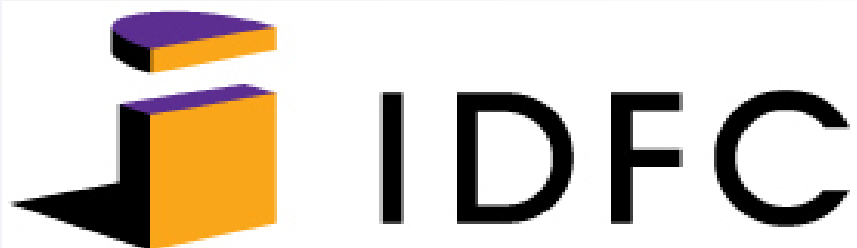


India Strategy



“Saat Khoon Maaf”

February 2012



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Delays in government decision making!

Tepid foreign inflows!

Wild fluctuations in domestic currency!

Longest stretch of high inflation ever!

Aggressive monetary policy stance!

Corporate earnings on a downtrend!

Sharp de-rating of market valuations!

Bear markets are always 'different'...

...and this one is no different!



'Singular' factors drove global bear markets in the past...

Great depression

Over exuberance and creation of investment bubbles

1929

UK stock market crash

Spiraling oil prices

1973

Asian financial crisis

Large capital flows - Asset bubbles

1997

Financial crisis

Exposure of US banks to sub-prime loans and credit default swaps

2008

1937

US recession

Spending cuts to balance fiscal budget

1991

Japanese asset price bubble

Asset bubbles

2000

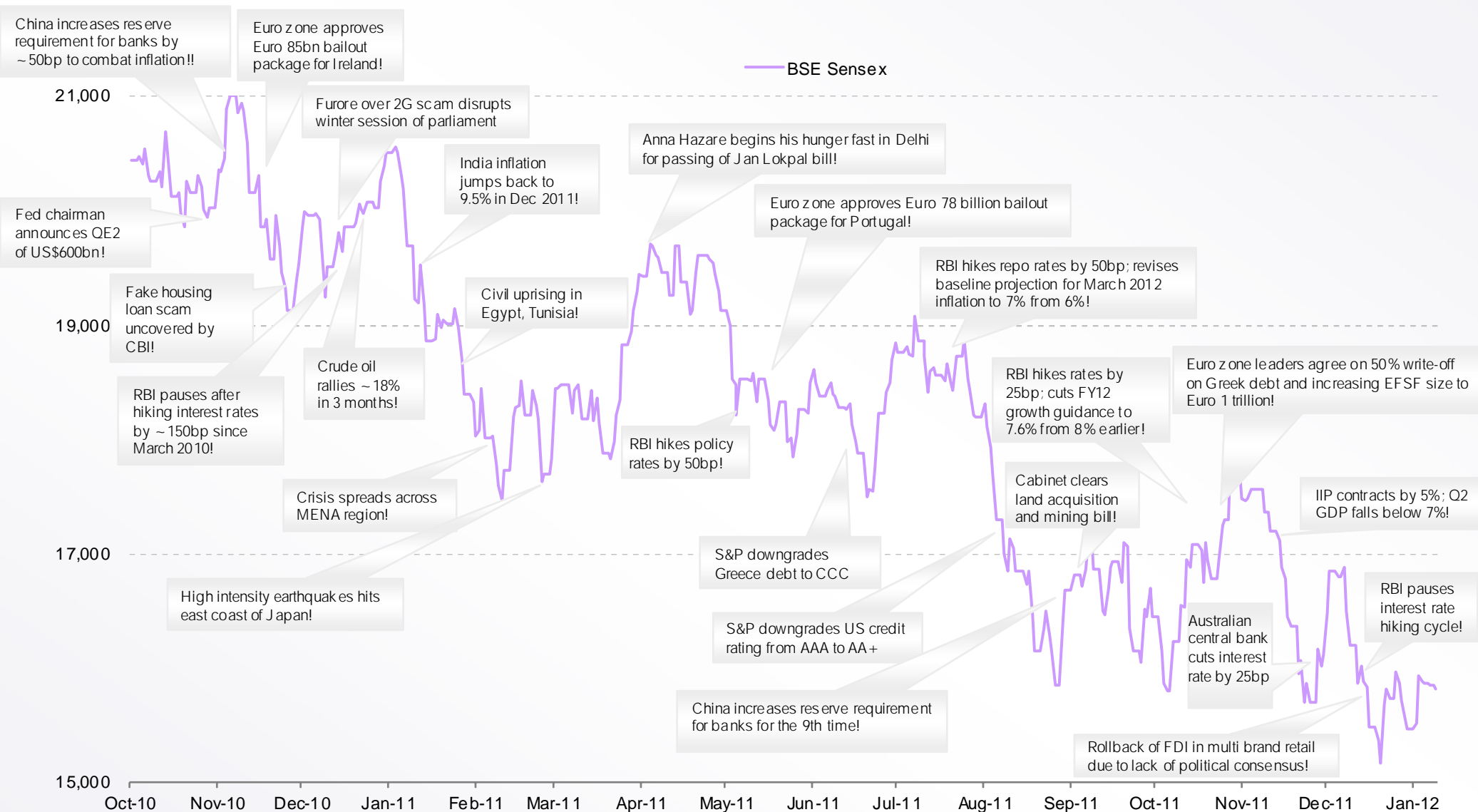
Dot com bubble

Speculative flows to technology stocks



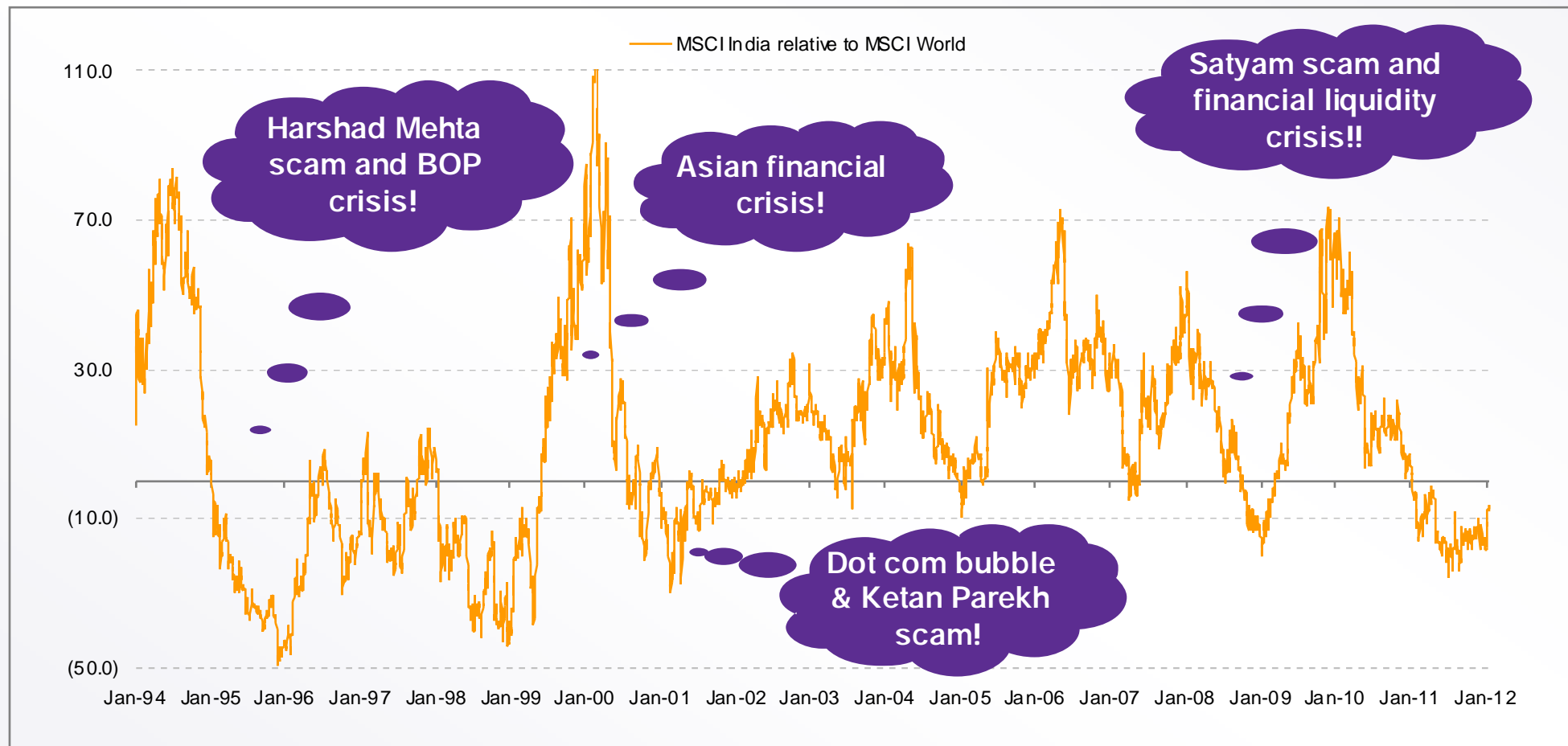
IDFC

...BUT, the current crisis is led by 'ALL' of them!



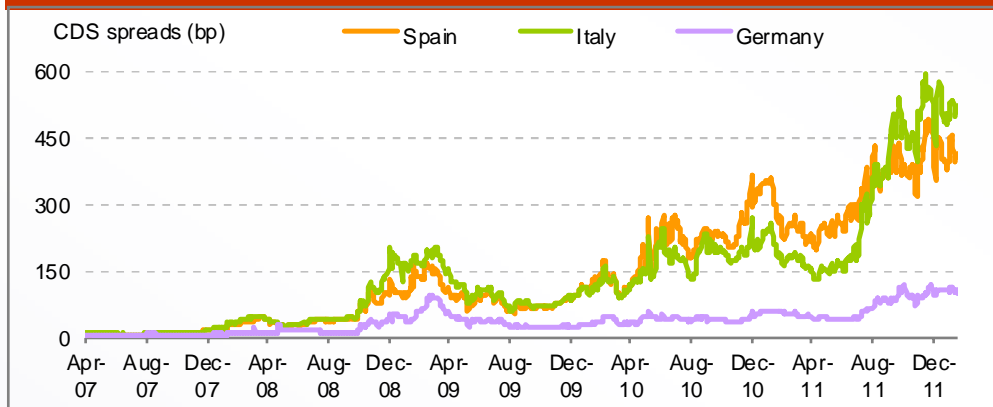


Bear markets of past 20 years in ***India*** caused by local events -
scams/ financial liquidity crunch!

