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Research
India

India Strategy

Deep Value, Contrarian vs. Over-loved Stocks

MORGAN STANLEY RESEARCH

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Deep Value, Contrarian vs. Over-loved Stocks

- **3 “U”s and 3 “O”s:** We have rerun our work on the 3 “U”s – unloved, under-owned and undervalued stocks – and the 3 “O”s – over-loved, over-owned and overvalued stocks (first done by our UK strategy team). In this version, we use an approach similar to our sector rotation model, which has back tested well (see our report dated June 29, 2010, entitled *India Sector Rotation Chartbook: Closing Materials Underweight*). We believe this should be especially useful to investors in a market that seems to be all about stock picking.
- Hence, the stocks which appear on the “overweight” list are the ones that have underperformed the market, seem to be disliked by the sell-side consensus, are under-owned by the buy side, appear to be inexpensive relative to history – both absolute and relative and have mixed fundamentals. In short, these are stocks that are under-owned, undervalued and unloved. The “underweight” list is exactly the opposite of this.
- **Focus List Changes:** Based on this we are removing ITC (ITC.BO, Rs165) from our Focus List and adding ACC (ACC.BO, Rs881). Our consumer analyst has also downgraded ITC on the back of valuation concerns. Our analyst likes ACC due to improving demand-supply dynamics in the cement sector.
- Our Focus List has outperformed the MSCI India benchmark by 2,420bp since inception and by 18bp in 2010.
- **3 “U”/3 “O” Model:** Our stock-picking model is based on 15 factors (see page 3 for the entire list).
- Four of these factors are based on stock performance, six are valuation metrics, three are earnings-related factors, and two metrics are associated with the consensus view – both buy and sell side.
- We rank stocks based on their position relating to each of these factors. For example, stocks that have delivered strong 12-month returns rank poorly, whereas stocks with negative sell-side views rank positively. We aggregate the scores across these metrics to arrive at the final ranks.
- We overlay trading volumes and our analyst ratings to arrive at the final list of stocks to overweight/underweight. Hence, a stock that comes on the “overweight” list will be ignored if Morgan Stanley’s rating is Underweight and vice versa. We also ignore all stocks that have traded less than US\$2 million in a day on an average over the past three months.
- The subsequent pages of this document detail the time series of each factor we use for the various stocks that are short listed by this quant model. The objective of the model is to provide discipline in stock picking but it is not the only input for the stocks in our Focus List.

Stocks to “Overweight”

Best Stocks Filtered by US\$2mn avg. trading value & MS analyst rating (out of 114 stocks covered by MS)

	Grasim	Aban Offshore	ACC	Bharti Airtel	Hindalco	UltraTech	BPCL	Ambuja Cement	Cipla	Idea
PERFORMANCE										
1M Absolute Performance	17%	-1%	8%	5%	18%	10%	3%	15%	-8%	6%
12M Absolute Performance	-13%	-24%	16%	-22%	75%	32%	30%	29%	18%	-11%
12M Rel to EM Performance	-31%	-40%	-7%	-38%	39%	5%	4%	2%	-6%	-29%
Deviation from 200 DMA	-4%	-23%	0%	5%	14%	-3%	17%	13%	-7%	16%
VALUATIONS										
Absolute PE	6.3	10.7	10.3	13.1	8.6	10.5	12.8	15.5	22.5	24.3
PE SD from Avg	-1.1	0.4	0.1	0.0	-0.6	-0.1	0.1	-0.3	-0.5	-0.5
Absolute PB	1.6	1.0	2.8	3.1	1.5	2.5	1.7	2.9	4.6	1.6
PB SD from Avg	-0.6	-0.9	-0.5	-0.9	-0.4	-0.8	-0.3	-0.3	-0.7	-0.5
Rel PE to MSCI India SD from Avg	-1.8	-0.9	-1.1	-1.2	-0.8	-0.6	-0.2	-0.8	-1.1	0.7
Rel PB to MSCI India SD from Avg	-0.7	-1.0	-0.6	-1.1	-0.6	-1.0	-0.4	-0.1	-0.9	-0.9
EARNINGS										
Earnings Revisions Breadth	13%	-25%	-17%	-31%	7%	-30%	19%	15%	-25%	13%
3M Earnings Growth Revision for F2011	-6%	-29%	1%	-8%	29%	-2%	2%	5%	-3%	6%
Current ROE % of 5 yr Avg ROE	99%	58%	102%	88%	130%	80%	122%	74%	100%	62%
CONSENSUS VIEW										
Δ Total Institutional ownership position (bps)	8.7	-7.1	-0.7	-49.9	-9.4	-7.6	-0.3	0.3	-0.4	30.2
Consensus Rating % of Avg MS Cov	109%	10%	-34%	103%	169%	-30%	21%	-54%	-27%	-40%
Rank Based on Cumulative Score	1	2	3	4	5	6	11	14	15	16
Share Price (19-Aug-2010)	2136	835	881	314	180	926	676	124	305	70
MS Analyst Rating	Overweight	Overweight	Overweight	Overweight	Equal-Weight	Overweight	Overweight	Overweight	Equal-Weight	Overweight

Past performance is no guarantee of future results. Results shown do not include transaction costs.

Source: FactSet, MSCI, IBES, Company Data, Morgan Stanley Research.

Stocks to “Underweight”

Worst Stocks Filtered by US\$ 2 m avg. trading value & MS analyst rating (out of 114 stocks covered by MS)

	Indian Hotels	Jain Irrigation	IndusInd Bank	Dabur	Dr. Reddy's	ITC	Essar Oil	Axis Bank	IDFC	Godrej Consumer
PERFORMANCE										
1M Absolute Performance	2%	5%	10%	-2%	-9%	13%	-5%	0%	-4%	7%
12M Absolute Performance	74%	82%	148%	72%	68%	48%	2%	66%	43%	77%
12M Rel to EM Performance	39%	45%	98%	37%	33%	18%	-19%	32%	14%	41%
Deviation from 200 DMA	8%	27%	34%	16%	7%	22%	-4%	18%	12%	31%
VALUATIONS										
Absolute PE	NM	35.9	31.0	36.1	211.4	31.3	543.8	21.9	26.0	37.4
PE SD from Avg	NM	51.1	35.2	1.2	1.9	1.9	1.7	26.8	36.0	1.3
Absolute PB	3.2	7.8	4.5	16.6	5.4	8.4	3.4	3.4	3.8	9.3
PB SD from Avg	0.5	0.3	2.8	0.9	-0.1	0.0	0.8	0.3	0.6	-1.1
Rel PE to MSCI India SD from Avg	NM	0.8	1.2	0.4	1.6	1.0	5.0	0.5	1.4	1.2
Rel PB to MSCI India SD from Avg	1.4	1.4	3.6	1.5	-0.1	0.1	1.0	0.6	0.9	-1.3
EARNINGS										
Earnings Revisions Breadth	0%	-27%	67%	12%	-17%	6%	-25%	8%	0%	15%
3M Earnings Growth Revision for F2011	-86%	32%	164%	1%	-1%	2%	4%	15%	-6%	28%
Current ROE % of 5 yr Avg ROE	-106%	115%	158%	93%	43%	102%	-16%	99%	105%	62%
CONSENSUS VIEW										
Δ Total Institutional ownership position (bps)	0.3	4.3	3.9	9.3	-6.2	15.7	-0.3	25.6	-104.2	4.1
Consensus Rating % of Avg MS Cov	239%	127%	239%	35%	89%	185%	115%	182%	126%	206%
Rank Based on Cumulative Score	112	111	110	107	106	97	94	93	90	89
Share Price (19-Aug-2010)	107	1248	230	206	1340	165	131	1359	184	390
MS Analyst Rating	Equal-Weight	Equal-Weight	Equal-Weight	Equal-Weight	Equal-Weight	Equal-Weight	Underweight	Equal-Weight	Equal-Weight	Equal-Weight

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Source: FactSet, MSCI, IBES, Company Data, Morgan Stanley Research.

