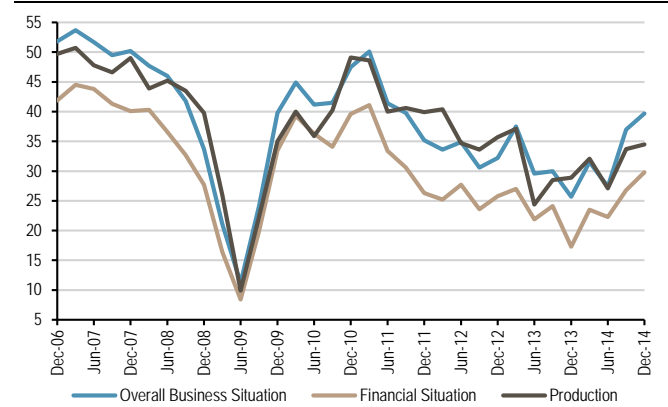
Business sentiment improvement sustains

Figure 6: Purchasing Managers' Index



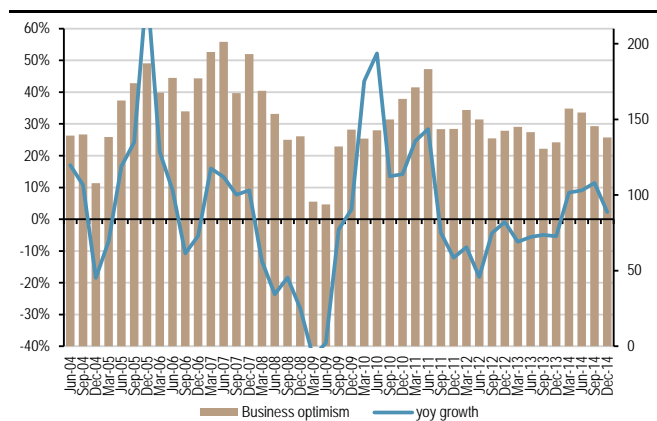
Source: Haver, UBS

Figure 7: RBI industrial outlook



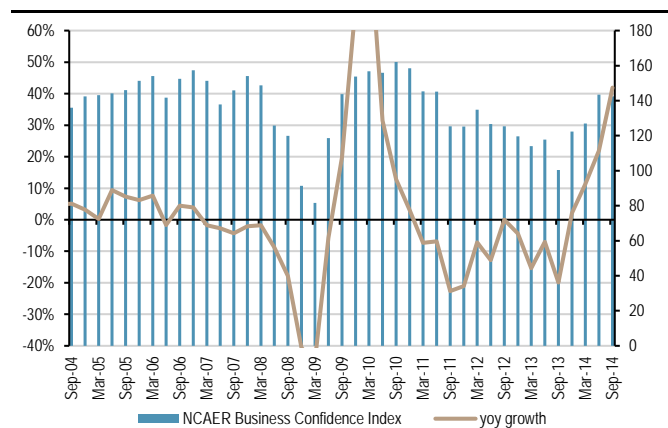
Note: Quarterly; Source: Datastream, UBS

Figure 8: D&B Business optimism



Note: Quarterly; Source: CEIC, UBS

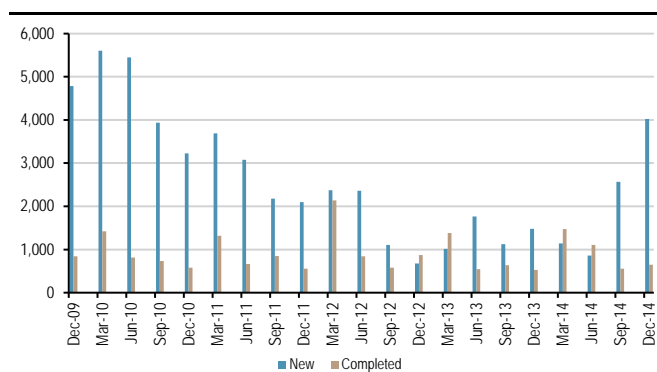
Figure 9: NCAER Business confidence Index