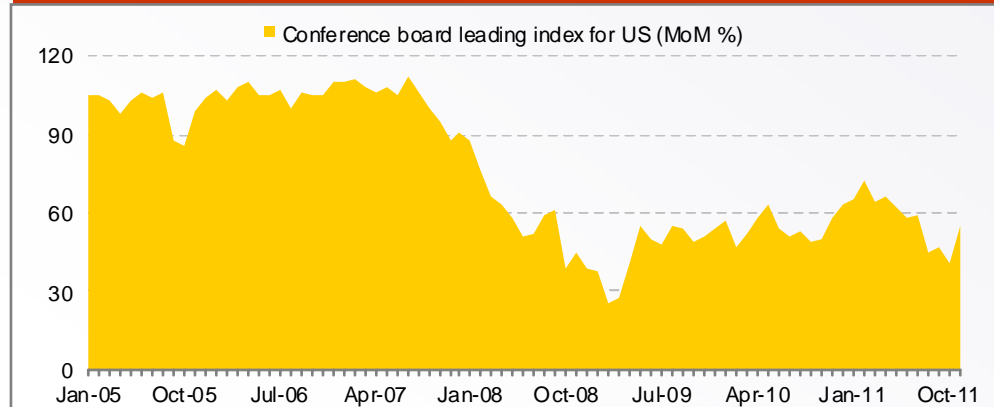




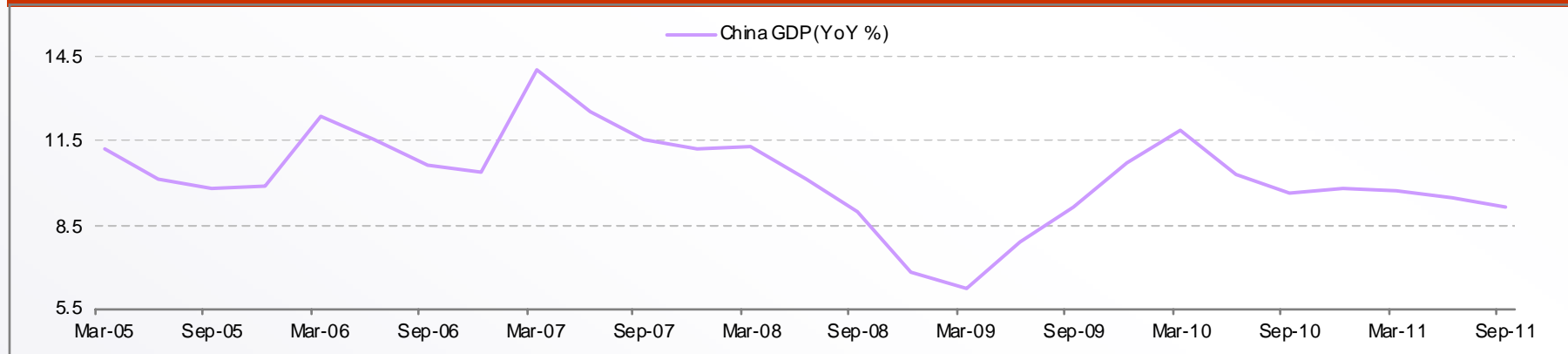
Euro crisis spreading to the 'core' economies!



Recovery in US not yet on firm footing!



Concerns of growth moderation in China!



