HSBC Global Research

Equity Strategy
India

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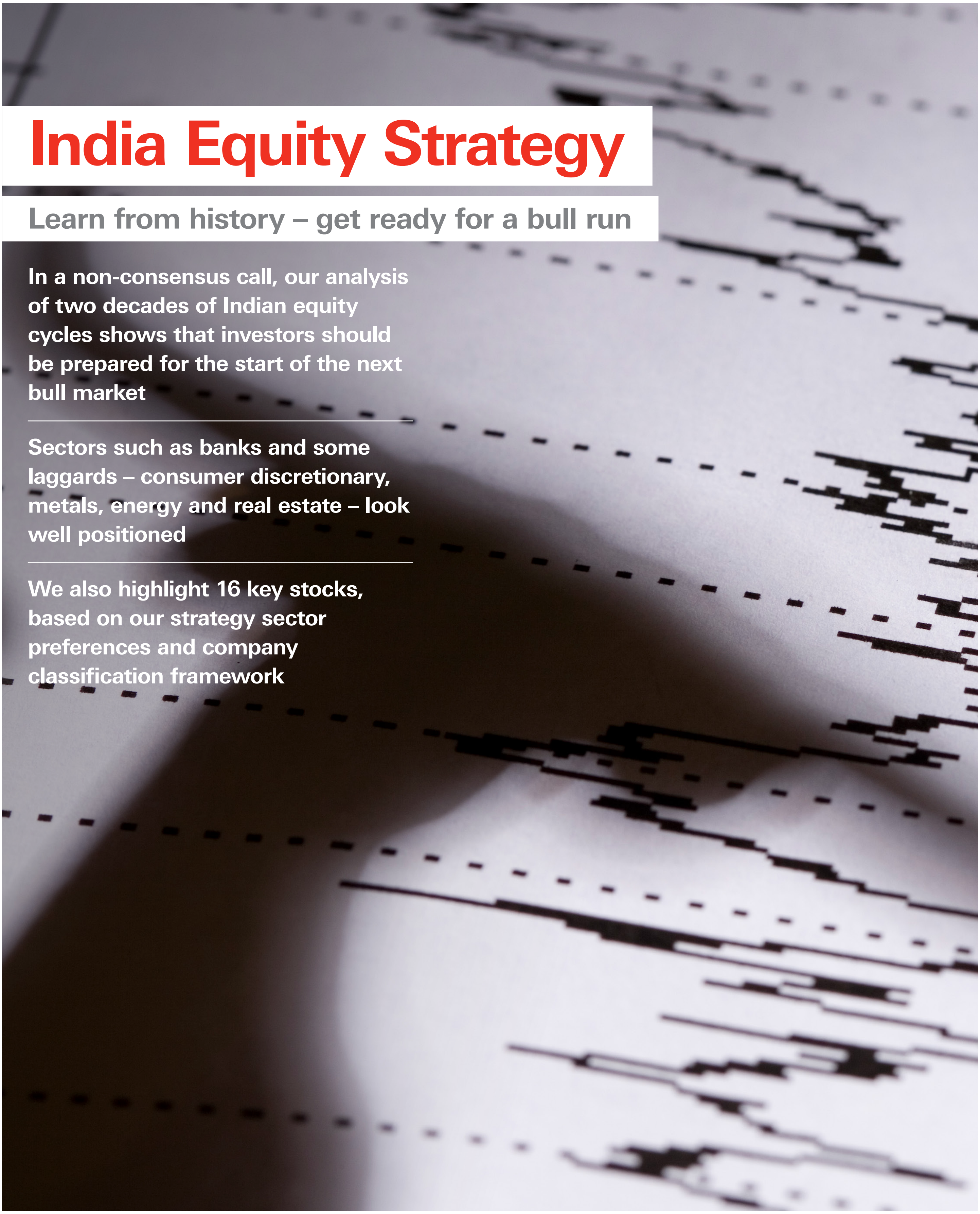

India Equity Strategy

Learn from history – get ready for a bull run

In a non-consensus call, our analysis of two decades of Indian equity cycles shows that investors should be prepared for the start of the next bull market

Sectors such as banks and some laggards – consumer discretionary, metals, energy and real estate – look well positioned

We also highlight 16 key stocks, based on our strategy sector preferences and company classification framework

Why read this report?

- We look beyond short-term risks and election-related volatility and take a deep dive into the factors that drove different market cycles over the past 20 years
- Our non-consensus verdict is that many of the elements required for a sustained bull run are now in place
- We use lessons learned from five bull and four bear markets to highlight our sector preferences and key stock ideas, based on our sector preferences and company classification framework

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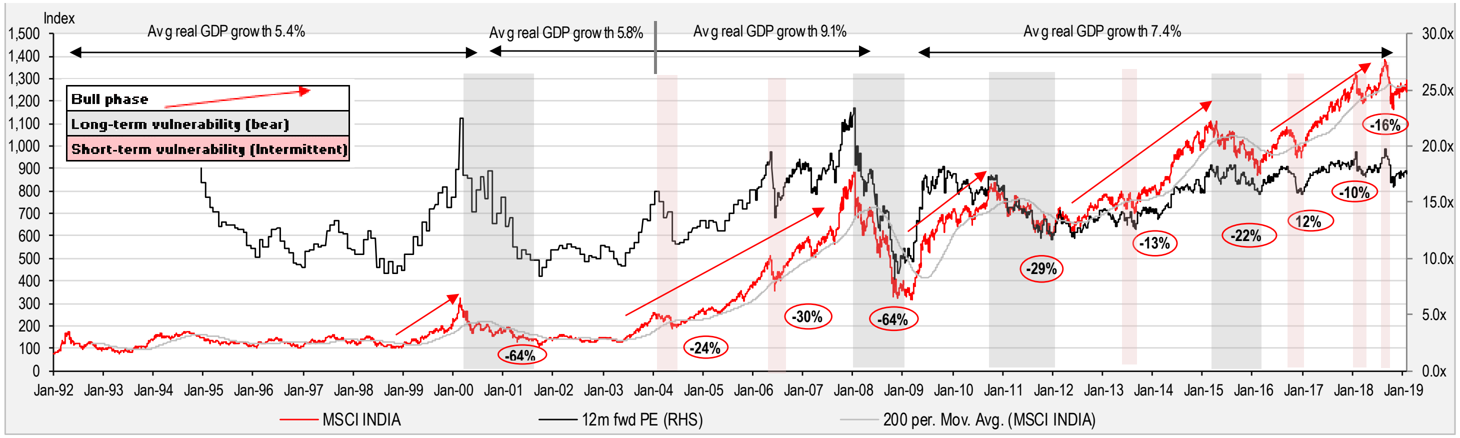
Indian equities in the past two decades: five bull markets, four bear markets and six phases of short-term vulnerability



	FY92	FY93	FY94	FY95	FY96	FY97	FY98	FY99	FY00	FY01	FY02	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12	FY13	FY14	FY15	FY16	FY17	FY18	FY19e
Domestic																												
GDP growth % y-o-y	1.1%	5.5%	4.8%	6.7%	7.6%	7.5%	4.0%	6.2%	8.8%	3.8%	4.8%	3.8%	7.9%	7.9%	7.9%	8.1%	7.7%	3.1%	7.9%	8.5%	5.2%	5.5%	6.4%	7.4%	8.0%	8.2%	7.2%	7.2%
Pvt consumption % y-o-y	2.2%	2.6%	4.3%	4.9%	6.1%	7.8%	3.0%	6.5%	6.1%	3.4%	6.0%	2.9%	5.9%	5.2%	7.5%	4.9%	7.3%	4.5%	5.0%	6.7%	7.4%	5.5%	7.3%	6.4%	7.9%	8.2%	7.4%	7.9%
Investment % y-o-y	-5.6%	9.0%	-0.9%	9.5%	16.3%	3.0%	8.9%	9.7%	7.9%	-1.4%	15.3%	-0.4%	10.6%	24.0%	16.4%	13.9%	16.3%	3.2%	7.7%	11.0%	12.1%	4.9%	1.6%	2.6%	6.5%	8.3%	9.3%	7.9%
CPI Inflation % y-o-y	13.5%	9.9%	7.3%	10.3%	10.0%	9.4%	6.8%	13.1%	5.7%	5.6%	4.3%	4.0%	3.9%	3.8%	4.4%	6.7%	6.2%	9.1%	11.0%	9.5%	9.5%	10.0%	9.4%	5.8%	4.9%	4.5%	3.6%	3.6%
CA balance (% GDP)	-0.4%	-1.7%	-0.4%	-1.0%	-1.6%	-1.1%	-1.3%	-0.9%	-1.0%	-0.6%	0.7%	1.2%	2.3%	-0.3%	-1.2%	-1.0%	-1.3%	-2.3%	-2.8%	-2.8%	-4.3%	-4.8%	-1.8%	-1.3%	-1.1%	-0.6%	-1.9%	-2.5%
Fiscal balance (% GDP)							-5.7%	-6.3%	-5.2%	-5.5%	-6.0%	-5.7%	-4.3%	-3.9%	-4.0%	-3.3%	-2.5%	-6.0%	-6.5%	-4.8%	-5.9%	-4.9%	-4.5%	-4.1%	-3.9%	-3.5%	-3.5%	-3.4%
Domestic yield (%)						13.7%	12.0%	12.2%	11.4%	11.0%	8.7%	6.9%	5.4%	6.3%	7.2%	7.8%	7.9%	7.6%	7.3%	7.9%	8.4%	8.2%	8.5%	8.3%	7.8%	7.2%	7.0%	7.8%
Credit growth (% y-o-y)	6.9%	15.7%	4.0%	26.6%	20.2%	13.2%	14.5%	13.0%	15.4%	14.4%	12.5%	28.4%	17.5%	37.3%	40.5%	28.2%	22.4%	18.0%	16.8%	21.3%	16.3%	13.5%	14.3%	7.9%	9.1%	8.4%	8.4%	12.8%
Retail credit growth (% y-o-y)								13.9%	30.4%	27.7%	25.1%	38.1%	57.2%	42.9%	38.0%	22.7%	12.0%	14.0%	4.1%	19.5%	11.9%	14.7%	15.5%	12.5%	19.4%	16.4%	17.8%	17.0%
Fwd PE				19.3	12.1	10.9	11.6	10.1	15.2	15.1	10.2	10.5	12.3	12.6	14.7	17.2	19.1	12.5	16.4	15.9	13.4	13.3	13.8	16.3	17.1	17.2	18.2	17.9
EPS growth				27.0%	24.2%	1.3%	11.6%	-5.0%	19.5%	-4.8%	-0.9%	21.2%	24.9%	33.2%	15.2%	21.7%	23.9%	-16%	15.0%	22.4%	5.8%	4.2%	6.8%	-4.9%	5.4%	7.6%	-0.9%	12.8%
Global																												
Crude prices (avg, USD/b)	19	19	16	16	17	21	18	13	21	28	24	27	28	42	60	66	82	88	72	88	113	109	107	87	50	51	58	71
US 10Y BY	7.7%	6.7%	5.8%	7.4%	6.2%	6.6%	6.1%	5.1%	6.0%	5.7%	5.0%	4.3%	4.0%	4.3%	4.4%	4.8%	4.4%	3.4%	3.5%	3.1%	2.4%	1.8%	2.5%	2.3%	2.1%	2.0%	2.4%	3.0%
USD DXY Index % y-o-y	7.2%	-3.1%	6.6%	-5.0%	-5.4%	5.8%	10.0%	0.1%	3.7%	9.9%	4.4%	-8.5%	-13%	-6.6%	2.8%	-4.0%	-7.8%	1.2%	-0.5%	2.1%	-4.7%	5.1%	0.4%	6.0%	12.4%	0.9%	-3.9%	0.9%
INR-USD	24.9	30.6	31.4	31.4	33.4	35.4	37.1	42.1	43.3	45.7	47.7	48.4	45.9	44.9	44.2	45.1	40.1	45.9	47.4	45.5	47.9	54.4	60.4	61.1	65.4	67.0	64.5	69.8
INR-USD % y-o-y	-24%	-19%	-2%	0%	-6%	-6%	-5%	-12%	-3%	-5%	-4%	-1%	5%	2%	1%	-2%	12%	-13%	-3%	4%	-5%	-12%	-10%	-1%	-7%	-2%	4%	-8%
Market returns	CY91	CY92	CY93	CY94	CY95	CY96	CY97	CY98	CY99	CY00	CY01	CY02	CY03	CY04	CY05	CY06	CY07	CY08	CY09	CY10	CY11	CY12	CY13	CY14	CY15	CY16	CY17	CY18
MSCI India (INR)			35%	9%	-24%	-2%	20%	-16%	89%	-17%	-19%	5%	65%	11%	40%	46%	52%	-57%	92%	15%	-26%	28%	7%	24%	-3%	0%	29%	-0.2%
MSCI India Mid Cap (INR)					-29%	-10%	4%	-3%	98%	-28%	-16%	18%	77%	15%	29%	58%	95%	-60%	124%	7%	-30%	57%	3%	31%	-2%	7%	45%	-12.9%
MSCi India Small Cap (INR)					-40%	-28%	-4%	8%	89%	-20%	-29%	19%	108%	27%	51%	28%	73%	-67%	113%	14%	-39%	38%	-5%	58%	6%	2%	56%	-19.7%
MSCI IN (USD)			33%	9%	-32%	-4%	10%	-23%	85%	-23%	-21%	6%	74%	16%	35%	49%	71%	-65%	101%	19%	-38%	24%	-5%	22%	-7%	-3%	37%	-8.8%
MSCI EM (USD)	56%	9%	71%	-9%	-7%	4%	-13%	-28%	64%	-32%	-5%	-8%	52%	22%	30%	29%	36%	-54%	74%	16%	-20%	15%	-5%	-5%	-17%	9%	34%	-16.6%
MSCI DM (USD)	16%	-7%	20%	3%	19%	12%	14%	23%	24%	-14%	-18%	-21%	31%	13%	8%	18%	7%	-42%	27%	10%	-8%	13%	24%	3%	-3%	5%	20%	-10.4%
Flows																												
FII (USDbn)											2.7	0.7	6.7	8.6	10.9	8.3	18.5	-12.9	17.6	29.3	-0.512	24.5	19.8	16.2	3.3	2.9	8.0	-4.9
DII (USDbn)											-1.1	-0.6	0.1	-0.3	3.0	3.4	1.7	3.3	-1.2	-6.0	1.3	-3.8	-3.9	3.9	10.9	7.0	18.3	16.8

Most suppotive — **Least suppotive**

Source: MSCI, Refinitiv Datastream, HSBC. Data as of 8 March 2019.
Note: Bull phases are periods when the market returned 20%-plus over at least one year. Bear phases are when the market declined by 20%-plus over at least one year. Short-term vulnerability are periods when the market declined by 10%-plus within a period of 2-3 months and then recovered sharply.

We've done our history homework

Forget the upcoming election and all the other short-term risks that are creating a lot of noise. This report drills down into what has made Indian equities tick over the past 20 years. We have crunched the numbers for five bull markets, four bear markets, and six periods of temporary weakness. Our non-consensus verdict is that many of the elements required for a sustained bull run are now in place. Sectors that have done well in past bull markets – such as banks and some recent laggards – consumer discretionary, metals, energy and real estate – look well positioned. We also highlight 16 key stocks, based on our strategy sector preferences and company classification framework.

Shut out the short-term noise

That loud rumbling sound we can hear is election noise. It's just been announced that the Indian general election – the world's biggest exercise in democracy – will be held between 11 April and 19 May. Prime Minister Narendra Modi is seeking re-election and will campaign on a range of issues, including the state of the economy and national security. The election will likely generate a swathe of research reports assessing the potential impact on the Indian equity market.

This is not one of them.

We look at what history can teach us about the Indian equity market

In this report, we rise above the election noise and other short-term risks and look at what history can teach us about the Indian equity market. We analyse the conditions that were in place during five bull markets, four bear markets, and six short periods of weakness over the last 20 years. We then apply these findings to the current state of the market. Our analysis is based on nine parameters that cover equity market fundamentals, such as earnings and valuations, the macroeconomic outlook, and global events.

We observe that bull markets, in general, have lasted twice as long as bear markets and coincide with favourable domestic macro and global factors. Financials, a consistent outperformer, metals, industrials and mid-caps have done well during bull phases. The bear markets are characterised by high domestic inflation and a deteriorating global macro environment, often triggered by adverse local and global events. Defensives (consumer staples and healthcare) and large-cap stocks have done well during bear markets.

Our verdict is that most of the necessary elements are now in place for the start of a bull run. For example:

- Valuations are well within the boundaries of the peaks and troughs of past bull and bear cycles.
- The earnings outlook for FY19 and FY20 is the highest in the region.
- Macro indicators, such as inflation, GDP growth, bond yields, and crude oil prices, also paint a positive picture.

We believe the market has now escaped the recent bear market, bottoming in October 2018. Since then, it has risen 10%. In line with this bright outlook, we recently moved India to overweight in the regional context of our strategy weightings.

Why current market conditions are favourable

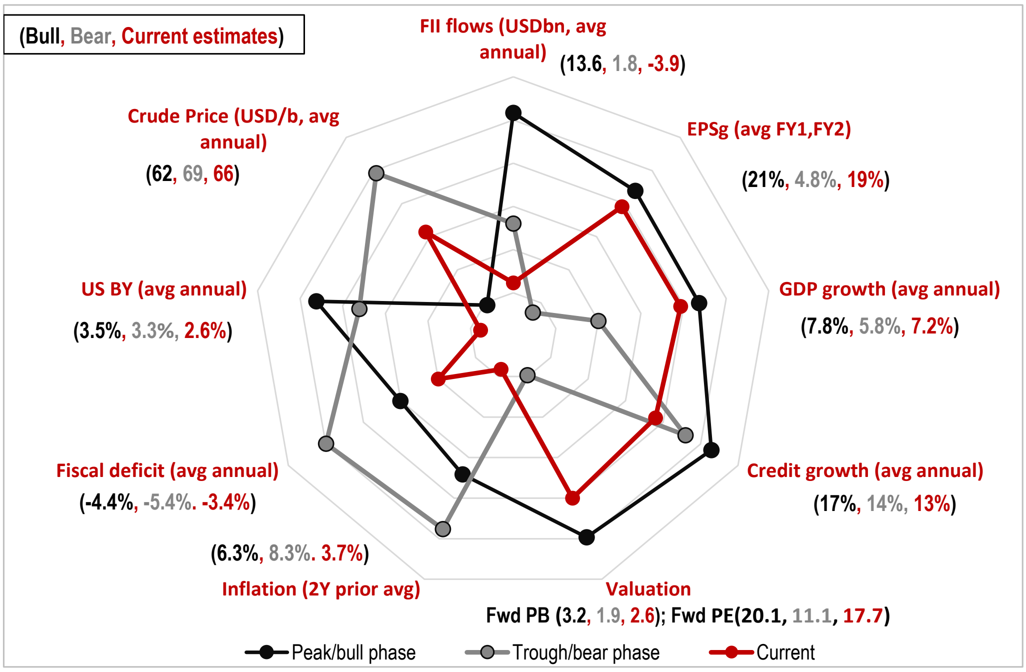
2018 strategy was based around risk aversion

The Indian market fell 0.2% in 2018 (8.8% in USD terms) and our strategy was based largely around risk aversion. We think investor sentiment is set to change for the following reasons:

- Inflation is persistently low and is expected to remain stable. Our economics team factors in another rate cut in April.
- GDP growth is expected stay healthy and India is likely to remain the fastest growing economy in the region.
- US bond yields have softened significantly.
- The crude price is within the tolerance level for Indian equities.
- After a long pause, earnings growth has returned.
- Valuations are no longer excessive – most sectors are well below their five-year means.
- India appears to be quite under-owned by foreign institutional investors. This should change as risk appetite returns.

For more information, see *India Equity Strategy: Quest for winners, laggards, and trespassers*, 13 August 2018, *India Equity Strategy: ideas from India for optimum risk-reward*, 3 December 2018, *The Flying Dutchman: Switch from Korea to India, Philippines* 6 March 2019, and *India's pivotal elections, 10 frequently asked questions*, 6 March 2019.

Indicators are favourably positioned within the boundaries of past bear/bull markets



Source: CEIC, Refinitiv Datastream, HSBC
Note: The radar chart plots the 'z-score' of the average values across bull/bear/current phases for all parameters, except valuation and EPS growth, which represent values at peak/trough. Clockwise from top – EPS growth to Credit growth – higher the better, and Valuation to Crude – lower the better.
Data as of 8 March 2019.

Timeline: Indian equity market cycles in the past two decade

		Comment	Duration (months)	Market return	Outperforming sectors	Underperforming sectors
Five bull markets						
Nov-98	Feb-00	Global technology sector boom	15	219%		
Apr-03	Jan-08	Longest bull phase, led by high infrastructure investment and ample liquidity support	57	610%	Industrials, financials, energy	Healthcare, consumer staples, IT
Mar-09	Nov-10	Recovery after the Global Financial Crisis	20	167%	Metals, financials, industrials	Telecom, utilities, consumer staples
Dec-11	Mar-15	Fed's easy money (QE programme continued until 2014)	39	88%	Healthcare, financials	Metals, utilities, telecom
Feb-16	Aug-18	Resurgent US economic growth and improvement in government finances amid a slew of reforms	31	59%	Metals, financials, industrials	Healthcare, telecom
Average returns per month			**32.5**	**7.5%**	**Industrials, financials, metals**	**Telecom, consumer staples, healthcare**
Four bear markets						
Feb-00	Sep-01	Tech bubble burst	19	-66%	Utilities, healthcare, energy	IT, financials
Jan-08	Mar-09	Global Financial Crisis	14	-64%	Healthcare, consumer staples, IT	Metals, telecom, financials
Nov-10	Dec-11	Domestic liquidity tightening and Eurozone debt crisis	14	-30%	Consumer staples, consumer discretionary, IT	Telecom, industrials, metals
Mar-15	Feb-16	China slowdown and the end of US easy money	12	-22%	Healthcare, energy, consumer staples	Metals, industrials, financials
Average returns per month			**14.6**	**-3.0%**	**Consumer staples, healthcare, energy**	**Metals, telecom, industrials**
Six periods of short-term vulnerability						
Feb-04	May-04	Surprise loss of incumbent BJP in the 2004 general elections	4	-24%	Healthcare, IT, construction material	Utilities, telecom, metals
May-06	Jun-06	Global sell-off triggered by fears of prolonged interest rate hikes in the US	1	-31%	IT, energy, consumer discretionary	Metals, telecom, industrials
May-13	Aug-13	Global sell-off amid risk of US QE tapering	3	-12%	IT, healthcare, telecom	Industrials, financials, construction materials
Sep-16	Dec-16	Demonetisation impact, FII outflows on fears of resumption in US rate hikes	3	-12%	Utilities, metals, energy	Construction materials, financials, healthcare
Jan-18	Mar-18	LTCG tax, fear of steeper US rate hike	2	-10%	Consumer staples, utilities, IT	Metals, healthcare, telecom
Aug-18	Oct-18	IL&FS debt default, rising crude oil prices, slowing global growth	2	-16%	Utilities, metals, IT	Consumer discretionary, construction materials, telecom
Average returns per month			**2.3**	**-12.9%**	**IT, utilities, energy**	**Financials, industrials, construction materials**

Source: MSCI, Refinitiv Datastream, HSBC
Note: Return is the performance of MSCI India price index, in local currency terms.