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Focus List: Replacing ITC with ACC

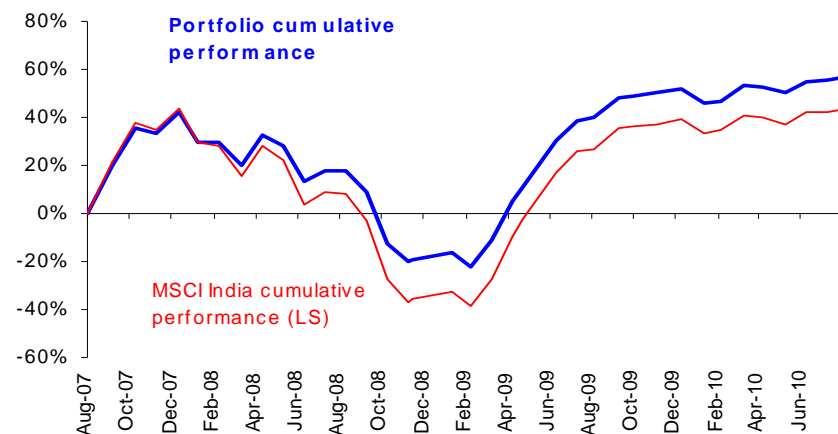
India Sector Model Portfolio

Sector	MSCI Weight (%)	Portfolio Weight (%)	Over/Under - Weight (bps)	Perf Rel. To MSCI India (YTD)	Perf Rel. To MSCI India (12M)
MSCI India				4%	26%
Consumer Disc.	4.9	3.9	-100	8%	21%
Consumer Staples	6.0	6.0	0	11%	4%
Energy	14.3	16.3	200	-10%	-16%
Financials	27.1	26.1	-100	10%	5%
Healthcare	3.7	1.7	-200	0%	13%
Industrials	10.2	12.2	200	0%	-2%
Technology	17.0	16.0	-100	4%	17%
Materials	10.5	12.5	200	-13%	1%
Telecoms	0.7	1.7	100	-6%	-44%
Utilities	5.6	3.6	-200	-12%	-18%

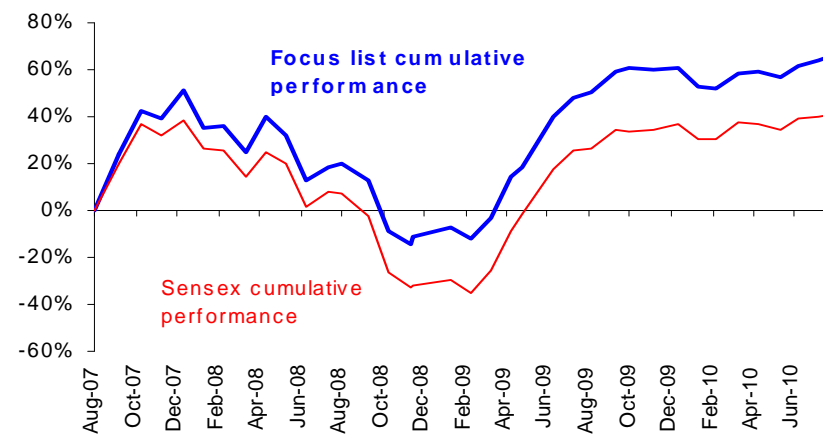
Focus List: Removing ITC, Adding ACC

Stocks	Sector	Ticker	Analyst Rating	Price (Rs) 19/Aug/2010	MCap (US\$ bn)	Avg 3M T/O (US\$ mn)	Relative to MSCI India YTD Perf	12m Perf
Cairn India	Energy	CAIR IN	NA	345	14	25	18%	17%
Reliance Ind	Energy	RIL IN	EW	977	69	108	-14%	-17%
DLF	Financials	DLF IN	OW	321	12	44	-14%	-31%
SBI	Financials	SBIN IN	OW	2,806	38	99	19%	32%
Ranbaxy	Healthcare	RBXY IN	OW	476	4	9	-12%	26%
Jaiprakash Asso.	Industrials	JPA IN	OW	123	6	27	-20%	-29%
L&T	Industrials	LT IN	OW	1,818	23	55	4%	-2%
ACC	Materials	ACC IN	OW	881	4	7	-3%	-7%
Sesa Goa	Materials	SESA IN	NA	328	6	72	-23%	20%
Bharti	Telecoms	BHARTI IN	OW	314	26	47	-8%	-38%
Adani Power	Utilities	ADANI IN	OW	140	7	3	36%	-
Reliance Infra	Utilities	RELI IN	OW	1,063	5	45	-11%	-22%

Sector Model Portfolio Performance vs. MSCI India



Focus List Performance Since Launch



Past performance is no guarantee of future results. Results shown do not include transaction costs.

Source: FactSet, MSCI, Bloomberg, Morgan Stanley Research

Please note performance of Cairn and Sesa Goa has been considered upto 13th August 2010. Stocks ratings are not Available. Please read detailed disclosures for more information.

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Focus List Timeline Since Inception

	Date Added	Dated Removed	MSCI India (in Rs) on date added	MSCI India (in Rs) on date when removed or current	Stock price when Added	Price when removed or current price	Dividend if any	Stock return*	Returns relative to MSCI India
ACC	19-Aug-10		735	735	881	881	-	-	-
Adani power	28-Apr-10		723	735	119	140	-	18%	16%
Bharti Airtel	28-Apr-10		723	735	295	314	1	6%	5%
Cairn India	22-Sep-09		669	735	263	355	-	35%	23%
DLF	15-Jul-09		564	735	322	321	2	0%	-23%
Jaiprakash Asso.	29-Nov-07		784	735	241	123	1	-49%	-46%
Larsen & Toubro	15-May-09		478	735	988	1818	14	84%	20%
Ranbaxy Lab	1-Dec-09		683	735	469	476	-	1%	-6%
Reliance Industries	22-Aug-07		573	735	884	977	7	10%	-14%
Reliance Infra	15-Jul-09		564	735	1,104	1063	8	-4%	-26%
Sesa Goa	29-Jun-10		722	735	356	354	3	-1%	-2%
State bank of India	13-Aug-09		615	735	1,799	2806	40	56%	31%
ITC	6-Nov-09	19-Aug-10	648	735	124	165	2	33%	17%
Arvind Ltd.	22-Aug-07	4-Dec-08	573	334	43	15	-	-65%	-41%
Bharti Airtel	22-Aug-07	15-Jul-09	573	564	424	390	1	-8%	-7%
Cipla Ltd.	4-Dec-08	15-May-09	351	478	184	231	2	25%	-8%
GAIL (India)	22-Aug-07	29-Nov-07	573	784	199	279	10	40%	2%
HDFC	22-Aug-07	29-Jun-10	573	711	1,901	2,902	34	53%	23%
Hindustan Unilever	21-Aug-08	6-Nov-09	573	650	236	273	11	16%	2%
Infosys Tech	29-Nov-07	1-Dec-09	784	683	1,570	2,395	27	53%	75%
Marico	22-Aug-07	15-May-09	573	478	58	63	1	9%	31%
Maruti Suzuki	15-May-09	28-Apr-10	478	723	848	1,271	4	50%	-1%
ONGC	22-Aug-07	22-Sep-09	573	680	809	1,155	34	43%	20%
Reliance Infra	22-Aug-07	29-Nov-07	573	784	725	1664	7	130%	68%
Sobha Developers	27-Sep-07	21-Aug-08	687	583	856	264	8	-69%	-64%
Sun Pharmaceutical	22-Aug-07	15-Jul-09	573	564	922	1,216	12	32%	34%
Tata Steel	22-Aug-07	21-Aug-08	573	583	503	589	13	17%	15%
TCS	22-Aug-07	27-Sep-07	573	687	512	531	7	4%	-14%
Union Bank	22-Aug-07	13-Aug-09	573	615	126	213	5	70%	58%
Zee Entertainment	21-Aug-08	28-Apr-10	571	723	209	303	2	45%	15%

