India Market Strategy --Maintain OVERWEIGHT

Radical solutions required for the growing problem of RIL's index weightings

Nilesh Jasani / Research Analyst / 91 22 6777 3720 / nilesh.jasani@credit-suisse.com
Arya Sen / Research Analyst / 91 22 6777 3807 / arya.sen@credit-suisse.com

- Reliance Industries' neutral weights have been rising rapidly, causing problems for all types of long-only institutional investors. The weights in Nifty and MSCI India have crossed 13% and 17%, respectively, and could rise further by 100-200 bp in the months ahead.
- Investors constrained by the ceiling that force them to hold less than 10% of assets under management in the stock have lost over 130 bp of relative performance so far this year simply because of such rules.
- Most foreign investors do not have regulatory constraint holding them back. Such investors should either seek to raise the issue of the limit with their clients or adopt benchmarks like MSCI 10/40 that reduce the tracking error.
- The situation is trickier for local investors. They should urge a regulatory review of the imposed limits or work on popularising a more suitable benchmark with the help of the exchanges.
- Highly underowned Reliance Industries – owned about a third less than the weights in various benchmarks – could begin to command a continuous valuation premium until the ownership constraints are somehow removed or reduced.

The "headache" of RIL outperformance

Long-only investors rarely mind well-deserved, good performance by any stock – except possibly when it comes from Reliance Industries (RELI.BO, Rs1896.00, NEUTRAL [V], TP Rs1424.00) these days. In an otherwise diversified Indian market, RIL's size has begun to create problems for many fund managers. The following table on institutional holding versus neutral weights makes this clear.

Figure 1: On a single stock around 500 bp tracking error and growing

	Reliance holding as % of portfolio value					Neutral weight	
Date	All institutions	Foreign	Local	MFs	Insurers	MSCI India	Nifty wt
12/31/2001	9.5	10.8	8.1	13.5	n/a	n/a	11.9
12/31/2002	9.2	10.4	8.2	12.9	n/a	13.1	12.1
12/31/2003	10.0	13.4	6.2	4.3	n/a	15.0	12.8
12/31/2004	5.7	6.7	4.1	2.5	n/a	12.1	8.3
12/31/2005	5.4	6.3	3.9	2.3	n/a	12.6	9.2
12/31/2006	6.2	6.8	4.9	3.6	7.6	11.5	9.0
12/31/2007	8.0	8.8	6.5	5.3	9.8	15.7	11.9
12/31/2008	7.9	8.9	6.2	5.0	8.7	14.5	10.6
3/31/2009	10.1	11.7	7.8	6.6	10.4	16.9	12.7

Source: CMIE, Bloomberg, MSCI, Credit Suisse estimates.

Institutional investors of all kinds are about 500 bp underweight on RIL, which in most cases is not deliberate but forced. Given the stock's outperformance this year, an average fund manager has likely lost anywhere between 130-180 bp of relative performance simply because of the tracking error on one stock.

The problem could grow further. With the completion of RIL-Reliance Petroleum (RPET.BO, Rs 115.05, Not Rated) merger, the stock's weightings in MSCI India and Nifty could rise by 100 bp and 200 bp, respectively. And this may not be all. With around US$6 bn of cash on its balance sheet and nearing the end of its major capital expenditure cycle, there is a possibility that it acquires some large-sized assets globally in the next few quarters. Effectively, one cannot rule out the possibility of the stock's neutral weights moving into the twenties in MSCI India in 2010.

Foreign investors have easier available options

The problem is for benchmark investors. For domestic benchmark investors, there is a regulator-imposed rule that they can not own more than 10% of their assets under management in a single stock. Similar regulatory limits do not exist for those from outside, yet many have such limits either self-imposed or compelled by clients for their Indian portfolio.

For foreign investors who feel constrained by such limits, the first solution should be an attempt to have the limits waived. We calculate that Samsung Electronics (005930.KS, W569,000, NEUTRAL, TP W560,000)in Korea has been more than 20% of total foreign holding in the country for many years. Similar examples may exist for the largest stocks in many other markets. If this is true, it could be possible to have less restrictive limits by explaining the sudden and growing nature of the problem to those involved in setting them.

The other solution is adoption of benchmarks like MSCI 10/40 index which incorporate investment constraints in index performance calculations. MSCI India 10/40 index has underperformed MSCI India by 240 bp since the beginning of 2009, largely because of the lower weight of RIL.

Domestic investors should seek a regulator review

The situation is trickier for local investors. The solution lies with bodies outside the investment community. We feel that the regulator, Securities and Exchange Board of India, should review the problem at the earliest to make sure that performance of the fund industry does not appear worse than it is because of things not in the control of investment managers. It should consider allowing the eventual investors to permit investments up to the neutral weight for large stocks.