Our sector preferences

Banks have outperformed almost every time the market has moved out of a bear market

Banks and financials: favoured destination

We think financials are well positioned. Banks have outperformed almost every time the market has moved out of a bear market or a period of short-term vulnerability. We think most of the overhang is behind us – for example, asset quality and earnings visibility have improved for private banks. While there has already been some re-rating, we think we are still in the re-rating cycle. The normalisation of credit costs for corporate lenders should continue to drive ROE expansion, while private banks should gain market share from public sector banks. Our analysts like **Axis Bank, Indusind Bank, and HDFC Bank**.

Non-banking financial companies (NBFCs) still face a number of challenges, but scale and quality remain the differentiating factors. Our analysts like **Bajaj Finance**.

Consumers are likely to have more money in their pockets

Consumer discretionary: potential tailwinds

The sector should enjoy tailwinds in 2019 as consumers are likely to have more money in their pockets. Stimulus in the interim budget helped, but the main driver is government policy to structurally improve the quality of life. Our analysts like **Asian Paints, Kajaria Ceramics, and Jubilant Foodworks**.

Real estate: strong balance sheets

While risks still linger, we see the sector as a potential risk-on play, supported by falling interest rates and an acceleration in macro growth. It offers undemanding valuations and should benefit from a favourable interest rate cycle. With small players struggling with weak balance sheets, funding issues and limited demand, this provides opportunities for developers with strong brands and balance sheets to expand their project pipelines at attractive rates of return. Our analysts like **Godrej Properties** as a structural opportunity with a sound balance sheet, and **Prestige Estates** as a laggard with accelerating sales momentum.

Consumer staples: need for a balanced approach

The sector has done well in the last two years, and growth expectations have been built into the valuations of leading companies. As the market's tolerance for risk rises, these stocks could underperform the market, as evident from the cycles of the last two decades. However, any sharp correction will create a good opportunity as consumer staples tend to outperform the year following risk-on. In the current context, our analysts like **Avenue Supermarts**, which is a network rollout story with a business model based on the value-seeking India consumer. Our analysts like **ITC**, which has been a sector laggard and offers an attractive valuation.

Energy: tailwinds from a low crude prices

With the exception of Reliance Industries, the sector has underperformed in the last year, and valuations now look quite compelling. Performance will likely depend on the trajectory of crude oil prices, which appear supportive, and related policy risks from subsidies. Our analysts' key ideas are **GAIL**, a structural gas play, and **HPCL**, a laggard play on low crude prices, offering an attractive valuation.

Autos: demand headwinds

Demand headwinds have led to a sharp deterioration in the growth outlook and a steep sector de-rating. Given the sector's respectable ROE, earnings growth is the most sensitive valuation driver. So, despite the undemanding valuation, the sector re-rating is unlikely unless the growth outlook improves. We participate in the sector through two-wheelers. Our analysts' preferred idea is **Bajaj Auto**, which is gaining market share, has a diversified portfolio, is launching new products, and has underperformed along with the whole sector; the risk-reward balance is favourable.

Other sectors

We are wary of sectors, such as healthcare, due to significant regulatory headwinds, delayed product launches and price erosion in generics. **Divi's Labs,** a play on global R&D spending by global majors, is our analysts' preferred idea in the sector. We are selective on metals and our analysts prefer **Hindalco**.

Key risks to our view: A deteriorating macro picture, such as a steep rise in inflation, any large scale escalation in geopolitical tensions, a slowdown in global growth, or a sharp rise in crude prices.

Our ideas for a balanced risk reward

We established a framework to categorise companies that are holding their own, those in trouble, and those with potential. We call these categories ‘structural winners’ (hard to beat), ‘trespassers’ (potential to become structural winners), and ‘laggards’ (can do better).

Having identified the companies that fit our three categories, we then overlay our sector preferences, look for reasonable valuations, good earnings growth, and stocks where our analysts have a clear preference.

India – Buy-rated ideas for a balanced risk reward

Bloomberg Code	Name	Mkt Cap (USDm)	ADTV (USDm, 3m)	Price (INR)	Target Price (INR)	3M return	Last 1Y return	FY19e EPSg	FY20e EPSg	FY19e ROE	FY20e ROE
Structural winners											
DMART IN	Avenue Supermarts	13,480	12.5	1,501.40	1,700.00	-3%	15%	23%	33%	19%	21%
APNT IN	Asian Paints	19,710	26.1	1,428.30	1,600.00	7%	26%	16%	20%	25%	27%
BAF IN	Bajaj Finance	19,193	53.3	2,828.15	3,190.00	10%	65%	48%	35%	22%	24%
HDFCB IN	HDFC Bank	87,190	68.5	2,226.55	2,430.00	4%	16%	13%	29%	16%	17%
GAIL IN	GAIL	11,407	21.4	351.60	487.00	3%	6%	39%	1%	15%	14%
DIVI IN	Divi's Laboratories	6,367	14.6	1,667.00	1,780.00	11%	68%	59%	17%	21%	21%
Trespassers											
AXSB IN	Axis Bank Ltd	27,299	100.4	738.00	790.00	20%	43%	1566%	130%	7%	14%
JUBI IN	Jubilant Foodworks	2,509	45.2	1,325.65	1,550.00	9%	30%	50%	28%	27%	29%
BJAUT IN	Bajaj Auto	12,530	19.1	3,010.00	3,200.00	5%	1%	10%	14%	22%	23%
KJC IN	Kajaria Ceramics Ltd	1,339	4.2	585.35	630.00	29%	3%	1%	22%	17%	18%
Laggards											
IIB IN	IndusInd Bank	14,187	39.3	1,636.35	1,950.00	-1%	-10%	3%	55%	15%	20%
ITC IN	ITC	51,981	49.9	294.90	340.00	7%	9%	13%	14%	23%	26%
HNDL IN	Hindalco	6,522	22.9	202.30	320.00	-8%	-11%	41%	4%	12%	11%
PEPL IN	Prestige Estates Projects	1,121	0.9	207.80	320.00	3%	-32%	47%	37%	12%	17%
GPL IN	Godrej Properties	2,301	2.6	697.50	870.00	7%	-4%	-48%	127%	5%	11%
HPCL IN	Hindustan Petroleum	5,872	17.9	267.85	298.00	19%	-29%	-38%	51%	16%	23%

Source: Bloomberg, HSBC estimates. Current market price as of 13 March 2019.
Note: Return is the stock performance in the last three months and one year.

History lessons

- In the last two decades India has witnessed five bulls runs, four bear markets, and six periods of short-term vulnerability
- Our analysis of these cycles shows that the market looks primed for another bull run
- Drawing lessons from the past, our sector preferences are broadly defensive; we are positioned for a gradual rise in risk-on sentiment

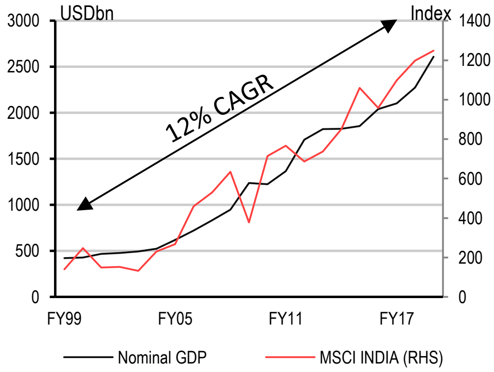
Learning from the last two decades

Our analysis of the different cycles of the Indian equity market shows that:

- The equity market has broadly mirrored the nominal GDP growth over the long term.
- The Indian equity market is a long-term wealth creator. It has returned a c12% CAGR in the last 20 years and a c11.9% CAGR in the last 15 years.
- The market has produced low single-digit returns only three times in the last two decades. Periods of low returns are often followed by a strong rebound.
- India has outperformed emerging markets (EM) in 15 of the last 20 years and developed markets (DM) 13 times.
- The direction of the Indian market direction is broadly in sync with EM equities; only once has it reported negative returns when the EM index return was positive.
- The market was opened to foreign institutional investors in 1993-94. Since then, it has witnessed periods of vulnerability, often related to global events, indicating a gradual rise in the linkage to global markets.

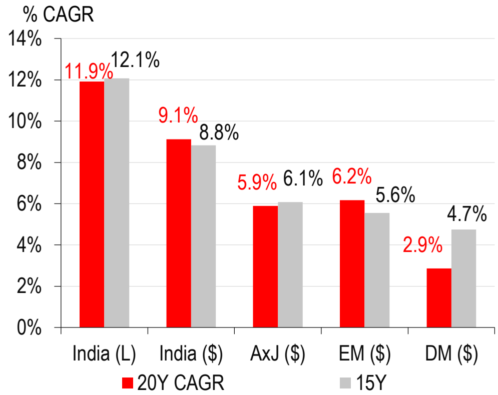
We now analyse these trends to help navigate the current market environment.

Equity market has mirrored macro growth



Source: CEIC, MSCI, Refinitiv Datastream, HSBC

A long-term wealth creator



Source: MSCI, Refinitiv Datastream, HSBC. Data as of 8 March 2019.

Our definitions of different market phases

- **Bull market:** A period when returns were above 20% over a period of at least one year.
- **Bear market:** When the market declined more than 20% over a period of at least one year.
- **Short-term vulnerability:** Any sharp fall in the market (10%-plus) within a period of 2-3 months followed by a quick recovery.

We assess common patterns to identify how and when the market moves from one phase to another.

Nine parameters

We use nine parameters grouped into three broad categories to explore shifts in market positioning.

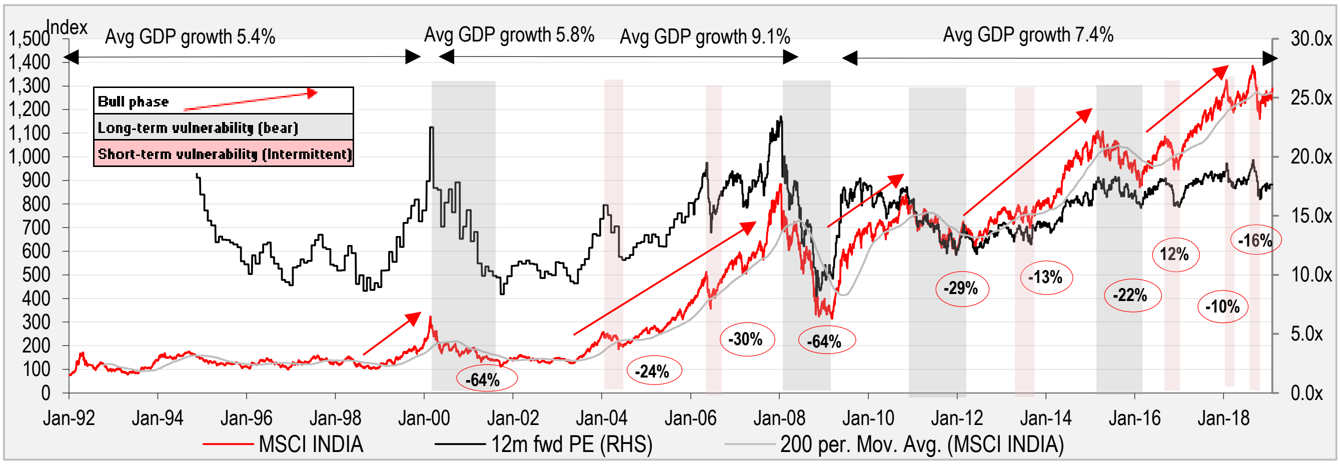
- **Equity market fundamentals:** The push-pull between: 1) equity market valuation, and 2) earnings growth expectations.
- **Domestic macro outlook:** The four macro parameters are: 3) real GDP growth, 4) inflation, which reflects interest rate expectations and cost of equity, 5) government finances/the fiscal deficit, and, 6) system-wide credit growth.
- **Global factors:** 7) US interest rates measured via bond yields, 8) crude oil prices, which impact the trade balance, the INR and eventually inflation, and 9) foreign fund flows.

Timelines – Indian equity market cycles

From	To	Description	Duration (months)	Market return	Mid cap	Small cap	EM return
Five bull markets							
Nov-98	Feb-00	**The global tech boom** coincided with political stability in India. The BJP-led coalition came to power in the 13th Lok Sabha election (November 1999). The Indian equity market went up by 219% in 15 months between November 1998 and February 2000, helped by easy liquidity and a strong macro environment. This was also a period of a strong domestic economy (GDP growth topped 8.8% in FY00), which fed into corporate earnings (+20% y-o-y in FY00)	15	219%	129%	142%	77%
Apr-03	Jan-08	**The longest bull run** took place during 2003-08 (57 months) when the market returned 610%. The period was marked by sustained GDP growth (8.8% per annum), led by double-digit growth in investment in infrastructure projects. The rally was fuelled by flush global liquidity (FII inflows averaged USD10bn/annum) and strong credit growth in the domestic market (average system credit growth 29% y-o-y)	57	610%	872%	875%	254%
Mar-09	Nov-10	**The recovery after the Global Financial Crisis (GFC):** During the recovery phase (20 months), the Indian market reversed most of the losses, rising 167%. FII flows were strongest in the history (USD24bn/year), helped by US quantitative easing (QE) and a benign interest rate environment. GDP growth averaged 9.2% and corporate earnings growth was in the high teens	20	167%	209%	255%	93%
Dec-11	Mar-15	**Global liquidity-driven rally:** As domestic interest rates peaked in 2011, GDP growth gradually improved, while inflation cooled. Meanwhile, the US committed to continuing QE until 2014, US rates maintained near zero, and FIIs into India where strong (USD20bn/year) in 2012-14. There were also tailwinds from the 2014 general elections when the NDA came to power. For the 39 months between December 2011 and March 2015, the Indian equity market returned 88%	39	88%	128%	127%	25%
Feb-16	Aug-18	**Rally led by global and local factors:** The latest bull market was driven by a confluence of: 1) improving government finances and GDP growth amid a slew of policy reform, benign crude prices and low inflation; 2) strong support from domestic institutional investors (USD14bn/year); and 3) resurgent US economic growth improving investor sentiment worldwide. The market gained 59% during this period of 31 months	31	59%	70%	77%	46%
Average returns per months			**32.5**	**7.5%**	**7.9%**	**8.6%**	**3.3%**
Four bear markets							
Feb-00	Sep-01	**Tech bubble burst:** The US Fed announced aggressive rate hikes in February 2000, resulting in a sell-off in US internet companies that were trading at inflated valuations. The liquidity crunch, combined with news of Japan entering a recession in March 2000, triggered a worldwide sell-off. India's GDP growth fell to mid-single digits and the equity market dropped 66% in the next 19 months between February 2000 and September 2001	19	-66%	-49%	-61%	-44%
Jan-08	Mar-09	**The Global Financial Crisis (GFC):** The sub-prime crisis followed the collapse in the US housing market and defaults by sub-prime lenders, which triggered a significant sell-off across asset class amid tightening US liquidity. In the period of 14 months between January 2008 and March 2009, the Indian equity market fell 64% as FIIs fled the market (USD13bn outflows). Credit-led growth in the domestic economy in prior years fuelled inflation (9% average for two years preceding the bear market), which led to a sharp slowdown in the domestic economy (3.9% GDP growth in FY09)	14	-64%	-68%	-75%	-50%
Nov-10	Dec-11	**Domestic liquidity squeeze, crude crossing USD100/b:** To counter high inflation (c10%), the RBI raised policy rates 12 times between March 2010 and December 2011 (cumulative 375bp rate hike), which squeezed liquidity. GDP growth fell to mid-single digits in FY12. Government finances deteriorated as crude oil prices soared to USD100/b in February 2011. The equity market declined by 30% in 14 months, as FII flows dried up (USD500m outflows in 2011) and as the Eurozone debt crisis continued to spook foreign investors	14	-30%	-36%	-47%	-17%
Mar-15	Feb-16	**China slowdown fears and end of easy money:** In 2015, global equity markets were hit by a risk of a China slowdown, which resulted in a sell-off in the Chinese equity market that spread across EM and DM. The period also coincided with the end of US QE (October 2014) and first US rate hike in more than a decade (November 2015). FII turned risk-averse, with inflows declining to USD3bn in 2015. Domestic institutional investors stepped in, pouring cUSD11bn into equities. The bear phase lasted for 12 months, with the market declining c22%	12	-22%	-22%	-19%	-20%
Average returns per month			**14.6**	**-3.0%**	**-3.0%**	**-3.4%**	**-2.2%**
Six periods of short-term vulnerability							
Feb-04	May-04	**The surprise defeat of the ruling BJP in the 2004 elections** resulted in the market shedding c20%. However, resilient macro conditions saw the market reverse all losses and end in the green by year-end 2004	4	-24%	-24%	-23%	-16%
May-06	Jun-06	**Global sell-off triggered by fears of prolonged US rate hike cycle:** The US Fed had already hiked the policy rate 16 times between June 2004 and May 2006 (c400bp) and rising inflationary pressure triggered a sell-off in the equity market, which shed 31% in one month.	1	-31%	-31%	-38%	-20%
May-13	Aug-13	**Risk of US QE tapering,** announced by the Fed in June 2013, led to a sell-off seen across global markets. The Indian market declined by 12% between May 2013 and August 2013	3	-12%	-20%	-21%	-7%
Sep-16	Dec-16	**Double whammy:** Concern about the impact of demonetisation, announced in November 2016, on domestic growth and sustained FII outflows (USD4.6bn between October 2016 and December 2016), plus fears of a resumption in US rate hikes (eventually announced in December 2016)	3	-12%	-16%	-12%	-6%
Jan-18	Mar-18	**Indian budget announcement of a 10% long-term capital gain tax** as the investors remained worried about a steeper US rate hike cycle. The Indian market lost 10% in two months and underperformed the MSCI EM Index	2	-10%	-13%	-14%	-6%
Aug-18	Oct-18	**Three factors:** The Indian market declined by c16% between August 2018 and October 2018, due to: 1) IL&FS's debt default and ensuing credit crunch; 2) crude oil prices crossing USD80/b and pushing the INR to record low levels against the USD; and 3) fear of slowing global growth	2	-16%	-17%	-20%	-12%
		Average returns per months	**2.3**	**-12.9%**	**-14%**	**-14.7%**	**-8.2%**

Source: MSCI, HSBC. Note: All equity market performance are for respective MSCI Indices in local currency.
Note: Return is the performance of MSCI price indices – MSCI INDIA, MSCI India Mid-cap, MSCI India Small-cap and MSCI Emerging Market index, all in local currency terms.

The Indian equity market since 1992



Source: MSCI, HSBC;
Note: Bull phases are periods when the market returned 20%-plus over at least one year. Bear phases are when the market declined by 20%-plus over at least one year. Short-term vulnerability are periods when the market declined by 10%-plus within a period of 2-3 months and then recovered sharply.

The bull and bear markets

Bull markets: Longer duration, supported by strong fundamentals

- On average, bull markets in India lasted for around 32 months and generated average monthly returns of 7.5% (total return of the period divided by the number of months).
- Mid-cap and small-cap indices outperformed the main index marginally, with average monthly returns of 7.9% and 8.6%, respectively.
- They featured both earnings upgrades and PE multiple re-ratings. PE multiples re-rated by around 3.5% per month, while forward EPS increased by 1.5% per month.
- The domestic economy was strong, with average GDP growth of 7.8% per annum. Inflation was benign preceding bull markets, while the trajectory of fiscal and current account deficits was broadly positive.
- The global macro environment was supportive as well. The average US bond yield was 3.5% and crude prices averaged USD54/b (excluding 2011-15 when crude rose above USD104/b, but easy liquidity helped the bulls).
- FII flows were strong during bull markets, with an annual run-rate of USD13bn. They were highest during 2009-10, around the start of the US QE programme.
- The investment cycle pick-up is associated with the longest bull run of the Indian market (between 2003 and 2008). While the investment cycle recovery seems less likely in the near term, other factors appear quite favourable.

Market boundaries: Bull markets

	PE max	PE avg	PB max	PB avg	EPSg FY1	EPSg FY2	GDP growth (avg)	Inflation (2Y prior)	US BY (period avg)	Crude price (USD/b)	FII flows (annual, USDbn)
1998-00	22.5x	13.4x			27.6	22.6	7.5%	5.8%	5.6%	17.1	
2003-08	23.0x	15.1x	4.3x	3.1x	13.9	21.1	8.8%	4.3%	4.4%	55.6	10.6
2009-10	18.2x	16.1x	2.9x	2.5x	22.9	22.7	9.4%	6.8%	3.3%	79.8	23.5
2011-15	17.9x	14.3x	2.8x	2.2x	16.4	18.1	6.5%	9.4%	2.3%	103.9	15.0
2016-18	19.4x	17.7x	2.9x	2.7x	24.2	21.8	6.9%	7.8%	2.2%	54.5	5.5
Average	**20.2x**	**15.3x**	**3.2x**	**2.6x**	**21.0**	**21.3**	**7.8%**	**6.8%**	**3.5%**	**62.2**	**13.6**

Source: CEIC, Refinitiv Datastream, HSBC

Financials, mid-small caps, metals, industrials tend to do well in these phases

- Cyclicals outperformed defensives.
- The financial sector consistently outperformed the market. Industrials, particularly during 2003-08, and metals also did well.
- Defensive sectors, such as healthcare, telecom and utilities, underperformed. Consumer staples, too, either underperformed or remained in line with the market.

Monthly average sector returns during the bull markets – cyclicals outperformed defensives (MSCI sector indices)

From	To	CD	CS	EN	FN	HC	ID	IT	CM	MM	TS	UT
Nov-98	Feb-00	*Sector index not available*										
Apr-03	Jan-08	8.3%	3.0%	17.4%	17.5%	2.3%	26.5%	5.7%	9.8%	16.0%	8.6%	14.0%
Mar-09	Nov-10	10.6%	4.4%	4.7%	12.0%	8.1%	10.8%	9.4%	6.8%	15.6%	1.5%	3.2%
Dec-11	Mar-15	2.8%	3.1%	0.7%	3.1%	4.0%	2.7%	2.8%	2.9%	0.2%	0.5%	0.4%
Feb-16	Aug-18	1.9%	2.7%	3.4%	2.8%	-0.4%	2.3%	1.3%	1.8%	7.6%	-0.2%	1.7%
Relative to MSCI INDIA												
Apr-03	Jan-08	-2.4%	-7.7%	6.7%	6.9%	-8.4%	15.8%	-5.0%	-0.8%	5.3%	-2.0%	3.4%
Mar-09	Nov-10	2.4%	-3.8%	-3.5%	3.8%	-0.1%	2.6%	1.2%	-1.4%	7.4%	-6.7%	-5.0%
Dec-11	Mar-15	0.5%	0.8%	-1.6%	0.8%	1.8%	0.4%	0.5%	0.6%	-2.1%	-1.7%	-1.9%
Feb-16	Aug-18	0.0%	0.8%	1.5%	0.9%	-2.3%	0.4%	-0.6%	-0.1%	5.7%	-2.1%	-0.2%
Avg of all phases		**0.1%**	**-2.5%**	**0.8%**	**3.1%**	**-2.2%**	**4.8%**	**-1.0%**	**-0.4%**	**4.1%**	**-3.1%**	**-1.0%**

Source: MSCI, Refinitiv Datastream, HSBC
Note: CD = "consumer discretionary", CS = "consumer staples", EN = "energy", FN = "financials", HC = "healthcare", ID = "industrials", IT = "Information technology", CM = "construction materials", MM = "metals and mining", TS = "telecom", UT = "utilities". Return is the monthly average performance of the respective MSCI INDIA sector price indices in local currency. **Heatmap** colour variation from 'dark green to dark red' represents sector outperformance/underperformance relative to the market – highest relative return (dark green) to lowest relative return (dark red).

