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Market Comment

UBS Investment Research

India Market Strategy

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Domestic drivers outweigh global worries

■ Raising our end-2007 Sensex target to 16,300; end-2008 target is 19,000

Driven by earnings upgrades, we raise our end-2007 Sensex target from 15,000 to 16,300, and introduce our end-2008 target of 19,000. Since January 2007, we have increased our FY08E Sensex EPS by 5.4%, and our FY09 EPS estimate by 9.6%. We believe domestic drivers for the Indian market override the concerns from recent dislocations in the global credit and mortgage markets. In our view, the key domestic drivers—a strong capex cycle and secular consumption growth—remain intact.

■ Corrections should be treated as buying opportunities

We believe global economic turmoil is far from over. UBS economists recently cut 2008 GDP growth forecasts in the US, the EU and Japan. In our opinion, the recent Fed rate and discount rate cuts—both 50bp—signal a reduced likelihood of financial market turmoil intensifying.

■ Overweight engineering, telecom, cement, auto, IT; raise banks to Neutral

Key themes for our portfolio are continued strength in the capex cycle and peaking interest rates. We therefore remain Overweight on capex-linked sectors, and increase the weighting on interest rate-sensitive sectors. We are Underweight pharma, energy (refining and marketing (R&M)) and utilities.

■ Our top picks: Reliance, Bharti, L&T, Grasim, Tata Steel

We expect earnings upgrades in the medium term for our top five companies, and look for the capex cycle to power Larsen and Toubro (L&T) and Grasim, exploration and production (E&P) assets to drive Reliance, continued growth in subscriber additions for Bharti and positive surprises on steel prices and raw material costs for Tata Steel.

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Summary and investment case

Domestic Indian market drivers override concerns on global credit markets

We believe domestic drivers for the Indian market override concerns arising out of the recent dislocations in the global credit and mortgage markets. In our view, the key domestic drivers—a strong capex cycle and secular growth in consumption due to sustainable rising income levels—remain intact. In addition, domestic interest rates could be peaking (though a significant interest rate decline may not happen near term), which could provide additional support to consumption demand in H2FY08 and more so in FY09.

We raise our end-2007 Sensex target to 16,300 from 15,000, and introduce our end-2008 target of 19,000

We raise our end-2007 Sensex target to 16,300 from 15,000, and introduce our end-2008 target of 19,000. Our target increase in 2007 is driven entirely by earnings upgrades. Our FY08E Sensex EPS has moved up 5.4% since January 2007, and our FY09 EPS estimate has risen 9.6%. Our target one-year forward PE at end-2007E is 16.5x, and 15.9x at 2008E-end. Given our Sensex EPS growth forecast of 19.4% in FY08 and 18.7% in FY09, we believe our target PEs are conservative.

Volatility due to global concerns may continue for some time

We believe the global economic situation remains tough. UBS economists have recently downgraded their GDP growth forecasts for 2008: in the US from 2.6% to 2.3%; the EU from 2.4% to 2.1%; and Japan from 1.9% to 1.8%. Although these are small adjustments, many of our global economists are highlighting downside risk. Our US economist Maury Harris ("Easing Rates and Forecasts", 14 September 2007) sees a 40% chance of recession in the US. However, these downgrades do not warrant a change in our economic outlook for Asia ex-Japan yet. We believe Asian (and Indian) economic fundamentals could suffer only in the event of a global recession—not in the soft-landing scenario we expect. We would treat any correction due to global economy concerns as a buying opportunity, not as a reason to worry about the Indian market.

EPS growth forecast at 19.4% in FY08, 18.7% in FY09; GDP growth forecast at 8.5% in FY08 and 9% in FY09

While global economic turmoil may lead to near-term volatility in the Indian market, ultimately the Indian economy remains driven by domestic factors (external trade constitutes only 33% of economy). These domestic drivers remain strong, and despite a sharp rise in interest rates (500bp in H1CY2007), IIP growth in FY08 YTD has been 9.6% (even after some slowdown in recent months), and GDP growth in Q1FY08 was 9.3%. The Reserve Bank of India's (RBI) monetary tightening measures are yielding results—visible in sharply declining inflation, declining bank credit growth, slowing IIP growth and declining auto sales. In response to monetary tightening and the consequent consumption slowdown, UBS economist Philip Wyatt recently cut his FY08 GDP growth forecast from 8.8% to 8.5%. Our FY09 GDP growth forecast remains 9%, pointing to a recovery from a cyclical slowdown in FY08.

Domestic political uncertainty could lead to volatility in 2008

Domestic political uncertainty is a significant risk to market valuations. Recent differences between the ruling UPA and the Left over the Nuclear Treaty with the US could escalate, leading—as some political observers believe—to a mid-term general election in 2008. In that event, not only could valuations suffer, but the capex cycle could also slow temporarily. However, if the composition of a new government is Congress- or BJP-led (which we believe is a highly probable outcome), the chances of a reversal of economic policy direction would be minimal.

In our view, the principal earnings drivers for the Indian market are likely to be:

(1) The continuation of a strong capex cycle, notwithstanding the temporary risk of a slowdown in the event of mid-term general elections in 2008.

(2) The peaking of domestic interest rates and the consequent revival of consumption in H2FY08, and more so in FY09.

Overweight engineering, IT, telecom, cement, auto

The above points lead us to maintain our Overweight rating on engineering, construction, capital goods and building materials. We move more into interest rate-sensitive sectors, and upgrade banks from Underweight to Neutral, and automobiles from Neutral to Overweight. We reduce our weighting on IT (though we remain Overweight) and pharmaceuticals (downgrade from Overweight to Underweight).

Table 1: UBS model portfolio sector tilt

Sector	Our portfolio weight	Benchmark weight	Recommendation
Telecom	9.0	4.8	Overweight
Engineering/Capital goods	14.0	9.8	Overweight
IT Services	18.0	16.3	Overweight
Automobiles	7.5	5.9	Overweight
Cement & conglomerates	5.0	3.7	Overweight
Banks & FIs	21.5	21.4	Neutral
Metals	2.5	2.6	Neutral
FMCG	5.0	5.9	Neutral
Pharmaceuticals	2.5	3.9	Underweight
Property	0.0	1.7	Underweight
Utilities	0.0	1.8	Underweight
Energy	15.0	20.9	Underweight

Source: UBS estimates

Our top company picks are: Reliance, L&T, Bharti, Tata Steel and Grasim. We expect all five to experience earnings upgrades in the medium term.

Table 2: Valuations of our top five picks

	Mkt Cap (US$m)	Price (Rs)	Price Target	EV/EBITDA (x)			PE (x)			PEG (x)	EVEG (x)	Avg Daily Turnover
Stock	19 Sep 2007	19 Sep 2007	(Rs)	FY07	FY08E	FY09E	FY07	FY08E	FY09E	(FY07-09E)	(FY07-09E)	US$m
Tata Steel	10805.8	744.7	875	3.8	1.4	1.4	10.2	6.9	6.5	0.40	0.06	15.47
Reliance Industries	75633.4	2172.9	2340	10.1	8.5	6.6	27.8	22.4	19.4	1.42	0.43	36.90
Bharti Televentures	42015.1	886.3	1125	13.7	8.9	6.4	39.5	25.5	19.1	0.90	0.29	5.30
Grasim	7624.7	3328.0	3745	6.5	5.1	4.6	15.5	11.3	10.1	0.65	0.34	3.06
Larsen & Toubro	18701.2	2669.8	2950	13.0	9.5	7.1	40.7	30.7	22.8	1.21	0.37	18.19

Source: UBS estimates

The local vs global debate

Over the past couple of months the investing community's focus has been on dislocations in the credit markets of developed economies (particularly the US) and their impact on US economic growth and consumption. In the context of emerging markets, investors seem to be concerned about the impact of a US slowdown on emerging economies, particularly exporting nations. Another source of worry for EM investors is the possibility of liquidity declining. Concern over Indian growth has escalated of late, with IIP growth data and consumer durable sales (particularly autos and two-wheelers) disappointing relative to market expectations.

In this section we look at the local issues first, and then consider global growth issues. We continue to believe that for the Indian market local issues (growth, interest rates and inflation, politics) have more influence than the impact of a possible global economic slowdown.

The domestic economy

Structural drivers of domestic economic growth—investment cycle, consumption—remain intact

The situation the Indian market faces today seems like déjà vu. In our report a year ago ("Growing in a slowing world", 27 September 2006) we examined whether the Indian economy could continue to grow in the face of a global economic slowdown. We concluded that Indian growth is likely to be sustainable, as three structural drivers support Indian consumption and investment growth over the long term:

(1) The penetration levels of various consumer goods in India remain low. A gradual increase in penetration levels is happening, and an acceleration in penetration levels going forward is a strong possibility, in our view.

(2) The consumption and savings rate should increase due to improving demographics and increasing affluence of the Indian population.

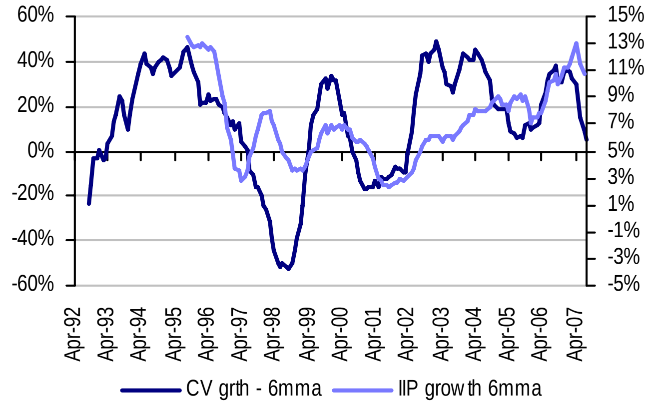
(3) Capex—both in infrastructure and industry—is rising steadily. We argue in a recent report ("How to play the investment boom", 5 July 2007) that the investment cycle is likely to provide a strong impetus to economic growth over the next four to five years.

We do not think investors doubt the sustainability of these structural economic and market drivers. Investors seem to be more concerned about potential interruptions to the structural growth story from cyclical corrections. Economic data, particularly IIP growth over past three to four months, shows that such a correction may already be under way.

Consumption has slowed in FY08

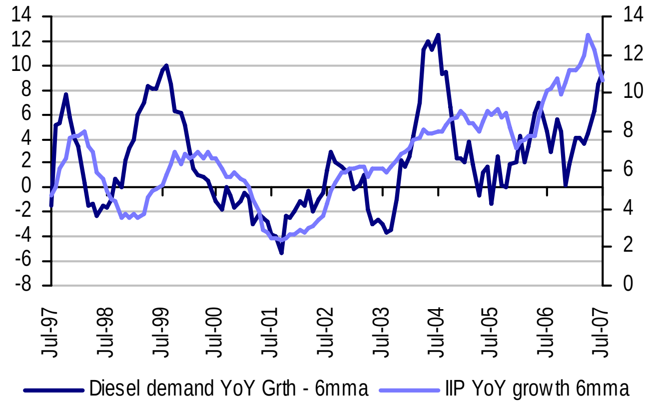
Charts 1-6 show that consumption goods sales, particularly those where a significant part is financed (primarily CV, autos and two-wheelers), have slowed significantly over the past 8-10 months. Cement demand growth, after slowing from July 2006 to June 2007, has revived over the past two months. Only diesel demand growth movement is completely divergent from IIP movement, but that is due to inventory build-up at dealers' (on the back of expectations of oil price hikes). Recent data on railway freight has been particularly worrisome because growth in road freight has historically been a good lead indicator of IIP.

Chart 1: CV demand growth and IIP growth



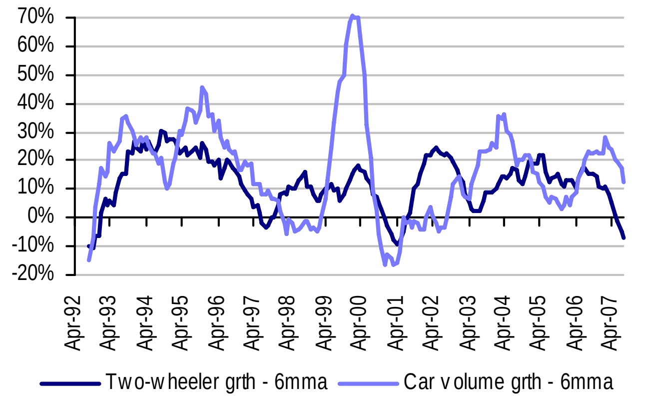
Source: Society of Indian Automobile Manufacturers (SIAM), CEIC

Chart 2: Diesel demand growth and IIP growth (%)



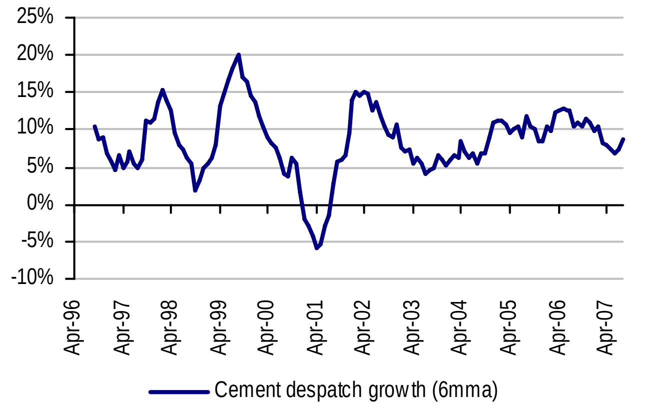
Source: Ministry of Petroleum, CEIC

Chart 3: Two-wheelers and car volume growth



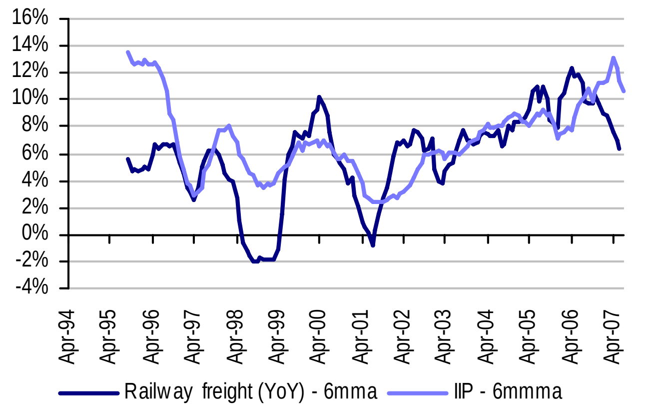
Source: SIAM

Chart 4: Cement despatch growth



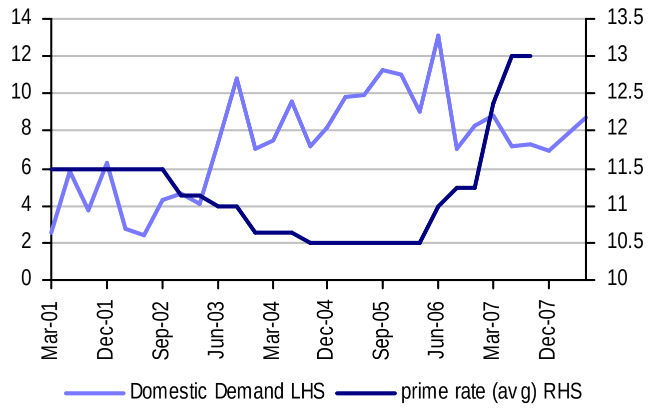
Source: Cement Manufacturers' Association (CMA)

Chart 5: Railway freight growth and IIP



Source: CMIE, CEIC

Chart 6: Domestic demand and prime lending rate (%)



Source: CEIC

UBS economist Philip Wyatt ("India: the mid-cycle correction", 31 August 2007) believes India is going through a temporary slowdown in growth in FY08 before a recovery in FY09. Philip believes the FY08 slowdown will be driven by a downturn in consumption, higher interest rates and slower consumer credit. Moreover, there is a concern that recent dislocations in the global credit market and the threat of a US recession could ration global capital for India, leading to an investment slowdown.

Temporary cyclical slowdown in FY08E, recovery in FY09E

We believe, however, that the current economic slowdown is temporary. The impact of capital rationing on investment could be modest, and transitory at worst. The interest rate cycle appears to have peaked (though rates may not decline appreciably near term), and that could lead to a consumption recovery in FY09.

Table 3: India—economic growth forecasts

(%)	FY07	FY08E	FY09E
By expenditure			
Real GDP	9.4	8.6	9.0
Private consumption	6.2	5.0	5.9
Government consumption	9.0	12.2	11.0
Gross fixed capital formation	14.6	13.0	15.2
Change in stocks	10.2	3.7	5.0
Domestic demand	9.2	7.9	9.1
Exports	8.6	5.0	15.0
Imports	11.4	9.1	16.1
By production			
Agriculture	2.7	3.0	3.0
Industry	11.0	9.8	11.0
- Mining	5.1	4.0	4.0
- Manufacturing	12.3	11.0	12.5
- Electricity	7.4	6.0	6.0
Services	11.0	9.8	10.0

Source: UBS Economic Research estimates

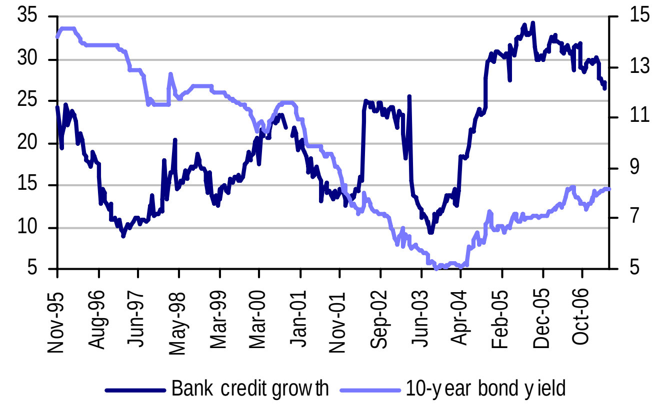
Table 3 shows we expect a recovery in FY09—not just in investment (gross fixed capital formation) but also in private consumption. We believe such a recovery would be driven by peaking interest rates, availability of large domestic capital for investment projects and implementation of projects already in the pipeline. We believe the recovery in FY09 should be led by two factors: (i) peaking interest rates and the consequent positive impact on private consumption; and (ii) continued support from a strong investment cycle.

Interest rates peaking

Credit growth and inflation have declined significantly

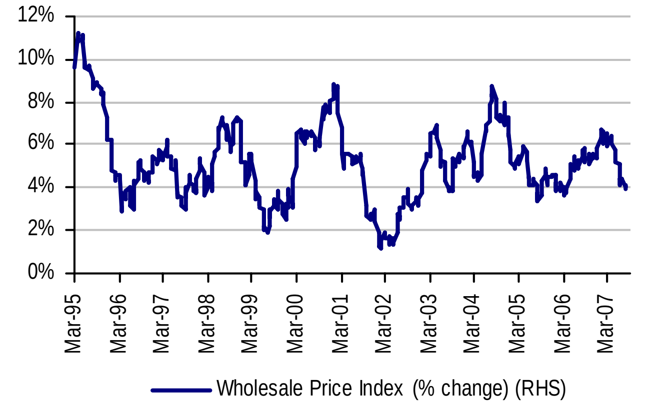
In our view, Indian interest rates—particularly lending rates—are close to peaking. Recent declines in mortgage rates announced by State Bank of India (SBI), Bank of Baroda (BoB) and a couple other public sector unit (PSU) banks point in this direction.

