India Strategy

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Our best BUY ideas

- **Long-term structural BUYs are: ICICI bank, BHEL, Bharti, Cairn, Sun Pharma, Sterlite and M&M. We believe investors should enter Maruti, Hero Honda, RIL, HDFC, and NTPC at lower prices.**
- **Key mid-cap BUYs are: Exide, IBREL, GSPL and OnMobile .**
- **Suzlon, SAIL and Axis Bank are trading ideas with identifiable catalysts.**

Investor interest in BUY ideas building up

Despite our near-term cautious view on the market, investor interest (particularly from long-only investors) on BUY ideas is on the rise. We attribute this rise to large cash positions in portfolios, and to investors' belief that both economy and markets will recover with a time lag.

Four classes of BUY ideas

We highlight (i) long-term structural BUYs (large-cap stocks, beneficiaries of structural drivers of Indian economy), (ii) mid-cap BUY ideas (beneficiaries of structural drivers, could become tomorrow's large caps), (iii) "Right business, wrong price" ideas (stocks where we like the business fundamentally but believe that investors should enter at lower price, and (iv) Trading BUY ideas (stocks with identifiable catalysts, which could lead to significant share price appreciation in the near term).

Long term structural BUYs

We believe structural drivers of the Indian economy are: (i) increase in infrastructure investments (ii) sustainable increase in domestic consumption, (iii) rising energy security and (iv) cost arbitrage in services and manufacturing. Top ideas on these themes are ICICI bank, BHEL, Bharti, Cairn, Sun Pharma, Sterlite and M&M.

Mid-cap BUYs

Our favourite mid-cap BUYs are Exide, IBREL, GSPL and OnMobile.

"Right business wrong price" ideas

We fundamentally like Maruti, Hero Honda, HDFC, Reliance Industries and NTPC. But we think investors should enter these stocks at lower prices to maximize returns.

Trading BUY ideas

We believe near term positive catalysts exist for Suzlon, SAIL and Axis Bank.

The most liquid and the most under-owned

Axis bank, Suzlon, BHEL, HDFC, Bharti, ICICI and Reliance are most liquid (average trading volume between USD50m to USD250m). Our analysis shows OnMobile, Sterlite, Cairn, GSPL, Reliance and Suzlon are under-owned relative to institutional ownership levels in the market

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Valuations Of Our Top BUYs

	— P/E —		EV/EBITDA		— P/BV —	
	FY09 (x)	FY10 (x)	FY09 (x)	FY10 (x)	FY09 (x)	FY10 (x)
ICICI Bank	12.7	9.6	—	—	0.9	0.8
BHEL	21.4	14.8	14.0	10.0	5.1	4.1
Bharti Airtel	13.5	10.7	7.9	6.2	3.8	2.8
Cairn Energy	33.7	18.1	36.5	11.1	0.9	0.9
Sun Pharmaceuticals	12.5	12.6	10.7	10.7	3.3	3.1
Sterlite Industries	4.9	6.0	1.0	1.1	0.8	0.7
Mahindra & Mahindra	5.5	5.1	5.0	4.7	1.0	0.9
Exide Industries	10.6	8.3	6.3	5.0	2.6	2.0
IBREL	24.1	6.3	15.7	7.6	0.4	0.4
GSPL	23.2	21.1	7.2	7.1	1.4	1.4
OnMobile Global	15.3	11.7	6.9	5.5	1.8	1.6
Maruti Suzuki	12.1	11.0	8.1	6.4	1.7	1.5
Hero Honda	14.6	12.9	8.2	7.0	4.7	3.8
HDFC	18.7	15.6	—	—	3.1	3.0
Reliance Industries	13.3	10.3	10.7	7.6	1.7	1.6
NTPC	19.6	18.1	13.9	12.5	2.7	2.5
Suzlon	4.5	4.2	3.5	3.1	0.7	0.6
SAIL	6.7	8.0	3.5	3.5	1.2	1.1
Axis Bank	10.2	8.2	—	—	1.5	1.3

Source: BNP Paribas estimates

Investor interest in BUY ideas building up

Despite our cautious view on the market for the near term, investors (particularly long-only investors) are becoming increasingly interested in BUY ideas. We believe this is because:

1) Investors have large cash holdings in portfolios – both domestic and foreign

2) Many investors believe that current low commodity prices (leading to further decline in inflation and narrowing down of fiscal and current account deficits), declining interest rates and cheap stock valuations are paving the way for the next bull market, albeit with a time lag.