Bear markets: characterised by deteriorating macro fundamentals

- On average, bear markets marked the end of a bull run and lasted for around 15 months, during which the market contracted by 3.0% on average per month.
- Mid-cap index returns were broadly in line with the market, while small-cap index underperformed with average monthly returns of -3.4%.
- De-rating was sharp, with the market hitting a trough PE multiple of 11.1x. Overall, PE multiples declined by 2.6% per month. The earnings trend was mixed, with consensus downgrading forward earnings estimates in two of the four bear phases.
- A rising inflation trajectory (average 8.2% for two years before the start of a bear market) often acted as a lead indicator, which led to a deterioration in the macro outlook, with average GDP growth declining to 5.8%.
- Deteriorating global macro factors (US rate hikes and high crude prices) were triggers for the bear markets, which led to a sell-off across EM, including India.

- FIIs were in risk-off mode, with average annual outflows of around USD1.8bn, excluding the period of the Global Financial crisis (2008-09).

Market boundaries: Bear markets

	PE min	PE avg	PB min	PB avg	EPSg FY1	EPSg FY2	GDP growth (avg)	Inflation (2Y prior)	US BY (period avg)	Crude price (USD/b)	FII flows (annual, USDbn)
2000-01	8.4x	14.0x					4.3%	7.5%	5.3%	25.9	2.7
2008-09	8.2x	14.0x	1.4x	2.5x	4.8	16.2	3.9%	9.5%	3.4%	87.6	-12.9
2010-11	11.8x	14.2x	1.9x	2.4x	7.9	16.9	6.6%	9.4%	2.4%	113.1	-0.5
2015-16	15.9x	17.2x	2.5x	2.7x	18.0	17.0	8.2%	6.9%	2.1%	49.7	3.3
Average	**11.1x**	**14.9x**	**1.9x**	**2.5x**	**10.3**	**16.7**	**5.8%**	**8.3%**	**3.3%**	**69.1**	**1.8**

Source: CEIC, Refinitiv Datastream, HSBC

Defensives, such as consumer staples, or exporters, such as IT and healthcare, did well

- Defensive sectors, such as consumer staples and healthcare, consistently outperformed the market.
- Meanwhile, metals, industrials and financials underperformed.
- The telecom sector underperformed across both bull and bear markets.

Monthly average sector returns during bear markets – consumption a good place to hide

From	To	CD	CS	EN	FN	HC	ID	IT	CM	MM	TS	UT
Feb-00	Sep-01	-3.3%	-1.5%	-1.4%	-2.8%	-1.3%	-2.2%	-4.7%	-2.4%	-2.2%	-3.4%	-1.1%
Jan-08	Mar-09	-3.1%	-2.0%	-4.2%	-5.3%	-2.6%	-5.1%	-3.1%	-4.0%	-5.5%	-5.7%	-4.4%
Nov-10	Dec-11	-0.6%	0.3%	-2.3%	-2.8%	-0.7%	-4.1%	-0.6%	-0.7%	-3.6%	-4.8%	-2.8%
Mar-15	Feb-16	-2.1%	-1.2%	-0.8%	-2.7%	-0.9%	-3.3%	-1.3%	-2.3%	-4.6%	-1.6%	-2.2%
Relative to MSCI INDIA												
Feb-00	Sep-01	0.1%	1.9%	2.0%	0.7%	2.2%	1.2%	-1.3%	1.0%	1.2%	0.0%	2.3%
Jan-08	Mar-09	1.4%	2.5%	0.3%	-0.8%	2.0%	-0.6%	1.4%	0.6%	-1.0%	-1.1%	0.2%
Nov-10	Dec-11	1.6%	2.5%	-0.1%	-0.6%	1.5%	-1.9%	1.6%	1.5%	-1.4%	-2.6%	-0.7%
Mar-15	Feb-16	-0.2%	0.6%	1.0%	-0.8%	1.0%	-1.4%	0.6%	-0.4%	-2.7%	0.3%	-0.4%
Avg of all phases		**0.7%**	**1.9%**	**0.8%**	**-0.4%**	**1.6%**	**-0.7%**	**0.6%**	**0.7%**	**-1.0%**	**-0.9%**	**0.4%**

Source: MSCI, Refinitiv Datastream, HSBC
Note: CD = "consumer discretionary", CS = "consumer staples", EN = "energy", FN = "financials", HC = "healthcare", ID = "industrials", IT = "Information technology", CM = "construction materials", MM = "metals and mining", TS = "telecom", UT = "utilities". Return is the monthly average performance of the respective MSCI INDIA sector price indices in local currency. **Heatmap** colour variation from 'dark green to dark red' represents sector outperformance/underperformance relative to the market – highest relative return (dark green) to lowest relative return (dark red).

Short-term periods of vulnerability: event-driven market shocks

- These were often triggered by a global risk event. In the past six such instances, the market declined c13% over a period of 2.5 months but quickly regained momentum.
- The average monthly sell-off was higher in small-caps (-14.7%) and mid-caps (-13.9%) compared to the main index.
- Market de-rating was quite sharp, with the trough PE multiple (15.3x period average) around 7% below the mean PE multiple for the period. That said, consensus earnings momentum held up well (earnings up 1%), which helped the market to make a quick recovery.
- As these intermittent sell-offs were event-driven risks, the domestic economy remained fairly strong with minimal disruptions in growth and inflation trajectories.
- These phases often witnessed a synchronised fall in EM. On average, the MSCI EM index declined by 9.6% – a reflection of a higher correlation between markets during bear phases.
- FII flows were disrupted during these short-term sell-offs but soon reversed.

Market boundaries: Periods of short-term vulnerability

	PE min	PE avg	PB min	PB avg	EPSg FY1	EPSg FY2
2004	14.1x	14.1x			14.9	12.5
2006	15.1x	17.4x	3.2x	3.6x	17.3	13.9
2013	12.7x	13.5x	1.9x	2.1x	8.1	16.5
2016	15.8x	16.8x	2.5x	2.6x	8.2	19.3
2018	17.4x	18.2x	2.6x	2.7x	21.3	17.6
2018	16.4x	18.2x	2.4x	2.7x	22.5	22.6
Average	**15.3x**	**16.4x**	**2.5x**	**2.7x**	**15.4**	**17.1**

Source: Refinitiv Datastream, HSBC

- Market corrections (excluding the 2004 sell-off) were driven largely by the construction materials (cements), financials and telecom sectors.
- Defensives, such as utilities and IT, outperformed the market.

Monthly average sector returns during periods of short-term vulnerability

From	To	CD	CS	EN	FN	HC	ID	IT	CM	MM	TS	UT
Feb-00	Sep-01	-3.3%	-1.5%	-1.4%	-2.8%	-1.3%	-2.2%	-4.7%	-2.4%	-2.2%	-3.4%	-1.1%
Jan-08	Mar-09	-3.1%	-2.0%	-4.2%	-5.3%	-2.6%	-5.1%	-3.1%	-4.0%	-5.5%	-5.7%	-4.4%
Nov-10	Dec-11	-0.6%	0.3%	-2.3%	-2.8%	-0.7%	-4.1%	-0.6%	-0.7%	-3.6%	-4.8%	-2.8%
Mar-15	Feb-16	-2.1%	-1.2%	-0.8%	-2.7%	-0.9%	-3.3%	-1.3%	-2.3%	-4.6%	-1.6%	-2.2%
Relative to MSCI INDIA												
Feb-00	Sep-01	0.1%	1.9%	2.0%	0.7%	2.2%	1.2%	-1.3%	1.0%	1.2%	0.0%	2.3%
Jan-08	Mar-09	1.4%	2.5%	0.3%	-0.8%	2.0%	-0.6%	1.4%	0.6%	-1.0%	-1.1%	0.2%
Nov-10	Dec-11	1.6%	2.5%	-0.1%	-0.6%	1.5%	-1.9%	1.6%	1.5%	-1.4%	-2.6%	-0.7%
Mar-15	Feb-16	-0.2%	0.6%	1.0%	-0.8%	1.0%	-1.4%	0.6%	-0.4%	-2.7%	0.3%	-0.4%
Avg of all phases		**0.7%**	**1.9%**	**0.8%**	**-0.4%**	**1.6%**	**-0.7%**	**0.6%**	**0.7%**	**-1.0%**	**-0.9%**	**0.4%**

Source: MSCI, Refinitiv Datastream, HSBC
Note: CD = "consumer discretionary", CS = "consumer staples", EN = "energy", FN = "financials", HC = "healthcare", ID = "industrials", IT = "Information technology", CM = "construction materials", MM = "metals and mining", TS = "telecom", UT = "utilities". Return is the monthly average performance of the respective MSCI INDIA sector price indices in local currency. **Heatmap** colour variation from 'dark green to dark red' represents sector outperformance/underperformance relative to the market – highest relative return (dark green) to lowest relative return (dark red).

Observations around the bottom (end) of bear markets

- India has witnessed 10 market troughs in the last two decades, marking the end of bear markets and periods of short-term vulnerability.
- Sector trends reversed around market troughs, with underperformers and outperformers switching sides.
- In the six months after troughs, consumer discretionary, financials (banks), metals, construction materials, and IT outperformed, while consumer staples, healthcare and utilities lagged the market around troughs.
- What it means in the current context: Sectors, such as consumer staples and IT, which have done quite well in the past year, might experience some sell-off pressure if risk-on becomes the main market narrative after the election.
- From the cycle point of view, materials (-9%), consumer discretionary (-18%) and energy (excluding Reliance Industries, -14%) have significantly underperformed the market in the past year and seem better positioned for a rally.

- Banks, with a 9.8% relative return in the six months around the previous market troughs, have been largely in line with the market in the past year and also look positioned for a strong recovery.

Relative sector returns around market troughs

Relative return %	-6M	-3M	-1M	+1M	+3M	+6M
MSCI INDIA	-13.9%	-13.7%	-12.2%	12.6%	23.3%	31.3%
Cons Discretionary	4.8%	2.2%	2.9%	-1.0%	-0.4%	3.0%
Cons Staples	8.0%	2.5%	1.4%	-1.9%	-11.2%	-11.3%
Energy	7.0%	3.7%	-0.4%	-0.7%	-2.5%	-1.7%
Financials	-4.8%	-6.4%	-2.1%	1.3%	6.4%	8.9%
Banks	-4.9%	-6.8%	-3.0%	2.4%	6.2%	9.8%
Healthcare	6.1%	6.0%	4.2%	-4.6%	-11.7%	-14.4%
Industrials	-5.3%	-5.9%	-2.4%	3.3%	8.6%	5.0%
IT	2.6%	7.4%	2.3%	-1.7%	1.9%	8.3%
Materials	-3.4%	-0.5%	-1.7%	4.3%	8.6%	9.2%
Cons Materials	5.5%	4.4%	0.7%	-1.5%	0.6%	-0.4%
Metals and Mining	-3.7%	-0.9%	-2.8%	6.9%	11.1%	16.3%
Telecom	-7.0%	-5.2%	-2.1%	4.4%	0.5%	-5.2%
Utilities	2.5%	1.6%	-0.8%	-2.3%	-5.5%	-10.7%

Source: MSCI, Refinitiv Datastream, HSBC
Note: Market troughs considered are September 2001, May 2004, June 2006, March 2009, December 2011, August 2013, December 2016, March 2018, and October 2018. Relative return is the performance of MSCI INDIA sector price indices, in local currency, relative to the performance of MSCI India index. **Heatmap** colour variation from 'dark green to dark red' represents sector outperformance/underperformance relative to the market – highest relative return (dark green) to lowest relative return (dark red).

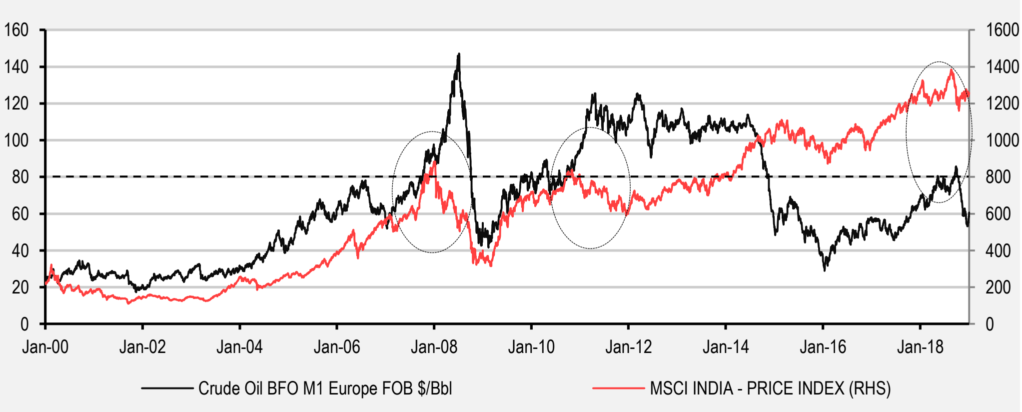
Sector hit rates (% times sector outperformed the market) around the trough

Hit rate	-6M	-3M	-1M	+1M	+3M	+6M
MSCI INDIA						
Cons Discretionary	80%	50%	70%	60%	40%	60%
Cons Staples	80%	60%	70%	50%	30%	40%
Energy	70%	60%	40%	30%	30%	40%
Financials	20%	20%	30%	70%	80%	70%
Banks	20%	20%	20%	80%	80%	90%
Healthcare	70%	70%	60%	10%	10%	20%
Industrials	30%	30%	40%	70%	80%	50%
IT	70%	80%	80%	40%	50%	70%
Materials	30%	40%	30%	90%	70%	60%
Cons Materials	60%	50%	50%	40%	70%	60%
Metals and Mining	20%	40%	10%	80%	60%	60%
Telecom	30%	40%	20%	60%	50%	40%
Utilities	60%	50%	60%	30%	30%	20%

Source: MSCI, Refinitiv Datastream, HSBC
Note: Market troughs considered are September 2001, May 2004, June 2006, March 2009, December 2011, August 2013, December 2016, March 2018, and October 2018.; **Heatmap** colour variation from 'dark green to dark red' represents sector outperformance/underperformance relative to the market – highest relative return (dark green) to lowest relative return (dark red).

Indian equities: tolerance zone for crude

The market appears to be tolerant of crude oil prices below USD80/b



Source: MSCI, Refinitiv Datastream, HSBC

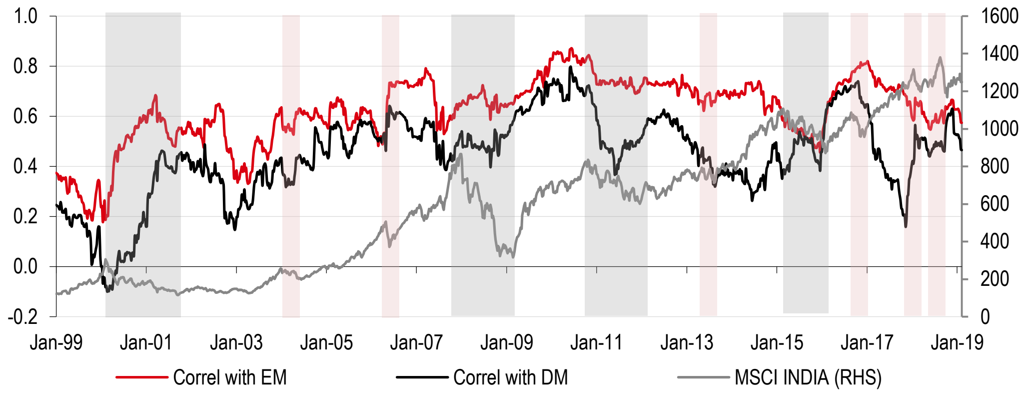
- The crude oil price is one of the keenly watched metrics. India's heavy dependence on crude oil (oil import constituted c28% of the total import bill in FY19) links its broader macro fortunes to movements in global crude oil prices.
- It also impacts the direction of the equity market, given crude's links to input costs and logistics for companies and general INR movements.

In the past two decades:

- The Indian equity market has been tolerant of rising crude oil prices below USD80/b.
- On the past three occasions that oil prices broke through USD80/b, the market witnessed a sharp sell-off, the latest being in September-October 2018.
- The rally in 2012-13 was an exception. Despite crude oil prices staying around USD100/b, the market was supported by flush global liquidity, helped by the US Fed's QE programme.
- So, while crude prices are up 24% YTD, at the current level of USD66/b we believe the equity market will remain immune to fluctuations in crude prices within a tight range.

Bull markets: helped by a favourable backdrop of EM performance

Indian market correlation with DM and EM indices



Source: MSCI, Refinitiv Datastream, HSBC.
Note: Grey/red areas are bear/intermittent vulnerability phases. Correlation is calculated on one-year rolling basis weekly returns.

Indian bull markets were also supported by strong EM performance

- Indian market cycles have broadly mirrored those of EM counterparts in the last two decades. This trend is also captured by the strong correlation (0.62) between MSCI India and MSCI Index returns over the period (India is part of the MSCI EM index).
- The correlation with DM is lower (0.45). The DM index has experienced less variation in cycles since the Global Financial Crisis.
- The Indian market has done well when global growth has been supportive and avoided recession. US GDP growth, a proxy for DM growth, has been slightly higher during Indian bull markets (2.3%) than bear markets (1.7%) in the last two decades.
- In our view, DM growth is not a key factor driving the Indian market cycle, as long as a modest growth rate is maintained.

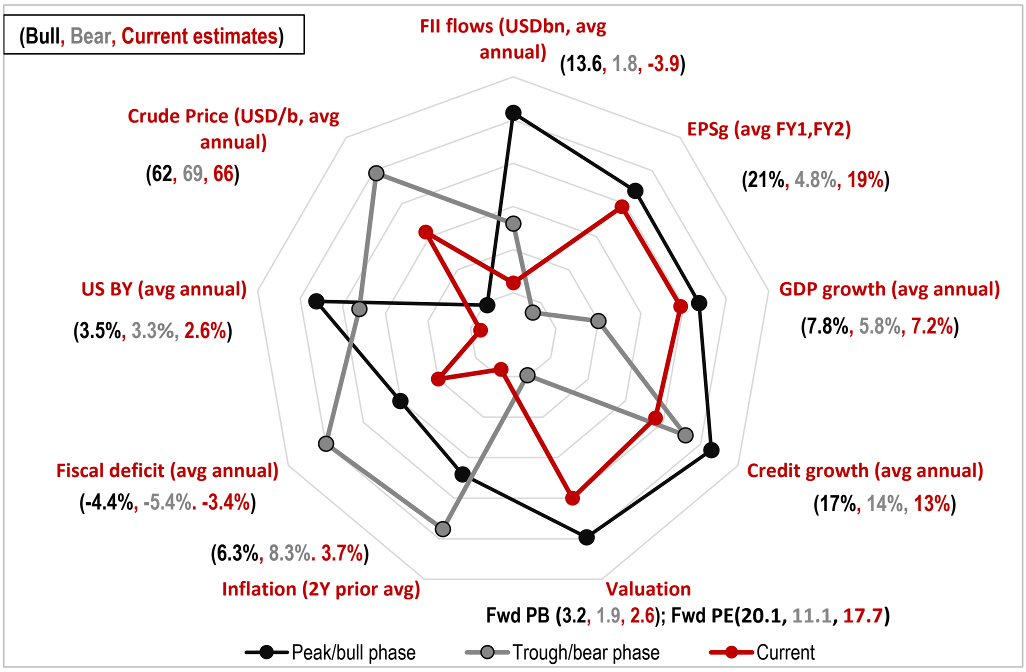
Indian and global market cycles comparison

From	TO	Duration	Event	India	China	EM	AxJ	US	DM	China	EM	AxJ	US	DM
				Index performance						Correlation of weekly returns				
5 bull runs														
Nov-98	Feb-00	15.0	Global technology sector boom	211%	-15%	77%	65%	13%	18%	5%	23%	28%	-4%	-4%
Apr-03	Jan-08	57.3	Longest bull phase led by high infrastructure investment and ample liquidity support	755%	531%	254%	274%	59%	93%	50%	64%	66%	40%	48%
Mar-09	Nov-10	20.3	Recovery after the GFC	212%	105%	93%	134%	79%	83%	72%	82%	84%	60%	69%
Dec-11	Mar-15	39.0	Fed's easy money (QE programme continuing until 2014)	61%	33%	25%	32%	70%	52%	56%	68%	72%	32%	42%
Feb-16	Aug-18	31.0	Resurgent US and domestic economic growth	55%	70%	46%	51%	59%	49%	59%	69%	68%	46%	54%
Average returns per months				**8.2%**	**3.3%**	**3.3%**	**3.6%**	**1.9%**	**2.0%**					
4 Bears (Long-term vulnerabilities)														
Feb-00	Sep-01	19.3	Tech bubble burst	-69%	-52%	-44%	-56%	-30%	-35%	14%	55%	66%	25%	34%
Jan-08	Mar-09	14.2	GFC	-73%	-57%	-50%	-59%	-52%	-55%	62%	64%	75%	43%	54%
Nov-10	Dec-11	13.5	Domestic liquidity tightening and Eurozone debt crisis	-41%	-29%	-17%	-23%	2%	-8%	64%	71%	69%	51%	51%
Mar-15	Feb-16	11.5	China slowdown and end of US easy money	-29%	-30%	-20%	-25%	-14%	-17%	45%	59%	58%	53%	62%
Average returns per months				**-3.6%**	**-2.9%**	**-2.2%**	**-2.7%**	**-1.6%**	**-1.9%**					
6 Short-term vulnerabilities														
Apr-04	May-04	0.8	Surprise loss of the incumbent BJP in the 2004 general elections	-27%	-19%	-16%	-19%	-5%	-6%	57%	87%	93%	88%	88%
May-06	Jun-06	1.2	Global sell-off triggered by fears of prolonged interest rate hikes in the US	-32%	-20%	-20%	-19%	-7%	-11%	85%	91%	93%	49%	60%
May-13	Aug-13	3.4	Global sell-off amid risk of US QE tapering	-27%	-5%	-7%	-11%	-2%	-2%	58%	79%	78%	15%	44%
Sep-16	Dec-16	3.2	Demonetisation impact, FII outflows on fears of resumption in US rate hikes	-13%	-12%	-6%	-10%	4%	1%	70%	78%	80%	16%	25%
Jan-18	Mar-18	2.0	LTCG tax, fear of steeper US rate hike	-12%	-9%	-6%	-7%	-9%	-9%	78%	79%	85%	59%	61%
Aug-18	Oct-18	2.0	IL&FS debt default, rising crude oil prices, slowing global growth	-20%	-16%	-12%	-15%	-8%	-9%	65%	77%	78%	71%	69%
Average returns per months				**-14.9%**	**-9.6%**	**-8.2%**	**-9.6%**	**-3.4%**	**-4.4%**					

Source: MSCI, Refinitiv Datastream, HSBC;
Note: Index performance is the performance of the receptive country/sector MSCI price indices, in local currency. **Heatmap** colour variation from 'dark green to dark red' represents the strength of the correlation – highest (dark green) to lowest (dark red) between India and other markets.