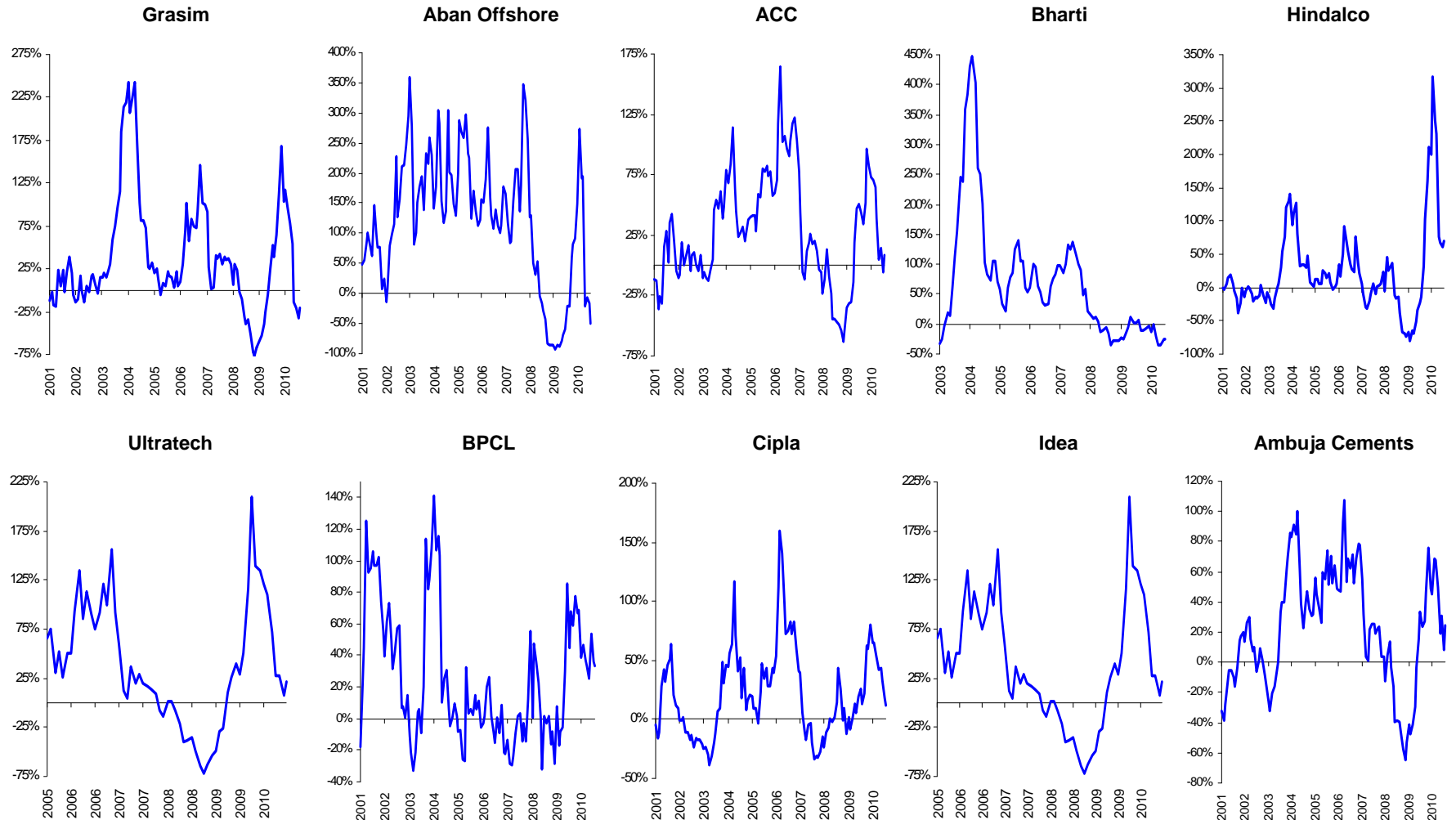
Source: FactSet, MSCI, Bloomberg, Morgan Stanley Research. Past performance is no guarantee of future results. Results shown do not include transaction costs.

Please note performance of Cairn and Sesa Goa has been considered up to 13 August 2010. Morgan Stanley & Co. Limited is acting as financial adviser and sponsor to Vedanta Resources PLC ("Vedanta") on Vedanta Group's proposed acquisition of 51% to 60% of Cairn India Limited ("Cairn India"), as announced on 16 August 2010. Morgan Stanley & Co. International plc. is also Corporate Broker to Vedanta.

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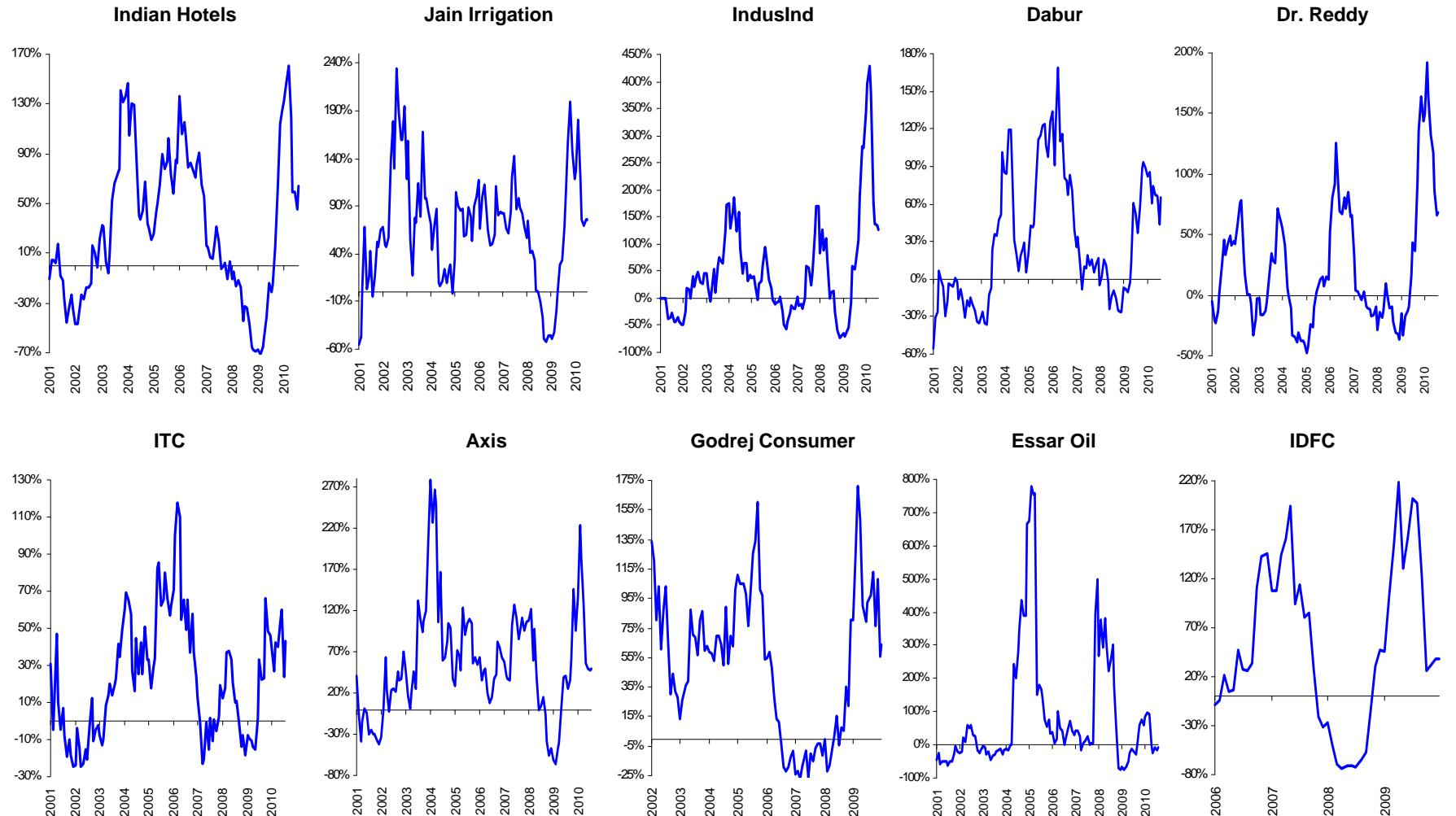
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YoY Absolute Returns (Top 10 Stocks)



Sources: FactSet, Morgan Stanley Research.