Chart 7: Credit growth and risk-free rate (%)



Source: RBI Bulletins, Bloomberg

Chart 8: WPI inflation



Source: CEIC

Recent evidence shows that RBI's aggressive tightening since late 2006 has had the desired effect on credit growth (Chart 7) and inflation (Chart 8). Both bank credit growth (latest reading 23.3%) and WPI inflation (latest 3.8%) are well within RBI's and the government's comfort zone (24-25% for credit growth and 4-5% for inflation). Admittedly, declines in these parameters were partly due to high bases in previous years, but that does not reduce the efficacy of RBI's tightening measures, in our view.

Credit growth slowdown has come primarily on the back of a decrease in personal loan growth (consumer and mortgage) from c25% a year ago to 10-12%. Consequently, banks (which are flush with liquidity after recent equity issuances), are attempting to revive consumer loan growth by reducing financing cost.

Industrial loan growth, on the other hand, has shrunk marginally (from 30% a year ago to 24% today) as the capex cycle (both government-led infrastructure and private industrial capex) remains strong.

Investment cycle firing on all cylinders

In a recent report ("How to play the investment boom", 5 July 2007) we argued that the Indian investment cycle is firing on all cylinders. The government targets US$320-350bn infrastructure capex in the 11th Five-Year Plan, and industrial capex could be US$250-300bn over the next three to four years. We estimate average annual real estate construction during FY08-11 at c40% higher than during FY01-07.

Infrastructure capex, industrial capex and real estate construction growing strongly

Table 4: Government's infrastructure investment targets in 11th plan

(Rs bn)	9th Plan (FY97-02)	10th plan (FY02-07)	11th Plan (FY07-12)
Airports	66	99	400
Irrigation	574	972	1,258
Ports	50	47	500
Power	866	1,581	4,200
Railways (including freight corridor)	464	694	3,220
Roads	546	1,329	2,140
Telecom	801	579	870
Tourism	6	25	29
Urban infrastructure + Housing	586	991	2,100
Total	3,959	6,317	14,717

Source: Plan documents, CIDC draft paper for construction sector in 11th Plan, UBS

Given the high capacity utilisation (more than 90%, according to a National Council for Applied Economic Research [NCAER] survey) in most sectors, industrial capex appears imperative for the Indian corporate sector. We expect a strong pick-up in industrial capex over the next three to five years. Our estimate suggests more than US$140bn in investments over the next four to five years by six leading capital-intensive sectors.

Table 5: Capex plans in key industries

(Rs bn)	Target expenditure (FY08-12)	Remarks
Steel	1,400	About 25-30MT capacity expected from Tata Steel, SAIL, Posco, Essar and RINL.
Oil & gas	1,637	About 110-120MT refining capacity under implementation/announced by RIL (27MT), IOC (20MT), MRPL (35MT), HPCL (19MT) and others.
Aluminium	475	Investments primarily from Vedanta (1.4MTPA alumina refinery in Orissa, expansion in copper and zinc), Hindalco (Alumina expansion by 3MT at four locations) and Nalco (expansion of Aluminium capacity and Bauxite mining capacity at Vizag plant).
Cement	400	Over 100MT of new capacity announced, to be commissioned over four to five years. Equipment manufacturers have 50MT clinker capacity in their order backlog.
Auto	420	Large investments from Tata Motors (Rs120bn), M&M (Rs60bn), Ashok Leyland (Rs40-50bn), Maruti (Rsc50bn) and multinationals.
Telecom	1,271	Total capex by Bharti, Reliance Communication and BSNL.
Total	5,603	

Source: CRIS INFAC, UBS estimates

We also estimate that average annual real estate construction could be 3.42bn sq ft during FY08-11, compared to 2.38bn sq ft during FY01-07—driven by shortages in housing, office space and strong modern retail growth plans.

Table 6: Total real estate construction estimates

(m sq ft)	FY06	FY07	FY08E	FY09E	FY10E	FY11E
Residential	2,644.1	2,869	3,052	3,266	3,534	3,824
Commercial—IT/ITES	17.3	21	25	30	36	42
Commercial—Others	5.8	6.6	7.5	8.5	9.5	10.7
Retail	20	40	90	110	140	160
Hotels		2.6	3.8	8.1	9.6	4.5
Total	2,687	2,939	3,179	3,422	3,729	4,041

Source: UBS estimates

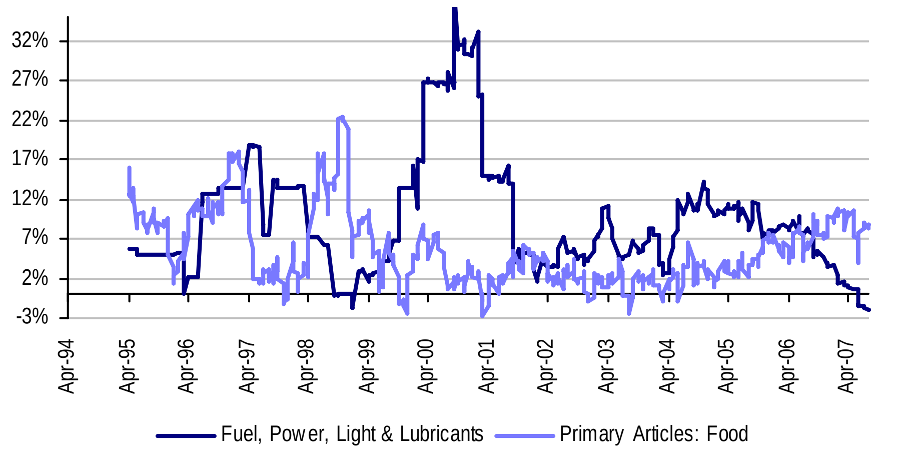
Finally, we believe that concerns on funding infrastructure projects are not as severe as they were earlier, because: (i) the government's fiscal deficit has declined over the past few years and alternative funding plans (primarily attracting private sector funds) are emerging; (ii) bank loans to infrastructure are growing rapidly, and given the risks to retail lending (due to the rise in interest rates and increase in risk weights), growing corporate and infrastructure loans seem to be a relatively less risky alternative for banks to achieve top-line growth; and (iii) pension and private equity funds are becoming more interested in infrastructure projects, given their predictable cash flows and income streams that are relatively uncorrelated with public equity markets.

Could inflation and interest rates spike again?

Oil prices and food prices constitute key risks to inflation

Since peaking at 6.5-7% in February 2007, inflation has declined to 3.5-4%, and all components of inflation apart from food prices have declined lately, as Chart 9 and Chart 10 show.

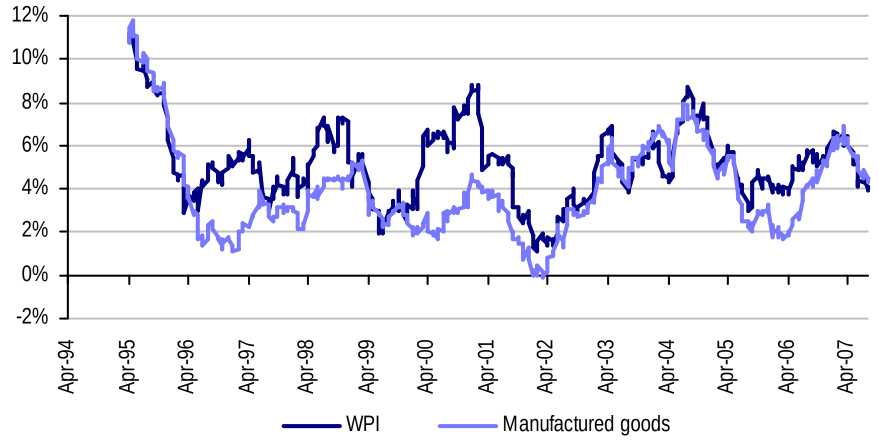
Chart 9: Food prices and fuel price inflation



Source: CEIC

Food forms 15.4% of WPI; manufactured goods 63.7%; fuel, power, etc, 14.2%; non-food primary articles (cotton, jute) 6.1%; and minerals 0.5%. Manufactured goods prices are largely linked to commodity (iron and steel, plastics, aluminum) prices.

Chart 10: Manufactured goods inflation



Source: CEIC

Philip Wyatt ("India: the mid-cycle correction", 31 August 2007) expects inflation to rise gradually to 4.5-5% in response to periodic domestic oil price adjustments and the low-base effect on foodgrain prices. Oil prices (particularly domestic diesel prices) remain a risk, in our opinion, with crude touching US$80/bbl. We estimate that to neutralise oil companies' under-recoveries at current prices, domestic diesel prices may have to be hiked Rs5/litre (15%) and petrol prices may have to be hiked Rs2.5/litre (5%). We believe this magnitude of hikes is unlikely in the current scenario, whereby domestic political considerations are coming to the forefront again.

We are less concerned about food article prices, as the 2007 monsoon has been good in terms of quantity and distribution, and *kharif* (autumn harvest) production is likely to be strong. The only risk we see could arise from strong global foodgrain prices. For example wheat prices are at all-time highs. They surged to US$8.69/bushel (CBOT, December delivery) on 18 September, up approximately 120% over one year. Minimal price support for wheat in India was raised by 15.4% YoY to Rs750/quintal for the 2006-07 rabi marketing season (RMS).

Monsoons and agri-production forecast

Good monsoons and good agricultural production could mitigate the food price risk

As Table 7 shows, 2007 has seen the best distribution of rainfall in the past five years. The Indian Meteorological Department (IMD) forecast of 29 June 2007 was for rainfall in 2007 to be around 93% of the long period average (model error of ±4%).

Table 7: Monsoon distribution history

Number of sub-divisions (year YTD)	2000	2001	2002	2003	2004	2005	2006	2007
Excess	5	2	1	6	1	6	6	13
Normal	24	26	16	27	23	21	19	17
Total (Excess/Normal)	29	28	17	33	24	27	25	30
Deficient	7	8	16	3	12	6	11	6
Scanty	0	0	3	0	0	3	0	0
Total (Deficient/Scanty)	7	8	19	3	12	9	11	6
Total	36	36	36	36	36	36	36	36
Agriculture production growth*	-2.0%	6.3%	-7.2%	10%	0%	6.0%	2.7%	3.0%

Source: Indian Meteorological Department (IMD), CEIC. * Agricultural production for 2007 is a UBS estimate

Advance estimates for *kharif* production reflect the impact of the good monsoon.

Table 8: Crop production advance estimates

(m tonnes)	FY07	FY08E	Forecast growth
Rice	78.3	80.1	2.3%
Bajra	4.1	3.7	-9.8%
Jowar	7.7	8.6	11.7%
Maize	12.2	11.4	-6.6%
Pulses	4.9	4.7	-4.1%
Total Oilseeds	16.8	13.9	-17.3%
Sugarcane	281.2	345.3	22.8%
Cotton #	18.5	22.7	22.7%
Jute and Mesta ##	10.8	11.3	4.6%

= m bales of 170kg each. ## = m bales of 180kg each
Source: Ministry of Agriculture

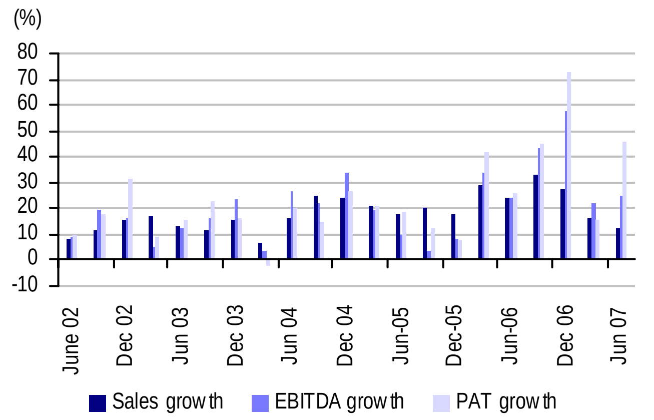
Since western Uttar Pradesh (UP) and parts of Punjab have not had enough rain, production targets of some food grains (bajra, maize, pulses) show negative growth. However, the most encouraging aspect of Table 8, in our opinion, is the strong growth forecast for sugarcane, cotton and other cash crops, as to a large extent these crops decide the consumption levels and purchasing power in rural India.

No let-up in corporate earnings

Upgrades to earnings forecasts continue

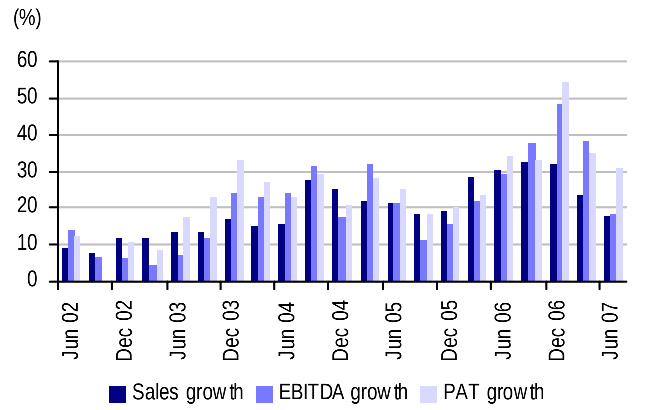
The earnings growth environment remains strong. In January-March 2007, quarter earnings growth of UBS's universe (78 stocks) was 16%. It accelerated to 46% in the April-June quarter. Excluding oil & gas (which we believe is the correct way to look at earnings, given regulation-induced fluctuations in oil companies' earnings), the April-June quarter saw 31% earnings growth compared to 35% in January-March.

Chart 11: UBS universe quarterly growth trend (%)



Source: Company data

Chart 12: UBS universe ex-oil & gas quarterly growth trend

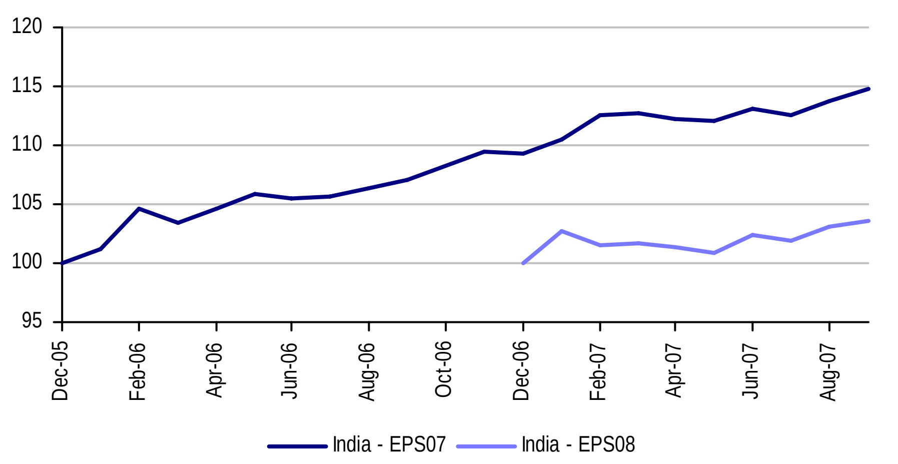


Source: Company data

Chart 11 and Chart 12 appear to indicate the onset of an earnings growth slowdown, but we note that the absolute level of earnings growth (30-35%) is still strong. The December 2006 peak (55% earnings growth was an aberration, partly due to the low base in December 2005. Moreover, data from the last four quarters indicates consistent EBITDA margin expansion (EBITDA growth higher than sales growth).

High growth is not just a matter of past earnings, but is reflected in future expectations as well. As Chart 13 shows, consensus earnings estimates for CY07 and CY08 have been upgraded by c2% during July-September 2007. Over the past two years, the general direction of EPS estimates has been upwards.

Chart 13: MSCI India—consensus earnings estimates



Source: IBES

We have consistently revised our EPS estimates for Sensex up over the past nine months. During the period, our estimates for Sensex EPS in FY08 are up 5.4%, and for FY09 they have risen 9.6%.

Table 9: UBS estimates for Sensex EPS

(Rs)	EPS estimate at CY07 beginning	EPS estimate at end-July 2007	Current EPS estimate	Increase over Jan-July	Increase over July-Sept
FY07	691	705.3	724.7	2.1%	2.8%
FY08E	821	826.9	865.1	0.7%	4.6%
FY09E	937	975.4	1026.8	4.1%	5.3%

Source: UBS estimates

The pace of estimate revision increased during July-September, primarily on the back of upward revisions in energy (Reliance), metals (Tata Steel), engineering, construction and cement. Downward revisions were in IT services and automobiles.

We forecast stable margins, ROE and ROCE in FY08 and FY09

We expect earnings growth for the UBS universe to remain stable over FY08 and FY09. While EBITDA and earnings growth in FY08 appear to fall off sharply from FY07 levels, it is primarily due to declines in growth estimates in IT, metals, automobiles, property and pharmaceuticals.

Table 10: UBS universe excluding oil & gas

	FY01	FY02	FY03	FY04	FY05	FY06	FY07	FY08E	FY09E
Sales growth	21.5%	39.0%	17.5%	20.6%	28.3%	24.1%	35.7%	43.5%	19.3%
EBITDA growth	21.8%	33.2%	26.5%	28.8%	42.8%	17.0%	56.7%	33.3%	22.0%
Earnings growth	7.1%	25.8%	27.1%	48.2%	40.1%	17.0%	48.4%	28.6%	22.4%
EBITDA margin	19.1%	18.3%	19.7%	21.1%	23.4%	22.1%	25.5%	23.7%	24.2%
Debt-equity	0.34	0.38	0.28	0.28	0.21	0.22	0.21	0.22	0.15
ROCE	17.2%	17.2%	22.0%	24.1%	27.8%	22.9%	27.6%	26.4%	26.1%
ROE	14.0%	15.2%	17.0%	22.4%	25.6%	23.0%	25.2%	23.7%	23.2%

Source: Company data, UBS estimates

The only risk to our current earnings estimates is from appreciation of the rupee, as it could potentially affect exporters and commodity manufacturers negatively, while importers and commodity users could be impacted positively. We estimate that positively impacted sectors contribute 12-13% to Sensex earnings, and the negatively impacted sectors contribute 44-47%. In an earlier report ("What's the impact of the appreciating rupee?", 9 May 2007), we estimated that an 8% increase in the Rs/US$ forecast (as in the previous case, when the end-2007 forecast went from Rs43 to Rs40) could lead to a 3.5-4% decline in our Sensex earnings forecast.

