

India Market Strategy

Critical event ahead – Govt fixing of MSP for crops

Equity Strategy

India

MSP fixing will reflect Govt's stance change, if any, on political economy

Some investors have been worried about potential change in Govt's stance on political economy. The new Govt has been focused on medium-term sustainable growth and thus bringing down inflation to mild levels. Weak rural trends, recent unseasonal rainfall affecting some crops, political capital needed to push land bill and decline in popularity as per surveys ([What could go wrong?](#)) has created concerns on potential dilution in this approach. The Govt has a majority mandate for 4 more years but will the above lead to some short-term populist measures? We believe the Govt decision on MSPs (minimum support prices) is a critical event ahead. This will give a clear indication of the Govt's stance on political economy, at least for the immediate term. Our base case is that the Govt will not give in to populism pressures in the short-term.

MSPs drove food inflation higher over FY09-13 and aided recent disinflation

We have argued earlier ([Inflation an enigma but will come off](#)) that sharp hikes in MSPs (FY09-13) played a role in driving food inflation and thus overall inflation higher, rather than any structural underpinnings. This was unwound over FY14-15, with muted MSP increases (0-5%, vs. 10-20% average in FY09-13). This played a role in containing inflation, apart from other factors (fiscal, monetary, wage guarantee schemes). Impact of poor monsoon rainfall on food inflation has also been correlated historically with the extent of MSP increases in the year. Forecasts by Australian Bureau of Meteorology and U.S.' Climate Prediction Centre imply 70% probability of El Nino in 2015. The Indian Meteorological Department has forecast a below normal monsoon for India in 2015 (expectation of 93% of normal rainfall).

CACP recommends 3.7% hike in rice MSP, government decision likely in June

According to media reports, the Commission for Agricultural Costs and Prices (CACP) has recommended a 3.7% hike in MSP for common paddy (rice). The government has historically announced official prices in June and has usually adopted the CACP recommendations. Given our forecast FY16/17 CPI of 5.3%/5%, any number below 5% is unlikely to drive inflation higher, ceteris paribus. Any number above 5% may hurt market sentiment, though it may aid some underperforming rural-focused stocks (for example Hero MotoCorp).

Risk-reward for India has improved; earnings cuts ahead but +ve rates surprise

We expect inflation and thus interest rates to surprise positively going forward, though economic and thus earnings recovery should be slower than street expectations. While reforms newsflow had been driving markets earlier, we expect earnings/macro data to gradually matter more into 2015, as has been seen recently. Recent correction in markets reflects reset of the growth trajectory expectations, as we had highlighted ([Earnings recovery elusive. For how long?](#)). While earnings estimates for FY16 have been cut 7% over the last 6 months, we still expect further cuts top-down. Our top-down Nifty earnings growth forecasts for FY16/17 are 10%/18%, vs. street forecasts of 18%/20%. Post the recent correction, risk-reward for the market has improved. Our Dec-2015 Nifty target of 9,200 is based on 17x one-year forward PE. This target implies a reasonable risk-reward given risk-free rate in India of 7.8%.