Ready for a bull run

Indicators are favourably positioned within the boundaries of past bear/bull markets



Source: CEIC, Refinitiv Datastream, HSBC
Note: The radar chart plots the 'z-score' of the average values across bull/bear/current phases for all parameters, except valuation and EPS growth, which represent values at peak/trough. Clockwise from top – EPS growth to Credit growth – higher the better, and Valuation to Crude – lower the better.
Data as of 8 March 2019.

Current market indicators are favourable

	Peak/bull	Trough/bear	12m fwd	
Fwd PE	20.2x	11.1x	17.7x	
Fwd PB	3.2x	1.9x	2.6x	
	Peak/bull	**Trough/bear**	**FY19e**	**FY20e**
EPSg (next 2 yrs)	21.1%	4.8%	12.8%	25.8%
GDPg (next 2 yrs)	7.8%	5.8%	7.2%	7.3%
CPI (2Y prior avg)	6.8%	8.3%	3.6%	4.1%
Fiscal deficit (next year)	-4.4%	-5.4%	-3.4%	-3.4%
	Peak/bull	**Trough/bear**	**CY19e**	**CY20e**
US BY (year-end)	3.5%	3.3%	2.5%	
Crude Price (USD/b, avg)	62	69	64	70
FII flows (USDbn, avg annual)	13.6	1.8	-3.9	

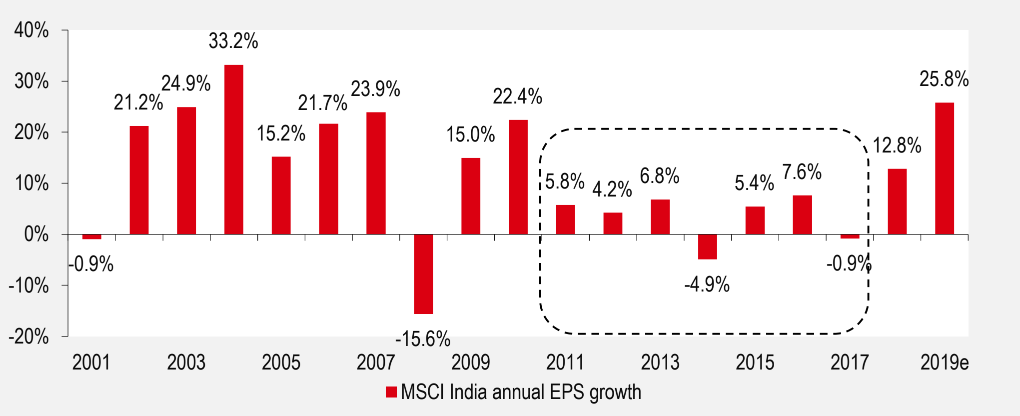
Source: MSCI, Refinitiv Datastream, HSBC. Note: Latest estimates as of 8 March 2019.

Based on our nine parameters, we believe most of the elements are in place for the start of a bull run. Equity market fundamentals are favourable, with reasonable valuations and strong earnings growth expectations setting a positive tone:

- Valuations (both PE and PB) are well within the boundaries of the peaks and troughs seen during past bull/bear market cycles. At a 12-month forward PE multiple of 17.7x the market is trading near (+2%) its five-year mean.
- The earnings outlook for FY19 and FY20 is strong, averaging c19% y-o-y, the highest in the region. This is still below expectations (21% y-o-y) during past market peaks.

- India is coming out of a prolonged earnings recession. Despite recent earnings downgrades, we believe that double-digit growth augurs well for the market.

Indian equities set to come out of a prolonged earnings recession

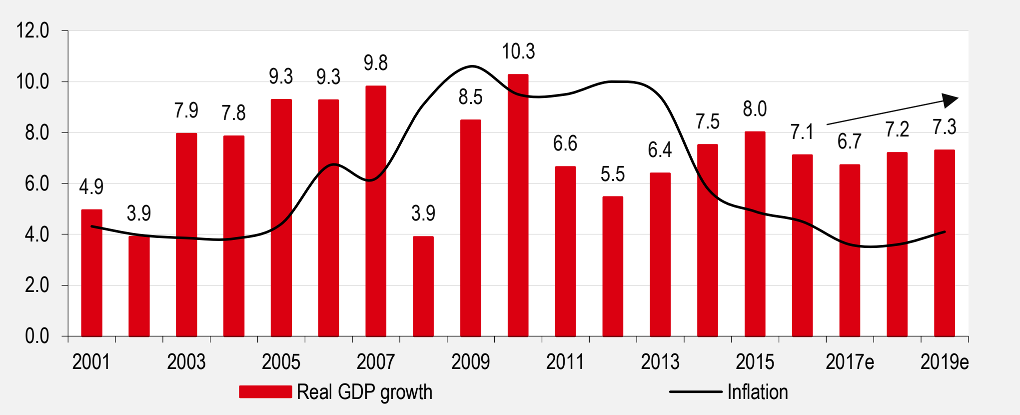


Source: MSCI, Refinitiv Datastream, HSBC estimates. Data as of 8 March 2019.

The domestic macro position is also resilient. The positive outlook is led by strong GDP growth expectations and benign inflation and the fiscal trajectory is also on the right path:

- HSBC economists expect GDP growth to average 7.3% over the next two years, slightly below the average (7.8%) in past bull markets but well above the 5.8% during bear markets.
- Inflation, often a lead indicator for upcoming bear markets, is quite benign. The 3.5% average for inflation expectations for FY19-20 should also keep policy rates supportive in terms of the market.
- The fiscal deficit, at 3.4% for FY19-20, is generally lower than during past market cycles and is moving in the right direction.

The domestic macro environment is strong

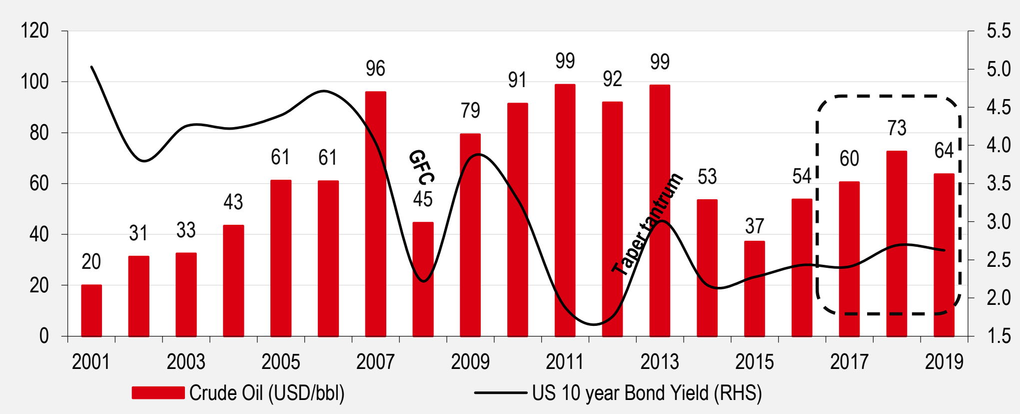


Source: MSCI, Refinitiv Datastream, HSBC estimates

External factors are, on balance, improving. Although growth risks, trade tensions and Brexit could keep the market risk-averse, crude oil prices and US policy rates expectations have turned more favourable in recent months.

- Crude oil price expectations (HSBC forecasts USD64/b in 2019 and USD70/b in 2020) are nearer to levels seen in bear markets. While this appears to be a risk, the market should remain tolerant of prices below USD80/b, as we have seen in past cycles.
- Despite a gradual rise, US bond yield expectations – HSBC forecasts 2.7% for end-2019 – are still quite low in a historical context. The average was 3.5% during bull markets and 3.2% during bears markets. Our economists expect just one rate hike in 2019, most likely in September, with the Fed moving into rate-cutting mode in 2020 as the US economy slows.

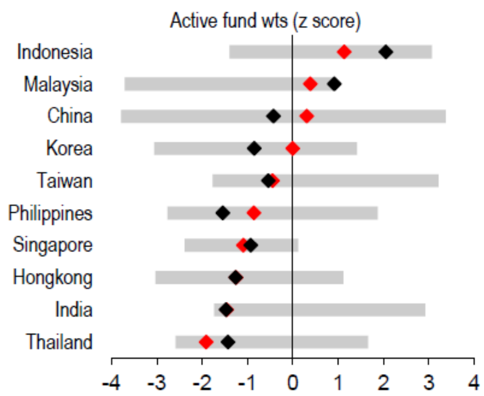
External factors are beginning to look more supportive



Source: MSCI, Refinitiv Datastream, HSBC estimates. 2019 data as of 8 March 2019.

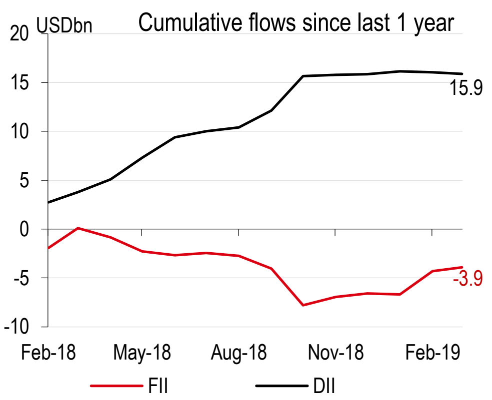
- **We think foreign fund outflows have troughed**. They totalled USD3.9bn in the last 12 months and current levels are below those during previous bear markets. HSBC proprietary analysis of foreign fund holdings shows that India is among the most under-owned market in the region and this may support a rotation into Indian equities.

India is under-owned in the region by FIIs



Source: EPFR Global, HSBC
Note: Red dot shows z-score of the current fund weight with respect to the neutral benchmark, the black dot shows the same three months ago, and the grey bar represents the five-year range.

DIIs have more than compensated for FII outflows



Source: Bloomberg, HSBC. Flows data as of 8 March 2019.

Balancing near-term risks with long-term cyclical support key for optimum risk reward

- We are in a phase of short-term vulnerability, with the market bottoming in October 2018. Since then, the market is up 10%, led by financials and IT.
- In our view, all the indicators – the inflation outlook, GDP growth rates, bond yields, crude oil prices, valuations and earnings – paint a positive picture. However, except for the uncertainty around the election, we think the next bull market would already be underway.
- For an optimum risk reward, we think investors should be aware of possible market volatility in the short term but be positioned for a gradual increase in risk-on sentiment in the long term.

Sectors and stocks

- We look at headwinds and tailwinds, where are we are in the cycle, and the balance between risk and reward
- Sectors like private banks, consumer discretionary and real estate, with selective exposure to metals, consumer staples, and energy look well positioned
- Our key stock ideas are based on our company classification framework of winners, laggards, and trespassers

Lessons from previous market cycles

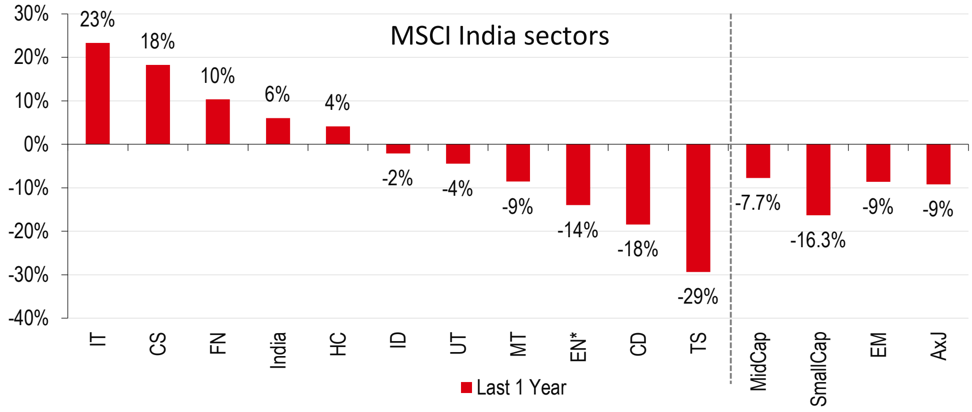
- We believe that, but for the elections, the market could already be at the start of a new bull market.
- The uncertainly surrounding the election could prolong the phase of short-term vulnerability until we have clarity about the next government.
- Our sector preferences take into account: 1) major headwinds and tailwinds in 2019; 2) the market's risk tolerance and where we are in the cycle; and 3) catalysts and favourable risk reward.

Sector winners/losers during previous market cycles

From	To	Market return	Outperforming sectors	Underperforming sectors
5 bull markets				
Nov-98	Feb-00	219%		
Apr-03	Jan-08	610%	Industrials, financials, energy	Healthcare, consumer staples, IT
Mar-09	Nov-10	167%	Metals, financials, industrials	Telecom, utilities, consumer staples
Dec-11	Mar-15	88%	Healthcare, financials	Metals, utilities, telecom
Feb-16	Aug-18	59%	Metals, financials, industrials	Healthcare, telecom
Returns per months		**7.5%**	**Industrials, financials, metals**	**Telecom, consumer staples, healthcare**
4 bear markets				
Feb-00	Sep-01	-66%	Utilities, healthcare, energy	IT, financials
Jan-08	Mar-09	-64%	Healthcare, consumer staples, IT	Metals, telecom, financials
Nov-10	Dec-11	-30%	Consumer staples, discretionary, IT	Telecom, industrials, metals
Mar-15	Feb-16	-22%	Healthcare, energy, staples	Metals, industrials, financials
returns per months		**-3.0%**	**Consumer staples, healthcare, energy**	**Metals, telecom, industrials**
6 periods of short-term vulnerability				
Feb-04	May-04	-24%	Healthcare, IT, construction material	Utilities, telecom, metals
May-06	Jun-06	-31%	IT, energy, consumer discretionary	Metals, telecom, industrials
May-13	Aug-13	-12%	IT, healthcare, telecom	Industrials, financials, construction materials
Sep-16	Dec-16	-12%	Utilities, metals, energy	Construction material, financials, healthcare
Jan-18	Mar-18	-10%	Consumer staples, utilities, IT	Metals, healthcare, telecom
Aug-18	Oct-18	-16%	Utilities, metals, IT	Consumer discretionary, construction materials, telecom
Returns per months		**-12.9%**	**IT, utilities, energy**	**Financials, industrials, construction materials**

Source: Refinitiv Datastream, HSBC
Note: Market return is the performance of MSCI INDIA price index, in local currency.

MSCI India sector returns last year – opportunities in bottomed out sectors?



Source: MSCI, Refinitiv Datastream, HSBC. Data as of 8 March 2019.
Note: Return is the performance of respective MSCI sector price Indices, in local currency.

Sectors we prefer

Banks and financials: favoured destination

- Financials are, in our view, well positioned. Banks have outperformed almost every time the market has moved out of a bear market or a period of short-term vulnerability. We think most of the overhangs is behind us – for example, asset quality and earnings visibility have improved for private banks. While there has already been some re-rating, we think we are still in the re-rating cycle. Credit cost normalisation for corporate lenders will continue to drive ROE expansion, while private banks should continue to gain market share from public sector banks. Our analysts like: **Axis Bank, Indusind Bank, and HDFC Bank**.
- Non-banking financial companies (NBFCs) still face a number of challenges, but scale and quality remain the differentiating factors. Our analysts like **Bajaj Finance**.

Consumer discretionary: potential tailwinds

- The sector should enjoy tailwinds in 2019 as consumers are likely to have more money in their pockets. Stimulus in the interim budget helped, but the main driver is government policy to structurally improve the quality of life, which is unlikely to change regardless of the election result. Our analysts like **Asian Paints, Kajaria Ceramics, and Jubilant Foodworks**.

Real estate: strong balance sheets

- While risks still linger, we see the sector as a potential risk-on play, supported by falling interest rates and an acceleration in macro growth. It offers undemanding valuations and should benefit from a favourable interest rate cycle. With small players struggling with weak balance sheets, funding issues and limited demand, this provides opportunities for developers with strong brands and balance sheets to expand their project pipelines at attractive rates of return. Our analysts like **Godrej Properties** as a structural opportunity with a sound balance sheet, and **Prestige Estates** as a laggard with accelerating sales momentum.

Sectors where we are selective

Consumer staples: need for a balanced approach

- The sector has done exceedingly well in the last two years, and growth expectations have been built into the valuations of leading companies. As the market's tolerance for risk rises, they could underperform the market, as evident from the cycles of the last two decades. However, any sharp correction will create a good opportunity as consumer staples tend to outperform the year following risk-on. In the current context, our analysts like **Avenue Supermarts**, which is a network rollout story with a business model based on the value-seeking India consumer. Our analysts also like **ITC**, which has been a sector laggard and offers an attractive valuation.

Automobile: demand headwinds

- Demand headwinds have led to a sharp deterioration in the growth outlook and a steep sector de-rating. Given the sector's respectable ROE, earnings growth is the more sensitive valuation driver. So, despite the undemanding valuation, a sector re-rating is unlikely unless the growth outlook improves. Our analysts prefer to participate in the sector through two-wheelers. Our analysts' key idea is **Bajaj Auto**, which is gaining market share, has a diversified portfolio, is launching new products, and has underperformed along with the whole sector; the risk reward balance is favourable.

Metals & mining: selective risk

- The sector has sold off in the past year – it is down 14% relative to the market – and most negatives now appear to be priced in. It is trading near multi-year trough valuations. During previous recoveries over the last two decades, the sector has often led the market turnaround and has outperformed during bull markets. We believe the fundamentals should improve as China's supply side is in a much better position to respond to weaker demand than before. Our analysts take a very selective approach to this high risk-high return sector and our analysts' pick is **Hindalco**.

Energy: tailwind from low crude prices

- With the exception of Reliance Industries, the sector has underperformed in the last year, and valuations now look quite compelling. Performance will depend on the trajectory of crude oil prices (which appear supportive) and related policy risks from subsidies. Our analysts' key ideas are **GAIL**, a structural gas play, and **HPCL**, a laggard play on low crude prices, offering an attractive valuation.

Healthcare: multiple headwinds

- The sector did well in previous downturns, supported by strong earnings growth. This time around it has underperformed due to significant regulatory headwinds, delayed product launches, and price erosion in generic drugs. **Divi's Lab**, which is a play on global R&D spending by global companies, is our analysts' pick.

Sectors we are avoiding

IT: upside seems limited

- Historically, IT has been a defensive sector in India, outperforming during bear markets and when equities start to recover. The story has not changed. IT is the best performing sector in India, with a 24% return in the last 12 months. The demand environment is supportive and the heightened volatility expected around the election bodes well for the sector. However, after a good run, the sector lacks INR support and may struggle in a bull market.

Industrials: in need of capex support

- While the market cycle appears broadly supportive – industrials tend to do well in recovery phases and bull markets – the sector still lacks investment momentum, one of the key catalysts in the past. Our analysts expect at best a fragmented recovery in 2019 as capacity utilisation in high capex sectors still appears sub-optimal. While sector valuations are supportive, we do not expect any significant upside unless the investment cycle picks up.

Telecom services: awaiting price rationalisation

- The telecom and media sector has been one of the consistent laggards across market cycles in the past two decades. While the long-term opportunities appear promising, given the rapid adoption of smartphones and increasing data consumption, much will depend on how soon rational pricing returns.

Given near-term risks, we also avoid sectors, such as **cement, infrastructure, insurance**, and **agricultural products**.

Autos

Sector snapshot

Bloomberg code	Name	Rating	Performance				Valuation			Earnings growth			ROE trend		
			13 Mar Price (INR)	6M	1Y	3Y	Fwd PE	6M back	Avg PE (5Y)	FY18a	FY19e	FY20e	FY18a	FY19e	FY20e
BJAUT IN	Bajaj Auto	Buy	3,010.00	1%	1%	8%	17.3x	16.6x	17.9x	7%	10%	14%	23%	22%	23%
EIM IN	Eicher Motors	Hold	22,777.25	-24%	-21%	3%	21.8x	26.5x	29.3x	30%	3%	14%	44%	34%	30%
HMCL IN	Hero MotoCorp	Buy	2,803.65	-18%	-24%	-1%	13.9x	16.0x	17.1x	9%	-5%	12%	34%	28%	29%
MM IN	Mahindra & Mahindra	Buy	684.20	-31%	-8%	3%	15.3x	21.5x	19.2x	23%	8%	2%	16%	15%	14%
MSIL IN	Maruti Suzuki India Ltd	Hold	7,091.05	-20%	-20%	26%	23.5x	26.6x	23.5x	5%	-2%	17%	20%	17%	18%
TTMT IN	Tata Motors	Hold	181.70	-35%	-48%	-19%	11.9x	8.6x	9.4x	20%	-421%		12%	-36%	10%
TVSL IN	TVS Motors	Hold	497.90	-17%	-25%	20%	24.2x	26.9x	28.4x	19%	16%	51%	25%	24%	30%
	Sector median			-20%	-21%	3%	17.3x	21.5x	19.2x						

Source: Bloomberg, HSBC estimates

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Why did the sector underperform/outperform in 2018?

- With a median return of -21% in the last one year, the sector has underperformed the market. The demand environment deteriorated in 2H18 due to an increase in the cost of ownership, weak wage growth, and regulatory issues (increase in insurance costs and higher axle loads).
- A further increase in commodity prices led to cost and margin pressures, which were partially offset by price hikes.
- The 2W industry was impacted by increasing competitive pressure and Bajaj's aggressive pricing strategy. Weak volumes from Eicher were also a negative surprise.

Are these factors still relevant? What could change?

- Pressure on demand still persists, but election-led rural spending and a decline in fuel prices could cause some green shoots to emerge in 2H19.
- Commodity prices have started to moderate.
- Dealer inventory levels have increased so far this year, but they have started to decline in the past few weeks.

Sector outlook – major headwinds and tailwinds in 2019

- We expect 2019 to start on a low note and growth to pick up in 2H19.
- Pre-buying before the transition to BS6 emission standards could provide support in the second half. Elections will likely play an important role in terms of consumer sentiment.
- Regulatory headwinds remain in 2019. However, with commodity prices moderating and valuations below their three- and five-year averages, the risk reward looks favourable.