Table 11: Sensex earnings impact due to 7-8% INR appreciation

	Earnings impact FY08E	Earnings impact FY09E	Earnings contribution FY08E	Earnings contributi on FY09E	Remarks
IT Services	-5.00%	-5.00%	14.00%	14.90%	1.5-2% impact on PAT for every 1% appreciation of INR
Pharmaceuticals	-4.50%	-9.70%	2.60%	2.90%	0.5-1% impact on margins from 7-8% appreciation of INR. Ranbaxy and Sun could gain they have foreign currency debt.
Petrochemicals (Reliance)	-15.00%	-16.00%	13.60%	12.10%	Ceteris paribus, 8% INR appreciation could lead to 14-15% impact on earnings.
Oil & Gas (ONGC)	-14.00%	-19.00%	6.20%	5.40%	-
Power (Reliance Energy)	8.70%	0.00%	1.20%	1.10%	REL could gain because of non-project-linked US$200m foreign debt on its books.
Total	-3.60%	-4.00%			

Source: UBS estimates

Currently, our forecast for the Rs/US$ stands at Rs40 by end-2007 and at end-2008. We believe the end-2008 forecast could have some upside risk, depending on the extent of weakness in the US economy.

While not so important for earnings (except for some potential temporary impact on the earnings of engineering and construction stocks), the market could react to political uncertainties, as recent experience shows.

Could political pressure mean an economic slowdown?

Domestic political uncertainty is increasing again

In 2005 and 2006, the domestic political scenario was placid. Political pressure on industry increased in H107 (with the government trying to curb cement and steel prices and banning sugar exports). In August 2007 political uncertainty reached a peak with the Left (59 MPs supporting the UPA government) threatening to withdraw support from the government if it went ahead with the civilian nuclear co-operation deal that India finalised with the US in July 2007. (Amendment of Section 123 of the U.S. Atomic Energy Act, 1954, lifting prohibitions on nuclear cooperation with India still needs to be approved by the US Congress and the Nuclear Suppliers Group of Nations.) The deal has received support from the UN nuclear watchdog IAEA, which is waiting for the Indian government to start discussions with it on an India-specific safeguards agreement. The agreement is widely viewed as helping India fulfill its soaring energy demands in addition to bringing US and India into a strategic partnership.

However, the Left has expressed concern about Indian vessels being checked in international waters, assurances of full civilian nuclear supply, the situation in the event of termination/suspension of the agreement, and the implications of the Hyde Act and India's participation in the highly controversial Proliferation Security Initiative. The Left and UPA are scheduled to meet on 5 October to discuss it further, though the Left has asked the government to postpone the nuclear agreement for at least six months.

We could face a mid-term general election in 2008

Political commentators have argued that the uncertainty surrounding the nuclear treaty could be a precursor to general elections ahead of schedule (May 2009). According to such analyses, a temporary truce was struck between UPA and the Left because none of the constituent parties are ready for general elections now, and could be preoccupied with the upcoming State Assembly elections (Gujarat, November 2007). General elections usually lead to uncertainty in the Indian market, and elections in mid-2008 should not be an exception. However, apart from short-term fluctuations, we do not see any significant long-term negative fallout from mid-term elections, because of the following:

(1) Despite the presence of a stable government over the past three years, the market-friendly reforms (disinvestment, labour law changes, pension and banking reforms) have stalled on account of Leftist pressure. The market has more than tripled despite these reform slowdowns—driven entirely by corporate earnings growth and productivity improvements.

(2) Whatever the results of a general election, we believe a BJP- or a Congress-led government will probably come into power. As Table 12 shows, even if the parties supporting UPA from outside decide to combine with the "others" and form a Third Front, it could be difficult for that front to achieve a majority in the Parliament. Moreover, pulls and pressures among the smaller parties (eg, the rivalry between the Bahujan Samaj Party and Samajwadi Party) could prevent the formation of a cohesive front. As long as there is a Congress- or BJP-led front running the government, we expect broad continuity on economic policy-related matters.

Table 12: Party position in current Lok Sabha (lower house of Parliament)

Party (Constituting UPA)	No of seats	NDA and Allies		Others	No of seats
Indian National Congress (INC)	145	Bharatiya Janata Party (BJP)	138	Samajwadi Party (SP)	36
Rashtriya Janata Dal (RJD)	24	Shiv Sena (SS)	12	Telangana Rashtra Samithi (TRS)	5
Dravida Munnetra Kazhagam (DMK)	16	Biju Janata Dal (BJD)	11	Marumalarchi Dravida Munnetra Kazhagam (MDMK)	4
Nationalist Congress Party (NCP)	9	Shiromani Akali Dal (SAD)	8	Telugu Desam Party (TDP)	5
Pattali Makkal Katchi (PMK)	6	Janata Dal (United) (JD(U))	8	Janata Dal (Secular) (JD(S))	3
Jharkhand Mukti Morcha (JMM)	5	All India Trinamool Congress (AITC)	2	Rashtriya Lok Dal (RLD)	3
Lok Jan Shakti Party (LJSP)	4			Asom Gana Parishad (AGP)	2
Kerala Congress (KEC)	1			Jammu and Kashmir National Conference (J&KNC)	2
All India Majlis-E-Ittehadul Muslimmen (AIMIM)	1			Bharatiya Navshakti Party (BNP)	1
Jammu & Kashmir Peoples Democratic Party (J&KPDP)	1			Mizo National Front (MNF)	1
Republican Party of India(A) (RPI(A))	1			MUL	1
UPA-Total	213			Nagaland Peoples Front (NPF)	1
Communist Party of India (Marxist) (CPI(M)) 1	43			National Loktantrik Party (NLP)	1
Communist Party of India (CPI) 1	10			IFDP	1
All India Forward Bloc (AIFB) 1	3			SJP	1
Revolutionary Socialist Party (RSP) 1	3			Independent (Ind.)	5
Bahujan Samaj Party (BSP)	19				
Sikkim Democratic Front (SDF)	1				
External supporters of UPA	79				
Total—UPA and allies	292	Total NDA and allies	179	Total—Others	72

Note: Actual numbers supporting any political group may change from time to time owing to policy changes of constituents.
Source: Election Commission (result of 2004 election)

Mid-term elections could slow infrastructure construction, but only temporarily, in our view

We believe the only impact of a mid-term general election could be a temporary slowdown in the pace of the capex cycle. In the initial stages of government formation, political parties tend to focus on internal stability rather than policy initiatives, which could lead to some slowdown in infrastructure capex. For instance, in H204 and H105, road projects slowed considerably as the Model Concession Agreements for build operate transfer (BOT) contractors were reviewed and modified by the new government.

Even without considering possible General Elections in 2008, the 2007-08 political calendar appears quite full. The most important political event in the remainder of 2007 is Assembly elections in Gujarat, while 2008 is likely to see important state elections, particularly in the second half.

Table 13: Political calendar for 2007 and 2008

2007	2008
28 February—Budget tabled by Central Government	Budget to be tabled—28 February
March 2007—assembly elections in Manipur	March 2008—Assembly election in Himachal Pradesh
March 2007—assembly elections in Uttaranchal	March 2008—Assembly election in Meghalaya
March 2007—assembly elections in Punjab	March 2008—Assembly election in Nagaland
May/June 2007- assembly elections in Uttar Pradesh	March 2008—Assembly election in Tripura
November/December 2007- assembly elections in Goa	Nov/Dec 2008—Assembly election in Chhattisgarh
November/December 2007- assembly elections in Gujarat	Nov/Dec 2008—Assembly election in Jammu & Kashmir
	Nov/Dec 2008—Assembly election in Madhya Pradesh
	Nov/Dec 2008—Assembly election in Mizoram
	Nov/Dec 2008—Assembly election in Delhi

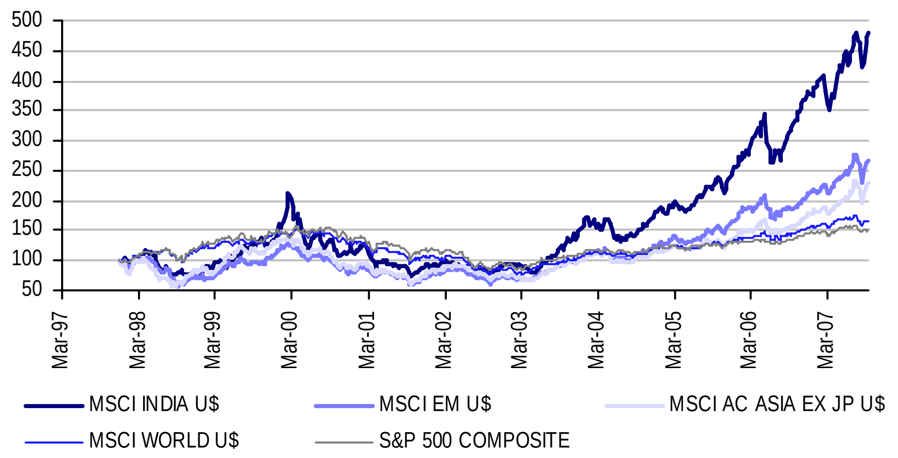
Source: Election Commission

The global economy

Global equity markets have had coordinated movements over the past four to five years

Over the past four to five years, the correlation among global equity market movements has increased to such an extent (Chart 14) that correct predictions on the direction of the global equity market (eg the MSCI Global) led to the right forecasts about the direction of almost any market. Especially in light of the recent turmoil in equity and credit markets, we believe it is important to take our forecasts about global equity markets and global economies into consideration.

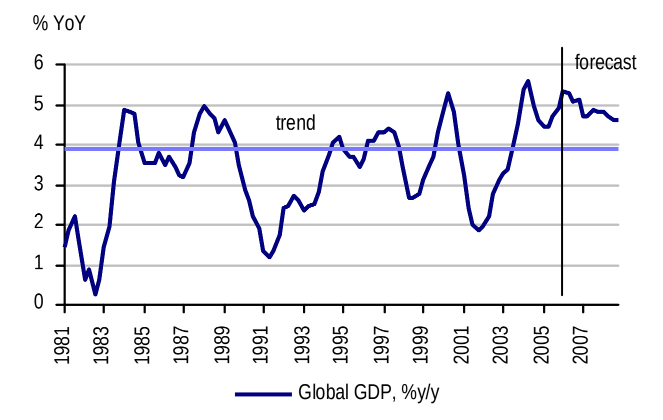
Chart 14: Movement in global equity markets



Source: Bloomberg

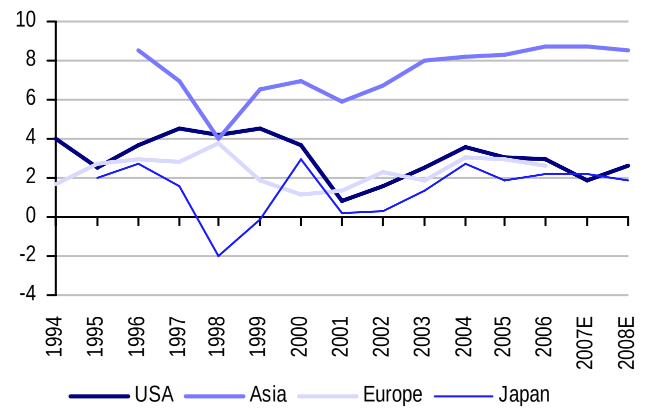
Over the past two to three months, the collapse of the US sub-prime lending market has led to mounting concerns about dislocations in global credit markets—more specifically, about ongoing impairments to earnings as the financial system adjusts to reduced credit formation and securitisation, and tighter lending standards and weaker borrowing capacity. UBS Global Economics research believes ("Opportunity or risk?", Larry Hatheway, 7 September 2007) that these financial events could lead to "real" consequences in terms of slowing consumption and economic growth. According to UBS forecasts, global GDP growth will decline over 2007-08, even though Asian and emerging economies should remain strong, supported by strong domestic consumption.

Chart 15: Global GDP growth



Source: UBS estimates

Chart 16: Region-wise GDP growth forecasts (%)



Source: UBS estimates

We note in Chart 15 and Chart 16 that apart from Asia's continued strength, we are forecasting an economic soft landing in most regions, not an economic recession. The critical difference between these two outcomes is the impact they have on Asian economies. As Jonathan Anderson ("Bad news and good news for Asia", 30 July and 20 August 2007) points out, apart from the possibility of regional equity markets coming off in any global correction, there seems to be no major implications for other asset classes or real growth outlook for the Asian region. Specifically the key findings of UBS Economics team are:

Asian growth likely to remain intact

(1) A US recession is unlikely, and there is no real possibility of a recurrence of the 2001 global downturn.

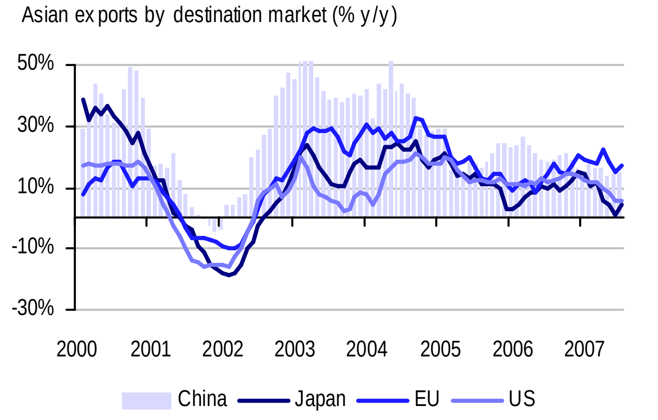
(2) Asia has very solid domestic growth fundamentals with no significant overheating risks.

(3) Regional financial markets are not overvalued and there are no pre-1997 style fragilities.

(4) Asia is not about to pull liquidity from the rest of the world.

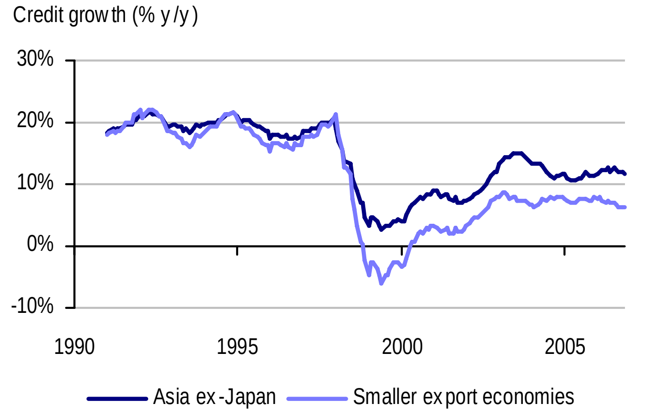
A reason investors are concerned about Asian economies is the experience of 2000-01, when exports from Asian countries collapsed in response to a global economic slowdown. We point out that the 2001 IT downturn was not a US-specific event. While US real GDP growth fell by 4%, Japanese and EU growth rates also dropped 3%, and each region went into outright or near recession. Consequently Asian exports to all four major global markets (the US, the EU, Japan, China) collapsed in 2001. We believe such a coordinated sharp downturn is extremely unlikely now because of relative growth stability in Japan and the EU, along with low inflation, rising productivity and high levels of corporate profitability.

Chart 17: Asian exports to all regions declined in 2001



Source: CEIC, UBS estimates

Chart 18: Recovering credit cycle, but Asia not over-leveraged



Source: CEIC, UBS estimates

Moreover, as Jonathan notes, in contrast to the post-Asian crisis period when domestic investment and credit growth disappeared and Asian economies had to depend solely on export expansion to drive the 1999-00 recovery, Asian growth is now increasingly driven by domestic factors, with a recovering construction and credit cycle.

Finally, UBS equity strategists remain positive on global markets, more so for the emerging Asian region, which has the benefit of moderate valuations, strong underlying growth and a relative lack of contagion from global credit market turmoil. UBS global equity strategist Jeffrey Palma ("Setting the stage for recovery", 22 August 2007) expects a period of stability for global equity markets, followed by a period of recovery on the back of solid earnings growth (10.8% in 2008E) and attractive valuations (PE of 13.4x 2008E). Jeffrey believes that given the current financial and economic uncertainties, Fed action is critical. We believe the Fed is willing to provide stability to the markets if necessary. UBS economist Maury Harris expects ("Still more easing expected after 50bp fed funds rate cut", 18 September 2007) that in spite of the 50bp rate cut in each of the Fed funds rate and discount rate on 18 September, lingering financial market concerns and housing-related soft economic data could trigger another 25bp Fed funds rate cut each at the two FOMC meetings (30-31 October and 11 December 2007).

US equity strategist David Bianco ("S&P 500 Undervalued: 1600 year-end target", 10 September 2007) raised the S&P 500 target to 1600 by end-2007 (8% higher than current levels). David believes that a broad US recession is required to jeopardise global GDP and S&P 500 EPS growth. That is not the scenario that we are forecasting now.

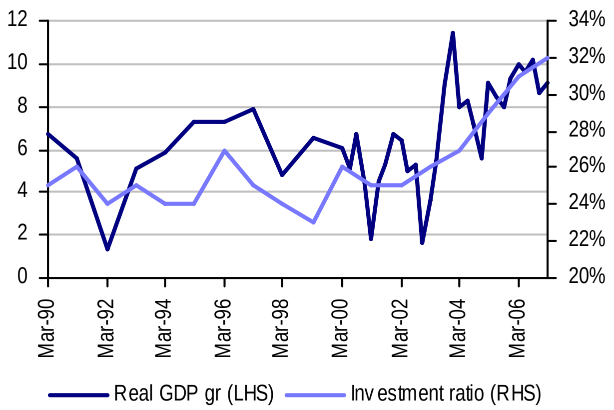
Capital constraint for India's infrastructure development should not be significant

The only India-specific fallout of a global credit market dislocation, as some investors have pointed out, could be "rationing" global capital necessary to sustain the Indian investment cycle. We believe Indian investment may be relatively immune from the whims of global capital flows, because:

(1) Foreign capital represents a minority of India's overall domestic investment. The bulk of private corporate investment is financed by internal accruals of corporates, domestic capital issuances and bank loans.

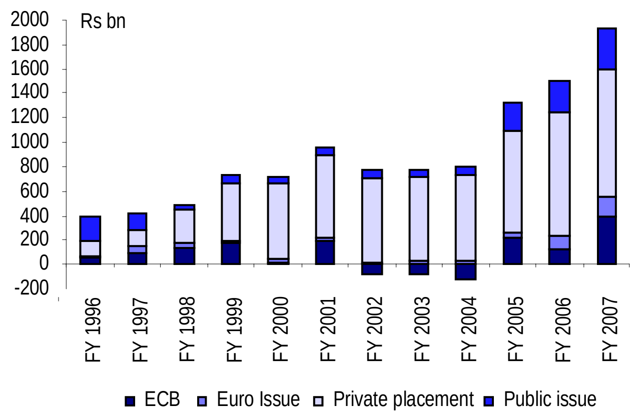
(2) With the steady rise in the domestic savings rate, the availability of domestic capital for infrastructure and industrial capex is increasing daily.

Chart 19: Real GDP growth and savings rate



Source: CEIC

Chart 20: External resources raised by Indian corporates



Source: RBI, UBS estimates

On balance we believe any impact of a global liquidity crunch on Indian investments is likely to be modest and temporary. Philip Wyatt ("India: The mid-cycle correction", 31 August 2007) draws parallels from ASEAN and Korea in the 1990s to arrive at the same conclusion.