Global uncertainties puts further pressure on already mounting domestic concerns!



Indian markets

Saat khoon maaf!!!



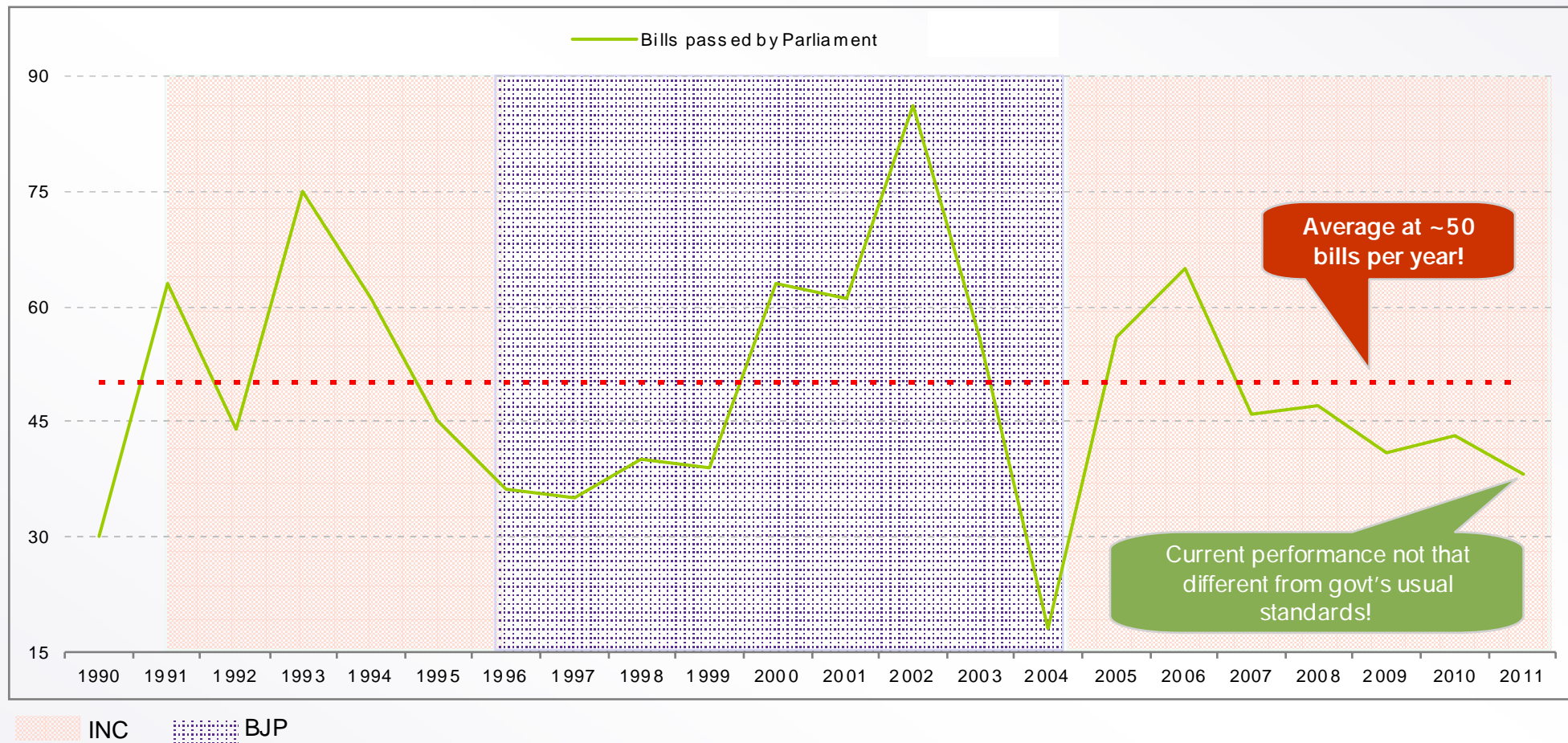
1 Government Inaction!