Auto components

Sector snap shot

Bloomberg code	Name	Rating	Performance: 13 Mar Price (INR)	6M	1Y	3Y	Valuation: Fwd PE	6M back	Avg PE (5Y)	Earnings growth: FY18a	FY19e	FY20e	ROE trend: FY18a	FY19e	FY20e
BIL IN	Balkrishna Industries	Hold	928.95	-23%	-12%	44%	18.3x	24.7x	17.7x	-1%	16%	20%	19%	19%	19%
BHFC IN	Bharat Forge	Buy	537.50	-26%	-32%	8%	18.7x	23.5x	26.2x	47%	44%	17%	19%	24%	24%
BOS IN	Bosch Ltd	Hold	18,608.90	-14%	2%	2%	30.5x	31.7x	35.0x	1%	21%	24%	16%	17%	18%
MACA IN	Mahindra CIE Automotive L	Buy	241.45	-17%	7%	9%	14.0x	16.7x	17.6x	90%	46%	20%	10%	13%	14%
MSS IN	Motherson Sumi	Buy	165.55	-19%	-23%	14%	21.4x	22.6x	23.2x	7%	44%	23%	19%	23%	24%
SKF IN	SKF India Limited	Buy	1,967.00	11%	14%	18%	26.1x	24.2x	26.1x	25%	17%	13%	16%	19%	20%
	Sector median			**-18%**	**-5%**	**12%**	**20.1x**	**23.8x**	**24.7x**						

Source: Bloomberg, HSBC estimates

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Why did the sector underperform/outperform in 2018?

- The sector is highly dependent on the global market. Fears of trade wars and a slowdown in the US car market resulted in a median return of -5% in the last year.
- Company-specific concerns, such as a lack of new plant start-ups and new products, resulted in earnings being deferred to next year.

Are these factors still relevant? What could change?

- The problems that weighed on stock performance continue. Fears of trade wars have subsided, but the main concern is now a broad global slowdown.
- However, we expect stocks to broadly outperform as underperformance last year was excessive and valuations have become supportive.
- The start-up of new plants and the introduction of new products, which were pushed out to 2019-20, will likely help earnings.

Sector outlook – major headwinds and tailwinds in 2019

- At the sector level, we expect headwinds from slowing global and Indian vehicle demand.
- However, the change in emission standards in April 2020 is likely to result in pre-buying during the second half of 2019.
- In addition, the expectation of higher content after the change in emission standards should continue to support the performance of the stocks.

Consumer discretionary (excluding autos)

Sector snap shot

Bloomberg code	Name	Rating	Performance: 13 Mar Price (INR)	6M	1Y	3Y	Valuation: Fwd PE	6M back	Avg PE (5Y)	Earnings growth: FY18a	FY19e	FY20e	ROE trend: FY18a	FY19e	FY20e
HAVL IN	Havells India Limited	Buy	766.60	8%	45%	37%	43.7x	46.1x	38.3x	17%	21%	22%	20%	21%	23%
VOLT IN	Voltas Ltd	Buy	618.80	-1%	-6%	35%	30.0x	30.3x	27.0x	13%	-1%	29%	16%	14%	16%
KJC IN	Kajaria Ceramics Ltd	Buy	585.35	27%	2%	6%	30.2x	24.4x	29.8x	-6%	1%	22%	19%	17%	18%
DMART IN	Avenue Supermarts	Buy	1,501.40	-7%	12%		73.8x	81.0x	73.9x	68%	23%	33%	19%	19%	21%
TTAN IN	Titan Company Ltd	Buy	1,078.30	21%	29%	46%	50.1x	49.1x	43.9x	44%	40%	20%	24%	28%	28%
JUBI IN	Jubilant Foodworks	Buy	1,325.65	-5%	33%	31%	44.9x	57.2x	51.1x	181%	50%	28%	22%	27%	29%
FRETAIL IN	Future Retail Ltd	Hold	436.60	-24%	-10%		25.5x	26.0x	28.8x	60%	17%	27%	22%	21%	23%
COXK IN	Cox And Kings	Buy	158.85	-16%	-27%	4%	9.8x	9.1x	9.4x	110%	4%	13%	16%	13%	13%
IH IN	Indian Hotels	Buy	153.95	12%	12%	16%	44.9x	45.6x	53.3x		257%	24%	2%	7%	8%
	Sector median			**-1%**	**12%**	**31%**	**43.7x**	**45.6x**	**38.3x**						

Source: Bloomberg, HSBC estimates

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Why did the sector underperform/outperform in 2018?

- The median return was down 1% in the past six months, with retailers doing better than consumer durables, and travel and hotel stocks.
- The solid performance from retailers was driven by strong same-store sales growth (SSSG) and market share gains.
- Consumer durables under our coverage faced margin pressure due to cost factors, the INR's depreciation, and higher competitive intensity.

Are these factors still relevant? What could change?

- SSSG growth and market share gains (from unorganised to organised retail) remain relevant for retailers and household durables in 2019.
- For durables, margins are expected to improve, led by price hikes, easing commodity prices, and supportive INR movements, which should support a volume rebound.
- The broader structural story of consumption-led growth remains intact.

Sector outlook – major headwinds and tailwinds in 2019

- Overall, we are positive on retailers and household durables.
- The demand environment is expected to remain strong and the easing of commodity prices and price hikes should support margins.

Consumer staples

Sector snap shot

			Performance				Valuation			Earnings growth			ROE trend		
Bloomberg code	**Name**	**Rating**	**13 Mar Price (INR)**	**6M**	**1Y**	**3Y**	**Fwd PE**	**6M back**	**Avg PE (5Y)**	**FY18a**	**FY19e**	**FY20e**	**FY18a**	**FY19e**	**FY20e**
BRIT IN	Britannia Industries	Hold	3,126.95	-1%	27%	30%	52.5x	57.8x	43.7x	13%	21%	19%	33%	32%	32%
NEST IN	Nestle India	Buy	10,723.30	-3%	31%	24%	49.0x	57.8x	47.9x	18%	33%	21%	40%	46%	49%
CLGT IN	Colgate-Palmolive	Buy	1,276.25	10%	21%	15%	40.4x	38.4x	38.3x	21%	9%	20%	49%	48%	55%
DABUR IN	Dabur India	Buy	440.30	-8%	33%	20%	43.2x	46.7x	37.1x	7%	16%	18%	26%	26%	27%
HMN IN	Emami Ltd	Buy	399.85	-31%	-30%	-8%	30.8x	41.5x	37.8x	-55%	22%	35%	16%	18%	22%
GCPL IN	Godrej Consumer Products	Hold	723.55	-21%	0%	19%	39.7x	46.5x	39.0x	-25%	9%	19%	27%	28%	31%
MRCO IN	Marico Industries	Hold	342.90	-6%	10%	12%	38.6x	45.2x	40.2x	2%	16%	23%	33%	35%	37%
ITC IN	ITC	Buy	294.90	-6%	13%	11%	26.0x	28.9x	26.3x	6%	13%	14%	22%	23%	26%
APNT IN	Asian Paints	Buy	1,428.30	5%	23%	16%	48.7x	51.0x	45.6x	2%	16%	20%	25%	25%	27%
BRGR IN	Berger Paints	Buy	307.80	-4%	23%	22%	45.5x	52.3x	44.1x	4%	20%	22%	23%	24%	25%
	Sector median			**-5%**	**22%**	**18%**	**41.8x**	**46.6x**	**39.6x**						

Source: Bloomberg, HSBC estimates

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Why did the sector underperform/outperform in 2018?

- The sector was one of the best performers last year with a median return of 22%, led by a strong volume trajectory despite some margin pressure.
- The sector benefited from the strong earnings outlook and a preference for risk aversion.
- With the GST channel issues sorted, companies focused on product launches and distribution network expansion, which also drove top-line growth.

Are these factors still relevant? What could change?

- We believe the volume trajectory will remain strong, led by the expansion of distribution channels and new product launches.
- The market's preference for risk aversion will likely aid the sector's returns until the election. After that, a risk-on rally could hurt stock performance.
- That said, sector fundamentals are likely to remain solid and margin pressure should ease after the decline in crude prices, keeping the earnings trajectory strong.

Sector outlook – major headwinds and tailwinds in 2019

- We are optimistic about the outlook in 2019, as fundamentals remain solid, and we expect the sector's outperformance, led by earnings, to continue.
- The uptick in rural demand in an election year is a major sector tailwind, along with premiumisation, a focus on modern trade, product launches, and margin expansion.
- With sector valuations building in significant long-term earnings growth expectations, any change in investor risk preference after the election could see the market favouring value stocks, which we see as a major headwind for the sector.

Energy

Sector snapshot

Bloomberg code	Name	Rating	Performance: 13 Mar Price (INR)	6M	1Y	3Y	Valuation: Fwd PE	6M back	Avg PE (5Y)	Earnings growth: FY18a	FY19e	FY20e	ROE trend: FY18a	FY19e	FY20e
BPCL IN	Bharat Petroleum	Buy	389.05	3%	-17%	10%	9.1x	7.7x	9.7x	29%	-24%	27%	24%	16%	19%
COAL IN	Coal India Limited	Buy	238.65	-18%	-23%	-10%	8.8x	10.5x	12.1x	-24%	130%	0%	32%	80%	78%
HPCL IN	Hindustan Petroleum	Buy	267.85	-1%	-31%	14%	7.9x	7.0x	9.5x	6%	-38%	51%	29%	16%	23%
IOCL IN	Indian Oil	Buy	148.75	-3%	-22%	14%	8.1x	7.8x	8.9x	0%	-17%	7%	16%	13%	13%
ONGC IN	Oil & Natural Gas Corp.	Buy	149.75	-13%	-17%	4%	6.1x	6.7x	8.9x	9%	31%	-5%	10%	13%	12%
OINL IN	Oil India Limited	Buy	175.45	-16%	-20%	4%	5.9x	7.4x	9.0x	5%	23%	-13%	10%	12%	10%
PLNG IN	Petronet Lng Ltd	Buy	242.50	-4%	-1%	24%	13.3x	13.5x	15.4x	22%	11%	6%	23%	22%	21%
RIL IN	Reliance Industries	Buy	1,347.30	-1%	39%	35%	15.9x	15.8x	13.3x	17%	15%	36%	13%	13%	15%
GAIL IN	GAIL	Buy	351.60	-7%	7%	21%	11.6x	14.7x	13.7x	21%	39%	1%	12%	15%	14%
	Sector median			**-4%**	**-17%**	**14%**	**8.8x**	**7.8x**	**9.7x**						

Source: Bloomberg, HSBC estimates

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Why did the sector underperform/outperform in 2018?

- 2018 was a tough year for the sector, which underperformed the BSE SENSEX by 25%.
- High oil prices coupled with several state elections raised investor concerns on price reforms.
- For gas players, tariff-related reforms were delayed.

Are these factors still relevant? What could change?

- Policy risks related to subsidies are already waning due to lower oil prices.
- For gas players, clarity on key pending reforms like the unification of tariffs and a decision about gas trading hubs is likely to emerge in 2H19.

Sector outlook – major headwinds and tailwinds in 2019

- We believe an oil price in the range of USD55-65/b is a sweet spot, where policy risks related to government policies and investor expectations are equally balanced.
- Policy risks are waning, the earnings outlook is resilient, and valuations are attractive – these factors should drive a recovery in 2019.
- State-owned oil companies are trading at an average FY20e PE of 7.8x, which is 15% below their historical average of the past 10 years despite 13% earnings growth in FY20. We think this makes the risk reward attractive.

Banks

Sector snap shot

Bloomberg code	Name	Rating	Performance: 13 Mar Price (INR)	6M	1Y	3Y	Valuation: Fwd PB	6M back	Avg PB (5Y)	Earnings growth: FY18a	FY19e	FY20e	ROE trend: FY18a	FY19e	FY20e
AXSB IN	Axis Bank Ltd	Buy	738.00	14%	41%	21%	2.5x	2.0x	2.0x	-93%	1566%	130%	0%	7%	14%
HDFCB IN	HDFC Bank	Buy	2,226.55	3%	15%	28%	3.5x	4.1x	3.6x	19%	13%	29%	18%	16%	17%
ICICIBC IN	ICICI Bank	Hold	391.90	11%	25%	23%	2.0x	1.6x	1.8x	-31%	-31%	203%	7%	5%	13%
IIB IN	IndusInd Bank	Buy	1,636.35	-19%	-10%	18%	2.9x	4.1x	3.3x	25%	3%	55%	16%	15%	20%
KMB IN	Kotak Mahindra Bank	Reduce	1,261.25	0%	14%	24%	4.9x	5.4x	4.8x	16%	18%	18%	13%	12%	13%
YES IN	Yes Bank	Hold	244.30	-28%	-25%	15%	1.5x	2.6x	2.3x	26%	10%	43%	18%	17%	20%
IDFCBK IN	IDFC Bank	Buy	50.05	7%	-1%	0%	1.1x	0.8x	1.0x	-4%	8%	14%	7%	7%	7%
PNB IN	Punjab National Bank	Reduce	84.85	-1%	-13%	1%	0.7x	0.6x	0.7x	-815%			-33%	-15%	5%
SBIN IN	State Bank of India	Buy	293.15	-4%	10%	15%	1.1x	1.1x	1.2x			383%	-6%	3%	13%
UNBK IN	Union Bank Of India	Reduce	82.60	-7%	-19%	-15%	0.4x	0.4x	0.5x	-655%		82%	-24%	5%	8%
BOB IN	Bank of Baroda	Hold	115.55	-23%	-15%	-7%	0.6x	0.8x	0.8x	-253%		71%	-6%	8%	12%
BOI IN	Bank of India	Reduce	92.05	-6%	-11%	-1%	0.5x	0.5x	0.5x				-23%	-10%	5%
CBK IN	Canara Bank	Reduce	263.00	-6%	1%	13%	0.6x	0.6x	0.5x	-407%			-15%	-1%	8%
	PVT Bank			**3%**	**14%**	**21%**	**2.47x**	**2.61x**	**2.30x**						
	PSU Bank			**-6%**	**-12%**	**0%**	**0.61x**	**0.60x**	**0.60x**						

Source: Bloomberg, HSBC estimates. Aggregate performance and valuations are the median for the sector.

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Why has the sector underperformed/outperformed in 2018?

- The Nifty Banks Index outperformed the market by 11% in 2018, driven by: 1) the consistently healthy profitability of defensive banks (HDFCB and KMB) supported by market share gains from weaker public sector banks; and 2) a re-rating of large private corporate lenders (AXSB and ICICIBC) on the back of improvements in asset quality and earnings visibility.

Are these factors still relevant? What could change?

- We expect a normalisation of credit costs to drive ROE expansion for corporate lenders through FY20 (e.g., Axis and ICICI).
- We continue to expect private banks to gain market share at the expense of public sector lenders, which remain under pressure in terms of asset quality and capital strength.

Sector outlook – major headwinds and tailwinds in 2019

- **Fresh challenges:** Competition for deposits to test net interest margins (NIMs). We expect stable NIMs for Axis and HDFC, but lower NIMs for ICICI and Kotak. Micro-, small- and medium-sized enterprises (MSME) and the quality of rural loan books will be in focus; potential regulatory changes, such as external loan pricing benchmarks, MSME loan restructuring, and large corporate credit exposure, could present new challenges.
- **Tailwinds:** Market share gains from public sector banks and non-banking financial companies (NBFCs); ROE expansion for private corporate lenders as credit costs normalise.

NBFCs

Sector snap shot

			Performance				Valuation			Earnings growth			ROE trend		
Bloomberg code	Name	Rating	13 Mar Price (INR)	6M	1Y	3Y	Fwd PE	6M back	Avg PE (5Y)	FY18a	FY19e	FY20e	FY18a	FY19e	FY20e
BAF IN	Bajaj Finance Ltd	Buy	2,828.15	1%	70%	64%	31.6x	39.9x	29.1x	38%	48%	35%	20%	22%	24%
EQUITAS IN	Equitas Holdings Limited	Buy	135.75	-21%	-11%		13.9x	21.7x	24.6x	-81%	433%	71%	1%	7%	11%
MMFS IN	Mahindra Finance	Buy	432.95	-5%	4%	24%	15.9x	19.2x	19.4x	90%	60%	18%	10%	14%	14%
SHTF IN	Shriram Transport Finance	Buy	1,280.30	1%	-8%	10%	10.1x	11.2x	12.7x	25%	52%	10%	13%	16%	16%
UJJIVAN IN	Ujjivan Financial	Hold	343.55	-8%	-8%		15.0x	16.7x	20.7x	-96%	2399%	45%	0%	10%	13%
LTFH IN	L&T Finance Holding	Buy	145.10	-16%	-11%	37%	10.5x	14.2x	15.3x	30%	61%	17%	13%	17%	18%
HDFC IN	HDFC	Buy	1,950.65	-2%	5%	18%	29.4x	32.7x	28.7x	8%	6%	10%	17%	14%	14%
LICHF IN	Lic Housing Finance	Buy	504.60	-1%	2%	3%	9.4x	11.2x	12.0x	3%	15%	13%	17%	17%	17%
	Sector median			**-4%**	**-3%**	**21%**	**14.4x**	**17.9x**	**20.0x**						

Source: Bloomberg, HSBC estimates

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Why did the sector underperform/outperform in 2018?

- 2018 was another eventful period for non-banking financial companies (NBFCs) as markets witnessed a liquidity crisis similar to that of 2013.
- The unanticipated liquidity crunch in the second half of the year halted the growth trajectory of NBFCs.
- The year-end liquidity crunch not only erased the gains of the first half of the year but also led to negative returns for most stocks. Despite this, HDFC and BAF ended the year with decent gains.

Are these factors still relevant? What could change?

- The liquidity situation is normalising, with the RBI injecting liquidity into the system and banks providing credit to NBFCs. This has eased some of the pressure, but the cost of borrowing has risen and has yet to normalise.
- If the cost of funds remains elevated for a long period, it could have a negative impact on margins.

Sector outlook – major headwinds and tailwinds in 2019

- We think borrowing costs will be a bigger issue than liquidity this year in terms of the growth and margin dynamics for NBFCs.
- We believe regulations will continue to tighten. The RBI has already increased capital requirements and asset quality standards for NBFCs and is now preparing to introduce new accounting standards (IND-AS).
- Asset quality for wholesale mortgage players will also be an important factor to watch.

Insurance

Sector snap shot

Bloomberg Code	Name	Rating	13 Mar Price (INR)	Performance 6M	1Y	3Y	Valuation Fwd PE	6M back	Avg PE (5Y)	Earnings growth FY18a	FY19e	FY20e	ROE trend FY18a	FY19e	FY20e
HDFCLIFE IN	HDFC Life	Hold	366.15	-13%	-9%		52.9x	69.0x	67.8x	24%	20%	8%	26%	26%	24%
IPRU IN	ICICI Prudential	Buy	333.80	-10%	-12%		28.6x	29.5x	28.2x	-4%	4%	9%	24%	23%	23%
SBILIFE IN	SBI Life	Buy	615.35	-13%	-10%		38.6x	44.6x	45.6x	21%	16%	11%	19%	19%	18%
GICRE IN	General Insurance Corp	Buy	257.50	-26%	-31%		12.5x	15.1x	15.3x	-15%	-7%	7%	15%	14%	14%
ICICIGI IN	ICICI Lombard	Hold	969.90	12%	22%		32.2x	29.5x	31.3x	22%	27%	25%	17%	20%	23%
	Sector median			**-13%**	**-10%**		**32.2x**	**29.5x**	**31.3x**						

Source: Bloomberg, HSBC estimates

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Why did the sector underperform/outperform in 2018?

- For life insurers, stock performance largely disappointed in 2018 due to slowing sales momentum. The base was high in 2017, when sales growth was up c40% y-o-y as they benefitted from rising stock markets and demonetisation.
- Another reason for weak sales is that insurers have been putting greater focus on protection and credit life products that have lower premiums (but higher margins).
- In the non-life space, ICICI Lombard outperformed due to continuing sector growth and sustained profitability.

Are these factors still relevant? What could change?

- It will be easier to assess the sales figures of life insurers as the base is now more benign.
- The top three life players – ICICI Pru, HDFC Life and SBI Life – should all continue to grow at or faster than the industry's average as they gain market share from LIC and smaller private players.
- For the non-life market, we expect low to mid double-digit growth for the year ending March 2020, due to low penetration rates.

Sector outlook – major headwinds and tailwinds in 2019

- Life premium growth, especially for unit-linked insurance plans, depends on equity market performance. Life insurance sales in March 2020 could benefit from the benign base in the previous year.
- We believe pension sales could get a boost, if the new life product regulations are implemented without major changes.
- Major regulatory changes were introduced in March 2019 for non-life insurance, especially in motor insurance. We expect non-life sales growth to eclipse life in March 2020, partly due to opportunities arising from lower penetration rates in non-life insurance.

Healthcare

Sector snap shot

Bloomberg code	Name	Rating	Performance: 13 Mar Price (INR)	6M	1Y	3Y	Valuation: Fwd PE	6M back	Avg PE (5Y)	Earnings growth: FY18a	FY19e	FY20e	ROE trend: FY18a	FY19e	FY20e
DIVI IN	Divi's Laboratories	Buy	1,667.00	25%	64%	17%	28.2x	25.0x	22.7x	-17%	59%	17%	15%	21%	21%
ALPM IN	Alembic Pharmaceuticals	Hold	550.10	-15%	0%	-5%	18.5x	22.8x	21.2x	2%	4%	25%	20%	18%	19%
ALKEM IN	Alkem Laboratories Ltd	Hold	1,734.90	-20%	-22%	9%	20.4x	23.0x	21.7x	-28%	24%	27%	13%	15%	16%
ARBP IN	Aurobindo Pharma	Buy	766.25	-8%	25%	1%	13.1x	13.8x	15.0x	3%	2%	10%	23%	19%	18%
CDH IN	Cadila Healthcare	Buy	330.65	-24%	-16%	-1%	16.8x	17.2x	20.6x	18%	2%	6%	22%	19%	17%
CIPLA IN	Cipla	Buy	532.80	-19%	-7%	0%	23.4x	25.5x	23.2x	6%	4%	31%	10%	10%	11%
DRRD IN	Dr Reddy's Laboratories	Hold	2,655.85	-1%	22%	-7%	20.7x	21.7x	21.5x	-22%	90%	23%	8%	14%	15%
GNP IN	Glenmark Pharmaceuticals	Hold	632.35	-13%	8%	-10%	17.4x	17.5x	16.3x	-23%	25%	5%	15%	16%	14%
IPCA IN	IPCA Laboratories	Buy	917.55	12%	33%	16%	21.0x	23.1x	21.3x	20%	57%	33%	9%	13%	15%
LPC IN	Lupin	Reduce	763.30	-19%	1%	-25%	23.3x	24.9x	21.2x	-51%	-30%	73%	10%	7%	11%
SUNP IN	Sun Pharma	Hold	456.50	-32%	-12%	-19%	21.5x	29.6x	24.3x	-53%	29%	20%	8%	10%	11%
TRP IN	Torrent Pharma	Buy	1,815.20	-3%	35%	11%	28.0x	30.1x	22.4x	-26%	5%	59%	15%	15%	21%
BIOS IN	Biocon Limited	Buy	618.55	-3%	2%	56%	33.7x	44.2x	37.2x	-39%	91%	48%	7%	13%	17%
	Sector median			**-14%**	**5%**	**0%**	**20.8x**	**23.0x**	**21.4x**						

Source: Bloomberg, HSBC estimates

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Why did the sector underperform/outperform in 2018?