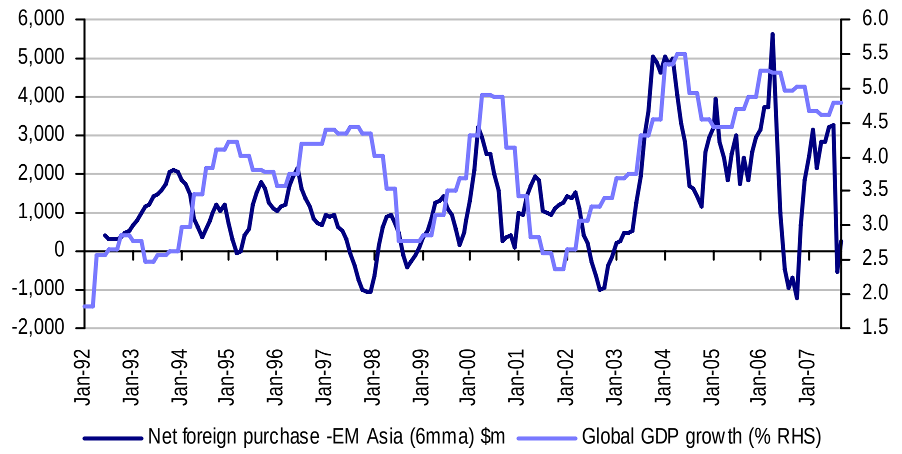
In the next section we focus on liquidity. Given the recent global credit crunch, the potential impact of declining foreign liquidity on the Indian (and emerging) markets is one of the questions uppermost on investors' minds.

Liquidity

We recapitulate the correlation of stock market liquidity with global growth (Chart 21). We believe concerns about a global slowdown usually lead to risk aversion, which manifests itself in a slowdown in equity inflows—particularly those into emerging markets.

Liquidity into Asian markets usually declines when global GDP slows

Chart 21: FII inflows into Asian emerging markets and global GDP growth



Source: Country stock exchanges, UBS

Outflows from Asia in May-July 2006 (US$14.5bn) and August 2007 (US$17.5bn) came on concerns about a liquidity crunch and global slowdown, respectively. Historically, withdrawal of money from Asia has led to withdrawal from India, but 2007 has been different.

Table 14: Net foreign inflows into Asian emerging markets

(US$m)	2007 YTD	2006	2005	2004	2003	2002	2001
Malaysia	N/A	N/A	N/A	4397	2173	-141	-657
% of Asian inflow	-	-	-	*12.6%*	*6.2%*	*-69.2%*	*-3.7%*
Indonesia	2,672	1,823	-1,741	2,191	1,117	856	441
% of Asian inflow	*57.4%*	*10.7%*	*-5.3%*	*6.3%*	*3.2%*	*419.5%*	*2.5%*
Thailand	2,808	1,857	2,976	117	-634	289	-149
% of Asian inflow	*60.3%*	*10.9%*	*9.0%*	*0.3%*	*-1.8%*	*141.9%*	*-0.8%*
Philippines	1710	1351	355	318.9	-81.7	-53	86
% of Asian inflow	*36.7%*	*8.0%*	*1.1%*	*0.9%*	*-0.2%*	*-25.9%*	*0.5%*
Korea	-14,758	-12,657	-3,584	11,212	12,430	-2,015	6,875
% of Asian inflow	*-317.0%*	*-74.5%*	*-10.9%*	*32.2%*	*35.4%*	*-987.9%*	*39.2%*
Taiwan	3,238	16,611	24,389	8,140	13,542	517	8,161
% of Asian inflow	*69.5%*	*97.8%*	*74.0%*	*23.4%*	*38.5%*	*253.4%*	*46.5%*
India	8,987	8,006	10,546	8,430	6,595	751*	2,802*
% of Asian inflow	*193.0%*	*47.1%*	*32.0%*	*24.2%*	*18.8%*	*368.1%*	*16.0%*
Total net purchases	4,656	16,991	32,940	34,805	35,141	204	17,559

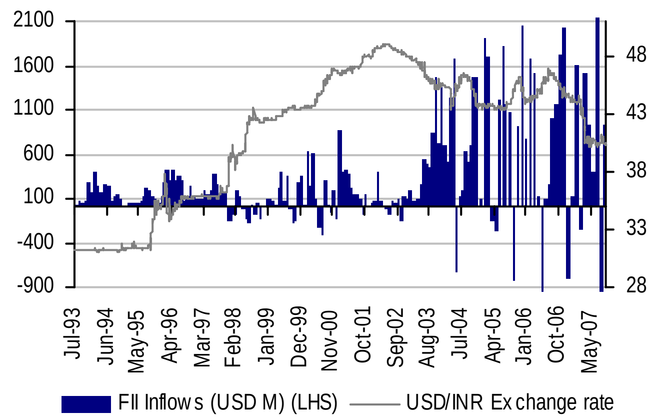
Source: Country stock exchanges

In 2007, Asian investors bought India, China (though not visible in Table 14), Taiwan, and Thailand, Indonesia and the Philippines (TIP), and sold Korea. Consequently inflows into India were almost double that into the whole of Asia. We believe this is due to investors' consensus belief that in the event of a global economic slowdown, domestically driven economies like India and China would be relatively less affected. We agree with this reasoning, though risk arises from the fact that c40% of Indian market earnings are from exports (IT, pharma) or from global commodities (metals, oil, petrochemicals).

Strong INR could aid FII inflows

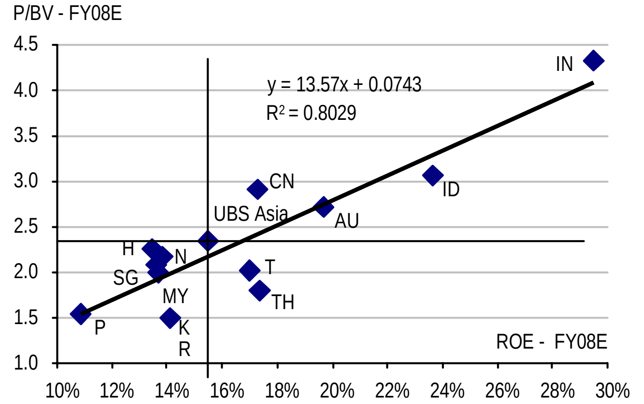
Foreign portfolio inflows have also been positively correlated with movements of the Indian rupee due to the propensity of overseas investors to hold their investments in an appreciating currency (Chart 22).

Chart 22: FII flows and Rs-US$ rate



Source: SEBI data on FII flow, Bloomberg

Chart 23: Asian valuation comparison (P/BV vs ROE)



Source: UBS estimates

We remain positive on FII inflows into India for four reasons:

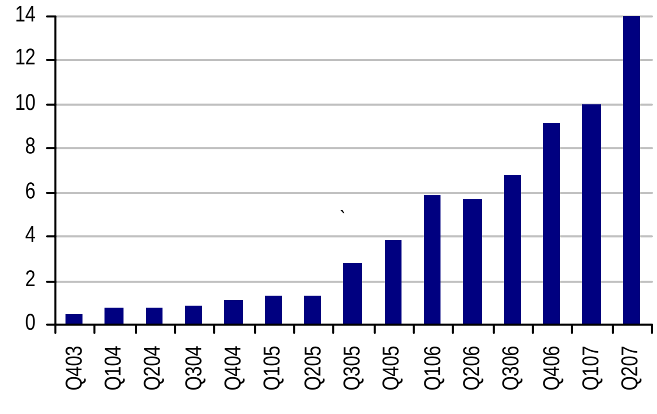
(1) The rupee is likely to remain strong relative to the US$. We forecast the Rs/US$ rate at Rs40 by end-2007 and Rs40 by end-2008, with some upside risk to the end-2008 forecast (as per Philip Wyatt).

(2) On growth-adjusted valuation multiples and return-adjusted P/BV, Indian valuations now appear reasonable relative to the Asian average. Given the pace of earnings upgrades, we believe valuations that appear relatively expensive today may seem cheaper later.

(3) During 2006 and 2007, close to 25-30% of incremental portfolio flows into India were from hedge funds. That proportion is increasing daily. According to HedgeFund.net, India-focused hedge funds generated a 53.6% return in the 12 months to July 2007, compared to 44.7% for the Sensex. Even in the three months to July, India-focused funds returned 12.33% compared to 3.3% for the hedge fund aggregate average. Superior absolute returns could reinforce FIIs' bullishness about India in the medium term.

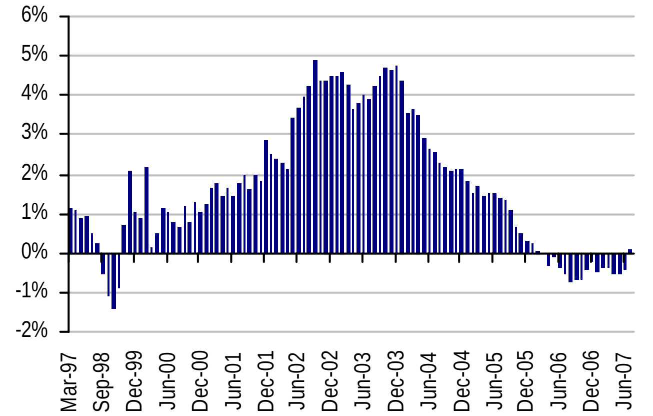
(4) Despite recent strong inflows from FIIs, they are not yet significantly Overweight on India. Emerging market investors were Underweight India for most of 2006 and H107, but since July 2007, signs of investors reversing their position to Overweight/Neutral have started to show.

Chart 24: Total assets of India-focused hedge funds (US$bn)



Source: HedgeFund.Net

Chart 25: EM investors' position (benchmark relative) on India



Source: EmergingPortfolio.com

FII flows remain unpredictable. Particularly due to recent global turmoil, uncertainty regarding FII flows has increased. We believe that over the past couple of years, the increase in domestic inflows (through the Mutual Fund and Insurance Scheme routes) can neutralise any potential decline in FII inflows.

Domestic inflows

Domestic inflows could more than neutralise any downturn in FII inflows

In a recent report ("Market turning less dependent on FII inflows", 27 August 2007), we argued that domestic institutional inflows were becoming increasingly important for the Indian market. We believe the trend of increasing domestic inflows will strengthen going forward because of the following factors:

(1) **Increasing inflows into MFs from retail investors**. In CY2007 YTD, retailers have invested (net) US$5bn in equity MFs, with US$1.9bn in August alone. During January-August 2006, the net inflow was US$5.2bn. In 2007 YTD, MFs have invested only cUS$800m in Indian equities, leading us to believe that they hold US$4-5bn cash in their portfolios—almost 10% of their assets. A larger chunk of domestic inflows into equities has come from insurance companies (we believe US$5-6bn, of which US$3bn from Life Insurance Corporation of India [LIC]), as close to 80% of investments in life insurance products are currently through Unit Linked Insurance Plans (ULIPs).

(2) **Rising savings rate**. The savings rate in India is 32% (of GDP), out of which household savings is 24-25%—implying that the current quantum of household savings is cUS$250bn, and is growing at the nominal 12-14% GDP growth rate. Approximately half of household savings is invested every year in real assets (jewelry, gold, real estate), and half in financial assets—implying that the current quantum of household financial investments is US$120-125bn. If just 10% of such financial savings is invested in equities (either through MFs or ULIPs), at the current levels of savings that would imply an annual inflow of US$12-12.5bn into equities—significantly greater than the highest FII inflow the Indian market has seen in any single year (US$10.5bn in CY2005). An assumption of 10% of financial assets going into equities is not far fetched, in our view. During the first half of the 1990s, household allocations in equities were 12-22%.

Regarding the impact on secondary market inflows, even a large IPO pipeline does not worry us significantly. In 2007 we have seen large issuances (US$7bn in June) with no significant dent on market returns.

IPO pipeline

Over the next six months we expect US$12-13bn of equity issuance. Given that US$9bn equity issuance came to the domestic market in January-July 2007, the magnitude of issuance does not alarm us.

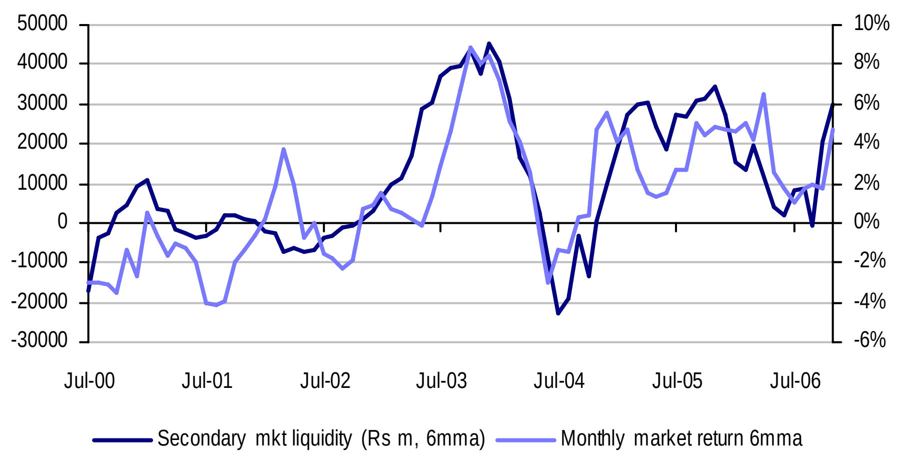
Table 15: Equity issuance pipeline

Sector	Amount (US$m)	Notable issuers
Real estate	1500	Emaar MGF, Peninsula
REIT	2000	DLF Assets overseas issue
Engineering	1500	Overseas issues from L&T, Suzlon
Energy	3000	-
Construction	500	Miscellaneous small issues
Financials	2500	SBI and other PSU banks
Oil & Gas	800	ABAN & OIL each could raise $300-500m
Miscellaneous	500	United Phosphorus
Total	12,300	

Source: Company data, UBS estimates

Market performance is closely linked to secondary market inflows, but in June 2007 severe decline in secondary market inflows did not cause a market decline—quite possibly due to the cushioning effect of insurance inflows.

Chart 26: Secondary market inflows and market performance



Source: SEBI, Bloomberg

Where the market is headed

In arriving at a fair valuation for the market (as represented by the BSE Sensex) for the end of 2007 and 2008, we first consider potential market catalysts (positive and negative) in the period.

Both positive and negative catalysts for the market in 2007 and 2008

Table 16: Expected catalysts to market performance

	Potential positive catalyst	Catalyst for increased uncertainty
2007	Beginning of easing by the Fed, starting with a 50bp cut in Fed rate on 18 September. We expect a further 50bp cut in the Fed rate in remainder of 2007	Heightened political uncertainty prior to Gujarat State elections
	Continued moderation in domestic inflation on the back of good agricultural production	Rise in inflation due to hike in domestic petrol and diesel prices
	RBI monetary policy in late October, when RBI is unlikely to hike or cut rates or CRR	
2008	Continued positive surprise on earnings and consequent upward revision in earnings estimates	Potential dissolution of Parliament and general elections ahead of schedule

Source: UBS

The strongest catalyst to uncertainty in 2008, in our view, could be an early general election. Election outcomes are usually sources of significant volatility in Indian markets. In 2004, during the last general election, the market's appreciation was significantly lower than EPS growth.

Table 17: History of EPS growth and return from Indian market

	EPS annualised to December year-end	EPS growth	Return from BSE Sensex
2002	233	28.1%	3.5%
2003	286	22.8%	72.9%
2004	393	37.4%	13.1%
2005	499	27.0%	42.3%
2006	674	35.2%	46.7%
2007E	830	23.1%	18.2%
2008E	986	18.8%	16.6%

Source: Bloomberg, Company data, UBS estimates

Table 17 shows that since the beginning of the bull run in 2003, the Indian market has been rerated yearly except in 2004, when the general election results threw up a negative surprise.

Earnings and valuation

We forecast 19.4% EPS growth for Sensex in FY08 followed by 18.7% in FY09

Notwithstanding global and domestic political uncertainties, we believe in the medium term the market is likely to be driven by domestic earnings growth. As we stated earlier (Table 9), over the past six to nine months we have seen constant upgrades to our Sensex EPS forecast—primarily due to upgrades in commodities, engineering, telecommunications and cement. Downgrades have come in IT and automobiles. We note that our EPS growth estimates (Table 18) are different from earnings growth estimates because of equity dilution—primarily in banks and metals. For instance, our earnings growth estimate for banks in FY08 is 34%, but our EPS growth estimate is only 13%.

Table 18: BSE Sensex: sector-wise EPS growth estimates

	% of total Mcap (FF Adj)	% of total PAT FY08	% of total PAT FY09	EPS (%, YoY) FY05	FY06	FY07	FY08E	FY09E	FY10E
Auto	5.8%	7.4%	7.2%	40%	34%	33%	3%	16%	13%
Banks and FIs	22.1%	17.3%	18.3%	65%	22%	18%	13%	25%	17%
Pure cement	2.5%	3.5%	3.4%	65%	-6%	185%	38%	16%	5%
IT Services	15.7%	12.6%	13.3%	43%	35%	49%	21%	25%	16%
Conglomerates	2.0%	3.5%	3.3%	17%	18%	90%	37%	12%	9%
Engineering	8.7%	5.8%	6.5%	9%	59%	74%	31%	32%	27%
Consumer staples	6.5%	5.4%	5.4%	-6%	21%	17%	17%	19%	16%
Metals	4.9%	12.9%	11.3%	73%	21%	18%	14%	4%	0%
Oil & Gas	3.7%	7.5%	6.4%	53%	7%	39%	1%	1%	-9%
Petrochemicals	12.7%	11.7%	11.5%	47%	20%	20%	24%	16%	89%
Pharmaceuticals	2.7%	2.4%	2.5%	-16%	-11%	123%	-9%	26%	15%
Power	3.1%	3.1%	2.7%	27%	26%	11%	14%	5%	10%
Telecom	9.6%	6.9%	8.2%	195%	83%	172%	53%	41%	38%
Sensex	100.0%	100.0%	100.0%	41.6%	23.5%	38.3%	19.4%	18.7%	22.6%

Source: Company data, UBS estimates

The key takeaway from Table 18 is that after c37% EPS CAGR for Sensex over FY04-07E, EPS growth is likely to mean-revert to 19-20% in FY08E and FY09E before rising again in FY10E—driven primarily by petrochemicals (Reliance's oil & gas assets should begin to generate revenue and earnings in FY10).