Alternatively, the two stock exchanges could be asked to actively develop and promote new benchmarks like their version of MSCI 10/40 index that take into account regulatory limits.

Underownership benefits for RIL stocks

Reliance Industries' stock has become so big in global indices that it has begun to dwarf the weights of a few small emerging markets. For almost all index-linked investor in India, the stock is now an allocation – i.e., underweight or overweight – decision rather than a buy or a sell decision.

There is a popular saying in financial markets that when a market is substantially under-owned, it does not underperform or fall as quickly. This adage should be remembered for the RIL stock going forward. Even without the changes that allow most investors to hold much more of it, the stock could command some valuation premium not justified by its fundamentals simply because few long-only investors could afford to increase the tracking error versus the benchmark.

Companies Mentioned *(Price as of 08 May 09)*
Reliance Industries (RELI.BO, Rs1896.00, NEUTRAL [V], TP Rs1424.00)
Samsung Electronics (005930.KS, W569,000, NEUTRAL, TP W560,000)
Reliance Petroleum (RPET.BO, Rs115.05, NOT RATED)

Disclosure Appendix

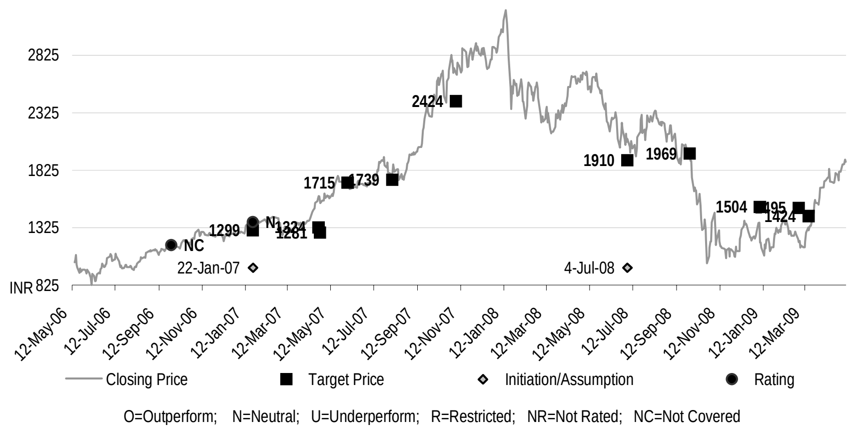
Important Global Disclosures

Nilesh Jasani & Arya Sen each certify, with respect to the companies or securities that he or she analyzes, that (1) the views expressed in this report accurately reflect his or her personal views about all of the subject companies and securities and (2) no part of his or her compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this report.

See the Companies Mentioned section for full company names.

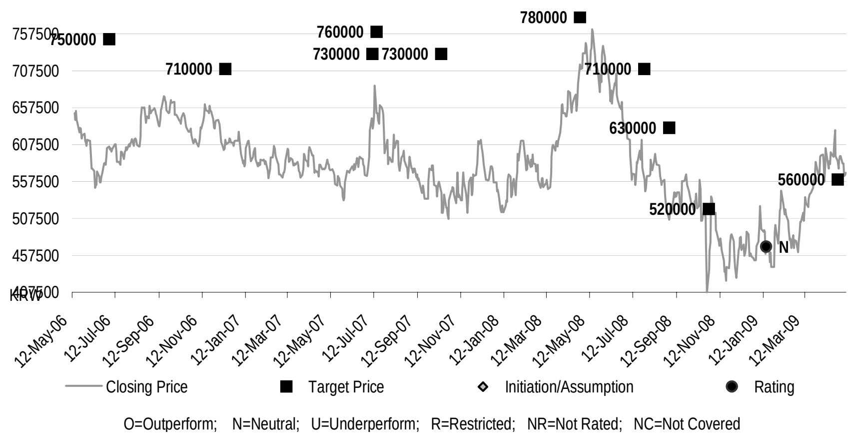
3-Year Price, Target Price and Rating Change History Chart for RELI.BO

RELI.BO Date	Closing Price (INR)	Target Price (INR)	Rating	Initiation/ Assumption
29-Sep-06	1,171.05		NC	
22-Jan-07	1,373.45	1299	N	X
25-Apr-07	1,599.85	1324		
27-Apr-07	1,538.2	1281		
5-Jun-07	1,745.05	1715		
7-Aug-07	1,805.85	1739		
5-Nov-07	2,663.65	2424		
4-Jul-08	2099	1910		X
30-Sep-08	1,946.35	1969		
7-Jan-09	1,196.8	1504		
3-Mar-09	1,199.05	1495		
17-Mar-09	1,300.35	1424		