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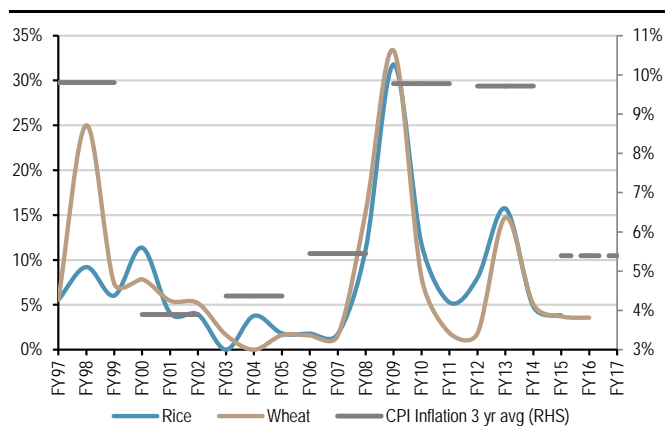
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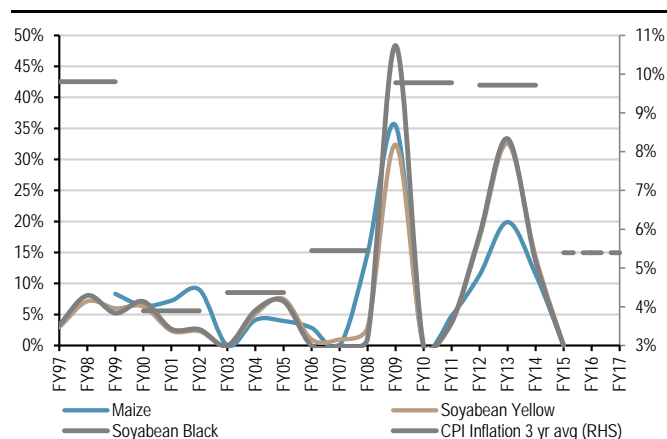
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Figure 1: MSPs of wheat and rice vs. CPI inflation



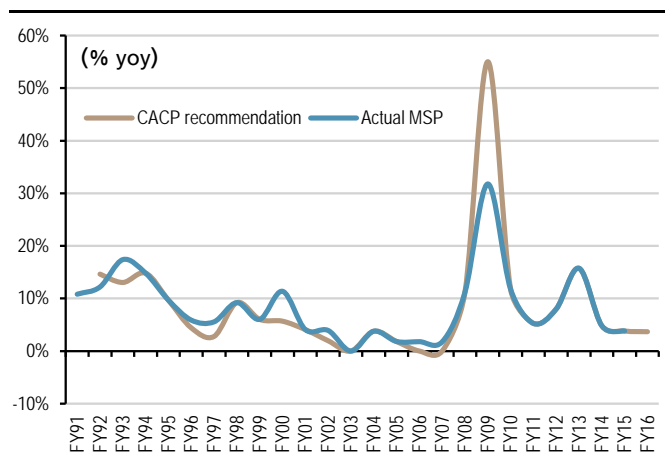
Source: CEIC, MoSPI, RBI, Ministry of Food, CACP

Figure 2: MSPs of animal feed vs. CPI inflation



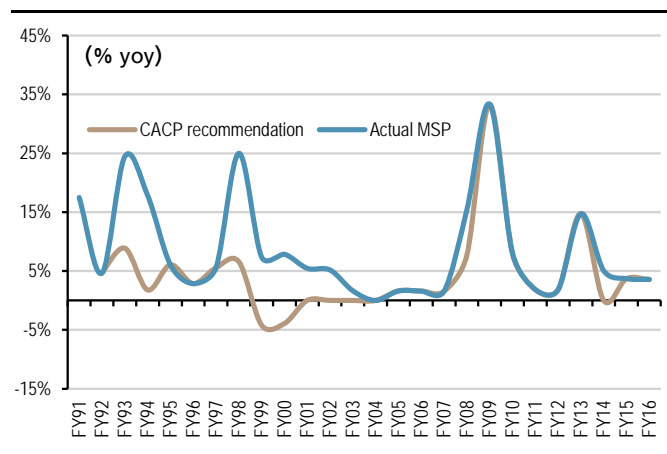
Source: CEIC, MoSPI, RBI, Ministry of Food, CACP

Figure 3: CACP reco vs actual govt MSP – rice



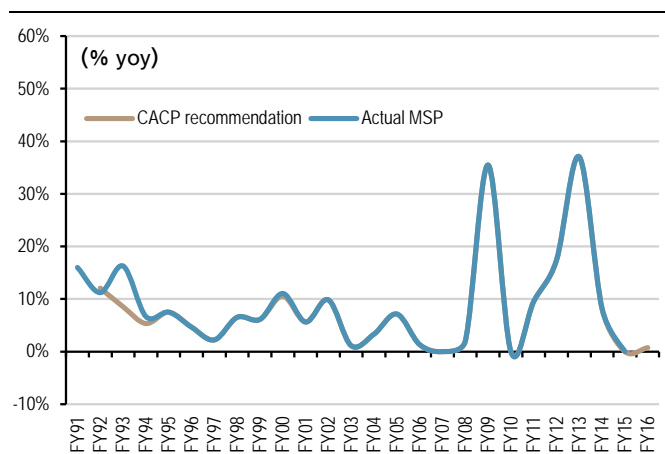
Source: CEIC, MoSPI, RBI, Ministry of Food, CACP