Table 19: Sector-wise disaggregation of valuation

	% of total Mcap (FF Adj)	PE (x) FY05	FY06	FY07	FY08E	FY09E	FY10E	PEG (x) PE-07/EPS CAGR (2007-09E)	PEG (x) PE-08E/EPS CAGR (2008-10E)
Auto	5.8%	24.6	18.3	13.8	13.4	11.5	10.2	1.44	0.93
Banks and FIs	22.1%	37.3	30.5	25.9	22.9	18.3	15.5	1.36	1.07
Pure cement	2.5%	50.6	53.7	18.8	13.6	11.8	11.3	0.71	1.36
IT Services	15.7%	50.0	37.0	24.7	20.5	16.4	14.1	1.08	1.00
Conglomerates	2.0%	33.4	28.4	15.0	10.9	9.7	8.9	0.62	1.02
Engineering	8.7%	100.6	63.1	36.3	27.8	21.0	16.6	1.16	0.95
Consumer staples	6.5%	38.1	31.6	27.1	23.1	19.4	16.8	1.50	1.35
Metals	4.9%	11.7	9.7	8.2	7.2	6.9	6.9	0.93	3.85
Oil & Gas	3.7%	12.4	11.5	8.3	8.2	8.1	8.9	7.34	-1.90
Petrochemicals	12.7%	36.9	30.8	25.6	20.6	17.7	9.4	1.27	0.43
Pharmaceuticals	2.7%	36.9	41.3	18.5	20.3	16.1	14.0	2.55	0.99
Power	3.1%	33.0	26.2	23.7	20.9	19.9	18.1	2.62	2.80
Telecom	9.6%	182.0	99.4	36.6	23.9	17.0	12.3	0.78	0.61
Sensex	100.0%	36.7	29.7	21.5	18.0	15.2	12.4	1.13	0.87

Source: Company data, UBS estimates

On our current earnings estimates, cement, metals, telecommunication and IT appear undervalued (with sub-market PEG). However, in a global slowdown scenario, we believe earnings estimates of IT, metals and commodities could suffer. Moreover, in a few months we believe the market will begin to look at FY09 earnings. At that point, PEG on FY08E earnings as a base would become relevant. PEG on FY08E presents a different picture from PEG in FY07E. In FY08E, auto, petrochemicals, engineering and telecom appear reasonable.

End-2007 target 16,300, end-2008 target 19,000

Increase in Sensex target driven entirely by EPS estimate revision

Our Sensex EPS estimate for FY08 has increased 5.4%, and our EPS estimate for FY09 has increased 9.6% since January 2007. Our December 2008 EPS estimate has increased by 8.6%, from Rs908 to Rs986. We consequently raise our end-2007 Sensex target from 15,000 to 16,300, driven entirely by EPS upgrades.

We also introduce our end-2008 target of 19,000. Our implied one-year forward PE estimate for December 2008 is 15.9x.

Table 20: Sensex target calculation

	Dec-07 target (earlier)	Dec-07 target (current)	Dec-08 target
(a) Target ERP	6%	6%	6%
(b) Target Rf	8.5%	7.5%	7.5%
(c) Target IEG	8.5%	7.5%	7.2%
(d) Target PE (1/(a+b-c))	16.5	16.5	15.9
(e) EPS: FY07	691	725	725
(f) EPS FY08E	821	865	865
(g) EPS FY09E	937	1027	1027
(h) EPS FY10E	-	1259	1259
(i) EPS: Dec08	908	986	986
(j) EPS Dec-09	-	1201	1201
Target Sensex—Dec 07 (d x i)	15004	16304	
Target Sensex—Dec 08 (d x j)	-	-	19063

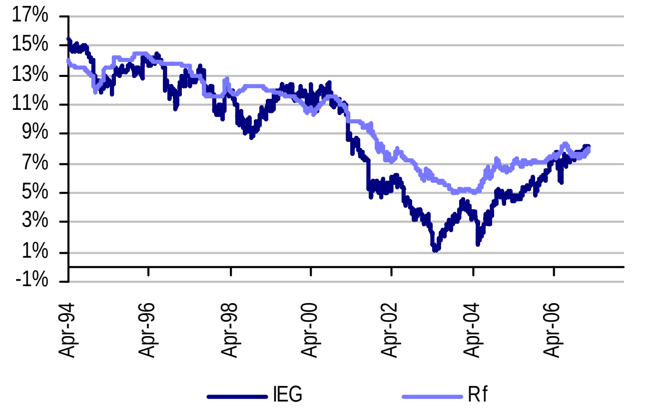
Source: UBS estimates

The following are the key takeaways from Table 20:

(1) For calculating our end-2007 target we have not changed our target PE multiple. It remains 16.5x, even though our target risk-free rate has declined (in line with the decline in our forecast 10-year bond yield).

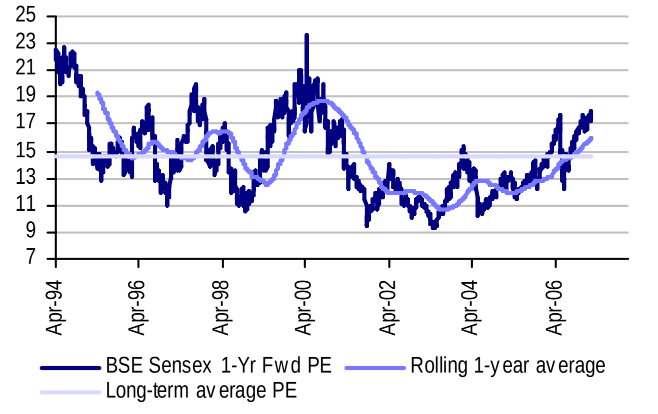
(2) For our end-2008 target, we have assumed a lower PE multiple (15.9x), as we believe a combination of continuing global uncertainty and potential emergence of domestic political uncertainty could moderate our valuations. We do not expect a moderation to be excessive, as earnings growth is likely to remain robust, and we do not expect significant risk to our growth forecasts owing to the presence of strong domestic drivers. Our target PE for end-2008E is 6% lower than our current PE multiple (16.8x).

Chart 27: IEG for market and risk-free rate



Source: UBS estimates

Chart 28: 1-year forward PE of Indian market



Source: UBS estimates

The current market PE (16.8x) is at a 15% premium to the long-term (last 12 years) average of 14.6x.

Bottom-up Sensex valuation: 18,480

Bottom-up price targets of UBS analysts appear marginally less bullish than our top-down Sensex forecast. Combining the 12-month price targets of constituent stocks, we arrive at a 12-month bottom up Sensex valuation of 18,480—up 19.2% from current levels.

Table 21: Bottom-up Sensex valuation analysis

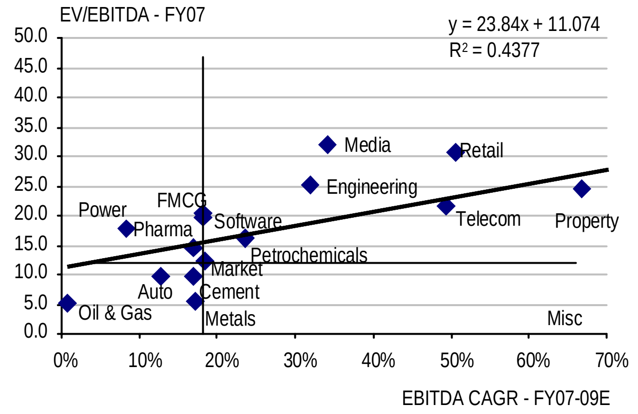
(Rs m)	Current adjusted market cap	Adjusted target market cap	Target return (%)	Weight in Sensex
Auto	561,967	664,149	18.2	5.5%
Banks and FIs	2,269,220	2,468,973	8.8	22.3%
Pure cement	311,265	347,306	11.6	3.1%
IT Services	1,404,972	2,016,171	43.5	13.8%
Conglomerates	235,541	274,703	16.6	2.3%
Engineering	978,771	1,061,251	8.4	9.6%
Consumer staples	709,775	812,600	14.5	7.0%
Metals	557,029	665,659	19.5	5.5%
Oil & Gas	268,151	341,043	27.2	2.6%
Petrochemicals	1,363,321	1,572,714	15.4	13.4%
Pharmaceuticals	260,210	350,209	34.6	2.6%
Power	322,401	308,432	-4.3	3.2%
Telecom	920,512	1,230,042	33.6	9.1%
Total	10,163,135	12,113,252	19.2	100.0%
Sensex	15504	18480	19.2	

Source: UBS estimates

Sector and stock selection

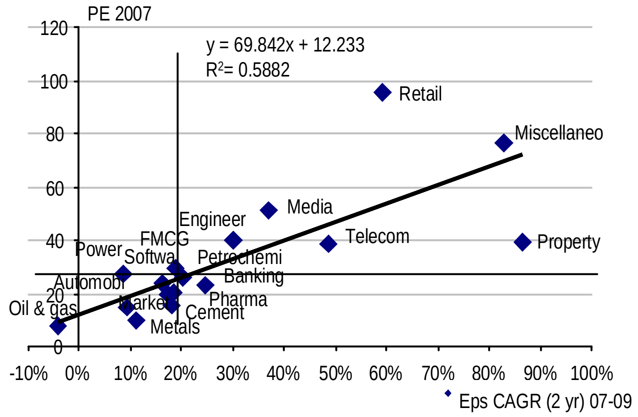
Our portfolio construction is essentially bottom-up, ie, weights on individual stocks add up to sector weights. However, we do take into account growth-adjusted relative valuations of sectors, and consider medium-term earnings growth drivers in each sector.

Chart 29: EV/EBITDA in relation to EBITDA growth



Source: UBS estimates

Chart 30: PE in relation to EPS CAGR



Source: UBS estimates

Chart 29 and Chart 30 indicate that on a growth-adjusted basis, metals, cement, auto, telecom and petrochemicals appear undervalued (ie, they appear below the diagonal). Engineering appears overvalued after recent outperformance, but continuous earnings upgrades could turn apparently expensive valuations cheap in the short term.

Key drivers—continuation of capex cycle and peaking of interest rates

We believe the principal earnings drivers for the Indian market are likely to be:

(1) Continuation of a strong capex cycle, notwithstanding the temporary risk of a slowdown in the event of a mid-term general election in 2008.

(2) Peaking of domestic interest rates and the consequent revival of consumption in H2FY08, and particularly in FY09.

The combination of points 1 and 2 above leads us to maintain our Overweight on engineering, construction, capital goods and building materials. We move more into interest rate-sensitive sectors—upgrading banks to Neutral (from Underweight) and automobiles to Overweight (from Neutral). We finance the positions from a reduction in weight on IT (remains Overweight) and pharmaceuticals (downgraded to Underweight from Overweight). A global economic slowdown could hurt net exporters (IT), but we believe new business for IT companies is unlikely to decline significantly unless the US economy moves into a recession—and that is not what we forecast now.

Sector selection

In our latest portfolio reshuffle we move more aggressively into interest rate-sensitive sectors and domestic cyclicals. Consequently we have upgraded banks from Underweight to Neutral, autos from Neutral to Overweight, and increase Overweight positions on engineering and cement. We downgrade pharmaceuticals from Overweight to Underweight due to lack of visible stock-specific triggers. We remain Neutral on FMCG and metals, and Underweight on energy (though Overweight on Reliance). We play the energy sector solely through Reliance, as E&P assets are largest drivers of Reliance's stock price currently.

Overweight engineering, telecom, autos, cement, IT. Underweight energy, pharmaceuticals. Neutral banks, FMCG, metals

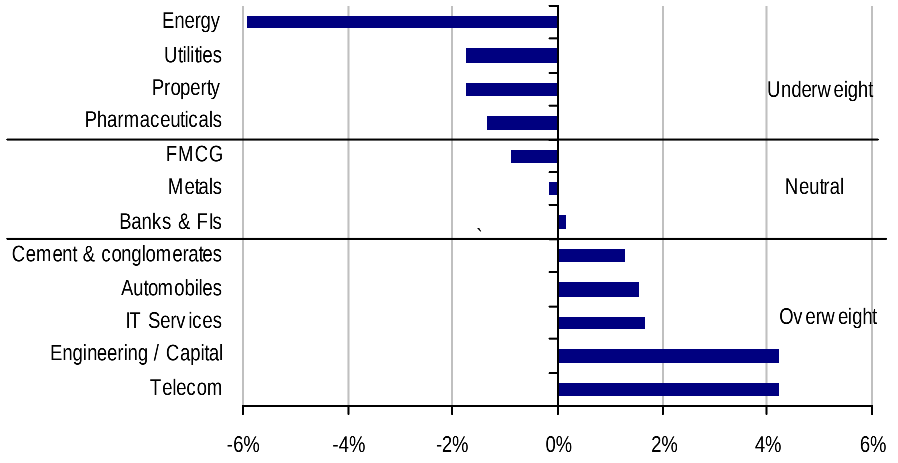
Table 22: UBS model portfolio sector tilt

Sector	Our portfolio weight	Benchmark weight	Recommendation
Telecom	9.0	4.8	Overweight
Engineering/Capital goods	14.0	9.8	Overweight
IT Services	18.0	16.3	Overweight
Automobiles	7.5	5.9	Overweight
Cement & conglomerates	5.0	3.7	Overweight
Banks & FIs	21.5	21.4	Neutral
Metals	2.5	2.6	Neutral
FMCG	5.0	5.9	Neutral
Pharmaceuticals	2.5	3.9	Underweight
Property	0.0	1.7	Underweight
Utilities	0.0	1.8	Underweight
Energy	15.0	20.9	Underweight

Source: UBS estimates

Among interest rate-sensitive sectors, banks are currently suffering from divergent drivers. Credit growth remains sluggish and banks with significant international business (ICICI, SBI, BOB) are facing higher borrowing costs overseas. In the Q2 results season we expect good YoY growth only from HDFC Bank (22-25% credit growth), and SBI (low base advantage). We increase our weighting in banks through the inclusion of SBI, and increase our weighting in HDFC Bank. For both banks, the loan book is more leveraged to corporate loans than to retail loans. In autos we include Maruti, but reduce our weighting on M&M and Tata Motors. While we retain our relative bullishness on four-wheelers, we believe Maruti is currently the least risky in that universe. We have recently turned more bullish on near-term cement prices, with the result that we increase our weighting on the sector by including ACC in the portfolio. We increase our weighting in engineering and construction/capital goods by including IVRCL in the portfolio. We think IVRCL is cheaper than large cap engineering stocks, and is more diversified in terms of order backlog and revenue stream. Finally, we remove Hindustan Unilever (HUL) from the portfolio after recent outperformance, as we believe valuations and potential earnings drivers favour ITC. We play the entire consumer staples sector only through ITC. Likewise, in pharmaceuticals we remove Sun Pharmaceuticals, playing the sector only through Ranbaxy.

Chart 31: UBS model portfolio sector tilts



Source: UBS estimates

UBS model portfolio

After the latest reshuffle, our portfolio is more diversified—with the number of stocks increasing from 21 to 23. We add four stocks—IVRCL, Maruti, ACC and SBI to our portfolio, and remove two—HUL and Sun Pharma.

IVRCL, ACC, SBI added; HUL, Sun Pharma removed

Table 23: UBS model portfolio

Sector	Tilt	Company	Weight (%)
IT Services	Overweight	TCS	7.0
		Satyam	6.0
		Infosys	5.0
Pharmaceuticals	Underweight	Ranbaxy Laboratories	2.5
Consumer staples	Neutral	ITC	5.0
Cement	Overweight	Grasim Industries	3.0
		Associated Cement	2.0
Engineering and construction	Overweight	Larsen & Toubro	5.0
		BHEL	5.0
		Maharashtra Seamless	2.0
		IVRCL	2.0
Energy	Underweight	Reliance Industries	15.0
Metals	Neutral	Tata Steel	2.5
Banks and Financial Institutions	Neutral	SBI	7.0
		HDFC Bank	7.0
		ICICI Bank	2.5
		Punjab National Bank	2.0
		IDFC	3.0
Automobiles	Overweight	Maruti	3.0
		M&M	2.5
		Tata Motors	2.0
Telecommunications	Overweight	Bharti Tele	5.0
		Reliance Communication	4.0

Source: UBS

Earnings and valuation drivers in each sector

We examine at the medium-term drivers in each sector in detail. Our sectoral stock selection is often based on different impacts of drivers on stocks within the same sector.

Engineering & capital goods

Apart from L&T and BHEL, which are gaining from new business and increasing order inflows, we have cheaper stocks—IVRCL and MFS

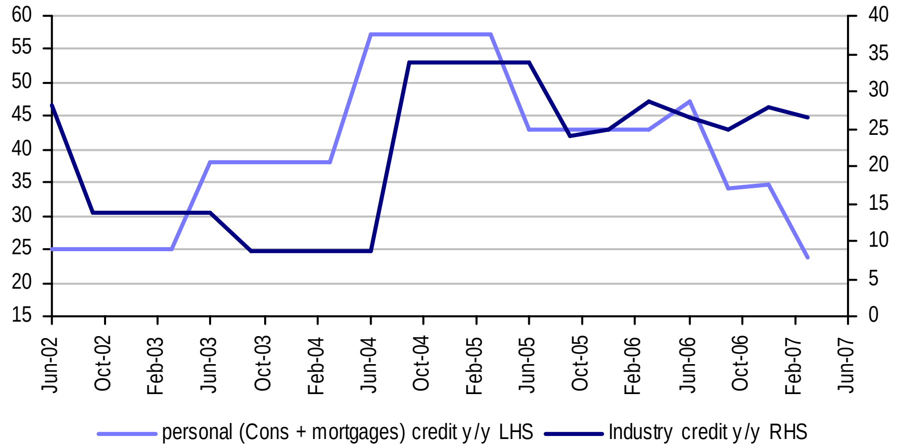
In our view, this sector has the advantage of revenue and earnings visibility on the back of strong order books for the next two to three years. L&T's E&C (74% of group revenues) order book is Rs416bn (to be executed over the next 18-24 months), and we expect it to grow more than 30% CAGR over the next three years, as Suhas Harinarayanan highlights in "Power Ready", 2 August 2007. We expect a 150bp expansion in margin (versus 50bp earlier) on account of better margins in E&C, MIP and Infotech, and stable margins in EBG. Large contracts like the Rs54bn Delhi International Airport Ltd are cost plus in the initial years. We expect BHEL, on the other hand, to benefit from an estimated 60GW of power projects, to be awarded in the XIth Five-Year Plan. Suhas maintains ("The next leg", 11 July 2007) BHEL's order inflow expectation of Rs1,121bn (34GW) over the next three years and FY07-10E CAGR of 23% (up marginally from 22%). We forecast BHEL will augment its capacity to 20,000MW by the end of XIth Five-Year Plan. Entry into power and expansion of shipyard facilities could be re-rating triggers for L&T, while competition and execution remain key risks for BHEL. Our other choices in the sector—Maharashtra Seamless (MHS) and IVRCL—are attractively valued plays on the capex cycle. IVRCL, apart from being a play on road construction, real estate and irrigation, has the advantage of not being dependent on a single sector for order inflows.

Banks

HDFC Bank and SBI could be key outperformers within the sector

Banks are suffering from low credit growth, particularly on the consumer side. A few banks have reduced mortgage rates recently to boost disbursals, though it may hurt spreads in the near term. We believe interest rates have peaked, though they may not come down in the near term. In the October credit policy we do not expect the RBI to cut or increase benchmark rates, or to change the reserve requirements. Consequently, we play those banks whose credit growth is higher than industry average (due to larger exposure to corporate loans). HDFC Bank's credit growth remains in the 22-25% range. SBI is also likely to outperform due to better-than-average earnings growth in Q2 and beyond, and SBI remains significantly cheaper than the private banks. We consequently increase our banking exposure through inclusion of SBI, and increase our weighting in HDFC Bank.