“Soch jab gehri ho jati hai...toh faisle kamzor ho jate hai”














Numbers of bills passed by the parliament



Functioning of the government not 'starkly' different from its earlier standards!

IDFC Status check on reforms

Reforms	Cabinet	Parliament	Act/Law	Key measures
Mandatory digitization of cable TV	✓	✓	✓	Digitization of cable has become a law; Sunset date for analog cable TV has been set; would resolve the issue of under reporting of revenues
FDI in single brand retail	✓	Not required	Not required	FDI of 100% in single brand retail has come into effect; For FDI > 51%, mandatory sourcing of at least 30% from the domestic small and cottage industries!
FDI in aviation		Not required	Not required	FDI of 49% in aviation is on the cards!
Land acquisition bill	✓			Companies to pay at least 2x market price in urban and 6x in rural areas; Companies shall provide for rehabilitation and resettlement
Mining bill	✓			Tax of 26% of profit of coal miners and 100% royalty for others; Also, central and state cess to be levied on mining companies
Goods & services tax	✓			Move towards a common indirect tax regime across the country; According to CII, GST could add 1-1.5% to GDP growth
Direct Tax code	✓			Move towards a simplified direct tax structure and lower tax rates; To improve tax collections due to lower evasions
Jan Lokpal bill	✓			It would enable filing of complaints against politicians and bureaucrats without prior government approval

With expectation at rock bottom, even a small progress on reforms could surprise the markets positively!

IDFC 'Populism' to take a back seat...soon!

Election schedule for 2012

State/UTs	Incumbent Party	Poll Dates	% of Lok Sabha seats
Punjab	SAD-BJP alliance	Jan-Feb 2012	2.4
Uttarakhand	Bharatiya Janata Party (BJP)	Jan-Feb 2012	0.9
Manipur	Indian National Congress (INC)	Jan-Feb 2012	0.4
Uttar Pradesh	Bahujan Samaj Party (BSP)	Feb-Mar 2012	14.5
Goa	Indian National Congress (INC)	Mar-2012	0.4
Gujarat	Bharatiya Janata Party (BJP)	Dec-2012	4.7

With elections due in a key state (UP), expect material reforms to kick-start post March 2012!!

Window
for policy action!

9-12 months

**Next key assembly election is in
May 2013 in Karnataka!**

Scams, lokpal and political consensus building left little room for reforms in 2011; expect politics to take a backseat post elections in 2012 and see more action on the reforms front!