Note: Quarterly; Source: Haver, UBS

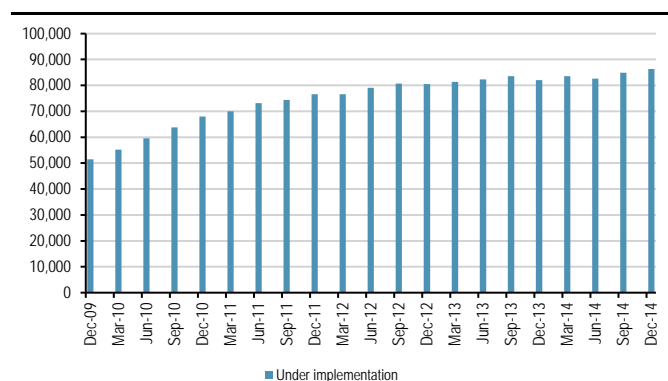
Uptick in new capex data, finally

Figure 10: New capex highest since 2010 (Rs bn)



Source: CapEx – CMIE

Figure 11: Capex under implementation (Rs bn)



Source: CapEx – CMIE

Figure 12: Projects accepted for consideration by CCI (no.)

No. of projects	Pending	Cleared	Total
Chemicals & Fertilizers - Chemicals/Petrochemicals	1	-	1
Chemicals and Fertilizers - Fertilizers	3	-	3
Civil Aviation	-	2	2
Coal	50	29	79
Commerce and Industry - Commerce	6	2	8
Commerce and Industry-DIPP	16	4	20
Mines	5	3	8
Petroleum and Natural Gas	32	17	49
Power	86	99	185
Railways	16	9	25
Road Transport and Highways	24	13	37
Shipping	11	8	19
Steel	45	6	51
Textiles	-	1	1
Urban Development	3	-	3
Grand Total	298	193	491

Note: Data as on 6th Jan; Source: CCI

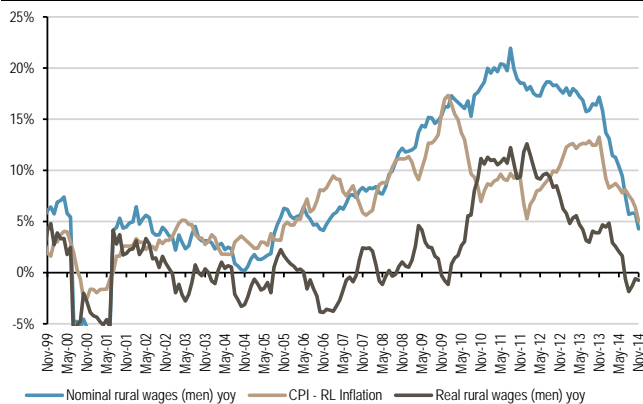
Figure 13: Projects accepted for consideration by CCI (amt)

Amount (Rs bn)	Pending	Cleared	Total
Chemicals & Fertilizers - Chemicals/Petrochemicals	90	-	90
Chemicals and Fertilizers - Fertilizers	192	-	192
Civil Aviation	-	240	240
Coal	1,298	124	1,422
Commerce and Industry - Commerce	423	100	523
Commerce and Industry-DIPP	231	142	373
Mines	375	137	512
Petroleum and Natural Gas	3,298	410	3,708
Power	5,529	4,504	10,032
Railways	259	194	453
Road Transport and Highways	367	183	550
Shipping	278	110	388
Steel	4,714	377	5,091
Textiles	-	13	13
Urban Development	1,040	-	1,040
Grand Total	18,093	6,534	24,628