Chart 32: Personal loans have slowed faster than corporate credit (%)



Source: CEIC

Automobiles

Maruti is our top pick, followed by M&M and Tata Motors

We believe the principal revenue and earnings drivers for the auto sector will be recovery in volume growth in H2FY08. Domestic sales of passenger cars and UVs have grown 14% and 10%, respectively, in FY08 YTD, and CVs have grown 4%. Two-wheelers have declined 8% (with motorcycles down 14%), as low-end consumers have borne the brunt of the credit squeeze and more stringent verification norms. Even though two-wheeler sales are beginning to revive, we continue to play the sector through four-wheelers, as they have been more immune to interest rate pressures. Our top pick in the sector is Maruti (the only company to have had earnings and price target upgrades in FY08E), followed by M&M (significantly undervalued, strong growth in non-core businesses), and Tata Motors. Tata's valuation, though cheap, may remain depressed in the near term due to the overhang of a possible large requirement in case the company acquires Ford's Jaguar and Land Rover divisions.

Telecommunications

Strong growth and regulatory changes drive our choices in telecom. Bharti is our top pick

The Indian telecom market continues to grow with a 57% increase in total subscriber base between August 2006 and July 2007 (189.08m). GSM subscriber growth of 63.7% (141.84m in July 2007) surpassed CDMA subscriber growth of 39.3% (47.25m in July 2007). Suresh Mahadevan ("Strong August keeps momentum going", 14 September 2007) remains bullish on the sector and expects geographical expansion, passive infrastructure sharing and increased affordability of handsets to further accelerate mobile adoption. There were no surprises from TRAI in its recent recommendations to DoT—higher cross holdings (up to 20% among operators) and the removal of the cap on the frequency spectrum in case of an M&A are positives for the market, in our view, while higher spectrum costs and stringent subscriber criteria for spectrum allocation are negatives. Lowering the combined market share threshold to 40% (from 67%) should act as a deterrent for M&A activity.

We remain positive on Bharti, Idea, Reliance Communication and Spice. There could be positive earnings surprises from Bharti & Idea, as the net subscriber additions in August 2007 were ahead of our estimates. Bharti has taken the lead in expanding its network and backbone. We believe it has a sustainable first mover advantage with its lifetime plans and MoU with Vodafone for sharing passive infra, which should lead to better tower occupancy and create shareholder value. We view Reliance Communication's resumption of wireless revenue growth as a positive sign indicating increasing returns on the investments in network expansion and handset initiative.

IT services

We remain Overweight post underperformance. No concern unless US goes into recession. Order of preference: TCS, Satyam, Infosys

The IT services sector has underperformed significantly over the past two quarters. In Q1FY08, the sector underperformed due to a sharp appreciation of the rupee, while in Q2 the concerns over the BFSI space in the US (generated by the subprime crisis) drove underperformance. Trideep Bhattacharya ("Momentum intact, but what if there is a recession in CY08", 22 August 2007) believes that only under recessionary conditions could Indian IT companies' growth slow for a couple of quarters, and a pricing increase be at risk. Indian IT companies are better positioned now compared to 2001 because of a well-diversified business mix. We forecast an economic soft landing in the US—not a recession—which leads us to maintain our Overweight position on IT. Our preference remains for the large caps—in the order: TCS, Satyam, Infosys.

Cement

Sector to remain stronger longer as capacities get delayed. Top picks: Grasim and ACC

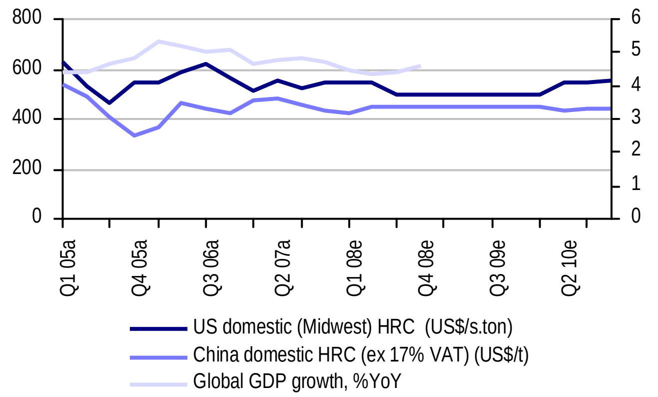
We believe ("Not done yet", 10 September 2007) new cement capacities are likely to get delayed to H2FY09 and FY10. We do not think the threat of imports from Pakistan and other regions is serious in the medium term. Consequently, we believe the current tight demand-supply situation is likely to last to H2FY09, and have increased our cement realisation estimates by c2% in FY08 and FY09. Our favourite in the sector remains Grasim (cheapest, sharply increasing operating efficiency), followed by ACC (high operating leverage and efficiency gains in association with Holcim).

Global cyclicals

Key picks in commodities: Reliance and Tata Steel

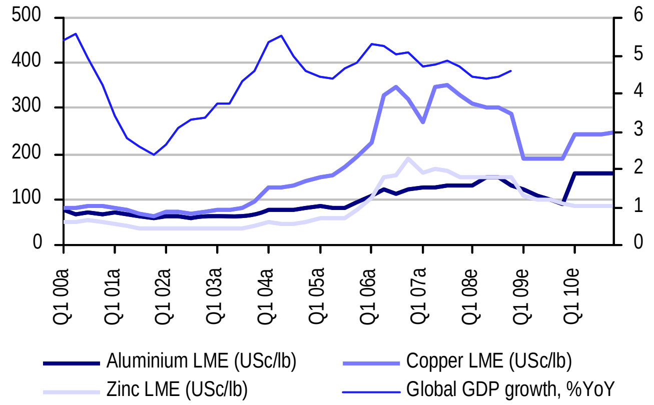
A decline in global growth expectations implies the possibility of a demand contraction and hence a price decline in commodities. Globally we remain bullish on aluminium, and Neutral on copper, nickel (though bullish long term) and zinc ("Commodity connections—Q307", 31 July 2007). UBS forecasts most metals to decline from CY08 until end-CY09 before stabilising in CY10.

Chart 33: Steel price forecasts



Source: UBS estimates

Chart 34: Base metal price forecasts

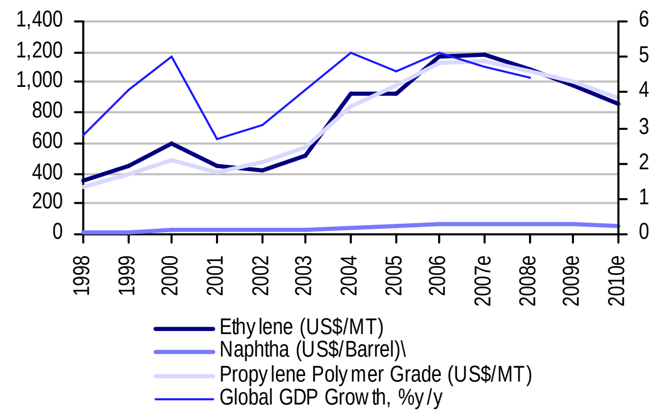


Source: UBS estimates

Aluminium has been a laggard, with price appreciation underperforming relative to other base metals ("Commodity connections—Q307", 31 July 2007). We remain positive on aluminium. According to UBS global forecasts, prices should remain well supported short term followed by long-term strength from rising cost inflation from power and bauxite in China. This favourable environment is likely to be positive for Indian aluminium manufacturers like Nalco, Hindalco and Sterlite.

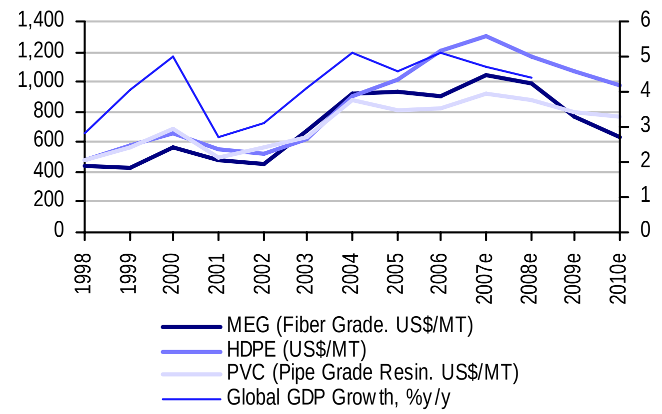
We have raised our iron ore price from 10% to 25% in JFY08 due to new Indian iron ore export taxes, appreciating producer currencies and strong global steel consumption ("Commodity connections—Q307", 31 July 2007). We expect global steel prices to track Chinese steel prices in the face of a rapid decline in export VAT rebate of 8% in March 2007 to a 5% export tax in June 2007. Our bullish stance on Tata Steel arises from our expectation of stable prices, a positive surprise from Corus and improving operating efficiency.

Chart 35: Chemical price forecasts—I



Source: UBS estimates

Chart 36: Chemical price forecasts—II



Source: UBS estimates

In oil & gas we believe Asian refining margins will remain relatively well-balanced through 2010 ("Asian refining sector: solid free cash flow support", 22 August 2007). We have upgraded our Asian refining margin expectations from US$6.5 to US$7.0/bbl for 2007 and from US$5.5 to US$6.3/bbl for 2008 on the back of large delays (particularly in the Middle East) and cancellations in refining projects. This should benefit Indian companies like Reliance, HPCL and BPCL, though the earnings of the latter two remain dependent on government policy on oil subsidies. Currently Asian refining margins are 50% below the seasonal peak in May 2007.

On chemicals we expect prices for products like ethylene, propylene, naphtha and others including MEG and HDPE to peak in 2007 and then follow a secular downturn. We believe this should augur well for Indian manufacturers who use these products as intermediaries like paints (eg, Asian Paints), but is likely to hurt margins for manufacturers of these products, like Reliance. The margin pressure from chemicals for Reliance should be offset by a positive outlook on refining margins (current EBITDA share: 51% refining, 43% petrochemicals and 6% existing E&P). New business initiatives (E&P, retail and RPL) now account for 54% of our sum-of-the-parts valuations for Reliance, while we account for the remainder with refining and petrochemicals ("Reliance Industries—another record refining margin", 30 July 2007). Consequently, we reduce the cyclical effects from petrochemicals.

Consumer staples

In the consumer sector, price increases are leading to improved margins and helping offset some cost increases. For instance, HUL's management committed to raising earnings growth by clawing back margin losses during the price wars of 2004-06, as Sandeep Bhatia points out ("Margin expansion points to well managed response to cost pressures", 30 July 2007). The sector is showing greater resilience (than in the past) to price increases. ITC's cigarette volumes did not decline despite a sharp price increase post the excise duty and VAT hike in the budget. We have revised ITC's cigarette volume growth to -4.4% in FY08 (from -6.5% earlier), helped by its multiple price point portfolio that should allow it to move consumers across segments rather than lose volumes. Hotel, paperboard and FMCG business recorded strong growth, and we believe losses in FMCG are set to decline. Valuations relative to forecast earnings growth remains a concern in the sector. ITC is cheaper than HUL, and we believe the possibility of an upward earnings revision is stronger in ITC—leading us to play the sector only through ITC.

Top picks

We choose our top picks based on the possibility of an upward earnings revision, strength of earnings drivers and growth-adjusted valuation parameters. Our top five are: Reliance, L&T, Bharti, Tata Steel and Grasim. They represent a 31% weighting of our model portfolio.

Table 24: Valuations of top five picks

	Mkt Cap (US$m)	Price (Rs)	Price Target	EV/EBITDA (x)			PE (x)			PEG (x)	EVEG (x)	Avg Daily Turnover
Stock	19 Sep 2007	19 Sep 2007	(Rs)	FY07	FY08E	FY09E	FY07	FY08E	FY09E	(FY07-09E)	(FY07-09E)	US$m
Tata Steel	10805.8	744.7	875	3.8	1.4	1.4	10.2	6.9	6.5	0.40	0.06	15.47
Reliance Industries	75633.4	2172.9	2340	10.1	8.5	6.6	27.8	22.4	19.4	1.42	0.43	36.90
Bharti Televentures	42015.1	886.3	1125	13.7	8.9	6.4	39.5	25.5	19.1	0.90	0.29	5.30
Grasim	7624.7	3328.0	3745	6.5	5.1	4.6	15.5	11.3	10.1	0.65	0.34	3.06
Larsen & Toubro	18701.2	2669.8	2950	13.0	9.5	7.1	40.7	30.7	22.8	1.21	0.37	18.19

Source: UBS estimates

For each of our top five picks we expect earnings upgrades in the medium term. Grasim, Tata Steel and L&T are strong plays on the capex cycle and are benefiting from firm cement and steel prices, and increasing order inflows, respectively. Bharti is a play on the secular consumption demand growth story, but does not depend on the interest rate cycle. Reliance has been providing positive surprises on E&P assets for a considerable period.

Appendices—valuations, estimate changes, stock performance

Table 25: Valuations of Indian companies under UBS India coverage

Stock	Rating	Mkt Cap (US$m) 19/09/07	Price (Rs) 19/09/07	EV/EBITDA (x) FY05	FY06	FY07	FY08E	FY09E	EPS (Rs) FY05	FY06	FY07	FY08E	FY09E	PE (x) FY05	FY06	FY07	FY08E	FY09E	PEG (FY07-09E)	EVEG (FY07-09E)	Avg Daily Turnover US$m
Auto / Auto ancillaries																					
Maruti	Buy	6683.8	925.85	12.5	10.9	9.1	7.4	6.7	30.5	42.1	55.0	65.0	70.9	30.4	22.0	16.8	14.2	13.1	1.24	0.54	3.27
Tata Motors	Buy	7308.6	722.2	13.9	11.2	8.8	8.3	7.0	36.3	43.9	53.6	53.4	64.4	19.9	16.4	13.5	13.5	11.2	1.40	0.74	6.56
Hero Honda	Sell	3494.6	700.4	12.9	11.0	12.8	13.1	11.3	40.4	48.6	43.0	40.8	47.4	17.3	14.4	16.3	17.2	14.8	3.20	1.96	0.69
Bajaj Auto	Neutral	6351.9	2512.4	21.3	15.1	14.3	15.5	13.0	83.8	109.3	128.3	118.3	135.2	30.0	23.0	19.6	21.2	18.6	7.46	2.97	3.61
M&M	Buy	4419.4	741.0	20.3	13.9	8.5	7.1	6.1	28.8	43.1	67.1	72.1	84.6	25.7	17.2	11.0	10.3	8.8	0.90	0.48	3.22
Consumer non-durables																					
Hindustan Lever	Buy	11965.8	217.0	34.9	34.7	30.4	25.4	21.4	5.4	6.2	7.0	8.3	10.0	39.8	35.3	31.0	26.3	21.8	1.60	1.58	3.15
ITC	Buy	17532.4	186.9	22.8	17.6	14.8	12.7	10.8	5.0	6.1	7.2	8.4	9.9	37.7	30.7	26.0	22.2	18.9	1.49	0.86	5.56
Nestle	Buy	3133.8	1300.8	22.4	19.3	18.8	16.1	13.5	29.1	34.1	33.9	41.6	51.4	44.6	38.1	38.4	31.3	25.3	1.66	1.05	1.30
Dabur	Buy	2306.0	107.0	39.9	28.9	24.1	20.9	17.4	1.8	2.6	3.3	3.8	4.5	58.7	40.6	32.5	27.8	23.9	1.94	1.37	0.68
Radico Khaitan	Neutral	522.3	216.7	28.8	19.9	18.5	16.7	14.6	3.7	4.7	4.6	4.7	5.6	58.3	46.3	47.5	46.0	38.4	4.21	1.48	1.08
United Spirits	Buy	3836.2	1814.7	82.3	30.6	13.4	10.1	8.8	8.6	21.1	28.0	38.9	46.8	211.4	86.1	64.9	46.6	38.7	2.21	0.57	5.94
Petrochemicals																					
Reliance Industries	Buy	75633.4	2172.9	14.3	12.8	10.1	8.5	6.6	54.3	65.1	78.2	97.0	111.7	40.0	33.4	27.8	22.4	19.4	1.42	0.43	36.90
Oil & Gas																					
Indian Oil Corporation	Sell	11383.9	390.1	11.2	11.0	8.4	8.3	10.2	41.9	42.1	57.7	39.9	37.6	9.5	9.3	6.8	9.8	10.4	-0.35	-0.93	0.82
Bharat Petroleum	Sell	2805.2	310.6	14.0	24.5	7.2	7.4	7.9	32.2	9.7	47.6	43.8	38.2	9.8	31.9	6.5	7.1	8.1	-0.62	-1.55	0.51
HPCL	Sell	2033.4	240.1	9.8	25.0	7.5	7.5	7.7	37.7	12.0	41.8	37.5	32.4	6.6	20.1	5.7	6.4	7.4	-0.48	-4.70	1.10
ONGC	Buy	48180.8	901.5	6.9	6.2	4.8	4.6	4.5	67.0	72.0	100.2	101.6	102.5	13.6	12.5	9.0	8.9	8.8	7.99	1.43	5.00
GAIL	Buy	7285.9	344.8	#N/A	#N/A	#N/A	#N/A	#N/A	23.1	#N/A	#N/A	#N/A	#N/A	14.9	#N/A	#N/A	#N/A	#N/A	#N/A	#N/A	0.88
Pharmaceuticals																					
Cipla	Neutral	3292.1	169.5	37.4	24.0	21.1	19.3	16.2	4.6	8.1	8.5	9.4	11.5	36.7	21.0	19.9	18.0	14.7	1.21	1.48	3.13
Dr. Reddy's Laboratories	Buy	2705.1	645.1	111.2	35.8	6.7	10.0	8.4	2.3	9.8	60.9	34.0	45.1	285.1	65.8	10.6	19.0	14.3	-0.76	-0.60	1.11
Aurobindo Pharma	Neutral	798.1	599.6	33.7	21.5	10.8	9.0	7.5	1.0	7.3	38.4	48.0	58.4	630.4	82.3	15.6	12.5	10.3	0.67	0.54	1.15
Ranbaxy Laboratories	Buy	3845.1	412.9	18.8	67.9	20.5	16.1	13.0	19.5	6.5	13.7	18.2	22.5	21.1	63.2	30.2	22.7	18.3	1.07	0.81	4.14
Wockhardt	Buy	1127.4	412.3	19.2	15.7	12.9	8.0	6.1	19.6	23.5	27.6	28.2	36.2	21.0	17.5	15.0	14.6	11.4	1.02	0.29	0.32
Sun Pharma	Buy	4888.0	1011.5	37.7	32.5	22.6	17.0	12.8	21.3	30.7	40.0	45.3	60.2	47.4	32.9	25.3	22.3	16.8	1.11	0.69	1.97
Nicholas Piramal	Buy	1449.3	277.5	27.5	23.0	14.3	10.8	8.9	5.1	5.1	11.0	13.4	17.5	54.2	54.6	25.2	20.7	15.9	0.97	0.53	0.90
Lupin	Neutral	1194.8	595.2	30.1	15.8	9.6	9.6	8.3	11.4	21.5	38.4	36.7	42.2	52.0	27.6	15.5	16.2	14.1	3.20	1.32	1.54
Glenmark	Neutral (CBE)	2350.8	391.8	35.6	37.3	12.9	7.7	6.4	4.5	3.6	12.3	21.9	27.4	87.7	108.1	31.8	17.9	14.3	0.65	0.31	1.76
Software																					
Infosys	Buy	26452.3	1853.3	42.8	32.4	22.8	18.6	14.4	34.0	45.0	67.4	81.9	103.1	54.6	41.2	27.5	22.6	18.0	1.16	0.88	14.30
Satyam	Buy	7160.4	429.5	27.4	20.3	15.4	12.8	10.1	11.1	15.1	21.1	26.0	31.6	38.5	28.4	20.4	16.5	13.6	0.91	0.65	6.95
BFL Software	Neutral (CBE)	1122.4	279.0	23.5	16.7	16.1	13.6	10.9	8.3	9.3	7.8	12.0	14.8	33.6	30.0	35.6	23.3	18.8	0.95	0.74	1.39
Polaris	Sell (CBE)	286.3	116.7	11.4	7.8	6.3	#N/A	#N/A	6.0	9.7	12.2	#N/A	#N/A	19.5	12.0	9.5	#N/A	#N/A	#N/A	#N/A	0.69
Wipro	Neutral	16338.1	448.2	37.1	30.0	22.2	18.6	15.0	11.6	14.5	20.2	22.4	27.5	38.7	30.9	22.2	20.0	16.3	1.33	1.03	3.30
HCL Technologies	Buy	4615.3	283.9	24.9	19.3	14.5	11.4	#N/A	9.6	12.6	16.1	18.4	#N/A	29.5	22.5	17.6	15.5	#N/A	#N/A	#N/A	1.00
I-Flex	Sell	3604.7	1891.0	36.7	33.8	27.4	#N/A	#N/A	31.0	31.1	38.2	#N/A	#N/A	61.0	60.9	49.4	#N/A	#N/A	#N/A	#N/A	0.73
TCS	Buy	25001.7	1022.5	40.3	28.3	20.5	16.6	13.0	21.7	29.5	42.2	51.1	66.0	47.1	34.7	24.2	20.0	15.5	0.97	0.79	9.02
Patni Computer	Neutral	1674.9	486.4	11.4	10.0	9.3	7.4	#N/A	21.2	20.1	25.2	29.5	#N/A	22.9	24.2	19.3	16.5	#N/A	#N/A	#N/A	3.17
Subex	Buy	390.5	451.5	58.8	41.6	42.9	16.5	11.7	#N/A	17.4	19.4	31.1	43.4	#N/A	26.0	23.3	14.5	10.4	0.47	0.47	0.41
Hexaware	Buy	418.3	125.9	20.9	14.9	12.6	10.2	8.0	5.3	7.2	8.7	9.5	12.0	23.9	17.5	14.4	13.3	10.5	0.82	0.50	0.63
Telecom																					
Bharti Televentures	Buy	42015.1	886.3	34.6	23.4	13.7	8.9	6.4	8.1	11.9	22.4	34.8	46.3	109.7	74.3	39.5	25.5	19.1	0.90	0.29	5.30
Reliance Communications	Buy	28812.0	564.0	#N/A	25.5	11.0	7.2	4.8	#N/A	2.4	15.6	23.2	34.9	#N/A	239.1	36.1	24.3	16.1	0.73	0.21	19.60
Idea Cellular	Buy	8030.5	122.0	31.9	24.5	17.7	11.3	8.1	0.3	0.9	1.9	3.9	5.1	360.0	130.1	62.9	30.9	24.0	1.02	0.37	4.97
Spice	Buy	921.5	53.5	#N/A	#N/A	#N/A	#N/A	#N/A	0.1	-0.9	-0.8	0.0	1.5	584.2	-61.1	-70.6	-1384.4	34.8	#N/A	#N/A	0.62