- Headwinds from the US, such as generic price erosion, rising competition, and current good manufacturing practice (cGMP) issues at some plants, impacted US sales.
- In addition, there were delays in approvals and launches of products in the US as companies struggled to meet changing Food and Drug Administration (FDA) guidelines. In specialty launches, sales were lower than expected due to competition from incumbents.
- Lastly, there was API price inflation due to supply disruptions in China.

Are these factors still relevant? What could change?

- Most of the challenges in the US will likely continue.
- While the timeline for final FDA approval remains uncertain, we believe management teams' ability to monetise new products once they are approved will be a key factor.
- Most companies have indicated some cooling of price increases from the peak. We expect API price inflation to persist as supply disruptions continue in China.

Sector outlook – major headwinds and tailwinds in 2019

- The US Department of Justice's (DoJ) investigation into alleged price fixing and market allocation remains an industry overhang. We expect greater clarity once the results are announced.
- The approval and launch of key products like NuvaRing and Levothyroxine could be a positive trigger for specific stocks; however, in our view, most launches are priced in.

Industrials (capital goods/infrastructure)

Sector snap shot

Bloomberg code	Name	Rating	Performance 13 Mar Price (INR)	6M	1Y	3Y	Valuation Fwd PE	6M back	Avg PE (5Y)	Earnings growth FY18a	FY19e	FY20e	ROE trend FY18a	FY19e	FY20e
LT IN	Larsen & Toubro	Buy	1,378.60	-1%	4%	19%	18.9x	19.5x	22.0x	22%	19%	16%	14%	15%	16%
ABB IN	ABB India	Hold	1,296.95	-6%	-11%	3%	38.1x	40.7x	47.4x	28%	-2%	36%	15%	13%	17%
BHEL IN	BHEL	Hold	68.00	-15%	-22%	-2%	15.6x	16.8x	22.5x	8%	87%	-5%	2%	5%	4%
CGPOWER IN	CG Power and Industrial	Hold	41.80	-36%	-54%	-9%	9.1x	16.9x	17.3x				-21%	-4%	7%
SUEL IN	Suzlon Energy Ltd	Buy	6.80	4%	-37%	-20%	23.7x	(26.7x)	16.2x	-198%			12%	20%	-1%
SIEM IN	Siemens India	Hold	1,053.75	3%	-7%	-1%	33.7x	34.1x	42.7x	19%	27%	17%	10%	11%	12%
KKC IN	Cummins India	Hold	735.15	-4%	-7%	-5%	24.3x	23.7x	26.6x	-9%	12%	12%	17%	18%	19%
ESC IN	Escorts Limited	Buy	788.00	-8%	-15%	75%	13.1x	16.8x	15.6x	103%	27%	6%	17%	16%	15%
TMX IN	Thermax India	Hold	1,051.45	-3%	-17%	8%	28.4x	31.5x	32.2x	-25%	33%	43%	9%	11%	14%
QUESS IN	Quess Corp Limited	Buy	782.95	-19%	-21%		28.2x	35.6x	38.9x	141%	0%	39%	22%	14%	17%
CCRI IN	Container Corp of India	Reduce	522.55	-7%	-2%	8%	23.0x	25.1x	27.2x	-40%	14%	14%	9%	10%	11%
VRLL IN	VRL Logistics	Buy	282.55	-19%	-37%	-11%	19.5x	23.6x	24.2x	32%	1%	36%	16%	15%	19%
ADSEZ IN	Adani Ports and SEZ	Buy	367.15	-9%	-12%	14%	15.5x	18.0x	18.2x	13%	4%	16%	20%	18%	18%
GPPV IN	Gujarat Pipavav Ports	Buy	93.75	-18%	-37%	-17%	17.4x	19.8x	22.2x	-22%	7%	19%	10%	11%	13%
	Sector median			**-17%**	**-23%**	**1%**	**18.1x**	**21.7x**	**23.4x**						

Source: Bloomberg, HSBC estimates

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Why did the sector underperform/outperform in 2018?

- It was good year in terms of revenue, order inflows, and margins, albeit from a low base.
- Despite this, the sector underperformed mainly because visibility about a broad-based recovery in orders did not improve.
- Valuation de-rating drove the underperformance in 2018.

Are these factors still relevant? What could change?

- Capacity utilisation across most segments remains sub-optimal.
- We do not expect to see a recovery in orders from some of the large sectors, such as power, oil and gas, steel and fertilisers, in 2019.
- A sharp improvement in demand in sectors, such as cement, electricity, and steel, could quicken the recovery process.

Sector outlook – major headwinds and tailwinds in 2019

- We believe it will be a year of a fragmented recovery.
- Despite the correction, current valuations are factoring in a robust recovery outlook in terms of orders and earnings.
- We have a cautious stance on the sector.

IT

Sector snap shot

			Performance				Valuation			Earnings growth			ROE trend		
Bloomberg code	**Name**	**Rating**	**13 Mar Price (INR)**	**6M**	**1Y**	**3Y**	**Fwd PE**	**6M back**	**Avg PE (5Y)**	**FY18a**	**FY19e**	**FY20e**	**FY18a**	**FY19e**	**FY20e**
HCLT IN	HCL Technologies	Buy	1,028.35	-6%	6%	7%	13.0x	13.8x	13.4x	5%	13%	14%	25%	24%	23%
INFO IN	Infosys Limited	Buy	708.45	-3%	23%	7%	17.8x	18.6x	16.0x	13%	4%	8%	24%	24%	23%
LTI IN	L&T Infotech	Buy	1,632.55	-16%	18%		16.9x	21.1x	15.7x	13%	38%	10%	32%	35%	31%
MTCL IN	Mindtree	Buy	923.90	-21%	13%	6%	18.0x	21.8x	17.3x	39%	34%	11%	21%	25%	24%
MPHL IN	MphasiS	Hold	975.70	-21%	18%	30%	15.8x	20.3x	15.3x	12%	33%	1%	15%	19%	18%
PSYS IN	Persistent Systems	Hold	655.50	-25%	-22%	2%	12.2x	17.1x	14.5x	7%	15%	2%	16%	16%	15%
TCS IN	TCS	Hold	2,000.50	-3%	35%	20%	21.9x	23.9x	19.1x	1%	22%	6%	29%	33%	31%
TECHM IN	Tech Mahindra	Hold	789.95	5%	34%	22%	15.0x	14.5x	13.4x	34%	14%	9%	22%	21%	20%
WPRO IN	Wipro	Hold	257.90	6%	20%	8%	16.1x	14.7x	14.5x	-4%	17%	13%	16%	17%	17%
	Sector median			**-6%**	**18%**	**8%**	**16.1x**	**18.6x**	**15.3x**						

Source: Bloomberg, HSBC estimates

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Why did the sector underperform/outperform in 2018?

- The sector outperformed as a result of numerous factors – the INR's depreciation, which led to earnings upgrades, state election results led to a shift to defensives like IT, and an improvement in spending across sectors in the US led to better growth momentum.
- The improvement in the growth outlook was also helped by US tax cuts, which helped increase tech spending in the US, especially in banking and retail.
- Better capital allocation also helped to improve sentiment, and deal signing remained strong for most companies.

Are these factors still relevant? What could change?

- The INR has started to appreciate, which could be a headwind for margins and sentiment in the coming months.
- Elections in India could have an influence on investor flows in and out of the sector.

Sector outlook – major headwinds and tailwinds in 2019

- The demand environment is likely to improve further in 2019. Most companies have referred to better deal wins and pipelines, and banks are looking to upgrade their core systems.
- Capital allocation remains a key focus. Infosys recently announced a buyback worth cINR82.6bn, which followed a INR19.5bn buyback by Tech Mahindra.
- An increase in onsite costs will likely remain a margin headwind in 2019. The visa rejection rate is at an all-time high in the US, so companies are hiring more locals and are also relying more on sub-contracting. A move to Canadian centres is also an emerging trend.

Metals and mining

Sector snap shot

Bloomberg code	Name	Rating	Performance: 13 Mar Price (INR)	6M	1Y	3Y	Valuation: Fwd PE	6M back	Avg PE (5Y)	Earnings growth: FY18a	FY19e	FY20e	ROE trend: FY18a	FY19e	FY20e
HNDL IN	Hindalco	Buy	202.30	-19%	-12%	33%	7.5x	8.4x	9.9x	139%	41%	4%	10%	12%	11%
HZ IN	Hindustan Zinc Ltd	Hold	276.75	-10%	-15%	15%	12.3x	11.6x	11.6x	9%	-5%	9%	27%	24%	24%
JSP IN	Jindal Steel & Power	Buy	167.30	-26%	-31%	35%	16.7x	13.8x	(16.6x)			19%	-5%	2%	2%
JSTL IN	JSW Steel	Buy	286.25	-30%	-1%	34%	10.5x	10.9x	12.0x	74%	33%	-6%	24%	25%	19%
MOIL IN	MOIL	Buy	160.70	-17%	-23%	16%	9.4x	8.3x	11.5x	58%	51%	-23%	15%	21%	14%
NACL IN	National Aluminium Co Ltd	Buy	52.50	-21%	-11%	13%	7.8x	8.9x	13.2x	15%	132%	-25%	7%	15%	11%
SAIL IN	Steel Authority of India	Hold	52.65	-32%	-28%	7%	7.4x	9.2x	8.8x			24%	-1%	7%	9%
TATA IN	Tata Steel Ltd	Buy	513.75	-18%	-20%	22%	7.3x	7.4x	11.5x	51%	-7%	6%	16%	11%	11%
VEDL IN	Vedanta Limited	Buy	171.60	-25%	-44%	24%	6.8x	6.6x	8.7x	10%	4%	22%	16%	15%	17%
	Sector median			**-21%**	**-20%**	**22%**	**7.8x**	**8.9x**	**11.5x**						

Source: Bloomberg, HSBC estimates

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Why did the sector underperform/outperform in 2018?

- Concerns related to the China-US trade dispute and its impact on global growth resulted in risk-off sentiment, which hurt the high beta metals sector. Uncertainties weighed on commodity prices and the sector significantly underperformed the benchmark indices.
- Macro indicators have deteriorated and global steel prices have fallen sharply over the last 4-5 months, sparking fears of further margin compression.
- Rising leverage due to big ticket acquisitions has further compounded problems for India's metals sector.

Are these factors still relevant? What could change?

- China is much more disciplined in terms of responding to weak demand, which should support metal prices. At current prices the Chinese steel producers are operating on wafer thin margins, which we believe is unsustainable.
- Steel demand in India remains robust, which should help. The presence of strong trade barriers for steel provide downside protection.

Sector outlook – major headwinds and tailwinds in 2019

- We believe most of the negatives are factored into share prices. With stocks trading at multi-year low valuations, the risk reward seems favourable, in our view.
- We think the steel cycle is driven by stable global demand and production, unlike earlier cycles that were largely demand-driven. While a seasonal mismatch in China could result in prices being volatile in the short term, we believe China's better supply-side discipline should lead to an improvement pricing fundamentals.
- Any pick-up in construction activities after the election should support domestic demand, while China's supply-side discipline should benefit prices.

Construction material (cement)

Sector snap shot

Bloomberg code	Name	Rating	Performance: 13 Mar Price (INR)	6M	1Y	3Y	Valuation: Fwd PE	6M back	Avg PE (5Y)	Earnings growth: FY18a	FY19e	FY20e	ROE trend: FY18a	FY19e	FY20e
ACC IN	ACC	Hold	1,571.40	0%	2%	8%	22.0x	23.2x	25.0x	44%	14%	5%	10%	11%	11%
ACEM IN	Ambuja Cements Ltd	Hold	229.80	-1%	-4%	4%	21.6x	22.5x	24.9x	31%	13%	16%	8%	8%	9%
DBEL IN	Dalmia Bharat	Buy	2,372.90	-7%	-13%	49%	61.8x	27.6x	28.4x	55%	42%	30%	10%	12%	14%
GRASIM IN	Grasim Industries	Buy	823.15	-21%	-27%	12%	19.9x	12.3x	13.5x	-28%	-3%	38%	7%	5%	7%
SRCM IN	Shree Cements	Reduce	17,929.00	-2%	10%	16%	35.0x	34.7x	33.3x	409%	-10%	38%	17%	13%	16%
UTCEM IN	Ultratech Cement	Reduce	4,025.65	-7%	-4%	10%	34.1x	33.6x	30.7x	-9%	-8%	39%	10%	8%	10%
	Sector median			**-4%**	**-4%**	**11%**	**28.0x**	**25.4x**	**26.7x**						

Source: Bloomberg, HSBC estimates

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Why did the sector underperform/outperform in 2018?

- Despite robust demand, anticipated price hikes have remained elusive as the industry focused on market share gains.
- There was significant cost inflation across the board, with petcoke, thermal coal, crude oil and slag prices rising. This led to significant margin erosion in 2018.
- Cement demand was driven by government-led infrastructure spending and affordable housing, where pricing remained challenging.

Are these factors still relevant? What could change?

- Cost pressures have declined, with petcoke and crude oil prices falling in the last three months. This should provide some respite.
- However, demand in 2018 was aided by pre-election spending, which should reverse. We expect demand growth to decline from c10% in FY19 to c7% in FY20.
- With c27mt of new supply in 2019, competitive intensity is likely to remain high, making it difficult to hike prices.

Sector outlook – major headwinds and tailwinds in 2019

- We expect 2019 to be another forgettable year for the cement sector as supply additions will keep competitive intensity high. We do not expect a meaningful recovery in the real estate or private sector capex.
- Earnings have been disappointing over the last few years, so we see consensus expectations of a c30% earnings CAGR for the sector over FY18-21 as too optimistic.
- We remain cautious going into 2019 as capacity utilisation is likely to stay below 70%. Optimistic earnings expectations coupled with high valuations imply that most positives are priced in. Risk reward remains unfavourable, in our view.

Agricultural products

Sector snap shot

			Performance				Valuation			Earnings growth			ROE trend		
Bloomberg code	Name	Rating	13 Mar Price (INR)	6M	1Y	3Y	Fwd PE	6M back	Avg PE (5Y)	FY18a	FY19e	FY20e	FY18a	FY19e	FY20e
BYRCS IN	Bayer Cropscience	Hold	4,344.10	-1%	9%	7%	40.7x	36.9x	34.1x	5%	5%	16%	16%	16%	17%
CRIN IN	Coromandel International	Hold	479.90	18%	-8%	40%	16.3x	15.4x	16.5x	39%	5%	15%	22%	21%	21%
DAGRI IN	Dhanuka Agritech	Buy	426.80	-20%	-27%	-8%	16.5x	18.5x	22.3x	6%	-9%	12%	22%	17%	17%
FNXP IN	Finolex Industries Limited	Buy	539.35	-10%	-15%	14%	16.9x	20.4x	19.8x	-14%	19%	25%	12%	13%	15%
PI IN	PI Industries	Buy	1,002.65	27%	16%	19%	26.5x	23.5x	24.2x	-20%	9%	16%	21%	19%	19%
RALI IN	Rallis India	Hold	161.65	-21%	-30%	1%	15.2x	17.5x	19.8x	-2%	11%	18%	15%	15%	16%
TTCH IN	Tata Chemicals	Buy	578.60	-24%	-17%	19%	13.0x	14.4x	13.9x	34%	-14%	14%	12%	9%	10%
UPLL IN	UPL	Buy	911.20	23%	24%	27%	17.1x	12.3x	15.5x	6%	8%	21%	27%	24%	24%
KSCL IN	Kaveri Seed	Hold	432.85	-34%	-11%	2%	11.5x	17.2x	13.9x	179%	6%	7%	21%	20%	18%
	Sector median			**-10%**	**-11%**	**14%**	**16.5x**	**17.5x**	**19.8x**						

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Why did the sector underperform/outperform in 2018?

- The sector underperformed the Nifty 50 Index by 13% in 2018.
- This weak performance can be attributed to: 1) low crop prices; 2) monsoons negatively affecting volume growth; 3) rising agro inputs and fuel costs denting farmers' profitability; and 4) adverse currency/US-China trade tensions.
- High raw material costs due to environmental concerns in China led to margin compression.

Are these factors still relevant? What could change?

- Crop prices remain low but lower fuel costs provide relief to farmers. Poor monsoons in 2018 will be an overhang for 2019 crops due to lower levels of sowing and drought conditions in some areas.
- For UPL, the largest manufacturer of agrochemicals in India, the currency in the Brazil (BRL) has bottomed and the new Brazilian government is positive on agriculture. US-China trade tensions could benefit UPL in the LatAm market due to higher soybean production.
- Softening of raw material prices in China and normalisation in crude oil prices could be a positive surprise for margins.

Sector outlook – major headwinds and tailwinds in 2019

- Headwinds are expected to continue but there could be surprises, such as any pre-election spending by the government, softening raw material prices, and the INR's depreciation for the exporters.
- We think strong domestic volume growth is unlikely, but any tailwinds from pre-election spending by the government and favourable monsoons could provide some impetus.

Real estate

Sector snap shot

Bloomberg code	Name	Rating	13 Mar Price (INR)	Performance 6M	1Y	3Y	Valuation Fwd PB	6M back	Avg PB (5Y)	Earnings growth FY18a	FY19e	FY20e	ROE trend FY18a	FY19e	FY20e
DLFU IN	DLF Ltd	Hold	192.15	-16%	-20%	18%	2.5x	2.0x	2.0x	528%	-5%	-21%	15%	16%	11%
GPL IN	Godrej Properties	Buy	697.50	3%	-6%	36%	3.5x	4.1x	3.6x	14%	-48%	127%	11%	5%	11%
OBER IN	Oberoi Realty Ltd	Buy	481.35	6%	-3%	26%	2.0x	1.6x	1.8x	21%	194%	0%	8%	20%	16%
PHNX IN	Phoenix Mills	Buy	627.10	2%	-12%	29%	2.9x	4.1x	3.3x	44%	50%	29%	10%	12%	13%
PEPL IN	Prestige Estates	Buy	207.80	-12%	-33%	10%	4.9x	5.4x	4.8x	38%	47%	37%	8%	12%	17%
SOBHA IN	Sobha Limited	Buy	440.50	1%	-20%	21%	1.5x	2.6x	2.3x	37%	13%	1%	8%	10%	11%
	Sector median			**2%**	**-16%**	**23%**	**2.7x**	**3.3x**	**2.8x**						

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Why did the sector underperform/outperform in 2018?

- After strong gains in 2017, the sector underperformed due to rising interest rates.
- Liquidity for NBFCs was squeezed in the second half of the year, which led to fears of a slowdown in mortgage lending and disruptions in developer financing. This resulted in further underperformance before the quality stocks bounced back a bit.

Are these factors still relevant? What could change?

- We believe the events of the last six years have prepared the ground for reputable developers to grow their sales significantly.
- The stronger developers will likely have a chance to acquire weaker operators and further increase their market share.

Sector outlook – major headwinds and tailwinds in 2019

- We believe much higher levels of discretion among lenders will mean support for only the stronger real estate players. This, in turn, should reduce the number of launches and sales across the sector.
- In this weak market, the developers with stronger balance sheets should benefit.
- However, an excessive squeeze on mortgage lending could result in much slower sales in 2019.

Communication services

Sector snap shot

Bloomberg code	Name	Rating	Performance: 13 Mar Price (INR)	6M	1Y	3Y	Valuation: Fwd PE	6M back	Avg PE (5Y)	Earnings growth: FY18a	FY19e	FY20e	ROE trend: FY18a	FY19e	FY20e
INOL IN	INOX Leisure Ltd	Buy	308.65	29%	19%	13%	23.0x	20.4x	23.6x	129%	29%	46%	11%	12%	14%
PVRL IN	PVR Ltd	Buy	1,620.70	13%	18%	30%	31.6x	30.9x	32.7x	26%	45%	29%	12%	14%	15%
INFOE IN	Info Edge India Ltd	Buy	1,899.45	10%	48%	29%	55.3x	52.0x	45.8x	2174%	-180%		11%	-8%	-14%
JUST IN	Just Dial	Buy	626.60	5%	29%	-5%	17.4x	21.6x	23.1x	29%	34%	24%	15%	20%	22%
DITV IN	Dish TV India Ltd	Hold	37.65	-46%	-45%	-22%	22.1x	30.5x	37.7x	-143%		121%	-2%	1%	2%
HATH IN	Hathway Cable & Datacom	Hold	27.15	10%	-25%	-12%	-61.9x	-47.6x	10.5x				-12%	-10%	-8%
SUNTV IN	Sun TV Network	Hold	612.55	-14%	-34%	21%	15.4x	19.9x	20.6x	10%	25%	9%	26%	28%	26%
Z IN	Zee Entertainment	Buy	448.80	-3%	-19%	5%	23.8x	28.7x	30.5x	35%	20%	13%	19%	20%	20%
BHIN IN	Bharti Infratel	Hold	313.15	10%	-8%	-7%	22.5x	20.7x	22.4x	-7%	-5%	-3%	15%	15%	16%
TCOM IN	Tata Communications	Hold	599.65	16%	-1%	21%	65.1x	52.7x	43.7x		50%	288%	5%	52%	-192%
IDEA IN	Vodafone Idea	Hold	33.95	-31%	-59%	-33%	-2.2x	-3.5x	-3.2x				-11%	-23%	-25%
	Sector median			**10%**	**-8%**	**5%**	**22.5x**	**21.6x**	**23.6x**						

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Telecom

Why did the sector underperform/outperform in 2018?

- 2018 was a challenging year, with declining revenues and profitability leading the sector to underperform the Nifty by 54%.
- Competition from Reliance Jio remained intense. Its disruptive pricing and superior 4G network capabilities has shrunk the industry to only three players, down from 11 in 2015.
- Pricing pressure on the incumbents remained intense, with the industry ARPUs as a proportion of disposable income falling by half since Reliance Jio's launch.

Are these factors still relevant? What could change?

- We expect the competitive intensity to gradually fade over the next two years. Reliance Jio's market share is now over 30% and is likely to reach 38% by FY21.
- Incumbents will likely continue to lose market share, but we expect their revenues to grow, led by recently announced minimum ARPU plans as well as data subscriptions.
- Airtel and Idea are looking to bridge the capacity gap, especially in their most important micro markets, which will likely enable them to defend their revenues,

Sector outlook – major headwinds and tailwinds in 2019

- We believe that the industry challenges are widely known and priced in, and downside risks to growth are lower in 2019.
- In a three-player industry servicing 95% of the subscriber market, we expect the price environment to eventually improve and support growth.
- That said, higher competitive intensity remains a major risk that could further dent the industry's profitability.

Media

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Why did the sector underperform/outperform in 2018?