Our best BUY ideas

We are highlighting the topmost BUY ideas in each sector. Our BUY ideas are divided into four groups according to varied investor interests (depending on whether they are long only or hedge funds, or whether they are large-cap focused or mid-cap focused).

1) **Long-term structural BUY**: These are frontline large-cap stocks that are likely to benefit from the structural growth drivers of the Indian economy in the long term. We believe the structural drivers include: (i) **increase in infrastructure investments** driven by the need to improve infrastructure (power, roads, port and airports, irrigation etc.) and supported by rising domestic savings rate (up from 22% in mid-1990s to 35% in 2008), (ii) **sustainable increase in domestic consumption**, especially in durables (driven by low product penetration coupled with increasing affluence, improving demographics and increasing urbanisation), (iii) **rising energy security**, driven by new oil and gas discoveries and acquisition of overseas oil fields, and (iv) **cost arbitrage in services and manufacturing**, leading to continuation of outsourcing from developed economies into India (and other emerging economies). Even though some of these structural drivers have come under cyclical pressure, the long-term positive impact of these drivers on the economy (and hence, on corporate earnings and share prices) is undeniable.

2) **Mid-cap BUY**: These are relatively small second-tier stocks that benefit from one or more of the structural drivers, and have the potential to become tomorrow's large caps.

3) **Right business, wrong price**: We like the business fundamentally and believe in management's ability to execute the business plans for these stocks. But we also believe that investors should enter these stocks at a price slightly lower than the current market price to maximise returns. These stocks are also likely to benefit from one or more of the structural drivers.

4) **Trading BUY**: These are stocks with identifiable catalysts, which could lead to significant share price appreciation in the near term. The fundamental medium-term recommendation on some of these stocks could be "Reduce", but we believe there could be some near-term upside.

The stock ideas

We present our best stock ideas in each category in Exhibit 1 through Exhibit 4.

Exhibit 1: Long-Term Structural BUY Ideas And Rationale

Stock	Positives	Risks
ICICI Bank	ICICI bank is one of the best positioned to leverage on increasing investment and consumption, and increasing penetration of organised sector financing. • Best seasoned loan book in terms of position on NPL cycle • Biggest beneficiary of interest rate decline • Change in bank's strategy to focus on profitability as against scale • Network to expand by 50% in the next one year- should lower cost of funds • Highest capital adequacy in the sector	• Little transparency on international loan book- no transparency • Fee income slowing down • Share price vulnerability to potential adverse news flow • Perception about management's disclosure levels relatively low among investor community.
BHEL	BHEL, as the largest boiler-turbine-generator manufacturer, is the biggest beneficiary of Government's focus on infrastructure, especially power. • Current order backlog of approx. $25b provides visibility for more than 4 years • We expect top-line growth of 28.4% CAGR over FY08-11 as execution cycles improve on capacity expansion from 10 to 15GW by Dec 2009 and 20GW by Dec 2011 and tying up of critical raw material • We expect 331bps EBITDA margin expansion in FY08-11 on falling wage costs and raw material prices • Strong balance sheet, high ROEs of 30% and FCF generation.	• Delays in capacity additions could slowdown revenue growth • Delays in 12th plan ordering • Rising domestic and Chinese competition
Bharti Airtel	Bharti is the biggest beneficiary of rising domestic consumption reflected in 7-8m mobile subscriber addition every month. • Will retain leadership leveraging its extensive network and scale economies • Strong balance sheet, positive FCF positions it best for upcoming 3G auction • Trading at historical trough valuation of 10x FY10; 2-year earnings CAGR of 29%	• Increasing competition and possibility of tariff war • Excessive bidding for 3G spectrum • Loss of high end subscribers on implementation of Mobile Number Portability
Cairn Energy	Cairn is a significant contributor to India's growing indigenous oil reserves. • Excellent execution capabilities, Good management • First oil from Rajasthan and pipeline construction completion on schedule in 2H CY09	• Depressed crude oil prices for an extended period of time
Sun Pharmaceuticals	Sun is focused on lifestyle-related disease segment (cholesterol, hypertension), which is the fastest growing segment in India. • Strong core earnings growth • Taro acquisition and synergies • Opportunity to participate in one off surprises with a margin of safety derived from the base business (which the company has consistently delivered in the past)	• Key geography (US) slowdown, • A stringent regulatory environment (FDA approvals regime), • Potential payment of a higher consideration for Taro's residual stake • Currency risk as the company has no active currency hedges
Sterlite Industries	With exposure to Copper, Aluminium and Zinc, Sterlite is a commodity manufacturer with exposure to infrastructure, construction and consumer sectors • We expect metal price recovery in 2HCY09 • Lower input costs and weak INR is providing support to profit margin	• If global recovery takes longer than expected, then metal prices would remain depressed beyond 2HCY09 • Investors historically have had concerns on Sterlite's corporate governance
Mahindra & Mahindra	Core business of utility vehicles and tractors are geared to increasing rural affluence. Subsidiaries in auto components, IT, financing and property leverage on outsourcing and domestic affluence. • Strong franchise ideally placed for the industry upturn • Margin expansion on commodity deflation to start in 1QFY10 • At 5.4x FY10 core auto business EPS, 1.0x P/B with FY10 ROE of 19%, we believe the stock is a value pick	• Recovery in UVs and tractors industry may be delayed more than expected. "Xylo" – the newly launched UV, not meeting targets • Company has earmarked INR20b (USD400m) for potential acquisitions. Aggressive acquisitions could require external funding