Table 25: Valuations of Indian companies under UBS India coverage (cont'd)

Stock	Rating	Mkt Cap (US$m) 19/09/07	Price (Rs) 19-Sep-07	EV/EBITDAx FY05	FY06	FY07	FY08E	FY09E	EPS (Rs) FY05	FY 06	FY 07	FY 08E	FY09E	PE (x) FY 05	FY 06	FY 07	FY 08E	FY09E	PEG (FY07-09E)	EVEG (FY07-09E)	Avg Daily Turnover US$m
Cement																					
ACC	Buy	5398.8	1153.0	22.9	29.7	9.8	7.1	6.2	20.2	12.5	62.2	83.6	96.1	57.2	91.9	18.5	13.8	12.0	0.76	0.37	8.03
Gujarat Ambuja	Buy	5608.6	147.6	15.7	#N/A	6.0	6.4	5.5	3.5	#N/A	11.6	10.3	11.9	42.0	#N/A	12.7	14.3	12.4	9.30	1.43	3.87
Grasim	Buy	7624.7	3328.0	12.7	12.5	6.5	5.1	4.6	96.0	113.0	214.6	293.5	329.7	34.7	29.4	15.5	11.3	10.1	0.65	0.34	3.06
Miscellaneous																					
Asian Paints	Buy	2244.6	933.0	22.9	18.8	15.4	12.1	10.0	18.5	23.0	28.0	36.0	43.0	50.5	40.6	33.3	25.9	21.7	1.40	0.64	0.63
Jet Airways	Sell (CBE)	1992.5	923.6	8.2	10.7	40.1	7.4	4.3	44.5	32.7	-29.3	-49.1	9.7	20.8	28.2	-31.6	-18.8	95.4	#N/A	0.20	0.97
United Phosphorus	Buy	1772.9	379.2	17.5	13.9	13.5	8.8	6.9	9.3	11.6	15.5	18.1	26.5	40.6	32.8	24.5	20.9	14.3	0.79	0.34	1.22
Power																					
Reliance Energy	Sell	5019.4	946.1	14.5	12.6	19.6	11.2	9.6	22.1	33.4	32.9	41.8	44.4	42.8	28.4	28.7	22.6	21.3	1.79	0.45	19.81
NTPC	Neutral	39043.4	189.5	17.6	15.9	11.8	13.3	12.1	6.7	7.1	8.3	8.9	9.2	28.5	26.8	22.8	21.3	20.5	4.31	-10.07	4.88
Tata Power	Neutral	3762.7	760.9	9.2	11.1	9.6	9.0	8.1	19.1	28.5	29.6	30.8	#N/A	39.9	26.7	25.7	24.7	#N/A	#N/A	1.13	2.00
Cairn	Neutral	7405.6	166.7	#N/A	#N/A	#N/A	#N/A	#N/A	#N/A	#N/A	2.2	1.2	0.1	#N/A	#N/A	75.0	141.9	1382.1	-0.98	#N/A	2.72
Suzlon Energy	Neutral	10559.7	1469.8	72.6	39.5	27.6	17.4	10.2	14.7	27.6	29.7	41.8	61.5	100.0	53.2	49.5	35.2	23.9	1.13	0.43	7.21
Media																					
Zee Telefims	Buy	3465.5	320.0	27.0	35.6	36.2	21.5	17.1	7.9	6.6	5.1	9.2	11.4	40.5	48.7	63.2	34.6	28.0	1.26	0.80	4.85
Sun TV	Sell	3283.0	333.4	58.1	37.3	17.9	14.2	11.5	96.0	4.7	7.4	9.5	12.1	3.5	70.5	45.0	35.2	27.6	1.62	0.73	1.02
HT Media	Buy	1237.6	211.5	35.3	22.3	13.9	9.9	7.7	9.1	12.8	4.9	6.7	8.9	23.2	16.5	42.9	31.4	23.7	1.25	0.41	0.29
ENIL	Buy	604.9	509.0	-89.9	33.1	27.4	18.4	11.7	-1.5	4.1	6.1	7.3	10.5	-332.1	123.1	83.3	70.2	48.5	2.68	0.52	2.09
Engineering																					
BHEL	Buy	23581.8	1927.9	29.8	19.6	13.1	10.7	8.4	20.5	34.0	53.2	65.2	82.3	93.9	56.6	36.2	29.6	23.4	1.49	0.53	7.61
Larsen & Toubro	Buy	18701.2	2669.8	28.2	20.7	13.0	9.5	7.1	25.7	36.2	65.6	86.9	117.1	103.8	73.8	40.7	30.7	22.8	1.21	0.37	18.19
Maharashtra Seamless	Buy	1019.8	611.5	19.4	12.0	7.3	5.1	3.8	14.7	24.2	33.4	46.3	62.1	41.5	25.3	18.3	13.2	9.9	0.50	0.19	0.64
GMR Infr	Sell	6517.8	787.9	35.6	31.3	23.7	20.6	10.5	4.3	2.7	7.0	6.0	12.3	181.6	297.0	113.0	130.8	64.1	3.45	0.47	25.90
Gammon	Neutral (CBE)	909.5	416.1	37.5	18.6	19.4	15.7	12.6	5.6	12.0	11.3	14.3	18.5	73.9	34.6	36.7	29.1	22.4	1.32	0.81	0.80
HCC	Buy (CBE)	876.6	136.9	25.4	21.4	16.6	12.4	8.5	2.7	3.2	2.4	3.9	6.8	50.5	42.3	56.9	35.1	20.2	0.84	0.42	1.91
IVRCL	Buy (CBE)	1360.5	403.3	42.8	27.5	16.1	11.3	8.5	6.7	8.7	10.5	14.7	20.0	60.4	46.4	38.5	27.4	20.1	1.01	0.43	4.27
Metals																					
Tata Steel	Buy	10805.8	744.7	4.9	5.0	3.8	1.4	1.4	62.7	63.3	72.7	107.2	114.6	11.9	11.8	10.2	6.9	6.5	0.40	0.06	15.47
SAIL	Buy	18964.5	183.8	3.0	4.8	3.2	2.8	2.6	16.8	9.9	15.2	17.4	18.6	10.9	18.6	12.1	10.5	9.9	1.12	0.27	6.95
Sterlite	Buy (CBE)	12122.4	684.8	15.3	7.0	2.8	2.7	2.8	15.0	30.1	82.0	63.2	62.9	45.6	22.8	8.3	10.8	10.9	-0.67	-2.15	3.02
Property																					
DLF	Buy (CBE)	30384.1	713.3	#N/A	#N/A	#N/A	#N/A	#N/A	0.5	1.1	11.4	36.5	50.8	1405.5	633.9	62.6	19.6	14.0	0.56	#N/A	12.09
Unitech	Buy (CBE)	5937.6	292.8	272.7	135.1	10.2	7.9	4.7	0.4	1.0	21.5	25.5	46.3	688.9	281.0	13.6	11.5	6.3	0.29	0.22	11.82
India Bulls real Estate	Neutral	3168.1	524.5	#N/A	#N/A	-16008	208.4	34.5	#N/A	#N/A	0.1	2.2	15.9	#N/A	#N/A	4727.8	233.4	33.0	4.31	#N/A	19.43
Banks																					
SBI	Buy	23277.1	1770.0						81.8	83.7	86.3	93.0	107.5	21.6	21.1	20.5	19.0	16.5	1.77		25.60
HDFC	Neutral	14666.7	2354.2						41.6	50.4	#N/A	#N/A	#N/A	56.6	46.7	#N/A	#N/A	#N/A	#N/A		5.47
HDFC Bank	Buy	9438.2	1326.3						23.1	27.7	35.7	42.4	57.4	57.5	47.9	37.1	31.3	23.1	1.39		2.68
ICICI Bank	Neutral	21556.4	970.4						27.2	28.5	34.6	40.1	51.4	35.7	34.0	28.0	24.2	18.9	1.28		15.92
Corporation Bank	Neutral	1360.6	379.6						28.0	30.7	#N/A	#N/A	#N/A	13.5	12.3	#N/A	#N/A	#N/A	#N/A		0.24
PNB	Buy	3418.3	515.7						44.8	44.3	48.8	53.2	61.1	11.5	11.6	10.6	9.7	8.4	0.89		2.17
OBC	Buy	1471.8	235.1						50.5	32.1	#N/A	#N/A	#N/A	4.7	7.3	#N/A	#N/A	#N/A	#N/A		0.50
Canara Bank	Buy	2741.5	267.6						21.4	32.8	#N/A	#N/A	#N/A	12.5	8.2	#N/A	#N/A	#N/A	#N/A		0.65
IDFC	Buy	3846.7	137.2						3.0	3.6	4.5	5.2	6.4	45.1	37.9	30.5	26.3	21.3	1.54		8.03
Retail					`																
Pantaloons	Buy (CBE)	2069.3	567.4			27.9	16.0	11.2	3.1	4.8	5.0	8.9	13.3	185.0	118.6	113.3	63.6	42.6	1.80	0.48	1.50
Shopper's stop	Sell	464.7	534.0			24.8	19.9	15.0	5.5	7.1	7.5	11.1	15.2	96.9	75.6	70.8	48.0	35.1	1.68	0.87	0.04

Source: UBS estimates

Table 26: Rating and/or earnings upgrades/downgrades, 1 April-19 September 2007

			Prosp. year one		% change	Prosp. 2 year forecast		% change	
Stock	Price 19/09/07 (Rs)	Target price (Rs)	New EPS forecast (Rs)	Old EPS forecast (Rs)	from previous forecast	New EPS forecast (Rs)	Old EPS forecast (Rs)	from previous forecast	Absolute Performance (%)
ACC	1,153	1,300	62.20	57.62	7.96	83.61	76.45	9.36	56.9
Asian Paints	933	NA	28.04	27.72	1.15	36.02	32.03	12.46	22.0
Aurobindo Pharma	600	NA	38.36	19.17	100.11	47.96	33.89	41.54	-11.7
Bajaj Auto	2,512	2,440	128.35	124.92	2.74	118.30	148.86	-20.52	3.6
BFL Software	279	295	7.84	7.92	-1.01	11.95	12.07	-1.01	-1.2
Bharat Petroleum	311	315	47.65	n/a	n/a	43.77	n/a	n/a	2.7
Bharti Televentures	886	1,125	22.45	22.45	0.00	34.79	34.60	0.56	16.1
BHEL	1,928	NA	53.22	98.32	-45.87	65.16	121.90	-46.54	70.6
Cairn	167	169	2.22	n/a	n/a	1.17	n/a	n/a	27.2
Canara Bank	268	330	n/a	n/a	n/a	n/a	n/a	n/a	37.4
Cipla	170	NA	8.50	8.82	-3.62	9.42	10.84	-13.07	-28.1
Corporation Bank	380	NA	n/a	n/a	n/a	n/a	n/a	n/a	31.4
Dabur	107	125	3.29	3.14	4.61	3.84	3.73	3.05	12.6
DLF	713	750	11.39	n/a	n/a	36.47	n/a	n/a	#N/A
Dr. Reddy's Laboratories	645	950	60.91	48.21	26.34	34.00	36.50	-6.87	-11.3
ENIL	509	575	6.11	5.85	4.44	7.25	7.74	-6.33	53.6
GAIL	345	NA	n/a	n/a	n/a	n/a	n/a	n/a	30.3
Gammon	416	485	11.33	10.25	10.57	14.30	14.53	-1.60	38.2
Glenmark	392	360	12.33	24.66	-50.00	21.94	43.89	-50.00	28.5
GMR Infr	788	695	6.97	n/a	n/a	6.03	n/a	n/a	118.7
Grasim	3,328	3,745	214.58	209.01	2.67	293.54	252.16	16.41	59.1
Gujarat Ambuja	148	155	7.73	7.32	5.61	10.33	10.19	1.35	38.3
HCC	137	157	2.41	2.92	-17.61	3.90	4.11	-5.07	53.0
HCL Technologies	284	380	0.37	0.37	0.00	0.92	0.46	100.00	-2.5
HDFC	2,354	NA	n/a	n/a	n/a	n/a	n/a	n/a	54.8
HDFC Bank	1,326	1,390	35.74	n/a	n/a	42.38	n/a	n/a	39.7
Hero Honda	700	690	42.96	45.93	-6.47	40.83	49.58	-17.64	2.2
Hexaware	126	170	8.72	9.48	-8.01	9.46	12.24	-22.73	-25.1
Hindustan Lever	217	260	6.99	6.99	0.00	8.25	8.26	-0.05	5.7
HPCL	240	240	41.76	n/a	n/a	37.49	n/a	n/a	-2.7
HT Media	211	249	4.92	5.16	-4.58	6.73	7.81	-13.88	19.8
ICICI Bank	970	980	34.61	n/a	n/a	40.12	n/a	n/a	13.7
Idea Cellular	122	175	1.94	1.94	0.00	3.94	3.08	27.89	29.0
IDFC	137	160	4.49	4.55	-1.35	5.21	5.27	-1.15	63.9
I-Flex	1,891	1,000	38.25	38.25	0.00	n/a	n/a	n/a	-9.2
India Bulls real Estate	525	NA	0.11	n/a	n/a	2.25	n/a	n/a	75.9
Indian Oil Corporation	390	405	57.74	n/a	n/a	39.88	n/a	n/a	-2.4
Infosys	1,853	2,600	67.40	67.76	-0.53	81.90	87.25	-6.13	-7.9
ITC	187	200	7.18	7.35	-2.34	8.40	7.69	9.25	24.2
IVRCL	403	438	10.48	8.33	25.79	14.70	14.27	2.97	38.1
Jet Airways	924	520	-29.26	-29.26	0.00	-49.12	-49.12	0.00	46.1
Larsen & Toubro	2,670	2,950	65.60	54.79	19.75	86.94	69.94	24.30	64.9
Lupin	595	NA	38.43	37.83	1.57	36.74	31.32	17.33	-1.7
M&M	741	950	67.07	57.78	16.08	72.09	69.89	3.16	-5.0
Maharashtra Seamless	611	706	33.43	33.61	-0.56	46.28	43.52	6.34	20.0
Maruti	926	1,070	54.97	53.96	1.88	65.05	61.87	5.14	12.9
Nestle	1,301	1,350	33.91	33.91	0.00	41.62	39.71	4.80	40.6
Nicholas Piramal	278	320	11.00	9.86	11.59	13.38	14.49	-7.67	13.0
NTPC	190	185	8.33	7.96	4.62	8.88	8.53	4.04	26.5
OBC	235	280	n/a	n/a	n/a	n/a	n/a	n/a	25.4
ONGC	902	1,063	100.22	96.43	3.94	203.27	101.09	101.07	2.7

Table 26: Rating and/or earnings upgrades/downgrades, 1 April-19 September 2007 (cont'd)