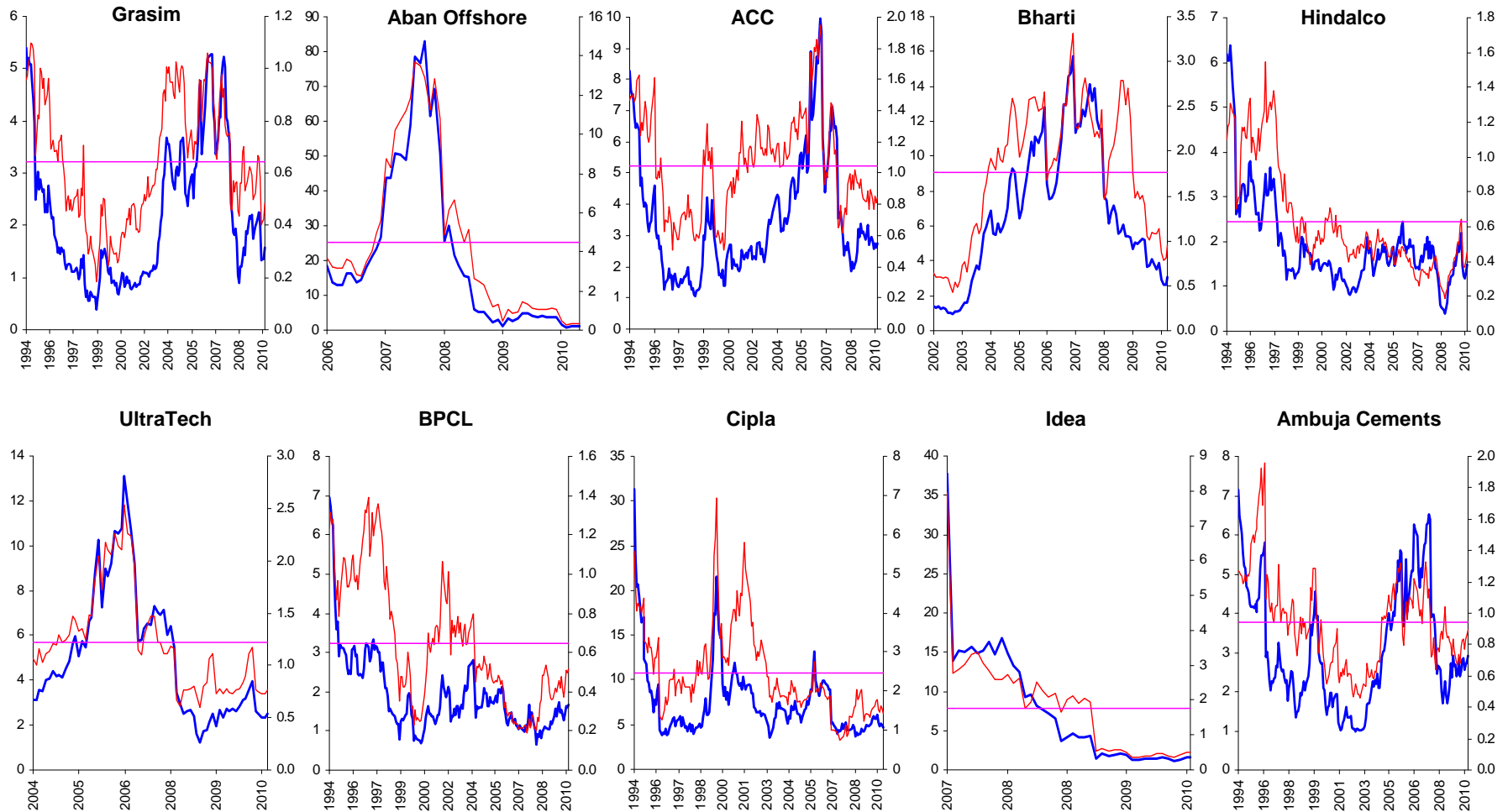
YoY Absolute Returns (Bottom 10 Stocks)



Sources: FactSet, Morgan Stanley Research.

Relative P/B to MSCI India (Top 10 Stocks)

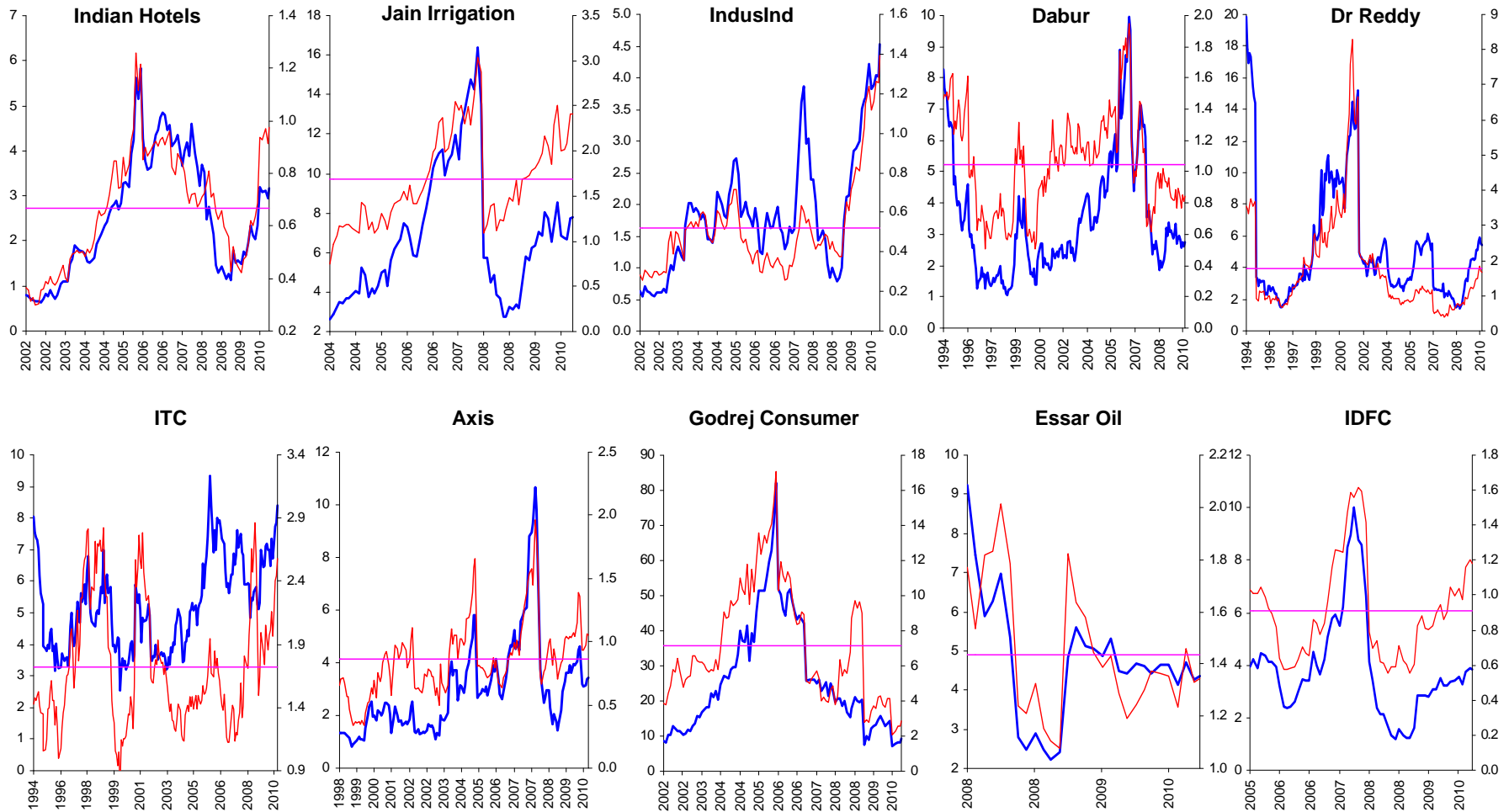
Dark blue Line – Price to Book – LS, Light red line – Sector P/B Relative to MSCI India – RS, Pink Line - Long Term Average of Relative P/B - RS