- It was a tough year for traditional media companies due to a surge in the use of video-on-demand (VoD) platforms.
- Reliance Jio announced investments in Hathway and Den Networks to reach the last-mile connections. Meanwhile, Zee Entertainment announced its intention to sell a stake in the company in an effort to bring a strategic partner on board so it can focus on the digital platform.
- Multiplex operators continued to open new screens and the Hindi box-office registered c15% growth in revenue.

Are these factors still relevant? What could change?

- We expect to see some more merger and acquisition announcements and further growth in VoD platforms, in line with increased internet penetration.
- The regulator's new tariff order will likely increase transparency about the pricing and packaging of TV services, a structural positive for the sector. The market will closely monitor how broadcasters, cable operators, and other stakeholders implement the new rules.

Sector outlook – major headwinds and tailwinds in 2019

- The increase in VoD penetration will likely remain a sector tailwind until existing players like Zee Entertainment and Sun TV Network invest enough to establish their own digital platforms.
- Multiplex operators are also expected to continue their expansion plans, with new screen additions across the country.

Utilities

Sector snap shot

			Performance				Valuation			Earnings growth			ROE trend		
Bloomberg code	Name	Rating	13 Mar Price (INR)	6M	1Y	3Y	Fwd PE	6M back	Avg PE (5Y)	FY18a	FY19e	FY20e	FY18a	FY19e	FY20e
PWGR IN	Power Grid Corp Of India	Buy	194.75	-4%	-4%	11%	9.2x	9.5x	10.7x	10%	13%	18%	16%	16%	17%
TPWR IN	Tata Power	Hold	73.80	-7%	-12%	6%	11.4x	10.2x	12.2x	-2%	9%	23%	10%	9%	10%
NTPC IN	NTPC	Buy	148.20	-10%	-8%	6%	9.7x	10.6x	11.6x	-5%	7%	16%	9%	10%	11%
	Sector median			**-7%**	**-8%**	**6%**	**9.7x**	**10.2x**	**11.6x**						

Source: Bloomberg, HSBC estimates

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Why did the sector underperform/outperform in 2018?

- Uncertainty about tariff policy was the key overhang.
- Weaker earnings for NTPCs and the limited number of new project additions for Power Grid also weighed on the shares.
- Project commissioning was weak in the first half of FY19.

Are these factors still relevant? What could change?

- India's Central Electricity Regulatory Commission (CERC) recently announced tariff regulations covering the next five years, effective 1 April 2019. We think the regulatory overhang is behind us.
- The pipeline of projects commissioned for both NTPC and Power Grid remains strong.
- After 2018's sharp correction, valuations look reasonable.

Sector outlook – major headwinds and tailwinds in 2019

- Unlike the draft regulations published in December 2018, in the final version of the new tariff rules there is no mandate for any reduction in equity for plants that are more than 25 years old. This is favourable for generators and transmission companies.
- That said, the new regulations are slightly tighter on fixed cost management and marginally more lenient on variable costs. This means the overall impact is largely neutral compared to the regulations for FY14-19.
- We like regulated entities like NTPC and PGCIL. They provide visibility and security of earnings in an environment where power distribution companies generate heavy losses and have limited capacity to pay or sign new power purchase agreements.

Our ideas for a balanced risk reward

We established a framework to categorise companies that are holding their own, those in trouble, and those with potential. We call these categories 'structural winners' (hard to beat), 'trespassers' (potential to become a structural winner) and 'laggards' (can do better).

Having identified the companies that fit our three categories, we then overlay our sector preferences, look for reasonable valuations, good earnings growth, and stocks where our analysts have a clear preference.

India – Buy-rated ideas for a balanced risk reward

Bloomberg Code	Name	Mkt Cap (USDm)	ADTV (USDm, 3m)	Price (INR)	Target Price (INR)	3M return	Last 1Y return	FY19e EPSg	FY20e EPSg	FY19e ROE	FY20e ROE
Structural winners											
DMART IN	Avenue Supermarts	13,480	12.5	1,501.40	1,700.00	-3%	15%	23%	33%	19%	21%
APNT IN	Asian Paints	19,710	26.1	1,428.30	1,600.00	7%	26%	16%	20%	25%	27%
BAF IN	Bajaj Finance	19,193	53.3	2,828.15	3,190.00	10%	65%	48%	35%	22%	24%
HDFCB IN	HDFC Bank	87,190	68.5	2,226.55	2,430.00	4%	16%	13%	29%	16%	17%
GAIL IN	GAIL	11,407	21.4	351.60	487.00	3%	6%	39%	1%	15%	14%
DIVI IN	Divi's Laboratories	6,367	14.6	1,667.00	1,780.00	11%	68%	59%	17%	21%	21%
Trespassers											
AXSB IN	Axis Bank Ltd	27,299	100.4	738.00	790.00	20%	43%	1566%	130%	7%	14%
JUBI IN	Jubilant Foodworks	2,509	45.2	1,325.65	1,550.00	9%	30%	50%	28%	27%	29%
BJAUT IN	Bajaj Auto	12,530	19.1	3,010.00	3,200.00	5%	1%	10%	14%	22%	23%
KJC IN	Kajaria Ceramics Ltd	1,339	4.2	585.35	630.00	29%	3%	1%	22%	17%	18%
Laggards											
IIB IN	IndusInd Bank	14,187	39.3	1,636.35	1,950.00	-1%	-10%	3%	55%	15%	20%
ITC IN	ITC	51,981	49.9	294.90	340.00	7%	9%	13%	14%	23%	26%
HNDL IN	Hindalco	6,522	22.9	202.30	320.00	-8%	-11%	41%	4%	12%	11%
PEPL IN	Prestige Estates Projects	1,121	0.9	207.80	320.00	3%	-32%	47%	37%	12%	17%
GPL IN	Godrej Properties	2,301	2.6	697.50	870.00	7%	-4%	-48%	127%	5%	11%
HPCL IN	Hindustan Petroleum	5,872	17.9	267.85	298.00	19%	-29%	-38%	51%	16%	23%

Source: Bloomberg, HSBC estimates. Current market price as of 13 March 2019.
Note: Return is the stock performance in the last three months and one year.

Investment thesis for the stocks

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Avenue Supermarts (DMART IN, Buy, INR1,501.40, TP INR1,700.00)

[Structural winner]

Investment thesis and catalysts

- Avenue is the largest organised mass-market grocery retailer in India (10% market share), with the best cost economics, industry-leading operational metrics, and a structural growth opportunity in a largely underpenetrated organised retail industry (2-3% organised).
- Avenue is the most profitable retailer in the sector in India, with double the throughput versus the industry average and high margins. Its growth outlook is strong and the high long-term implied earnings growth built into the current price could rise further.
- Avenue's cluster-based approach to opening new stores has allowed the company to optimise inventory levels at stores and minimise logistics cost. Its strategy of owning stores rather than renting them and its focus on cost management have been a success, and allowed it to pursue a strategy of 'everyday low cost, everyday low price'.
- Avenue's growth has continued its impressive momentum, as reflected in the average sales growth of 36% y-o-y in the last two quarters. However, margins slipped as the company traded margins for growth to stave off competition from both online and offline rivals.
- We think the concern over the dip in EBITDA is overdone because: 1) despite a low gross margin of 14.7%, an 8.3% EBITDA margin is still the highest among grocery retailers. DMART's is creating a formidable value retailing platform, which many offline and online players will find hard to emulate; and 2) this should, in turn, lead to the building of an online value retailing platform capable of selling a broader range of categories.
- The stock trades at a c52x FY21e PE multiple and builds in an implied average earnings growth expectation of 20% for the 15 years beyond FY21e. This looks fairly achievable; we think network rollout and revenue mix opportunities mean that DMART can exceed a 25% earnings growth CAGR.

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Bajaj Finance (BAF IN, Buy, INR2,828.15, TP INR3,190.00)

[Structural winner]

Investment thesis and catalyst

- Bajaj Finance (BAF IN) is a disruptor in the traditional retail lending business that has changed the way retail credit is delivered to Indian consumers.
- BAF has built a highly scalable and quality retail lending franchise. Management has a strong execution track record, making the company one of the fastest growing and most profitable BFSI companies, which allows it to command a valuation premium over its peers.
- The business model might appear easily replicable; however, in the past decade the industry hasn't seen any player scale up in this line of business to this degree while maintaining profitability and quality. We think BAF's execution and scale are key competitive advantages.
- We expect BAF's consolidated AUM to register a CAGR of 35% over FY19-21e. Compression in the net interest margin should be compensated for by benefits from operating leverage in the form of lower opex.
- It is comfortably placed in the current uncertain liquidity scenario, as suggested by the strong growth momentum in 3Q. BAF diversified its liability mix by reducing its dependence on any single source of borrowing. BAF maintains a minimum 60% positive ALM gap across various short-term maturity buckets, which makes it comfortably placed in the current environment.

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HDFC Bank (HDFCB IN, Buy, INR2,226.55, TP INR2,430.00)

[Structural winner]

Investment thesis and catalyst

- HDFC Bank, the largest private lender in India, has a strong track record of delivering steady growth and profitability. It has weathered the deteriorating asset quality cycle in recent years better than most peers with similar-sized balance sheets.
- It has delivered steady growth (loan and EPS CAGRs of 26% and 22% over FY08-18, respectively) and profitability (average ROE of more than 18% in FY08-18) aided by a growing market share (7.6% at end-FY18 from 2.7% in FY08) , healthy margins, improving cost efficiencies, and stable asset quality.
- Its healthy balance sheet, comprehensive product suite, entrenched branch network and diversified balance sheet position it to capture opportunities across both investment and consumption. We expect it to continue to increase its market share in loans.
- We believe the competitive environment has eased in the last couple of years due to the struggles faced by several public sector banks. This enhances earnings visibility.
- We do not expect any meaningful de-rating due to HDFC Bank's positioning as one of the few solid defensive banks in the banking sector. The stock is trading at 3.5x P/AB (one-year forward), which we believe offers a balanced risk-reward ratio.

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Asian Paints (APNT IN, Buy, INR1,428.30, TP INR1,600.00)

[Structural winner]

Investment thesis and catalyst

- Asian Paints has over 50% market share and benefits from a dominant scale, having the largest distribution network and leadership across price points.
- The market's oligopolistic structure, high barriers to entry and dominant scale and the company's astute pricing strategy make it well positioned to monetise the structural growth opportunity in decorative paints.
- Volume growth has been strong in the last four quarters, and accelerated further in 3QFY19, dispelling concerns about market share losses that emerged after the GST introduction.
- Margin pressure to ease: Asian Paints has increased prices c7% in FY19, while at the same time its key input cost drivers, such as titanium dioxide (TiO_2) and crude oil in INR terms, are now trending down. This means gross margins should improve in the coming quarters. The product mix should also improve from 4QFY19e onwards, in our view.
- The valuation looks expensive as it builds in long-term annual earnings growth of 14-15%. However, in our view, this is undemanding, given the structural growth of the category and the company's dominant scale.

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Gail (GAIL IN, Buy, INR351.60, TP INR487.00)

[Structural winner]

Investment thesis and catalyst

- GAIL has a dominant position in the gas distribution chain in the country, with a two-thirds share in overall transmission. It also owns more than 30% of regas capacity in the country and has CGD operations spanning 35 cities through its subsidiary.
- GAIL's earnings are on a secular growth path in all its business divisions over the next 3-5 years, in our view. While the core gas transmission business is set to gain from higher volumes and tariff revisions, higher oil prices should benefit the Petrochemical and LPG segments as their prices tend to move up with oil prices while feedstock gas prices should remain relatively subdued leading to margin expansion.
- Further, GAIL is executing on both eastern and southern pipelines that should tap latent gas demand in these markets, which currently remain underserved, supporting long-term volume growth, in our view.
- Regulatory clarity on its pipeline tariffs as well as improving gas supplies are two key catalysts to play out in FY20e. GAIL is trading at FY20e PE of c12x; despite being near its historical average, we find this attractive, considering that GAIL's growth and return profiles appear significantly better than those of the past 10 years.

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Divi's Laboratories (DIVI IN, Buy, INR1,667.00, TP INR1,780.00)

[Structural winner]

Investment thesis and catalyst

- The share price of Divi's Lab, a differentiated player in contract research and manufacturing services (CRAMS), has risen recently. However, we believe the outlook remains strong, driven by its strong chemistry skills, sticky customer relationships with top innovator companies, focus on margins, and a global competitive advantage in generic APIs.
- The recent completion of the FDA audits at its facilities re-emphasised its focus on cGMP compliance.
- In view of capacity constraints at plants and a delay in finalising a new greenfield site, there were concerns about the long-term growth outlook. However, it has commenced two brownfield expansion projects and made efforts to reduce bottlenecks at existing plants.
- Divi's Lab reported strong results for 3QFY19 due to the normalisation of supplies after the resolution of cGMP issues at its plants. This points to a broad-based recovery in its operations and we think the overall outlook remains strong.
- At the current 12-month forward PE of 26.4x, Divi's is trading at a 16.8% premium to its three-year average. However, the business recovery and strong margin profile in a challenging market, justifies this premium, in our view.

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Jubilant Foodworks (JUBI IN, Buy, INR1,325.65, TP INR1,550.00)

[Trespasser]

Investment thesis and catalyst

- Jubilant Foodworks is a bellwether Indian quick service restaurant (QSR) and a master franchisee of Domino's Pizza and Dunkin' Donuts in India.
- A play on the changing consumer landscape shaped by rapid urbanisation, a growing middle class and rising income levels, we believe Jubilant stands to benefit from the growth potential in the still underpenetrated market.
- Jubilant focuses on: 1) product and innovation; 2) technology to improve the quality of its digital presence and customer analytics; 3) value for money; 4) seamless customer experiences; and 5) efficiency and productivity. This has resulted in higher growth as demonstrated by consistent results – Jubilant's SSSG has averaged 21% in the last five quarters.
- Jubilant has started to roll out the Dominos network more aggressively, while keeping a close eye on cost discipline, which augers well for long-term structural growth.
- The QSR market represents an attractive long-term opportunity for a scaled player like Jubilant, which is exploring the prospect of new QSR formats, such as Chinese food.
- While the share price ran up last year, a 37x FY21e PE builds in long-term earnings growth of c13-14%, which we see as undemanding.

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Axis Bank (AXSB IN, Buy, INR738.00, TP INR790.00)

[Trespasser]

Investment thesis and catalyst

- Axis Bank is one of the largest private lenders in India, with a growing presence in retail. Retail loans as a percentage of the loan mix have grown to 47% in FY18 from 23% in FY08.
- A diversified funding base (retail liabilities form 82% of deposits) and a focus on the SME segment are among the bank's key strengths.
- ROE has averaged 18% over FY08-15; however, in the last few years profitability has come under pressure due to a fall in corporate asset quality.
- Similar to other front-line corporate lenders, bad loans are coming down and provision coverage has risen, setting the stage for a near-term ROE recovery.
- In the last four months, Axis has outperformed HDFC Bank significantly. This has been led by improving visibility about a ROE recovery in FY20e on account of falling credit costs.
- We believe the differentiated approach of expanding its branch network, core strength in the SME segment, and increasing share of higher yielding retail loans will bolster the ROE outlook for FY20-21e.
- We see ROE rising to c17% by FY21e. Our FY20-21e EPS estimates are 9-10% above consensus estimates and valuations are reasonable, in our view.

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Bajaj Auto (BJAUT IN, Buy, INR3,010.00, TP INR3,200.00)

[Trespasser]

Investment thesis and catalyst

- Bajaj Auto is the world's third-largest manufacturer of motorcycles and the second-largest and most diversified 2W player in India. Bajaj Auto derives nearly 40% of its sales volume from exports.
- Recent launches and pricing action have helped growth in the domestic market, while exports have risen on the back of a stable macro environment and exchange rates in key overseas markets. Its market share in the domestic motorcycle segment has grown from 14% in 1QFY18 to c20% in 3QFY18.
- We expect domestic demand to be helped by measures taken by the government ahead of the general election. The recent interim budget announced a direct benefit scheme for farmers and income tax exemptions for a portion of the middle class.
- Bajaj has a relatively well-diversified business portfolio, with presence across two wheelers, three wheelers, and a relatively high exposure to export markets. This makes the stock more defensive, in our view. However, it trades at 14x FY20e earnings (excluding KTM valuation), a significant discount to its five-year average of 17x. We believe valuations are undemanding, given the higher growth (relative to peers) and margins bottoming out in FY19e.

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Kajaria Ceramics (KJC IN, Buy, INR585.35, TP INR630.00)

[Trespasser]

Investment thesis and catalyst

- Kajaria Ceramics is India's largest tile manufacturer, with an 11% market share in a highly fragmented industry. It has a 5-6% brand premium over its closest rivals.
- Value creation should be driven by market share gains, branding, margin expansion driven by a higher mix of value added products, and lower competition as unorganised players lose market share to organised players. Urbanisation and rising disposable income should also drive growth.
- We expect market share gains to continue as tight liquidity crowds out unorganised players. Lower gas prices reverse the advantage the unorganised segment enjoyed and could be a tailwind on margins.
- Volume growth has been impressive in 9MFY19 (16% in 3Q, 11% in 2Q, and 9% in 1Q), but pricing is tight.
- After a dull two years, we expect Kajaria to return to earnings growth and investors should start to appreciate the favourable operational outlook.
- The stock trades at a 12-month forward PE of 29x (slightly above its five-year average) and bakes in a 13% earning CAGR for the next 15 years. This is conservative, in our view. Despite a strong recovery and improved operational outlook, we see further re-rating opportunities.

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IndusInd Bank (IIB IN, Buy, INR1,636.35, TP INR1,950.00)

[Laggard]

Investment thesis and catalyst

- IndusInd Bank is one of the fastest growing lenders in India. Its loan market share has more than doubled in the last six years to 1.7%.
- The bank has a well-diversified loan book with a strong presence in high-yielding niche segments like vehicle financing and microfinance.
- The liabilities franchise has been steadily improving as the bank has scaled up its branch network at 25% y-o-y, which is reflected in a CASA ratio of 44%. This has contributed to the bank delivering an average ROE of 17% in the past five years.
- The bank's vehicle finance franchise is best-in-class thanks to a wide reach and access to long-term customer history.
- The acquisition of Bharat Financial (BHAFIN IN, Not Rated) creates opportunities to deepen the bank's presence in rural areas. Overall, we believe the bank's strong and diversified balance sheet position will deliver an average ROE of 18.5% for FY19-20e.
- The disclosure that its exposure to stressed IL&FS Group stands at a material 1.8% led to the share price underperforming. However, the bank's overall exposure to stressed sectors is low and its rating profile is healthy and stable.
- We think the valuation is compelling relative to direct retail-led peers – HDFC Bank and Kotak Mahindra Bank (KMB IN, INR1,261.25, Reduce). Loan growth and ROE prospects suggests that the recent underperformance creates an attractive buying opportunity, in our view.

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ITC (ITC IN, Buy, INR294.90, TP INR340.00)

[Laggard]

Investment thesis and catalyst

- ITC is the largest FMCG player in India if cigarettes are included. It has around a 70% volume share and an 80% value share of the cigarette market.
- The company has made significant moves into other FMCG businesses like packaged food, education, and stationery products. It has a presence in hotels and has built up its agriculture sourcing business, which feeds into the cigarette franchise and other FMCG businesses.
- ITC has significantly underperformed its consumer peers in the past three years (CAGR of 11% vs CNX FMCG Index CAGR of c16%). Volume growth had been patchy, leading to a pause in price increases and single-digit cigarette EBIT growth.
- In this context, the recent price hikes in selected low-priced branded cigarettes in March 2019 indicates that volumes have stabilised and points to a gradual shift in the entire price curve: This should be seen as a positive development as cigarette EBIT growth is likely to accelerate to double digits in the coming quarters.
- This also signals that ITC has started preparing for a potential taxation hike that may be announced in the coming year. The GST rate revisions may lead to a modest increase in taxation overall for ITC. Each price increase should prove to be a key catalyst for the share price performance.

- The only overhang is the possibility of much higher levels of tax on cigarettes. However, the stock price implies a long-term earnings CAGR of 9% (or c7% cigarette EBIT CAGR), which is relatively undemanding, in our view, and reflects investor concerns about the taxation overhang.

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Hindalco Industries (HNDL IN, Buy, INR202.30, TP INR320.00)

[Cyclical laggard]

Investment thesis and catalyst

- Hindalco Industries is a flagship company of the Aditya Birla Group. Novelis – Hindalco's fully-owned subsidiary – accounts for 55% of HNDL's operating profit and is the world's largest aluminium rolling company. Hindalco's Indian operations include fully integrated aluminium smelters with 1.3mtpa capacity (30-35% of EBITDA) and a 500ktpa copper smelter (10-15% of EBITDA).
- We like Hindalco's largely de-risked business model as c75-80% of the operating profit is not exposed to commodity price volatility. Novelis and the copper refining business are mainly conversion businesses with profitability largely decoupled from LME prices. The aluminium business is exposed to LME prices, but Hindalco has hedged c15% of its FY20e aluminium output at much higher prices compared to spot. We expect aluminium markets to remain in a severe deficit over the coming years and think aluminium prices will recover from USD1,860/t currently to cUSD2,150/t in 2020e and USD2284/t in 2021e.
- Hindalco's share price has corrected sharply on uncertainty about the trade dispute and an overall slowdown in macro indicators, leading to falling commodity prices. Our expectations of sustained robust earnings from Novelis and copper and a recovery in aluminium prices are strong re-rating catalysts.
- The stock is trading at a multi-year low valuation and provides an attractive upside, in our view. While we expect a relatively modest EBITDA growth of 2% and EPS growth of a 9% CAGR in FY20-21e compared to the strong growth in the prior two years, the commissioning of automotive capacity at Novelis in 2020e and potential synergies from the Aleris merger could further support the stock's re-rating in the medium to long term, in our view.

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Prestige Estate (PEPL IN, Buy, INR207.80, TP INR320.00)

[Laggard]

Investment thesis and catalyst

- Prestige is a diversified real estate company with a presence across asset classes. It primarily operates in South India and is dominant in Bangalore. Its key customer segment is mid-income to high-income individuals.
- PEPL has a good mix of commercial office space, hotels, malls, and residential projects, which reduces the cyclicality of its earnings.
- It is trying to monetise its annuity portfolio. Recent launches should allow it to accelerate its sales momentum.
- The company has INR25bn of finished and unsold residential stock, which should improve its balance sheet as it makes progress in terms of monetisation.
- The share price is down 33% in the last year. We see this as a high-risk, high-return opportunity, supported by sales momentum.

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Godrej Properties (GPL IN, Buy, INR697.50, TP INR870.00)

[Laggard]

Investment thesis and catalyst

- Godrej Properties is one of the few real estate companies with a presence in multiple cities across regions.
- It has one of the largest business development teams, coupled with experience in entering partnerships with landlords or smaller developers.
- It has created a strong brand, based on timely delivery and ethical business practices. This attracts buyers and improves sales market share.
- GPL raised money last year and has access to funding. This makes it well positioned to take over stressed projects at attractive valuations, in our view.
- We believe GPL can become a top 2-3 developer in each of the cities where it operates.