Source: BNP Paribas

Exhibit 2: Mid-Cap BUY Ideas

Stock	Positives	Risks
Exide Industries	Exide is the market leader in auto and industrial batteries with a duopolistic industry structure. • Auto batteries demand to remain unaffected by auto OEM sales slowdown due to strong replacement demand • Industrial batteries segment to continue impressive growth. • Sustained low lead prices to improve margins over time	• Investment in ING Vysya Life insurance - unrelated business diversification
IBREL	IBREL is an urban commercial real estate developer which is likely to enter urban residential real estate. • Recurring annual cash flow stream from FY11 of at least INR3b through dividends and property mgmt fee • Gross Cash of INR104/share versus current stock price of INR94 • Power venture could provide significant valuation upside (INR166/share)	• High operational cash burn can weaken valuation support • Weak property demand environment and lack of experience in sector
GSPL	GSPL is a gas transportation company operating in western India – a play on rising gas supplies in India. • Volumes to grow 32% over FY08-11 • New regulations will provide upside to returns. Will become a safe pure play regulated gas transmission utility with a post tax ROCE of 12%	• Delay in supply of KG basin gas to RIL • Change in Gas allocation policy can lead to gas being diverted to other states and not allocated to the state of Gujarat where the company currently operates
OnMobile Global	OnMobile is a leading Mobile Value Added Services (VAS) provider in India. Growth in VAS – like musical ring tones, sports updates etc. are predicated on increasing domestic affluence. • We expect 3-year revenue CAGR of 31% over FY08-11 • International expansion will drive next level of growth; several contract wins in Asia; in the process of expanding into Africa, Europe and Middle East • Strong balance sheet with cash per share of INR 48 (23% of M Cap) which management plans to selectively utilize for small to mid sized acquisitions	• Slowdown in Mobile VAS usage in view of general economic slowdown • Reduction in prices of MVAS or reduction in revenue share of OnMobile • Concentration of revenue to top 5 customers (75% of revenue comes from top 5 Indian wireless operators) • Execution risks related to offering MVAS in international markets