Stock	Price 19/09/07 (Rs)	Target price (Rs)	Prosp. year one New EPS forecast (Rs)	Prosp. year one Old EPS forecast (Rs)	% change from previous forecast	Prosp. 2 year forecast New EPS forecast (Rs)	Prosp. 2 year forecast Old EPS forecast (Rs)	% change from previous forecast	Absolute Performance (%)
Pantaloons	567	615	5.01	8.65	-42.10	8.93	14.62	-38.93	42.9
Patni Computer	486	535	25.16	24.26	3.69	29.53	28.39	4.01	25.7
PNB	516	620	48.84	n/a	n/a	53.23	n/a	n/a	9.3
Polaris	117	120	12.23	12.23	0.00	n/a	n/a	n/a	-35.2
Radico Khaitan	217	NA	4.56	n/a	n/a	4.71	n/a	n/a	63.9
Ranbaxy Laboratories	413	490	13.69	14.44	-5.17	18.17	18.60	-2.28	17.1
Reliance Communications	564	675	15.62	15.17	2.94	23.23	23.57	-1.48	34.3
Reliance Energy	946	750	32.95	33.22	-0.83	41.84	36.30	15.27	91.1
Reliance Industries	2,173	2,340	78.25	78.25	0.00	97.01	92.91	4.41	58.8
SAIL	184	180	15.16	n/a	n/a	17.45	n/a	n/a	61.0
Satyam	430	600	21.05	21.62	-2.59	26.00	26.89	-3.30	-8.6
SBI	1,770	1,875	86.29	n/a	n/a	93.00	n/a	n/a	78.3
Shopper's stop	534	NA	7.54	10.07	-25.11	11.12	15.04	-26.03	-13.7
Spice	53	70	-1.19	n/a	n/a	-0.04	n/a	n/a	#N/A
Sterlite	685	775	82.02	n/a	n/a	63.18	n/a	n/a	46.3
Subex	451	760	19.41	n/a	n/a	31.12	n/a	n/a	-20.0
Sun Pharma	1,011	1,215	40.02	37.01	8.15	45.33	45.33	0.00	-4.5
Sun TV	333	301	7.40	29.62	-75.00	9.47	37.89	-75.00	-11.9
Suzlon Energy	1,470	1,650	29.70	39.69	-25.18	41.79	50.83	-17.78	46.7
Tata Motors	722	825	53.59	53.32	0.50	53.44	64.70	-17.41	-0.8
Tata Power	761	NA	29.62	29.62	0.00	30.84	30.84	0.00	49.4
Tata Steel	745	875	72.71	n/a	n/a	107.20	n/a	n/a	65.6
TCS	1,022	1,570	42.22	42.50	-0.67	51.11	53.98	-5.32	-17.0
Unitech	293	560	21.47	21.47	0.00	25.50	25.50	0.00	-24.4
United Phosphorus	379	425	15.45	n/a	n/a	18.10	n/a	n/a	16.8
United Spirits	1,815	NA	27.97	n/a	n/a	38.91	n/a	n/a	119.3
Wipro	448	550	20.17	20.00	0.83	22.45	25.48	-11.89	-19.7
Wockhardt	412	570	27.56	27.60	-0.14	28.17	31.18	-9.64	3.7
Zee Telefims	320	370	5.06	6.34	-20.08	9.24	9.94	-7.12	27.7

Source: UBS estimates

Table 27: Performance of Indian stocks under coverage by UBS India

	Price 19/09/07	Absolute (%)				Relative (%)			
Stock	(Rs)	1m	3m	6m	1y	1m	3m	6m	1y
ACC	1,153	19.7	35.9	53.2	22.6	5.8	20.0	21.5	-10.1
Asian Paints	933	-0.3	9.9	32.3	41.1	-11.9	-3.0	5.0	3.5
Aurobindo Pharma	600	0.1	-21.0	-1.9	-5.2	-11.6	-30.3	-22.2	-30.5
Bajaj Auto	2,512	11.0	16.2	0.6	-9.1	-1.9	2.6	-20.2	-33.4
BFL Software	279	-3.2	-12.2	-3.4	48.9	-14.4	-22.5	-23.4	9.2
Bharat Petroleum	311	0.1	-6.5	-0.4	-17.3	-11.5	-17.5	-21.0	-39.4
Bharti Televentures	886	7.2	7.5	16.4	101.7	-5.3	-5.1	-7.7	47.9
BHEL	1,928	19.7	34.9	83.3	70.9	5.8	19.1	45.4	25.3
Cairn	167	18.3	20.9	31.4	#N/A	4.6	6.7	4.2	#N/A
Canara Bank	268	8.4	-2.7	39.0	2.5	-4.2	-14.1	10.3	-24.9
Cipla	170	-7.9	-19.4	-27.1	-33.4	-18.6	-28.8	-42.2	-51.1
Corporation Bank	380	23.0	18.4	44.0	1.2	8.7	4.6	14.2	-25.8
Dabur	107	6.6	4.0	23.2	17.3	-5.8	-8.2	-2.3	-14.0
DLF	713	23.1	#N/A	#N/A	#N/A	8.8	#N/A	#N/A	#N/A
Dr. Reddy's Laboratories	645	3.3	0.5	-4.9	-14.7	-8.7	-11.2	-24.6	-37.4
ENIL	509	10.5	30.5	53.4	113.1	-2.4	15.2	21.7	56.2
GAIL	345	13.1	15.5	24.1	35.1	-0.1	1.9	-1.6	-0.9
Gammon	416	3.6	4.6	44.7	14.6	-8.4	-7.6	14.7	-16.0
Glenmark	392	25.6	17.8	32.7	124.3	11.0	4.0	5.3	64.5
GMR Infr	788	3.0	34.3	110.3	271.8	-9.0	18.6	66.8	172.7
Grasim	3,328	19.9	32.4	58.0	36.4	6.0	16.9	25.3	0.0
Gujarat Ambuja	148	15.4	24.9	38.7	30.2	2.0	10.3	10.0	-4.5
HCC	137	11.9	31.5	45.7	32.1	-1.1	16.1	15.6	-3.1
HCL Technologies	284	-7.5	-15.8	-4.5	2.1	-18.2	-25.7	-24.2	-25.1
HDFC	2,354	22.9	30.0	52.5	74.8	8.7	14.8	21.0	28.2
HDFC Bank	1,326	17.9	20.6	37.3	50.7	4.2	6.5	8.9	10.5
Hero Honda	700	9.1	4.7	7.6	-8.8	-3.6	-7.5	-14.6	-33.1
Hexaware	126	4.8	-23.4	-17.5	-21.5	-7.4	-32.4	-34.5	-42.4
Hindustan Lever	217	9.4	15.1	13.8	-12.3	-3.3	1.6	-9.8	-35.6
HPCL	240	4.8	-8.7	-9.3	-17.1	-7.4	-19.4	-28.1	-39.2
HT Media	211	-2.9	-3.9	11.4	83.9	-14.2	-15.1	-11.6	34.9
ICICI Bank	970	11.3	2.4	11.5	50.0	-1.6	-9.6	-11.6	10.0
Idea Cellular	122	7.5	5.9	31.1	#N/A	-4.9	-6.5	3.9	#N/A
IDFC	137	18.1	14.1	59.9	119.6	4.4	0.8	26.9	61.1
I-Flex	1,891	-0.7	-26.6	-3.8	32.8	-12.3	-35.2	-23.7	-2.6
India Bulls real Estate	525	7.2	29.9	#N/A	#N/A	-5.3	14.7	#N/A	#N/A
Indian Oil Corporation	390	1.8	-9.4	-6.9	-25.8	-10.0	-20.0	-26.2	-45.6
Infosys	1,853	1.3	-5.2	-11.5	2.0	-10.4	-16.3	-29.8	-25.2
ITC	187	19.6	20.5	29.0	1.5	5.7	6.4	2.3	-25.5
IVRCL	403	16.1	11.5	38.0	66.5	2.7	-1.5	9.4	22.1
Jet Airways	924	23.3	16.9	37.8	41.3	9.0	3.2	9.3	3.6
Larsen & Toubro	2,670	13.4	31.6	77.7	101.7	0.2	16.2	41.0	47.9
Lupin	595	1.0	-13.0	0.8	24.1	-10.7	-23.2	-20.1	-9.0
M&M	741	15.4	4.1	-1.9	16.5	2.0	-8.1	-22.2	-14.5
Maharashtra Seamless	611	7.5	-2.9	28.1	66.2	-5.0	-14.3	1.6	21.9
Maruti	926	18.4	20.5	16.9	1.0	4.6	6.4	-7.3	-25.9
Nestle	1,301	11.2	9.2	44.5	23.9	-1.7	-3.6	14.6	-9.1
Nicholas Piramal	278	12.3	-8.8	12.1	26.7	-0.7	-19.5	-11.1	-7.1

Table 27: Performance of Indian stocks under coverage by UBS India (cont'd)

Stock	Price 19/09/07 (Rs)	Absolute (%) 1m	3m	6m	1y	Relative (%) 1m	3m	6m	1y
NTPC	190	15.5	26.1	32.1	48.7	2.1	11.3	4.8	9.0
OBC	235	15.4	7.5	32.5	7.0	2.0	-5.1	5.1	-21.5
ONGC	902	10.2	-1.7	10.9	17.4	-2.6	-13.2	-12.0	-13.9
Pantaloons	567	16.0	29.7	35.1	74.5	2.5	14.5	7.1	28.0
Patni Computer	486	24.3	-7.7	24.1	24.2	9.8	-18.5	-1.6	-8.9
PNB	516	4.8	0.3	14.2	6.2	-7.4	-11.4	-9.4	-22.1
Polaris	117	1.1	-25.9	-36.8	3.9	-10.7	-34.6	-49.9	-23.8
Radico Khaitan	217	32.3	54.0	63.5	48.7	16.9	35.9	29.7	9.1
Ranbaxy Laboratories	413	13.2	17.4	24.3	0.4	0.0	3.6	-1.4	-26.4
Reliance Communications	564	11.0	11.5	37.6	70.2	-1.9	-1.6	9.1	24.8
Reliance Energy	946	30.4	75.9	92.6	107.2	15.3	55.3	52.8	52.0
Reliance Industries	2,173	21.3	25.5	62.2	94.3	7.2	10.8	28.6	42.5
SAIL	184	28.4	36.1	70.4	152.8	13.5	20.1	35.1	85.4
Satyam	430	-0.7	-9.0	-4.9	2.5	-12.2	-19.6	-24.5	-24.8
SBI	1,770	14.2	24.2	80.2	81.0	0.9	9.7	42.9	32.8
Shopper's stop	534	6.6	-9.5	-11.0	-4.6	-5.8	-20.1	-29.4	-30.1
Spice	53	7.2	#N/A	#N/A	#N/A	-5.2	#N/A	#N/A	#N/A
Sterlite	685	22.0	13.3	52.1	58.8	7.8	0.0	20.7	16.5
Subex	451	-17.1	-24.9	-19.4	1.1	-26.7	-33.7	-36.1	-25.9
Sun Pharma	1,011	5.4	-3.7	-0.5	9.7	-6.8	-15.0	-21.1	-19.5
Sun TV	333	-1.1	-13.2	-13.7	6.3	-12.6	-23.4	-31.6	-22.0
Suzlon Energy	1,470	13.0	6.4	47.8	24.6	-0.1	-6.0	17.2	-8.6
Tata Motors	722	11.2	5.1	-6.9	-13.1	-1.7	-7.2	-26.2	-36.3
Tata Power	761	10.7	21.8	50.1	47.1	-2.1	7.6	19.0	7.9
Tata Steel	745	30.9	22.5	73.2	52.4	15.7	8.1	37.3	11.8
TCS	1,022	-3.0	-10.8	-19.3	1.2	-14.3	-21.2	-36.0	-25.8
Unitech	293	-40.6	-43.3	-31.7	11.0	-47.5	-49.9	-45.9	-18.6
United Phosphorus	379	20.2	23.8	19.2	65.0	6.3	9.3	-5.4	21.0
United Spirits	1,815	39.5	53.8	119.9	175.6	23.3	35.8	74.4	102.1
Wipro	448	-4.5	-14.1	-23.0	-12.6	-15.6	-24.2	-38.9	-35.9
Wockhardt	412	12.3	4.3	11.6	4.5	-0.8	-7.9	-11.5	-23.4
Zee Telefims	320	7.2	9.4	27.2	4.3	-5.3	-3.4	0.9	-23.5

Source: UBS

■ Statement of Risk

Risks to investing in Indian equities arise from premium valuations, domestic political uncertainty, possible spikes in inflation, etc.

■ Analyst Certification

Each research analyst primarily responsible for the content of this research report, in whole or in part, certifies that with respect to each security or issuer that the analyst covered in this report: (1) all of the views expressed accurately reflect his or her personal views about those securities or issuers; 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 by that research analyst in the research report.

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UBS Investment Research: Global Equity Rating Allocations

UBS 12-Month Rating	Rating Category	Coverage[1]	IB Services[2]
Buy	**Buy**	48%	39%
Neutral	**Hold/Neutral**	40%	37%
Sell	**Sell**	12%	26%
UBS Short-Term Rating	**Rating Category**	**Coverage[3]**	**IB Services[4]**
Buy	**Buy**	N/A	N/A
Sell	**Sell**	N/A	N/A

1:Percentage of companies under coverage globally within the 12-month rating category.
2:Percentage of companies within the 12-month rating category for which investment banking (IB) services were provided within the past 12 months.
3:Percentage of companies under coverage globally within the Short-Term rating category.
4:Percentage of companies within the Short-Term rating category for which investment banking (IB) services were provided within the past 12 months.

Source: UBS. Rating allocations are as of 30 June 2007.

UBS Investment Research: Global Equity Rating Definitions

UBS 12-Month Rating	Definition
Buy	FSR is > 6% above the MRA.
Neutral	FSR is between -6% and 6% of the MRA.
Sell	FSR is > 6% below the MRA.
UBS Short-Term Rating	**Definition**
Buy	Buy: Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.
Sell	Sell: Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event.

KEY DEFINITIONS

Forecast Stock Return (FSR) is defined as expected percentage price appreciation plus gross dividend yield over the next 12 months.
Market Return Assumption (MRA) is defined as the one-year local market interest rate plus 5% (a proxy for, and not a forecast of, the equity risk premium).
Under Review (UR) Stocks may be flagged as UR by the analyst, indicating that the stock's price target and/or rating are subject to possible change in the near term, usually in response to an event that may affect the investment case or valuation.
Short-Term Ratings reflect the expected near-term (up to three months) performance of the stock and do not reflect any change in the fundamental view or investment case.

EXCEPTIONS AND SPECIAL CASES

US Closed-End Fund ratings and definitions are: Buy: Higher stability of principal and higher stability of dividends; Neutral: Potential loss of principal, stability of dividend; Reduce: High potential for loss of principal and dividend risk.
UK and European Investment Fund ratings and definitions are: Buy: Positive on factors such as structure, management, performance record, discount; Neutral: Neutral on factors such as structure, management, performance record, discount; Reduce: Negative on factors such as structure, management, performance record, discount.
Core Banding Exceptions (CBE): Exceptions to the standard +/-6% bands may be granted by the Investment Review Committee (IRC). Factors considered by the IRC include the stock's volatility and the credit spread of the respective company's debt. As a result, stocks deemed to be very high or low risk may be subject to higher or lower bands as they relate to the rating. When such exceptions apply, they will be identified in the Companies Mentioned or Company Disclosure table in the relevant research piece.

Company Disclosures

Company Name	Reuters	12-mo rating	Short-term rating	Price	Price date
ACC Limited	ACC.BO	Buy	N/A	Rs1,153.00	19 Sep 2007
Bharat Heavy Electricals Limited	BHEL.BO	Suspended	N/A	Rs1,927.90	19 Sep 2007
Bharti Airtel Ltd.[2a, 4a, 5, 12]	BRTI.BO	Buy	N/A	Rs886.30	19 Sep 2007
Grasim Industries[16]	GRAS.BO	Buy	N/A	Rs3,327.95	19 Sep 2007
HDFC Bank Ltd.[2a, 4a, 5, 16]	HDBK.BO	Buy	N/A	Rs1,326.30	19 Sep 2007
Hindustan Petroleum[4b]	HPCL.BO	Sell	N/A	Rs240.05	19 Sep 2007
ICICI Bank[2b, 4b, 8, 16]	ICBK.BO	Neutral	N/A	Rs970.40	19 Sep 2007
Idea Cellular[2a, 4a]	IDEA.BO	Buy	N/A	Rs121.95	19 Sep 2007
Infosys Technologies Ltd.[2a, 4a, 8, 16]	INFY.BO	Buy	N/A	Rs1,853.30	19 Sep 2007
Infrastructure Development Finance[2a, 4a, 5]	IDFC.BO	Buy	N/A	Rs137.15	19 Sep 2007
ITC	ITC.BO	Buy	N/A	Rs186.85	19 Sep 2007
IVRCL[13, 20]	IVRC.BO	Buy (CBE)	N/A	Rs403.25	19 Sep 2007
L & T	LART.BO	Buy	N/A	Rs2,669.75	19 Sep 2007
Maharashtra Seamless[13]	MHSM.BO	Buy	N/A	Rs611.45	19 Sep 2007
Mahindra & Mahindra	MAHM.BO	Buy	N/A	Rs740.95	19 Sep 2007
Maruti Udyog Limited	MRTI.BO	Buy	N/A	Rs925.85	19 Sep 2007
Nalco Holding Company[2b, 4b, 16]	NLC.N	Neutral	N/A	US$28.06	19 Sep 2007
Punjab National Bank	PNBK.BO	Buy	N/A	Rs515.65	19 Sep 2007
Ranbaxy[2b, 4a]	RANB.BO	Buy	N/A	Rs412.90	19 Sep 2007
Reliance Communication Limited[5]	RLCM.BO	Buy	N/A	Rs563.95	19 Sep 2007
Reliance Energy	RLEN.BO	Sell	N/A	Rs946.10	19 Sep 2007
Reliance Industries[2b, 4a, 6]	RELI.BO	Buy	N/A	Rs2,172.90	19 Sep 2007
Satyam Computer Services Ltd.[16]	SATY.BO	Buy	N/A	Rs429.50	19 Sep 2007
Spice Communications[2a, 4a, 5]	SPCM.BO	Buy	N/A	Rs53.45	19 Sep 2007
State Bank of India	SBI.BO	Buy	N/A	Rs1,770.00	19 Sep 2007
Sterlite Industries[16, 20]	STRL.BO	Buy (CBE)	N/A	Rs684.75	19 Sep 2007
Sun Pharmaceuticals Industries Limited	SUN.BO	Buy	N/A	Rs1,011.45	19 Sep 2007
Tata Consultancy Services Ltd.[8]	TCS.BO	Buy	N/A	Rs1,022.45	19 Sep 2007
Tata Motors Ltd.[16, 22]	TAMO.BO	Buy	N/A	Rs722.20	19 Sep 2007
Tata Steel Ltd.[5, 22]	TISC.BO	Buy	N/A	Rs744.70	19 Sep 2007

Source: UBS. All prices as of local market close.
Ratings in this table are the most current published ratings prior to this report. They may be more recent than the stock pricing date

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