Source: FactSet, MSCI, Morgan Stanley Research

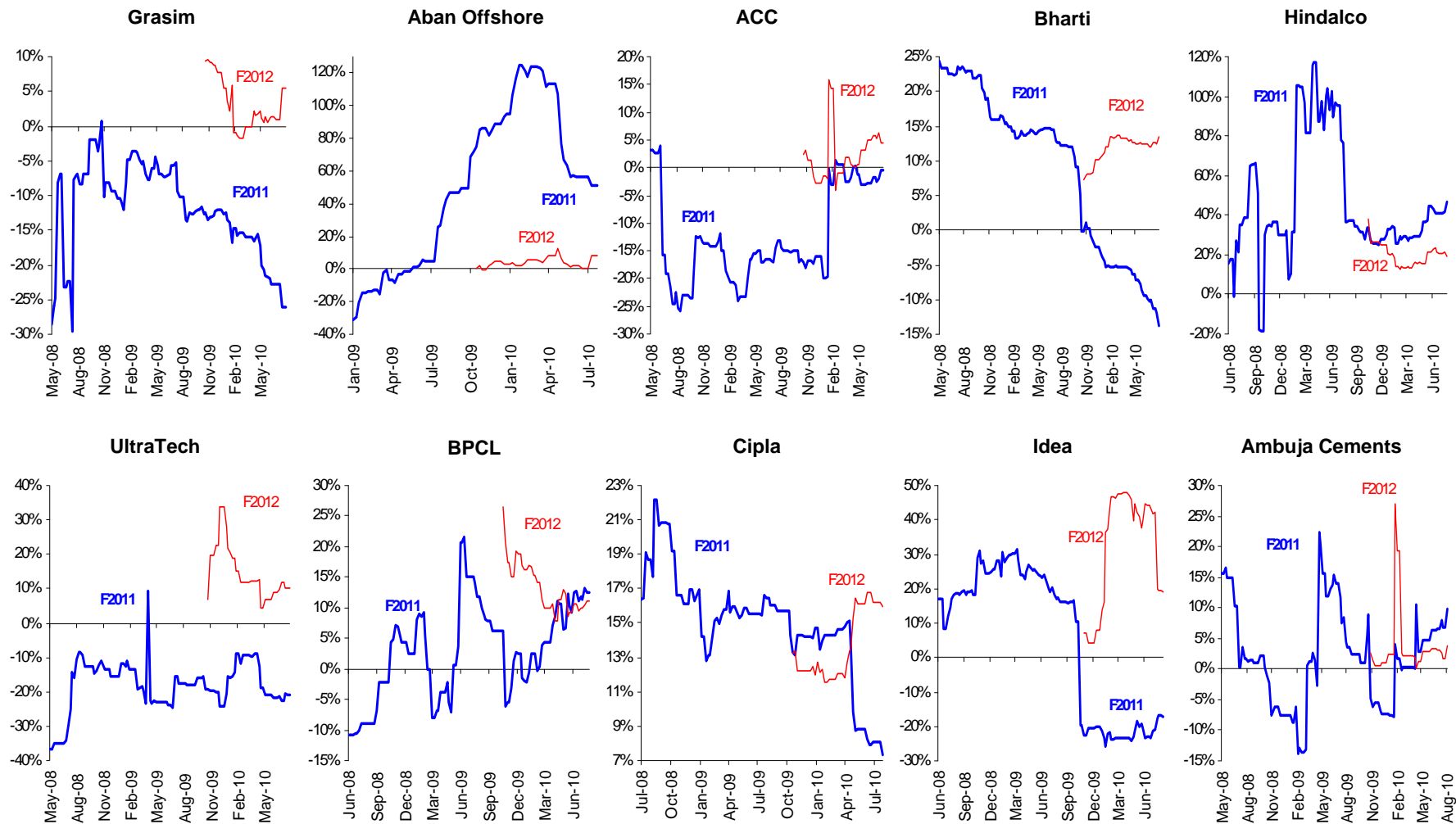
Relative P/B to MSCI India (Bottom 10 Stocks)

Dark blue Line – Price to Book – LS, Light red line – Sector P/B Relative to MSCI India – RS, Pink Line - Long Term Average of Relative P/B - RS



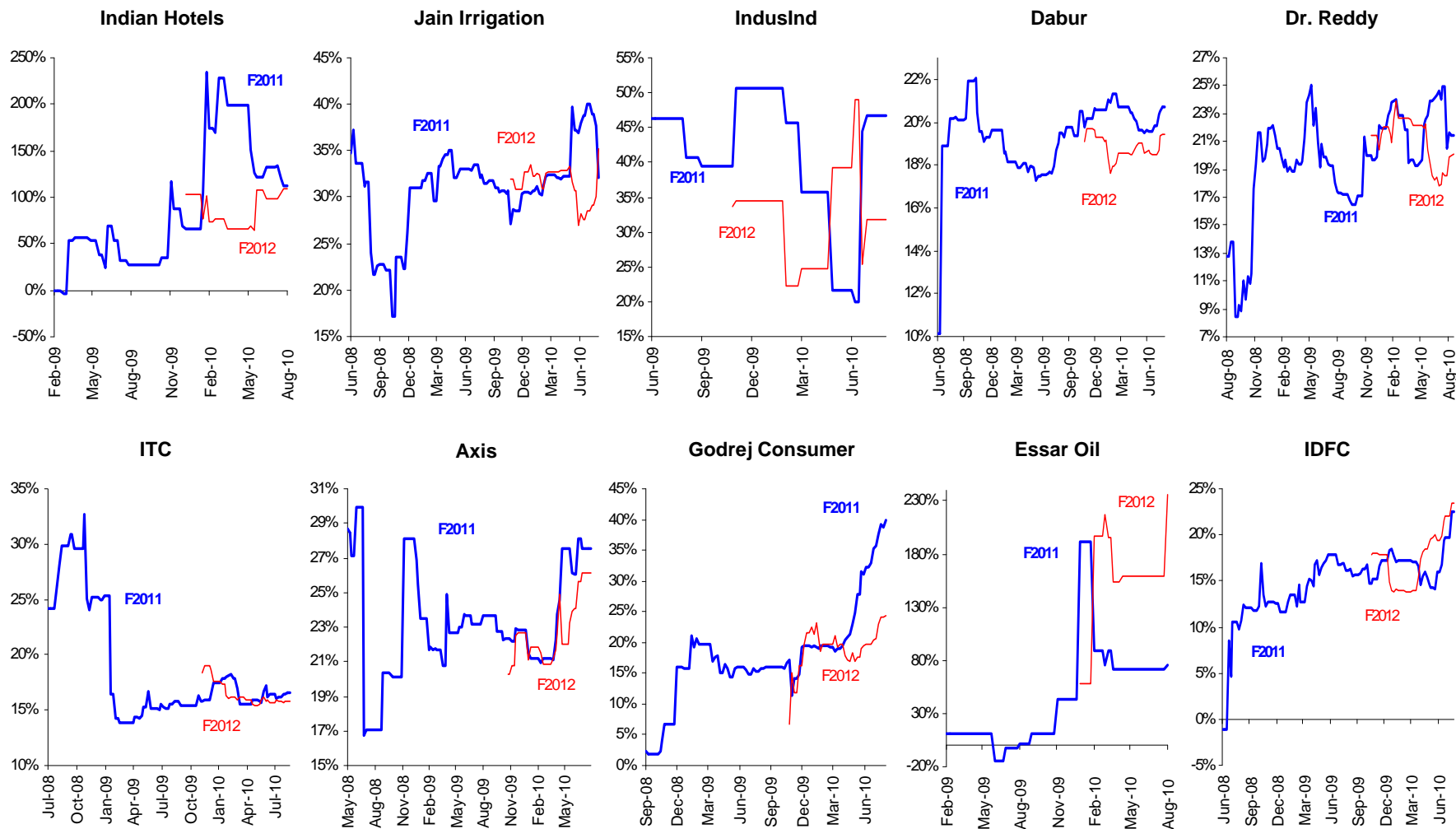
Source: FactSet, MSCI, Morgan Stanley Research

Consensus Earnings Growth (Top 10 Stocks)