Source: BNP Paribas

Exhibit 3: Right Business Wrong Price

Stock	Positives	Risks	Correct price to enter (INR)
Maruti Suzuki	Market leader in passenger cars, especially small cars. • Lower commodity prices, price hike to bring back margins • To regain lost market share in small car segment on back of new products, and build on market share in entry-level sedans • Strong balance sheet, net cash position	• We do not expect significant industry volume recovery in the near-term • JPY appreciation a threat to margins	500
Hero Honda	Market leader in motorcycles. • Strong company fundamentals, market share improvement • Margin improvement potential due to fall in commodity prices • Strong balance sheet, net cash position	• Expect the industry volumes to remain flat over the next 6-9 months, and forecast a recovery only in 2HFY10 • EPS growth to slow down due to weak volumes; at 13x FY10 P/E, we see limited near-term upside	750
HDFC	Market leader in housing mortgages. • Supply demand gap in low ticket mortgage to drive growth • Cushion of legacy provision buffer, best in class risk management • Lowest cost to income ratio, ability to maintain spreads owing to a stickier customer base • Strong management credibility	• Source of funding going forward • Exposure to real estate sector • Possibility of NPLs rising • Relatively expensive valuation (3x P/BV)	1300
Reliance Industries	Largest petrochemical manufacturer and oil refiner. Beneficiary of large natural gas discovery in East coast of India. • KG D6 Gas Production start and ramp-up • RPL Refinery Start to drive earnings in FY10-12	• Refining and Petrochemical cycle getting worse from here	1000-1100
NTPC	India's largest power utility. • One of the best defensive plays in a bear market with assured ROE of 15.5% • Has strong earnings visibility, stable cash flows and one of the best ROE among global peers	• Coal shortages on account of poor production by Coal India. Needs to diversify its coal sources	150-160

Source: BNP Paribas

Exhibit 4: Trading BUY Ideas And Catalysts

Stock	Catalyst	Expected timeline for catalyst to materialise
Suzlon	• Repayment of INR2.5b debt by March 2009 • Management confident of booking 1000MW of order in next six months • Buying of Martifer's stake in REpower thereby raising Suzlon's stake in REpower from current 73.7% to 90%	• Part repayment of debt expected in next 1 month • New orders expected over next 6 months • Martifier's stake in REPower expected to be bought in April and May
SAIL	Increase in import duty on steel from 5% currently to 10%	Steel makers are currently in discussion with the Government, we would expect a decision in the next 30 days
Axis Bank	• NPL accretion slowing down • Announcement of replacement for chairman post retirement could ease concern on succession	Next 1-2 quarters

Source: BNP Paribas

Are our top BUYs over-owned?

A common criticism of Buy ideas in the present market (where investors' focus have narrowed down to a small set of large-cap good management names) is that these ideas are consensus favourites and hence over-owned by institutional investors. We therefore attempt to screen over-owned stocks from our best BUY list. For the overall Indian stock market, we estimate 43.3% is free float, and FIIs own 14.2% of the market while domestic institutions own 9.8%. So FIIs and DIIs own 55% of overall free-float market cap. If for any stock, the total institutional holding (as proportion of free float) is higher than 55%, we classify it as over-owned relative to the market.

Exhibit 5: Liquidity And Ownership Levels

Stock	BNPP rating	Market cap (USD m)	Average daily turnover (USD m)	FII stake (%)	Domestic institutions' stake (%)	Free float (%)	Institutional stake as % of free float (%)
ICICI Bank	BUY	8,904	130	37	22	100	59.0%
BHEL	BUY	13423	65	16.02	9.52	32.28	79.1
Bharti Airtel	BUY	24,298	82	22.0	6.5	32.9	86.6
Cairn Energy	BUY	6,167	38	8.7	5.8	35.3	41.1
Sun Pharmaceuticals	BUY	4,500	0.8	18.84	5.75	36	68.3
Sterlite Industries	BUY	3,872	28.7	6.81	7.86	39.01	37.6
Mahindra & Mahindra	BUY	1,500	6.5	24.2	26.7	73.5	69.2
Exide Industries	BUY	700	0.6	9.0	20.0	51.1	56.7
IBREL	BUY	491	33.3	42.92	0.45	73.94	58.7
GSPL	BUY	352	1.9	12.5	10.4	50.8	45.1
OnMobile Global	BUY	260	3.2	6	4.0	43.0	23.3
Maruti Suzuki	HOLD	3,500	15.2	14.4	25.0	45.8	86.1
Hero Honda	HOLD	3,600	7.2	24.7	11.1	45.0	79.5
HDFC	BUY	8,307	70	74	13	100	87.0
Reliance Industries	BUY	42,556	249	15.5	9.0	47.3	52.0
NTPC	HOLD	32,578	32	4.1	3.0	10.5	67.2
Suzlon	BUY	1,318	53.3	13.07	5.2	34.2	53.4
SAIL	REDUCE	6,426	45.3	3.62	7.49	14.18	78.3
Axis Bank	REDUCE	2,898	50	25.5	10.5	57.6	62.5