3-Year Price, Target Price and Rating Change History Chart for 005930.KS

005930.KS Date	Closing Price (KRW)	Target Price (KRW)	Rating	Initiation/ Assumption
3-Jul-06	605000	750000		
14-Dec-06	614000	710000		
10-Jul-07	629000	730000		
16-Jul-07	650000	760000		
15-Oct-07	542000	730000		
28-Apr-08	716000	780000		
28-Jul-08	560000	710000		
1-Sep-08	506000	630000		
27-Oct-08	438000	520000		
16-Jan-09	469000		N	
27-Apr-09	585000	560000		



The analyst(s) responsible for preparing this research report received compensation that is based upon various factors including Credit Suisse's total revenues, a portion of which are generated by Credit Suisse's investment banking activities.

Analysts' stock ratings are defined as follows***:

Outperform (O): The stock's total return is expected to exceed the industry average* by at least 10-15% (or more, depending on perceived risk) over the next 12 months.

Neutral (N): The stock's total return is expected to be in line with the industry average* (range of ±10%) over the next 12 months.

Underperform (U):** The stock's total return is expected to underperform the industry average* by 10-15% or more over the next 12 months.

**The industry average refers to the average total return of the relevant country or regional index (except with respect to Europe, where stock ratings are relative to the analyst's industry coverage universe).*

***In an effort to achieve a more balanced distribution of stock ratings, the Firm has requested that analysts maintain at least 15% of their rated coverage universe as Underperform. This guideline is subject to change depending on several factors, including general market conditions.*

****For Australian and New Zealand stocks a 7.5% threshold replaces the 10% level in all three rating definitions, with a required equity return overlay applied.*

Restricted (R): In certain circumstances, Credit Suisse policy and/or applicable law and regulations preclude certain types of communications, including an investment recommendation, during the course of Credit Suisse's engagement in an investment banking transaction and in certain other circumstances.

Volatility Indicator [V]: A stock is defined as volatile if the stock price has moved up or down by 20% or more in a month in at least 8 of the past 24 months or the analyst expects significant volatility going forward.

Analysts' coverage universe weightings are distinct from analysts' stock ratings and are based on the expected performance of an analyst's coverage universe* versus the relevant broad market benchmark:**

Overweight: Industry expected to outperform the relevant broad market benchmark over the next 12 months.
Market Weight: Industry expected to perform in-line with the relevant broad market benchmark over the next 12 months.
Underweight: Industry expected to underperform the relevant broad market benchmark over the next 12 months.
**An analyst's coverage universe consists of all companies covered by the analyst within the relevant sector.*
***The broad market benchmark is based on the expected return of the local market index (e.g., the S&P 500 in the U.S.) over the next 12 months.*

Credit Suisse's distribution of stock ratings (and banking clients) is:

	Global Ratings Distribution	
Outperform/Buy*	36%	(56% banking clients)
Neutral/Hold*	44%	(58% banking clients)
Underperform/Sell*	18%	(48% banking clients)
Restricted	2%	

**For purposes of the NYSE and NASD ratings distribution disclosure requirements, our stock ratings of Outperform, Neutral, and Underperform most closely correspond to Buy, Hold, and Sell, respectively; however, the meanings are not the same, as our stock ratings are determined on a relative basis. (Please refer to definitions above.) An investor's decision to buy or sell a security should be based on investment objectives, current holdings, and other individual factors.*

Credit Suisse's policy is to update research reports as it deems appropriate, based on developments with the subject company, the sector or the market that may have a material impact on the research views or opinions stated herein.

Credit Suisse's policy is only to publish investment research that is impartial, independent, clear, fair and not misleading. For more detail please refer to Credit Suisse's Policies for Managing Conflicts of Interest in connection with Investment Research: http://www.csfb.com/research-and-analytics/disclaimer/managing_conflicts_disclaimer.html

Credit Suisse does not provide any tax advice. Any statement herein regarding any US federal tax is not intended or written to be used, and cannot be used, by any taxpayer for the purposes of avoiding any penalties.