Figure 4: CACP reco vs actual govt MSP – wheat



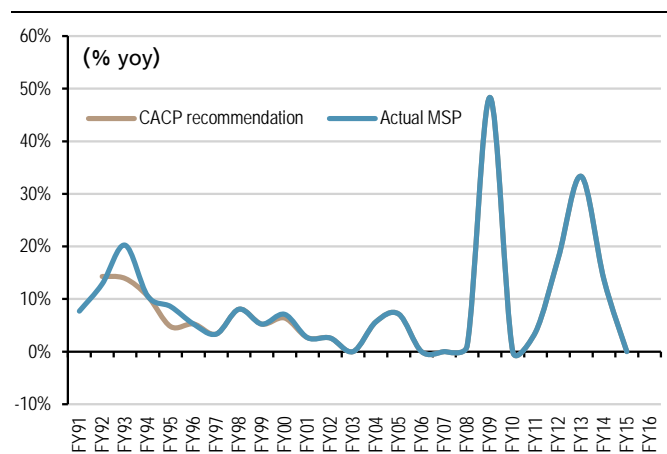
Source: CEIC, MoSPI, RBI, Ministry of Food, CACP

Figure 5: CACP reco vs actual govt MSP – groundnut



Source: CEIC, MoSPI, RBI, Ministry of Food, CACP

Figure 6: CACP reco vs actual govt MSP – soyabean



Source: CEIC, MoSPI, RBI, Ministry of Food, CACP

Figure 7: 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

Figure 8: 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

Figure 9: 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	25,371	401	480	19.8%	21.7	17.4	2.3	2.0	6.8	10.9%	126.6	26.0%
Coal India	Buy	37,278	373	470	26.1%	14.4	12.9	5.5	5.2	11.6	39.1%	(145.5)	10.9%
HDFC Bank	Buy	37,107	1,004	1,300	29.5%	19.3	15.5	3.5	3.0	-	19.4%	-	26.0%
LIC Housing Finance	Buy	3,496	437	575	31.4%	12.7	10.0	2.4	2.0	-	20.4%	-	26.4%
ITC	Buy	42,335	338	430	27.4%	23.1	19.3	7.6	6.6	15.9	35.0%	(46.0)	17.7%
JSW Energy	Buy	2,853	110	134	22.3%	11.3	10.0	2.1	1.9	6.4	19.9%	70.4	14.3%
Maruti Suzuki India	Buy	18,305	3,827	4,200	9.8%	21.0	16.2	4.2	3.5	11.2	21.4%	(16.1)	36.6%
Oil & Natural Gas	Buy	41,687	308	400	30.0%	9.2	8.4	1.3	1.2	4.9	14.4%	18.4	11.3%
Reliance Industries	Buy	40,308	865	1,315	52.0%	10.1	8.8	1.1	1.0	8.0	11.0%	36.9	10.7%
State Bank of India	Buy	32,204	272	400	46.8%	12.0	9.5	1.4	1.3	-	12.7%	-	29.3%
Sun Pharma	Buy	35,329	924	1,260	36.3%	25.6	20.7	4.4	3.8	18.9	18.5%	(21.3)	22.7%
Least Preferred													
Bajaj Auto	Sell	9,098	1,986	2,300	15.8%	14.1	12.6	4.3	3.7	8.7	32.4%	(31.3)	12.0%
BHEL	Sell	9,033	233	202	-13.3%	21.8	23.5	1.6	1.5	14.5	7.5%	(23.3)	34.4%
Hero MotoCorp	Neutral	7,451	2,356	3,000	27.3%	13.6	11.8	5.8	4.8	8.6	46.6%	(26.2)	21.7%
Hindustan Unilever	Neutral	29,442	860	1,000	16.3%	37.9	32.9	33.1	26.2	28.8	97.8%	(65.9)	19.2%
Infosys Ltd	Sell	35,561	1,961	1,600	-18.4%	17.3	15.9	4.0	3.7	11.5	24.5%	(64.0)	7.0%
Jubilant FoodWorks	Sell	1,466	1,415	1,200	-15.2%	55.3	40.7	11.0	8.6	25.6	22.0%	(3.0)	33.9%
Top Midcap picks													
Multi Commodity Exch	Buy	818	1,013	1,500	48.1%	32.0	20.3	4.4	4.1	16.4	13.8%	(19.5)	50.7%
MMYT	Buy	946	\$22.9	\$28	22.3%	(203.2)	233.9	6.6	6.4	227.7	-3.2%	(48.4)	-
Info Edge	Buy	1,359	786	1,000	27.2%	44.1	35.7	5.3	4.8	28.3	12.6%	(86.3)	28.9%
Cholamandalam	Buy	1,361	601	700	16.5%	16.2	12.5	2.4	2.1	-	17.0%	-	32.0%
Kajaria Ceramics	Buy	864	722	900	24.7%	23.0	18.2	5.9	4.7	12.5	28.8%	17.2	33.1%