Sources: BNP Paribas; Bloomberg

Exhibit 5 shows that according to our definition of under-ownership, OnMobile, Sterlite, Cairn, GSPL, Reliance and Suzlon are under-owned relative to institutional ownership levels in the market.

Exhibit 6: Valuations Of Our Top BUYs

Stock	P/E			EV/EBITDA			P/BV		
	FY08 (x)	FY09 (x)	FY10 (x)	FY08 (x)	FY09 (x)	FY10 (x)	FY08 (x)	FY09 (x)	FY10 (x)
ICICI Bank	10.0	12.7	9.6	—	—	—	0.9	0.9	0.8
BHEL	22.9	21.4	14.8	15.0	14.0	10.0	6.1	5.1	4.1
Bharti Airtel	17.7	13.5	10.7	10.6	7.9	6.2	5.3	3.8	2.8
Cairn Energy	nm	33.7	18.1	71.2	36.5	11.1	1.0	0.9	0.9
Sun Pharmaceuticals	13.6	12.5	12.6	12.8	10.7	10.7	4.3	3.3	3.1
Sterlite Industries	4.3	4.9	6.0	0.7	1.0	1.1	1.0	0.8	0.7
Mahindra & Mahindra	4.0	5.5	5.1	4.2	5.0	4.7	1.2	1.0	0.9
Exide Industries	13.0	10.6	8.3	7.5	6.3	5.0	3.2	2.6	2.0
IBREL	nm	24.1	6.3	18.1	15.7	7.6	0.6	0.4	0.4
GSPL	16.6	23.2	21.1	6.5	7.2	7.1	1.5	1.4	1.4
OnMobile Global	18.8	15.3	11.7	6.0	6.9	5.5	2.1	1.8	1.6
Maruti Suzuki	9.7	12.1	11.0	5.3	8.1	6.4	2.0	1.7	1.5
Hero Honda	18.1	14.6	12.9	10.0	8.2	7.0	5.9	4.7	3.8
HDFC	22.7	18.7	15.6	—	—	—	3.4	3.1	3.0
Reliance Industries	12.8	13.3	10.3	10.9	10.7	7.6	2.2	1.7	1.6
NTPC	21.0	19.6	18.1	15.2	13.9	12.5	3.0	2.7	2.5
Suzlon	5.5	4.5	4.2	5.0	3.5	3.1	0.8	0.7	0.6
SAIL	4.2	6.7	8.0	2.2	3.5	3.5	1.3	1.2	1.1
Axis Bank	12.8	10.2	8.2	—	—	—	1.6	1.5	1.3

Source: BNP Paribas estimates

DISCLAIMERS & DISCLOSURES

Recommendation structure

All share prices are as at market close on 4 February 2009 otherwise stated. Stock recommendations are based on absolute upside (downside), which we define as (target price* - current price) / current price. If the upside is 10% or more, the recommendation is BUY. If the downside is 10% or more, the recommendation is REDUCE. For stocks where the upside or downside is less than 10%, the recommendation is HOLD. In addition, we have key buy and key sell lists in each market, which are our most commercial and/or actionable BUY and REDUCE calls and are limited to at most five key buys and five key sells in each market at any point in time.

Unless otherwise specified, these recommendations are set with a 12-month horizon. Thus, it is possible that future price volatility may cause a temporary mismatch between upside/downside for a stock based on market price and the formal recommendation.

*In most cases, the target price will equal the analyst's assessment of the current fair value of the stock. However, if the analyst doesn't think the market will reassess the stock over the specified time horizon due to a lack of events or catalysts, then the target price may differ from fair value. In most cases, therefore, our recommendation is an assessment of the mismatch between current market price and our assessment of current fair value.