Note: Data as on 6th Jan; Source: CCI

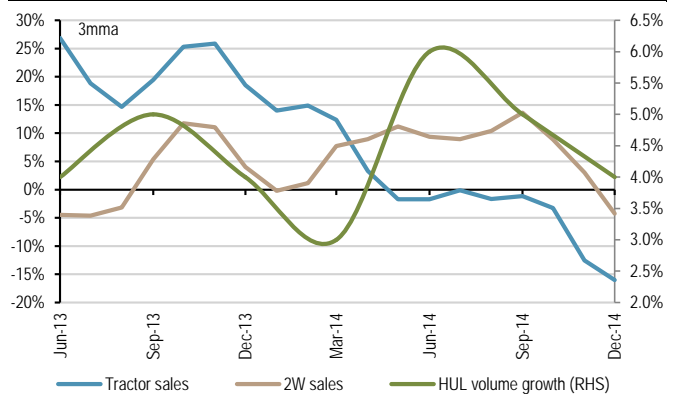
Rural slowdown clearly evident

Figure 14: Rural wages – nominal and real (using CPI)



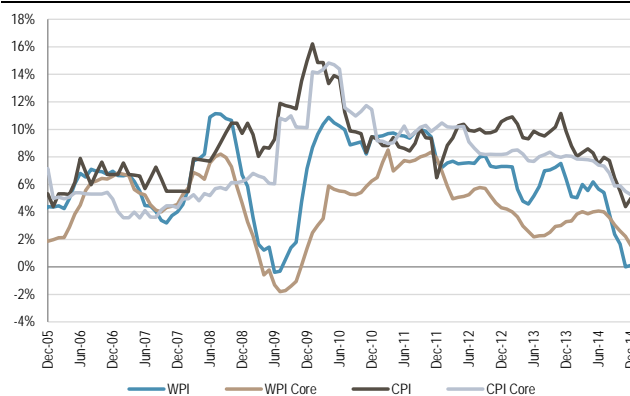
Source: Note: Rural wages classification has changed since Nov'13, and hence recent growth rates are based on some adjustments; Source: RBI, Labour Bureau

Figure 15: Rural slowdown – tractors, 2Ws, HUL volumes



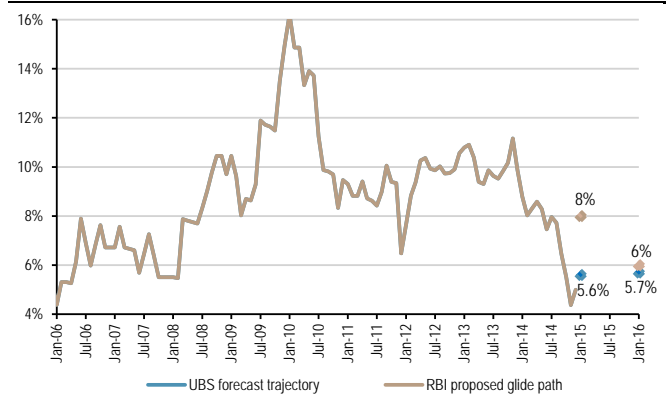
Source: CRISIL, SIAM, Company data, UBS

Figure 16: Inflation – CPI and WPI



Source: CEIC, UBS

Figure 17: CPI inflation – RBI glide path vs. UBS estimates



Source: CEIC, RBI, 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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UBS Investment Research: Global Equity Rating Definitions

12-Month Rating	Definition	Coverage ¹	IB Services ²
Buy	FSR is > 6% above the MRA.	47%	37%
Neutral	FSR is between -6% and 6% of the MRA.	42%	32%
Sell	FSR is > 6% below the MRA.	11%	21%
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 December 2014.

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.

3:Percentage of companies under coverage globally within the Short-Term rating category. 4:Percentage of companies within the Short-Term rating category for which investment banking (IB) services were provided within the past 12 months.

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UBS Securities India Private Ltd: Gautam Chhaochharia; Sanjena Dadawala.