“Kanoon ke haath bahut lambe hote hain”



“There’s a sense that the bureaucracy has stopped taking decisions as they fear that action might be taken against them in future even for honest mistakes.”

- Sunil Bharti Mittal

Fight against corruption resulting in prolonged decision making!



Politicians

2G spectrum scam: Former telecom minister A Raja arrested

PTI Feb 2, 2011, 07:41pm IST

NEW DELHI: A Raja, who as telecom minister had allegedly manipulated procedures in allocation of 2G spectrum that has dented UPA government's image, was on Wednesday arrested along with two officials by CBI, a week before it has to file its final investigation report in the Supreme Court.

Retired bureaucrat, Siddhartha Behura, who was

Kanimozhi arrested in 2G scam, sent to Tihar jail

New Delhi: DMK Rajya Sabha MP Kanimozhi has been arrested and sent to Tihar Jail today. The Delhi court hearing the 2G case rejected her bail application and ordered her immediate arrest on Friday afternoon.

The bail plea of Kalaingar TV Managing Director Sharath Kumar was also rejected by Special CBI Judge O P Saini and he too has been taken to jail.

Corporates

Five corporate honchos arrested in 2G case, taken to Tihar

April 20, 2011 in Featured, India | 0 Comments and 0 Reactions

Five corporate executives, named as accused by the CBI in the 2G scam, were today arrested and taken to Tihar Jail after a Delhi court rejected their bail pleas, saying the agency's apprehensions that they may tamper with evidence and influence witnesses cannot be ruled out.

The court had on April 15 reserved its order on the bail applications of Swan Telecom director Vinod Goenka, Unitech Wireless (Tamil Nadu) Ltd managing director Sanjay Chandra, and three top officials of Reliance ADA Group -- Gautam Doshi, Surendra Pipara and Hari Nair.

2G scam: DB Realty's Shahid Balwa is Arrest No 4

The CBI, which on Tuesday sought and got extension of custody of former Telecom Minister A Raja, arrested Shahid Usman Balwa, director of Mumbai-based DB Realty in the 2G spectrum case.

"We have arrested Shahid Balwa for his role in the 2G scam. He is alleged to be involved in receiving and channelling money for Raja," said CBI spokesperson Binita Thakur, adding that Balwa would be brought to Delhi on Wednesday.

Bureaucrats

Kalmadi, two others arrested in Commonwealth Games scam

BS Reporters / New Delhi Apr 26, 2011, 00:17 IST

Suresh Kalmadi, MP, ex-Union minister and controversial chief of the Organising Committee (OC) of last year's Commonwealth Games, was arrested today on charges of corruption and criminal conspiracy. He is to be produced in court tomorrow.

Two bureaucrats on the OC were taken into custody as well, A S V Prasad and Surjeet Lal. Prasad was a joint director-general and Lal a deputy DG.

Adarsh Society missing files case: CBI arrests 3 UDD officials

May 5, 2011, 10:49pm IST

Tags: CBI | Adarsh scam | Adarsh Housing Society

MUMBAI: The CBI on Thursday arrested three state government officials in connection with the Adarsh Housing Society missing files case.