See the Companies Mentioned section for full company names.
Price Target: (12 months) for (RELI.BO)
Method: Our target price for Reliance Industries is Rs1,424. We value the company using a discounted cash flow (DCF) based sum-of-the-parts valuation. We use a weighted average cost of capital (WACC) of 12.2%. Our DCF-based valuations for the core business - Chemicals and Refining - imply an EV/EBITDA (enterprise value/earnings before interest, tax, depreciation, amortisation) of 4.2x and 5.3x, respectively, for 2010, in line with its global peers. We value the existing known blocks in E&P at US$17.9bn, and the exploration at US$6.9bn for the reserves that have not been discovered.
Risks: There are risks on the downside to our Rs1,424 target price for Reliance Industries if: 1) global growth slows and chemical and refining margins revert back to mid-cycle faster than expected; 2) gas reserves are lower than modelled; 3) gas pricing is lower than modelled; 4) execution of the retail business build-out is short of our expectations on either market growth, or Reliance's market share.
Price Target: (12 months) for (005930.KS)
Method: Our 12-month target price of W560,000 for Samsung Electronics is derived using the average-low historical multiple since 1990, which is based on 1.5x price to book ratio (P/B).
Risks: Potential risks to our 12-month target price of W560,000 for Samsung Electronics are: slowing consumption in developed countries, due to macro concerns and rising interest rates, as well as won appreciation. Rising competition from new entrants in the company's key business area, NAND flash, could increase pricing competition, and market dominance may also have a negative impact on our earnings estimates.

See the Companies Mentioned section for full company names.
The subject company (RELI.BO, 005930.KS) currently is, or was during the 12-month period preceding the date of distribution of this report, a client of Credit Suisse.
Credit Suisse provided investment banking services to the subject company (RELI.BO, 005930.KS) within the past 12 months.
Credit Suisse expects to receive or intends to seek investment banking related compensation from the subject company (RELI.BO, 005930.KS) within the next 3 months.

Important Regional Disclosures

The analyst(s) involved in the preparation of this report have not visited the material operations of the subject company (RELI.BO, 005930.KS) within the past 12 months.

Restrictions on certain Canadian securities are indicated by the following abbreviations: NVS--Non-Voting shares; RVS--Restricted Voting Shares; SVS--Subordinate Voting Shares.
Individuals receiving this report from a Canadian investment dealer that is not affiliated with Credit Suisse should be advised that this report may not contain regulatory disclosures the non-affiliated Canadian investment dealer would be required to make if this were its own report.

For Credit Suisse Securities (Canada), Inc.'s policies and procedures regarding the dissemination of equity research, please visit http://www.csfb.com/legal_terms/canada_research_policy.shtml.

As of the date of this report, Credit Suisse acts as a market maker or liquidity provider in the equities securities that are the subject of this report.

Principal is not guaranteed in the case of equities because equity prices are variable.

Commission is the commission rate or the amount agreed with a customer when setting up an account or at anytime after that.

To the extent this is a report authored in whole or in part by a non-U.S. analyst and is made available in the U.S., the following are important disclosures regarding any non-U.S. analyst contributors:
The non-U.S. research analysts listed below (if any) are not registered/qualified as research analysts with FINRA. The non-U.S. research analysts listed below may not be associated persons of CSSU and therefore may not be subject to the NASD Rule 2711 and NYSE Rule 472 restrictions on communications with a subject company, public appearances and trading securities held by a research analyst account.

- Nilesh Jasani, non-U.S. analyst, is a research analyst employed by Credit Suisse Securities (India) Private Limited.
- Arya Sen, non-U.S. analyst, is a research analyst employed by Credit Suisse Securities (India) Private Limited.

Important MSCI Disclosures

The MSCI sourced information is the exclusive property of Morgan Stanley Capital International Inc. (MSCI). Without prior written permission of MSCI, this information and any other MSCI intellectual property may not be reproduced, re-disseminated or used to create any financial products, including any indices. This information is provided on an “as is” basis. The user assumes the entire risk of any use made of this information. MSCI, its affiliates and any third party involved in, or related to, computing or compiling the information hereby expressly disclaim all warranties of originality, accuracy, completeness, merchantability or fitness for a particular purpose with respect to any of this information. Without limiting any of the foregoing, in no event shall MSCI, any of its affiliates or any third party involved in, or related to, computing or compiling the information have any liability for any damages of any kind. MSCI, Morgan Stanley Capital International and the MSCI indexes are services marks of MSCI and its affiliates.

The Global Industry Classification Standard (GICS) was developed by and is the exclusive property of Morgan Stanley Capital International Inc. and Standard & Poor’s. GICS is a service mark of MSCI and S&P and has been licensed for use by Credit Suisse.

For Credit Suisse disclosure information on other companies mentioned in this report, please visit the website at www.credit-suisse.com/researchdisclosures or call +1 (877) 291-2683.

Disclaimers continue on next page.

Disclaimers

ASIA/PACIFIC: +852 2101-6000 **EUROPE: +44 (20) 7888-8888** **UNITED STATES OF AMERICA: +1 (212) 325-2000**