Sources: FactSet, MSCI, IBES, Morgan Stanley Research

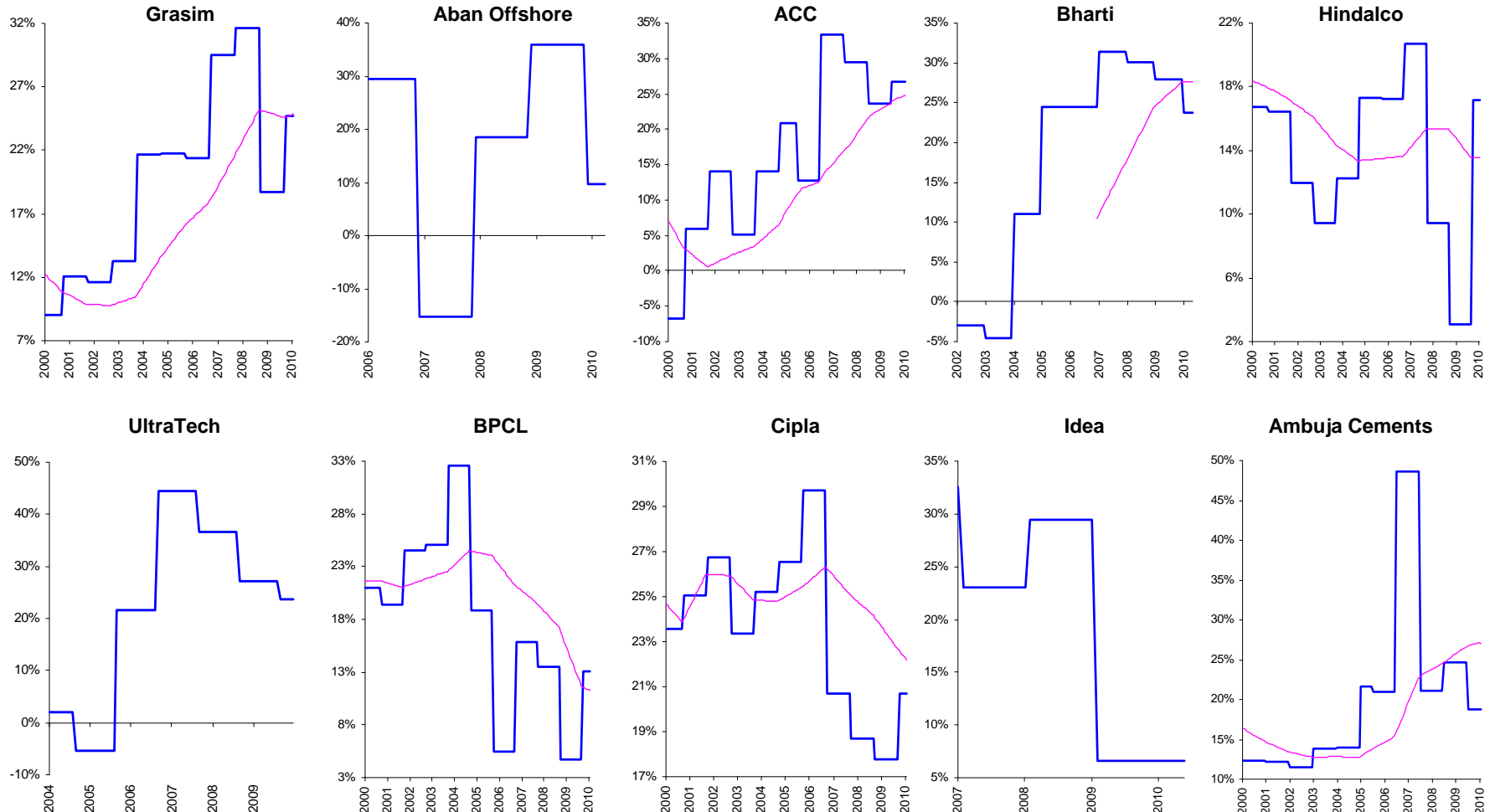
Consensus Earnings Growth (Bottom 10 Stocks)



Sources: FactSet, MSCI, IBES, Morgan Stanley Research

ROE Trend (Top 10 Stocks)

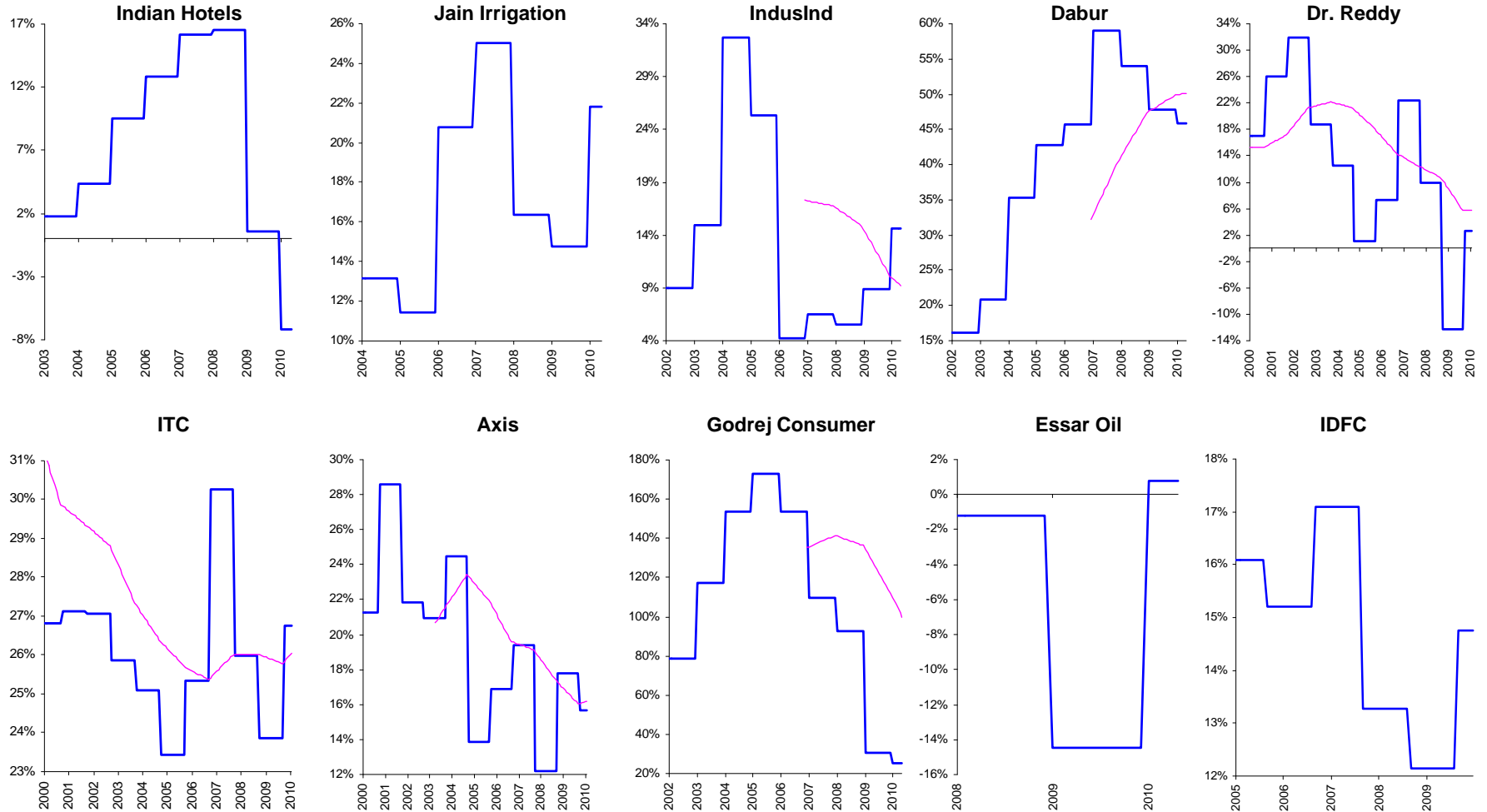
Dark blue Line – Trailing ROE, Pink Line - 5 Year Moving Avg



Sources: FactSet, MSCI, Morgan Stanley Research.