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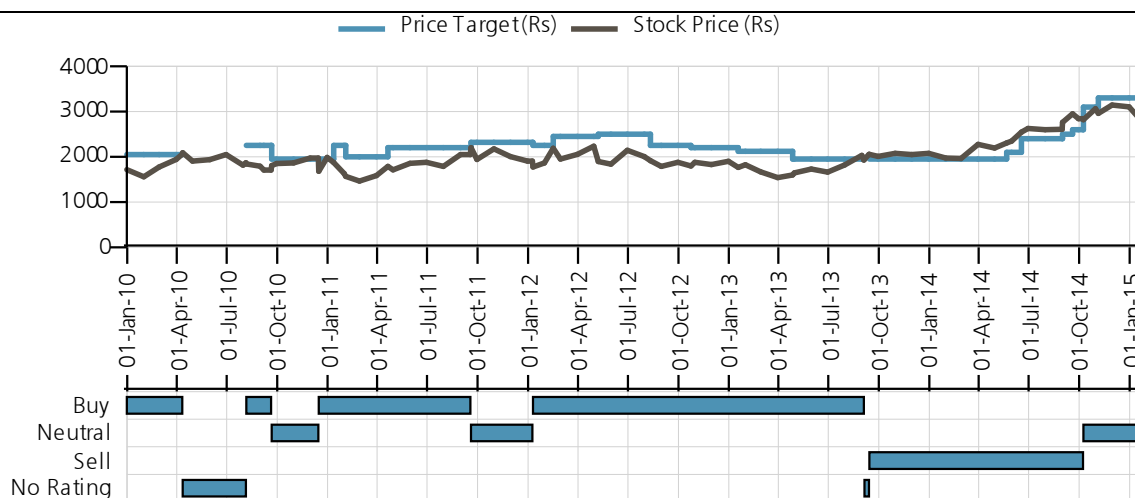
Company Name	Reuters 12-month rating	Short-term rating	Price	Price date
Hero MotoCorp	HROM.BO	Neutral	N/A Rs2,827.70	20 Jan 2015
Hindustan Unilever	HLL.BO	Neutral	N/A Rs895.70	20 Jan 2015
Mahindra and Mahindra Financial Services	MMFS.BO	Neutral	N/A Rs276.30	20 Jan 2015
United Spirits Ltd	UNSP.BO	Sell	N/A Rs3,361.90	20 Jan 2015

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

Ratings in this table are the most current published ratings prior to this report. They may be more recent than the stock pricing date

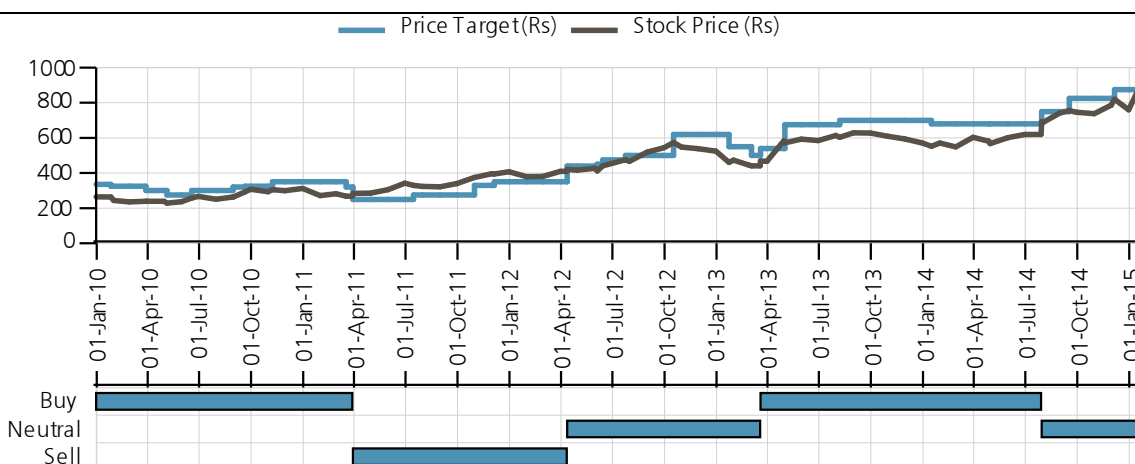
Unless otherwise indicated, please refer to the Valuation and Risk sections within the body of this report.