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Hindustan Petroleum (HPCL IN, Buy, INR267.85, TP INR298.00)

[Laggard]

Investment thesis and catalyst

- Hindustan Petroleum Corporation (HPCL) is a government-owned business that operates two major refineries in Mumbai and Visakhapatnam. It also owns 49% equity in Bathinda refinery and 16.95% in the listed refiner Mangalore Refinery and Petrochemicals (MRPL IN, INR73.25, Not Rated).
- HPCL has significantly underperformed the market in the last year (down 31%), primarily due to high crude oil prices, which increased risks to its profitability. We think it trades at an attractive valuation.
- **Fundamentals remain supportive**. Around 70% of HPCL's core EBITDA is attributable to marketing oil products, an area where we expect high growth over the next 3-5 years. HPCL is gaining market share and the limited threat from private fuel retailers augurs well for the stock, in our view.
- We view marketing profitability as a long-term structural growth story, balancing cyclical exposure. We expect HPCL's share price to be supported by a 5-6% p.a. increase in petroleum product sales volumes over the forecast horizon.
- In refining, our proprietary demand-supply model suggests refining margins should remain stable above USD6/b, producing steady refining earnings over the next two years.

Valuation and risks

		Valuation	Risks
Avenue Supermarts DMART IN **BUY**	Current price: **INR1,501.40** Target price: **INR1,700.00** Up/downside: **13.2%**	We use DCF with a cost of equity of 11%, which includes a risk-free rate of 3.0%, a market risk premium of 6.0%, a beta of 1.3 and terminal growth rate of 4.5%. Our target price implies upside of c13% from the current share price; we have a Buy rating as the investment case for DMART remains compelling, given the impressive execution (superior margins) of its strategy of "everyday low prices" while Indian organised retail presents a multi-decade compounding opportunity. **Amit Sachdeva*** | amit1sachdeva@hsbc.co.in | +91 22 2268 1240	Key downside risks: (1) further margin dip due to prolonged price-based competition (including increased competition from e-commerce players) leading to pressure on SSSG and gross margin; 2) failure to consistently achieve network rollout; and (3) a severe macroeconomic slowdown weighing on demand.
Bajaj Finance BAF IN **BUY**	Current price: **INR2,828.15** Target price: **INR3,190.00** Up/downside: **12.8%**	We arrive at our target price by using a residual Income valuation methodology. Our assumptions are: cost of equity 9.0%, risk-free rate 3.0%, risk premium 6.0%, long-term growth 5.0%, and beta 1.00. At our target price, BAF would trade at a 5.8x FY21e PB and a 25.6x FY21e PE. Our target price implies upside of c13% from the current share price; we have a Buy rating as 3QFY19 results clearly demonstrate management's execution capability during challenging times and the team's ability to grow the balance sheet while maintaining asset quality. **Umang Shah*** | Umang.shah@hsbc.co.in | +91 22 2268 1243	Key downside risks: (1) slower customer franchise growth could hurt the company's growth and return ratios; (2) a rapid rise in its share of non-consumer business could dent return ratios; and (3) potential departure of the current CEO is a 'key man risk'.
Asian Paints APNT IN **BUY**	Current price: **INR1,428.30** Target price: **INR1,600.00** Up/downside: **12.0%**	We use DCF to derive our target price. We apply a cost of equity of 9% with a risk-free rate of 3.0%, a market risk premium of 6.0% and a terminal growth rate of 3.5%. Our target price implies upside of c12% from the current share price; we have a Buy rating as we believe decorative paints is an attractive segment where double-digit volume growth is possible over the next decade. **Amit Sachdeva*** | amit1sachdeva@hsbc.co.in | +91 22 2268 1240	Key downside risks: (1) sustained slowdown in decorative paints' demand weighing on volume growth; and (2) substantial rise in crude and TiO_2, which may trigger fears for margin erosion.
Godrej Properties GPL IN **BUY**	Current price: **INR697.50** Target price: **INR870.00** Up/downside: **24.7%**	Our valuation is based on a DCF model of project cash flows. We assume a WACC of 9.7%, a risk-free rate of 3%, an equity risk premium of 6%, and a beta of 1.3. We calculate the 12-month forward fair value by applying a premium of 36%, or 2 standard deviations above the mean to our NAV estimate of INR692 per share. The premium reflects the greater opportunities we see for NAV accretion. We then discount the value back by nine months to reflect the current fair value, arriving at our target price of INR870. Our target price implies c25% upside from the current share price; we have a Buy rating as we expect strong project additions in the current year. **Puneet Gulati*** | puneetgulati@hsbc.co.in | +91 22 2268 1235	Key downside risks: (1) severe slowdown in the NCR market; (2) large price cuts by the developer; and (3) slippages from the expected launch pipeline.
HDFC Bank HDFCB IN **BUY**	Current price: **INR2,226.55** Target price: **INR2,430.00** Up/downside: **9.1%**	We use an excess returns valuation methodology to value HDFC Bank. The present value of excess returns, i.e., the difference between ROE and COE, is the residual profit, which is then added to the existing net worth to arrive at our intrinsic value. We assume a cost of equity of 10.0% (a risk-free rate of 3.0% and an equity risk premium of 6.0%; beta of 1.2) and a growth rate of 5%. Our target price implies upside of c9% from the current share price; we have a Buy rating as we believe the bank's strong balance sheet and branch presence position it well to surprise on the upside in case of higher-than-expected system loan growth. **Ravi Singh*** | ravi5.singh@hsbc.co.in | +91 22 2268 1238	Key downside risks: (1) slower loan growth and worse-than-expected asset quality performance; (2) greater-than-expected competition resulting in lower-than-expected loan growth and/or margins; and (3) an inability to replace the current CEO Aditya Puri whose tenure ends in 2020 due to the age limit set by the regulators.
Prestige Estate PEPL IN **BUY**	Current price: **INR207.80** Target price: **INR320.00** Up/downside: **54.0%**	Our valuation is based on a DCF model of project cash flows. We assume a WACC of 10.9%, a risk-free rate of 3%, an equity risk premium of 6%, and a beta of 1.75. We calculate the 12-month forward fair value by applying a discount of 22% at one standard deviation above the mean to our NAV estimate of INR474 per share. We then discount the value back by one year to reflect the current fair value, arriving at our target price of INR320. Our target price implies c54% upside from the current share price; we have a Buy rating. **Puneet Gulati*** | puneetgulati@hsbc.co.in | +91 22 2268 1235	Key downside risks: (1) large price cuts by the developer; (2) sales taking longer than expected to recover; and (3) an increase in debt to meet construction capex.

		Valuation	Risks
ITC **ITC IN** **BUY**	Current price: **INR294.90** Target price: **INR340.00** Up/downside: **15.3%**	We value ITC using a sum-of-the-parts (SOTP) approach. For the hotel business, we use a FY19e EV/EBITDA of c16x, in line with the multiple expansion for other hotel players in the recent past. For Other FMCG, we use a FY19e EV/sales multiple of 3.5x, which is pegged at a discount to that of other FMCG players as ITC's FMCG business currently generates low profitability. For the PP&B business, we use a FY19e EV/EBITDA multiple of 11x, in line with industry peers. For the agri business, we use FY19e EV/EBITDA of 7.5x, in line with industry peers. Our SOTP approach yields a target price of INR340. Our target price implies upside of c15% from the current share price; we have a Buy rating as we believe the stock's valuations look appealing, and we think earnings are likely to remain on a growth trajectory. **Amit Sachdeva*** | amit1sachdeva@hsbc.co.in | +91 22 2268 1240	Key downside risks: (1) slower-than-expected progress or a loss of market share in growing categories in other FMCG; (2) excessive taxation shocks to which ITC's share price is sensitive; and (3) slower-than-expected cigarette volume growth.
GAIL **GAIL IN** **BUY**	Current price: **INR351.60** Target price: **INR487.00** Up/downside: **38.5%**	We use an EV/EBITDA multiple-based valuation methodology. We value GAIL's gas transmission business at 10x EV/EBITDA, LPG transmission multiple at 8x attributed to weaker long-term outlook due to lower volumes, the trading business at a multiple of 4x and the petchem/LPG businesses at a multiple of 8x. E&P business multiple is marked to market to 6.3x while 'other' segment is valued at 8.4x which is the weighted average of the rest of the businesses. We value listed investments at market prices and unlisted investments at book value. Our target price of INR487 implies c39% upside from the current share price; we have a Buy rating. **Rakesh Sethia*** | rakesh.sethia@hsbc.co.in | +91 22 2268 1245	Key downside risks: (1) lower profitability or any penalty on take-or-pay could lead to downside to our earnings; (2) lower-than-estimated transmission tariffs could lead to downside to our estimates; (3) lower-than-expected marketing volumes and marketing margins on natural gas – fall in petchem spreads compared to our assumptions; and (4) potential exclusion of hydrocarbon-related equities from portfolio performance benchmarks.
Jubilant Foodworks **JUBI IN** **BUY**	Current price: **INR1,325.65** Target price: **INR1,550.00** Up/downside: **16.9%**	We value the company using a DCF methodology, which is based on the cost of equity of 10.6%, with a risk-free rate of 3.0%, a market risk premium of 6.0%, a beta of 1.25 and a terminal growth assumption of 5.0%). Our target price of INR1,550 implies upside of c17% from the current share price; we have a Buy rating as we believe operational momentum will not only remain strong but will be a key catalyst for future stock performance. **Amit Sachdeva*** | amit1sachdeva@hsbc.co.in | +9122 2268 1240	Key downside risks: (1) failure to sustain momentum in SSSG, impacting both growth and margins; (2) new entrants; and (3) an inability to execute the network expansion.
Axis Bank **AXSB IN** **BUY**	Current price: **INR738.00** Target price: **INR790.00** Up/downside: **7.0%**	We assume a cost of equity of 11.7% (risk-free rate of 3.0% and equity risk premium of 6.0%; beta of 1.5) and a terminal growth rate of 5%. We use an excess returns valuation methodology. Our target price implies upside of c7% from the current share price; we have a Buy rating as we think the stock is well positioned to accelerate balance sheet growth in case of a better-than-expected macro environment. **Ravi Singh*** | ravi5.singh@hsbc.co.in | +91 22 2268 1238	Key downside risks: (1) lower-than-expected loan growth; (2) margins surprising on the downside due to stronger competition exerting pressure on pricing or a continued slowdown pushing banks to lend to higher rated customers (which typically carries lower yields); (3) worse-than-expected slippages or haircuts on NPLs; and (4) lower-than-expected recoveries.
Divi's Laboratories **DIVI IN** **BUY**	Current price: **INR1,667.00** Target price: **INR1,780.00** Up/downside: **6.8%**	We derive our target price by discounting back the one-year forward value based on 28x (Gordon growth-based PE) December 2020e EPS of INR68.50. Our assumptions in the Gordon growth model are: a) long-term growth of 5.1%, b) COE of 7.8%, and c) sustainable ROE of 21.5%. Our target price implies upside of c7% from the current share price; we have a Buy rating in view of Divi's positive long-term outlook based on its strong chemistry skills, sticky customer base of top innovator companies, and global competitive edge in generic APIs. **Damayanti Kerai*** | damayantikerai@hsbc.co.in | +91 22 6164 0692	Key downside risks: (1) lower revenue growth of key contributing products; (2) lack of new launches, especially in the custom synthesis segment, which is essential to driving margins growth; (3) adverse regulatory actions (e.g., US FDA) at its manufacturing plants on failure to maintain cGMP compliance; (4) customer & product concentration risk: the top 5 customers account for 42% and the top 5 products contribute for 46% of total sales in FY18; (5) Divi's is vulnerable to currency risk as c88% of sales are contributed by exports; and (6) lack of disclosures due to confidentiality and terms of projects would add to investment risks.
IndusInd Bank **IIB IN** **BUY**	Current price: **INR1,636.35** Target price: **INR1,950.00** Up/downside: **19.2%**	We assume a cost of equity of 10.8% (a risk-free rate of 3.0% and an equity risk premium of 6.0%; beta of 1.3) and a terminal growth rate of 5%. We use an excess returns valuation methodology. Our target price implies upside of c29% from the current share price; we have a Buy rating as its strong loan growth and ROE prospects suggest that the recent underperformance creates an attractive buying opportunity. **Ravi Singh*** | ravi5.singh@hsbc.co.in | +91 22 2268 1238	Key downside risks: (1) the credit cycle failing to recover; (2) higher-than-expected slippages from the commercial vehicle book; (3) lower-than-expected NIMs; (4) risks materialising in high-growth segments, such as microfinance and loans against property; and (5) lower-than-expected synergies, benefits from the acquisition of BHAFIN.

		Valuation	Risks
Hindalco HNDL IN **BUY**	Current price: **INR202.30** Target price: **INR320.00** Up/downside: **58.2%**	We value HNDL on a FY20e EV/EBITDA-based sum-of-the parts (SOTP) approach, with a multiple of 5.0x for the India business (in line with the average valuation for global peers) and 7.0x for Novelis (which we believe should trade higher than its India business, given that it does not have commodity pricing risk). We discount the valuation base to arrive at our fair value target price. We include the value from HNDL's investments in various group companies at a 20% discount to their respective market values on a conservative basis. Our valuation of NVL forms c66% of the consolidated enterprise value of HNDL in our SOTP-based target price. Our target price of INR320 implies c58% upside from the current share price; we have a Buy rating. **Rajesh Lachhani* |** rajeshvlachhani@hsbc.co.in**|** +91 22 6164 0687	Key downside risks: (1) lower-than-expected aluminium prices and copper TC/RCs form key risks; (2) higher-than-expected cost increases pose further risks to HNDL's valuation; (3) while we expect Novelis' performance to continue to improve, the overhang of exposure to developed markets remains and prolonged macro weakness in these markets could hurt shipments and earnings; (4) also, NVL's auto sheets segment is leveraged to the focus on tightening of fuel efficiency and emission norms and, as such, policy backtracking could hurt volume growth; and (5) further escalation of trade wars and lower-than-expected demand could also pose downside risks to our valuation.
Bajaj Auto [BJAUT IN] **Buy**	Current price: **INR3,010.00** Target price: **INR3,200.00** Up/downside: **6.3%**	We value the core business based on a DCF methodology. In line with HSBC's methodology, our DCF-based valuation factors in a country risk-free rate of 3% and a market risk premium of 6% for India. We arrive at a WACC of 10.1%. We also include Bajaj's stake (48%) in KTM AG, valuing it at INR130 per share (based on 17x CY17 earnings, in line with KTM's peers, and a 25% holding company discount). Our target price implies upside of c6% from the current share price; we have a Buy rating as we see the risk reward favourable, given the stock is trading at an undemanding valuation. **Yogesh Aggarwal*** | yogeshaggarwal@hsbc.co.in | +91 22 2268 1246	Key downside risks: (1) the unsuccessful launch of new products; (2) increasing competition in the premium segment; (3) further volatility in export markets; and (4) higher-than-expected earnings deterioration due to pricing strategy. Every 1% depreciation in the INR can lead to a nearly 30bp impact to our earnings estimates.
Hindustan Petroleum HPCL IN **Buy**	Current price: **INR267.85** Target price: **INR298.00** Up/downside: **11.3%**	We use sum-of-the-parts (SOTP) approach. We value HPCL's core marketing and refining segment net profits at a one-year forward PE multiple of 10.5x (based on the standalone ROE profile of 25-30% and long-term growth expectation of 3%). We value HPCL's stake in listed companies (MRPL and Oil India) at a 25% holding company discount to market value. Unlisted subsidiaries are valued at 1x PB multiple. Our target price of INR298 implies c11% from the current share price; we have a Buy rating as we view its marketing profitability as a long-term structural growth story, balancing cyclical exposure. **Rakesh Sethia** | rakesh.sethia@hsbc.co.in | +91 22 2268 1245	Key downside risks: (1) lower-than-expected GRM and marketing volumes; (2) we expect oil prices at USD64/b for 2019e and USD70/b in 2020e. Any significant delay in the receipt of Kerosene- and LPG-related subsidies from the government could result in higher working capital requirements; (3) the government may prevent state refiners from raising retail prices for higher oil prices, posing significant downside risks to our rating and estimates; and (4) potential exclusion of hydrocarbon-related stocks from performance benchmarks is also downside risk.
Kajaria Ceramics KJC IN **BUY**	Current price: **INR585.35** Target price: **INR630.00** Up/downside: **7.6%**	Our fair value target price is based on a two-stage DCF methodology, which we discount back to arrive at a target price of INR630. Our cost of equity of 11.0% is based on a global risk-free rate of 3.0%, an equity risk premium of 6.0% for India, and a beta of 1.3 (two-year weekly basis). We use a terminal growth rate of 5%, which is in line with our long-term inflation rate expectations. Our target price of INR630 implies c8% upside from the current share price; we have a Buy rating as Kajaria's journey to value creation in the long term remains intact, driven by market share gains, branding and margins expansion. **Saurabh Jain** | saurabh2jain@hsbc.co.in | +91 22 6164 0691	Key downside risks: (1) increase in oil prices; (2) slower-than-expected pick-up in construction activity; (3) prolonged slowdown in the real estate sector; and (4) major slippage on key government schemes.

Priced at 13 March 2019.
Source: Bloomberg, HSBC estimates
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Notes

Notes

Disclosure appendix

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Important disclosures

Equities: Stock ratings and basis for financial analysis

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From 23rd March 2015 HSBC has assigned ratings on the following basis:

The target price is based on the analyst's assessment of the stock's actual current value, although we expect it to take six to 12 months for the market price to reflect this. When the target price is more than 20% above the current share price, the stock will be classified as a Buy; when it is between 5% and 20% above the current share price, the stock may be classified as a Buy or a Hold; when it is between 5% below and 5% above the current share price, the stock will be classified as a Hold; when it is between 5% and 20% below the current share price, the stock may be classified as a Hold or a Reduce; and when it is more than 20% below the current share price, the stock will be classified as a Reduce.

Our ratings are re-calibrated against these bands at the time of any 'material change' (initiation or resumption of coverage, change in target price or estimates).

Upside/Downside is the percentage difference between the target price and the share price.

Prior to this date, HSBC's rating structure was applied on the following basis:

For each stock we set a required rate of return calculated from the cost of equity for that stock's domestic or, as appropriate, regional market established by our strategy team. The target price for a stock represented the value the analyst expected the stock to reach over our performance horizon. The performance horizon was 12 months. For a stock to be classified as Overweight, the potential return, which equals the percentage difference between the current share price and the target price, including the forecast dividend yield when indicated, had to exceed the required return by at least 5 percentage points over the succeeding 12 months (or 10 percentage points for a stock classified as Volatile*). For a stock to be classified as Underweight, the stock was expected to underperform its required return by at least 5 percentage points over the succeeding 12 months (or 10 percentage points for a stock classified as Volatile*). Stocks between these bands were classified as Neutral.

*A stock was classified as volatile if its historical volatility had exceeded 40%, if the stock had been listed for less than 12 months (unless it was in an industry or sector where volatility is low) or if the analyst expected significant volatility. However, stocks which we did not consider volatile may in fact also have behaved in such a way. Historical volatility was defined as the past month's average of the daily 365-day moving average volatilities. In order to avoid misleadingly frequent changes in rating, however, volatility had to move 2.5 percentage points past the 40% benchmark in either direction for a stock's status to change.

Rating distribution for long-term investment opportunities

As of 14 March 2019, the distribution of all independent ratings published by HSBC is as follows:

Buy	54%	(29% of these provided with Investment Banking Services)
Hold	37%	(28% of these provided with Investment Banking Services)
Sell	9%	(19% of these provided with Investment Banking Services)

For the purposes of the distribution above the following mapping structure is used during the transition from the previous to current rating models: under our previous model, Overweight = Buy, Neutral = Hold and Underweight = Sell; under our current model Buy = Buy, Hold = Hold and Reduce = Sell. For rating definitions under both models, please see "Stock ratings and basis for financial analysis" above.

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HSBC & Analyst disclosures

Disclosure checklist

Company	Ticker	Recent price	Price date	Disclosure
ASIAN PAINTS	ASPN.BO	1428.30	13 Mar 2019	7
AVENUE SUPERMARTS	AVEU.NS	1501.40	13 Mar 2019	7
AXIS BANK LTD	AXBK.BO	738.00	13 Mar 2019	1, 5, 6, 7
BAJAJ AUTO	BAJA.BO	3010.00	13 Mar 2019	5, 6, 7
BAJAJ FINANCE LTD	BJFN.NS	2828.15	13 Mar 2019	6, 7
GAIL	GAIL.BO	351.60	13 Mar 2019	6, 7
GODREJ PROPERTIES	GODR.BO	697.50	13 Mar 2019	7
HDFC BANK	HDBK.BO	2226.55	13 Mar 2019	1, 5, 6, 7
HINDALCO	HALC.BO	202.30	13 Mar 2019	2, 6, 7
HINDUSTAN PETROLEUM	HPCL.BO	267.85	13 Mar 2019	6
INDUSIND BANK	INBK.BO	1636.35	13 Mar 2019	5, 6, 7
ITC	ITC.BO	294.90	13 Mar 2019	7
JUBILANT FOODWORKS	JUBI.BO	1325.65	13 Mar 2019	7
PRESTIGE ESTATES PROJECTS LTD	PREG.BO	207.80	13 Mar 2019	4, 6, 7

Source: HSBC

1. HSBC has managed or co-managed a public offering of securities for this company within the past 12 months.
2. HSBC expects to receive or intends to seek compensation for investment banking services from this company in the next 3 months.
3. At the time of publication of this report, HSBC Securities (USA) Inc. is a Market Maker in securities issued by this company.
4. As of 28 February 2019, HSBC beneficially owned 1% or more of a class of common equity securities of this company.
5. As of 31 January 2019, this company was a client of HSBC or had during the preceding 12 month period been a client of and/or paid compensation to HSBC in respect of investment banking services.
6. As of 31 January 2019, this company was a client of HSBC or had during the preceding 12 month period been a client of and/or paid compensation to HSBC in respect of non-investment banking securities-related services.
7. As of 31 January 2019, this company was a client of HSBC or had during the preceding 12 month period been a client of and/or paid compensation to HSBC in respect of non-securities services.
8. A covering analyst/s has received compensation from this company in the past 12 months.
9. A covering analyst/s or a member of his/her household has a financial interest in the securities of this company, as detailed below.
10. A covering analyst/s or a member of his/her household is an officer, director or supervisory board member of this company, as detailed below.

11 At the time of publication of this report, HSBC is a non-US Market Maker in securities issued by this company and/or in securities in respect of this company

12 As of 11 Mar 2019, HSBC beneficially held a net long position of more than 0.5% of this company's total issued share capital, calculated according to the SSR methodology.

13 As of 11 Mar 2019, HSBC beneficially held a net short position of more than 0.5% of this company's total issued share capital, calculated according to the SSR methodology.

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1 This report is dated as at 15 March 2019.

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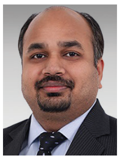

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