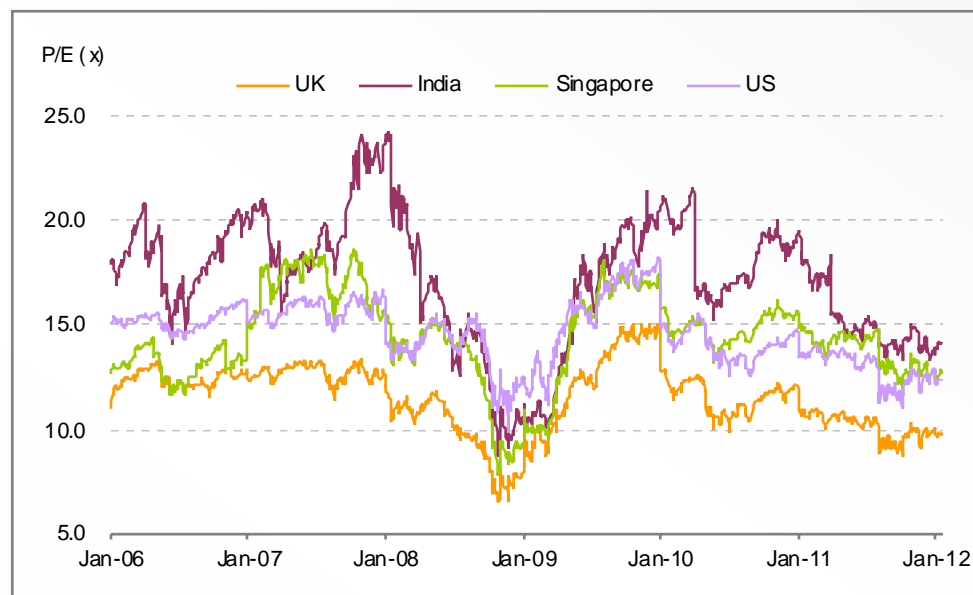
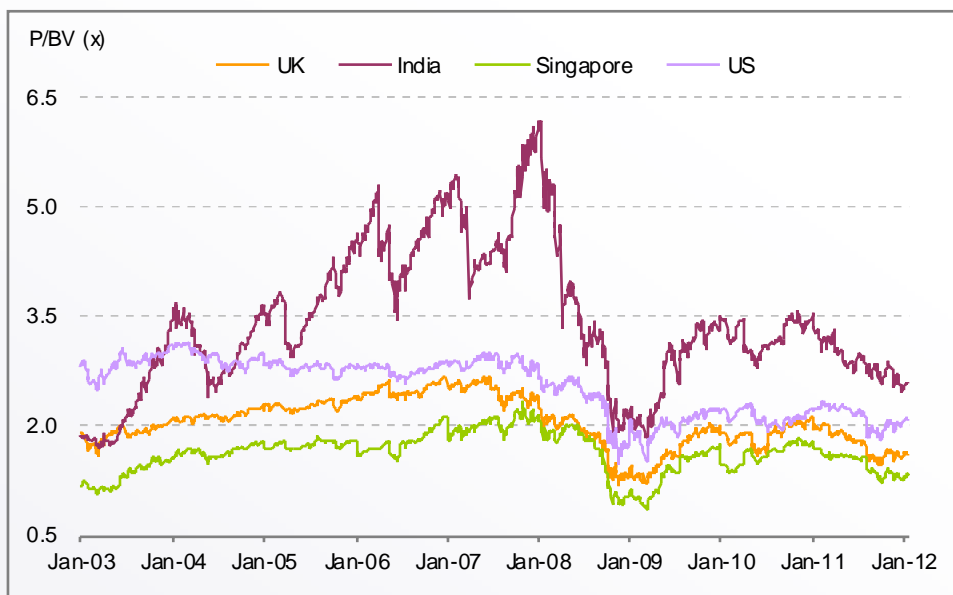
Desk officer G Wajpe, Assistant Town Planner N N Navekar and Waman Rawool, all officials of the State Urban Development Department, were arrested this evening, a senior CBI official said.

For the first time ever, India saw a series of high level 'corruption' related arrests!



India has slipped to 95th position (out of 178 countries) in the transparency International corruption index!!!

Countries which are 'perceived' to have lower levels of corruption...tend to be less volatile and hence demand better valuations!



***What's good for the country in the long term cannot be bad for the markets...
near term pain to build the case for long term re-rating!***