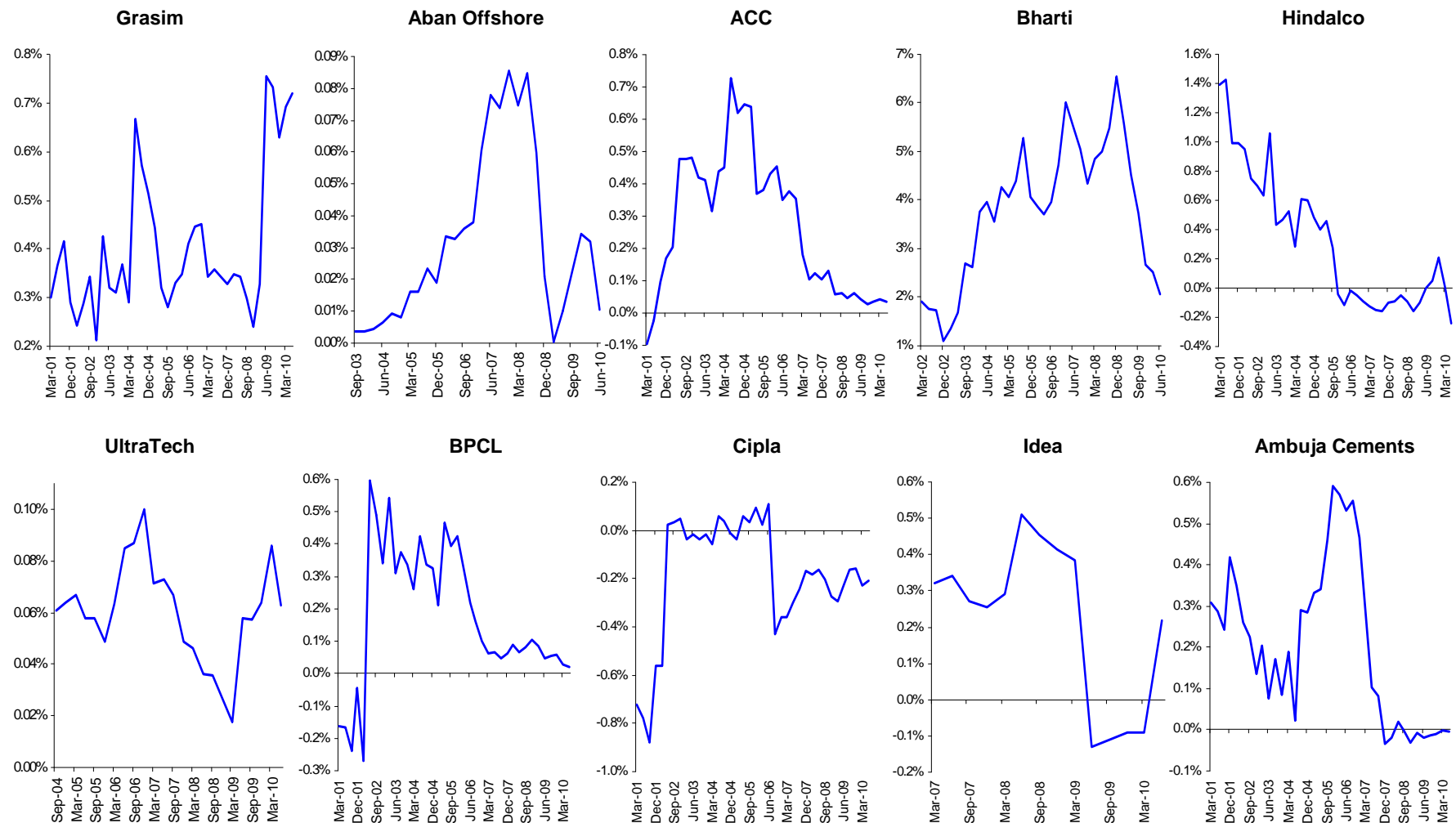
ROE Trend (Bottom 10 Stocks)

Dark blue Line – Trailing ROE, Pink Line - 5 Year Moving Avg



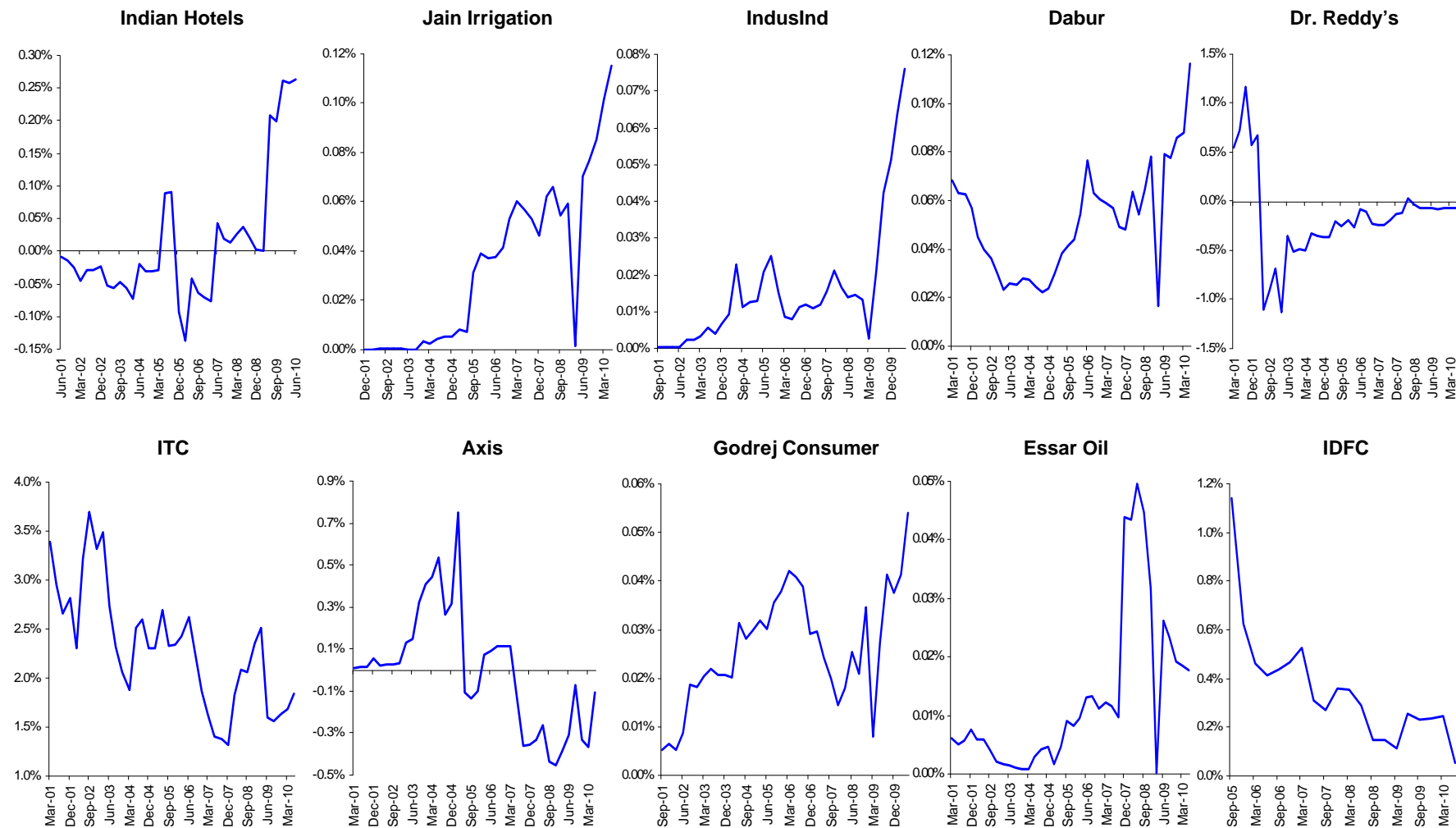
Sources: FactSet, MSCI, Morgan Stanley Research.

Total Institutional Holdings: Positions Relative to MSCI India (Top 10 Stocks)



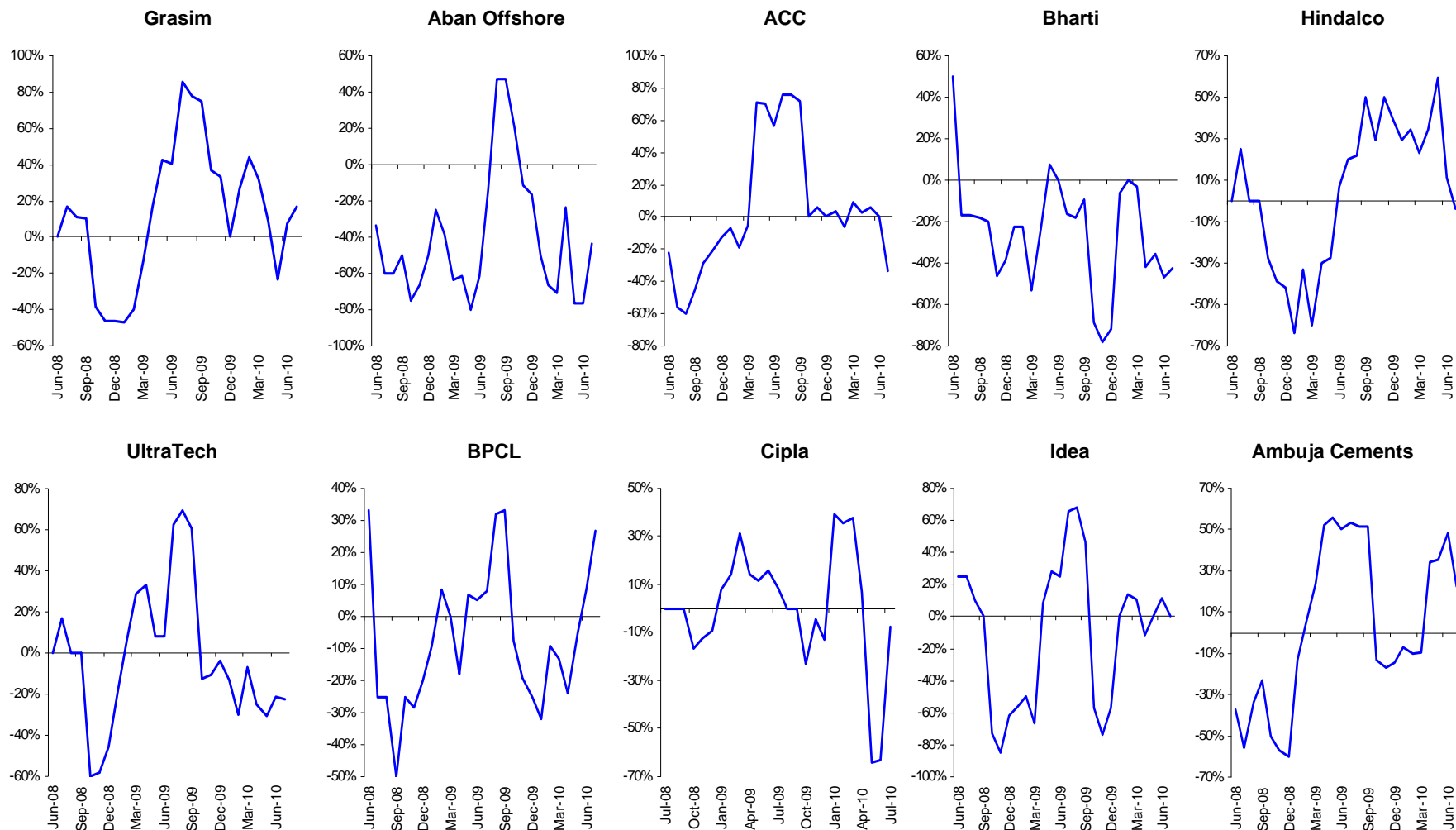
Sources: FactSet, MSCI, IBES, Morgan Stanley Research. Calculated as total institutional stock ownership minus the sector weight in MSCI India Index.