Source: UBS Estimates

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.

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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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Neutral	FSR is between -6% and 6% of the MRA.	43%	33%
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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.

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Bharat Heavy Electricals Limited	BHEL.BO	Sell	N/A	Rs233.05	28 Apr 2015
Bharti Airtel Ltd. ^{3, 4}	BRTI.BO	Buy	N/A	Rs400.80	28 Apr 2015
Cholamandalam Investment & Finance	CHLA.BO	Buy	N/A	Rs600.75	28 Apr 2015
Coal India	COAL.BO	Buy	N/A	Rs372.70	28 Apr 2015
HDFC Bank ^{2, 4, 5, 6, 16}	HDBK.BO	Buy	N/A	Rs1,004.05	28 Apr 2015
Hero MotoCorp	HROM.BO	Neutral	N/A	Rs2,356.35	28 Apr 2015
Hindustan Unilever	HLL.BO	Neutral	N/A	Rs859.70	28 Apr 2015
Info Edge (India)	INED.BO	Buy	N/A	Rs786.00	28 Apr 2015
Infosys Ltd ¹⁶	INFY.BO	Sell	N/A	Rs1,961.35	28 Apr 2015
ITC	ITC.BO	Buy	N/A	Rs337.50	28 Apr 2015
JSW Energy	JSWE.BO	Buy	N/A	Rs109.85	28 Apr 2015
Jubilant FoodWorks	JUBI.BO	Sell	N/A	Rs1,415.00	28 Apr 2015
Kajaria Ceramics	KAJR.BO	Buy	N/A	Rs721.65	28 Apr 2015
LIC Housing Finance ¹³	LICH.BO	Buy	N/A	Rs437.45	28 Apr 2015
Makemytrip ^{5, 16}	MMYT.O	Buy	N/A	US\$22.59	28 Apr 2015
Maruti Suzuki India	MRTI.BO	Buy	N/A	Rs3,826.65	28 Apr 2015
Multi Commodity Exchange of India	MCEI.BO	Buy	N/A	Rs1,012.50	28 Apr 2015
Oil & Natural Gas Corporation ^{1, 5}	ONGC.BO	Buy	N/A	Rs307.70	28 Apr 2015
Reliance Industries	RELI.BO	Buy	N/A	Rs865.00	28 Apr 2015
State Bank of India ⁴	SBI.BO	Buy	N/A	Rs272.40	28 Apr 2015
Sun Pharmaceuticals Industries Limited	SUN.BO	Buy	N/A	Rs924.35	28 Apr 2015

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

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