Hero MotoCorp (Rs)



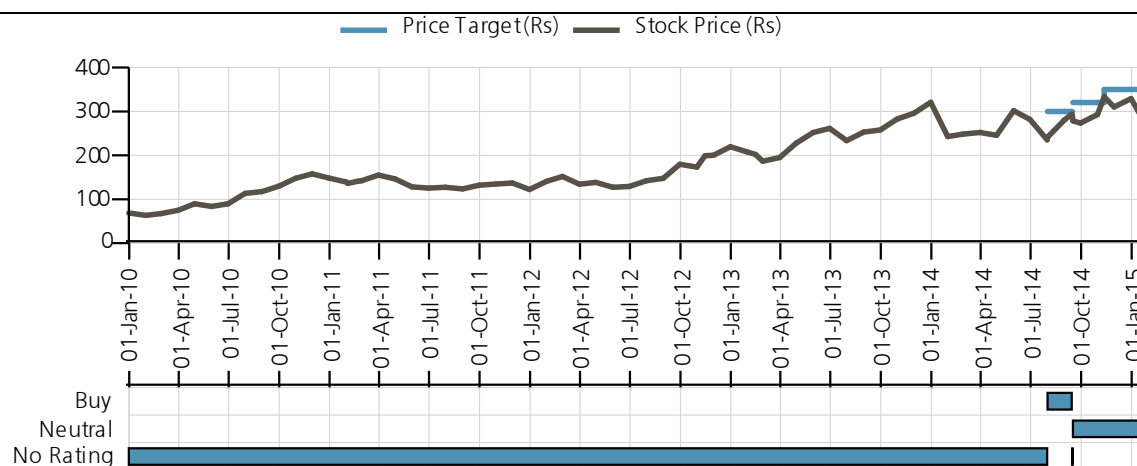
Source: UBS; as of 20 Jan 2015

Hindustan Unilever (Rs)



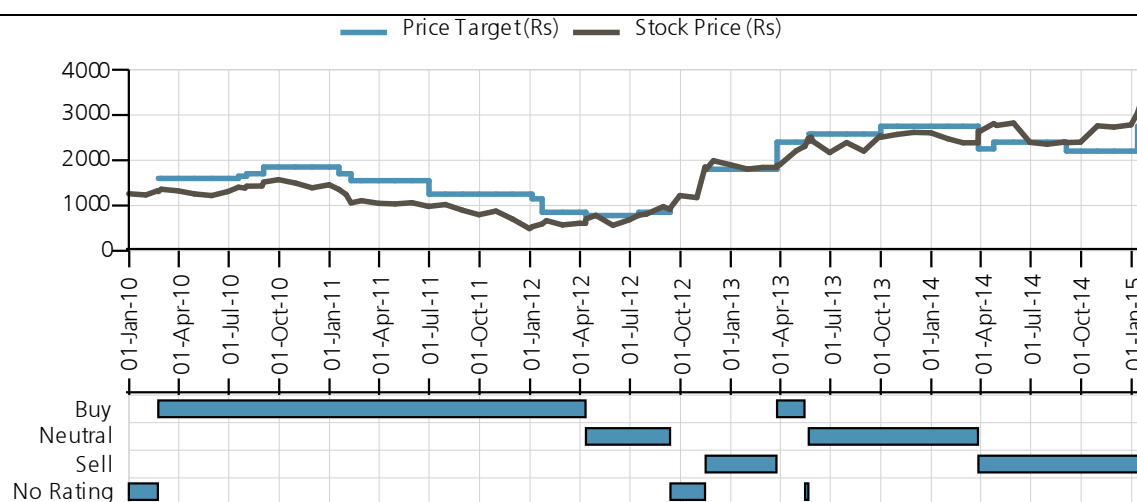
Source: UBS; as of 20 Jan 2015

Mahindra and Mahindra Financial Services (Rs)



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United Spirits Ltd (Rs)



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