Total Institutional Holdings: Positions Relative to MSCI India (Bottom 10 Stocks)



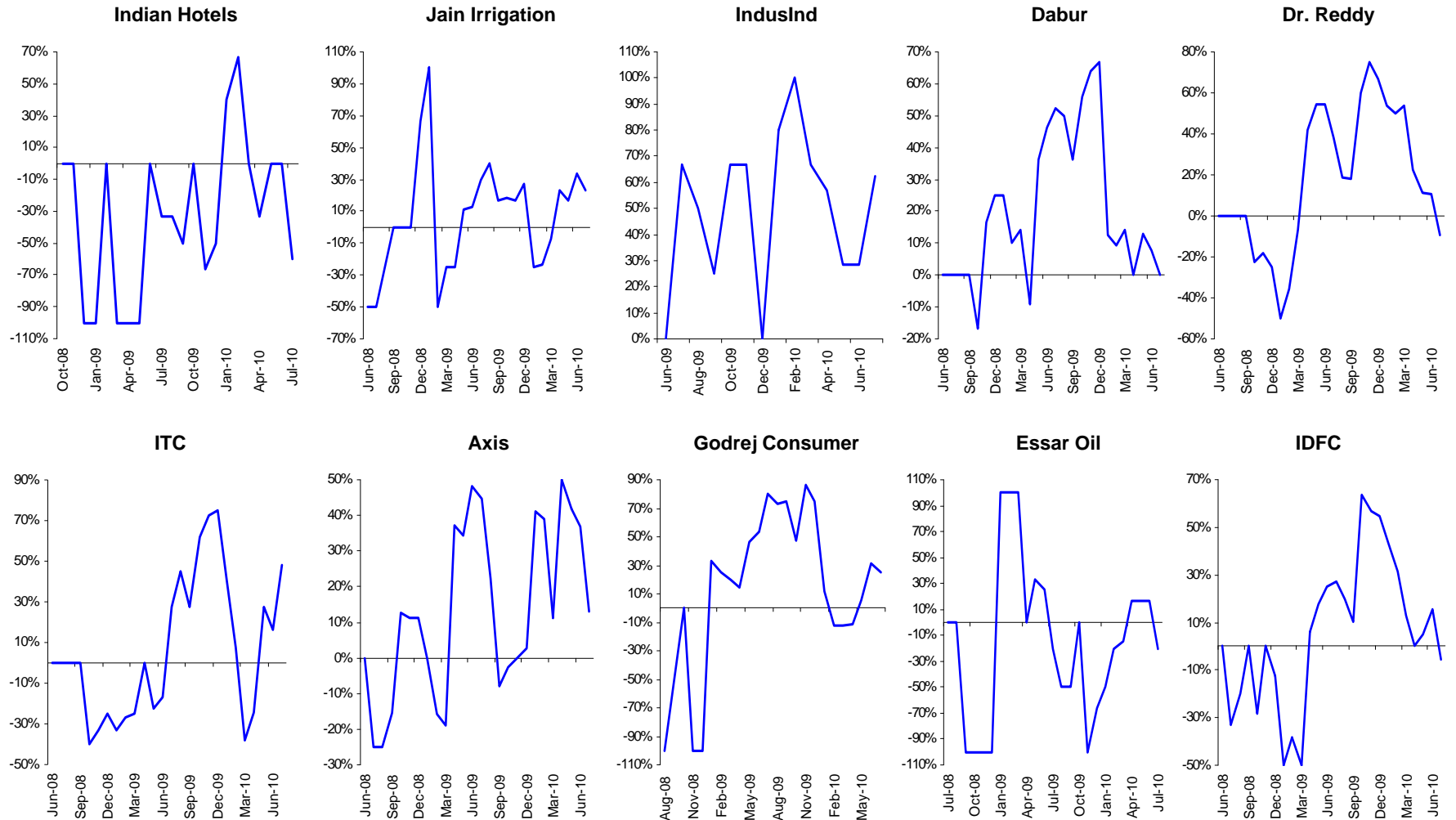
Source: FactSet, MSCI, Morgan Stanley Research. Calculated as total institutional stock ownership minus the sector weight in MSCI India Index.

Sell-Side Consensus Net Buy Ratio (Top 10 Stocks)



Source: FactSet, Morgan Stanley Research. Stock consensus rating is calculated as ratio of net buy ratings of the stock to the total number of ratings of the stock.

Sell-Side Consensus Net Buy Ratio (Bottom 10 Stocks)



Source: FactSet, Morgan Stanley Research. Stock consensus rating is calculated as ratio of net buy ratings of the stock to the total number of ratings of the stock.



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(as of July 31, 2010)

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Stock Rating Category	Coverage Universe		Investment Banking Clients (IBC)		
	Count	% of Total	Count	% of Total IBC	% of Rating Category
Overweight/Buy	1095	42%	380	44%	35%
Equal-weight/Hold	1123	43%	388	45%	35%
Not-Rated/Hold	14	1%	4	0%	29%
Underweight/Sell	362	14%	93	11%	26%
Total	2,594		865		

Data include common stock and ADRs currently assigned ratings. An investor's decision to buy or sell a stock should depend on individual circumstances (such as the investor's existing holdings) and other considerations. Investment Banking Clients are companies from whom Morgan Stanley received investment banking compensation in the last 12 months.

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Overweight (O or Over) - The stock's total return is expected to exceed the total return of the relevant country MSCI Index, on a risk-adjusted basis over the next 12-18 months.

Equal-weight (E or Equal) - The stock's total return is expected to be in line with the total return of the relevant country MSCI Index, on a risk-adjusted basis over the next 12-18 months.

Not-Rated (NR) - Currently the analyst does not have adequate conviction about the stock's total return relative to the relevant country MSCI Index on a risk-adjusted basis, over the next 12-18 months.

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Unless otherwise specified, the time frame for price targets included in Morgan Stanley Research is 12 to 18 months.

Analyst Industry Views

Attractive (A): The analyst expects the performance of his or her industry coverage universe over the next 12-18 months to be attractive vs. the relevant broad market benchmark, as indicated below.

In-Line (I): The analyst expects the performance of his or her industry coverage universe over the next 12-18 months to be in line with the relevant broad market benchmark, as indicated below.

Cautious (C): The analyst views the performance of his or her industry coverage universe over the next 12-18 months with caution vs. the relevant broad market benchmark, as indicated below.

Benchmarks for each region are as follows: North America - S&P 500; Latin America - relevant MSCI country index or MSCI Latin America Index; Europe - MSCI Europe; Japan - TOPIX; Asia - relevant MSCI country index.

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