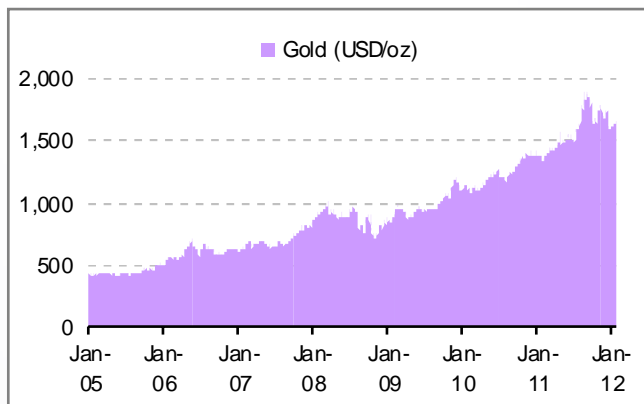
2 Inflows



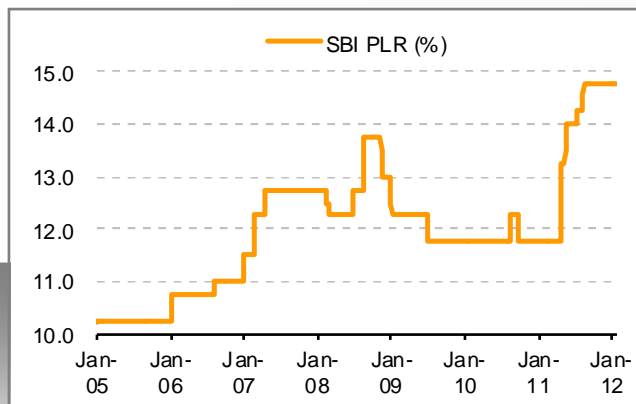
....“**Khush** toh bahut hoge tum **Aaj**”



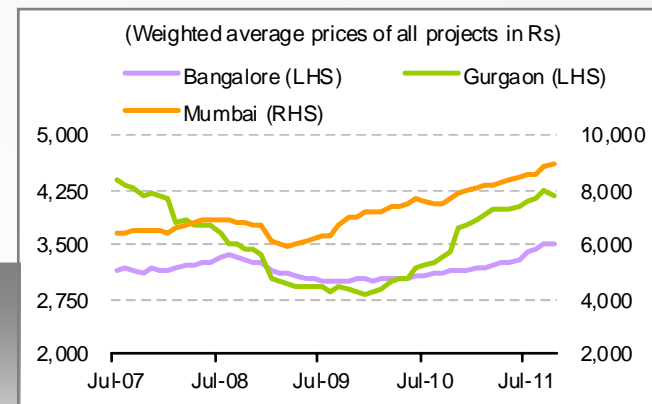
Gold



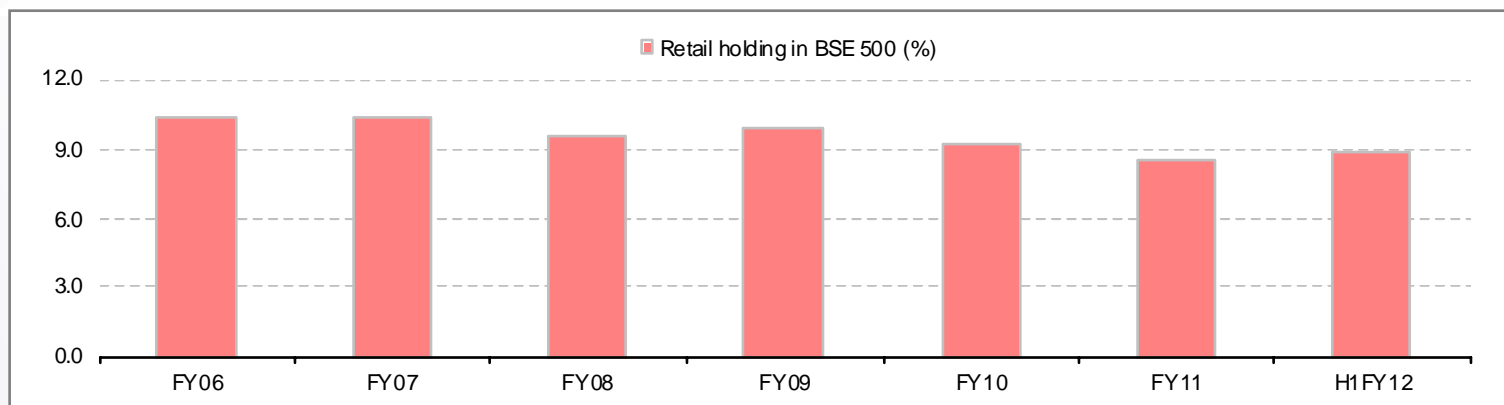
Debt



Real estate



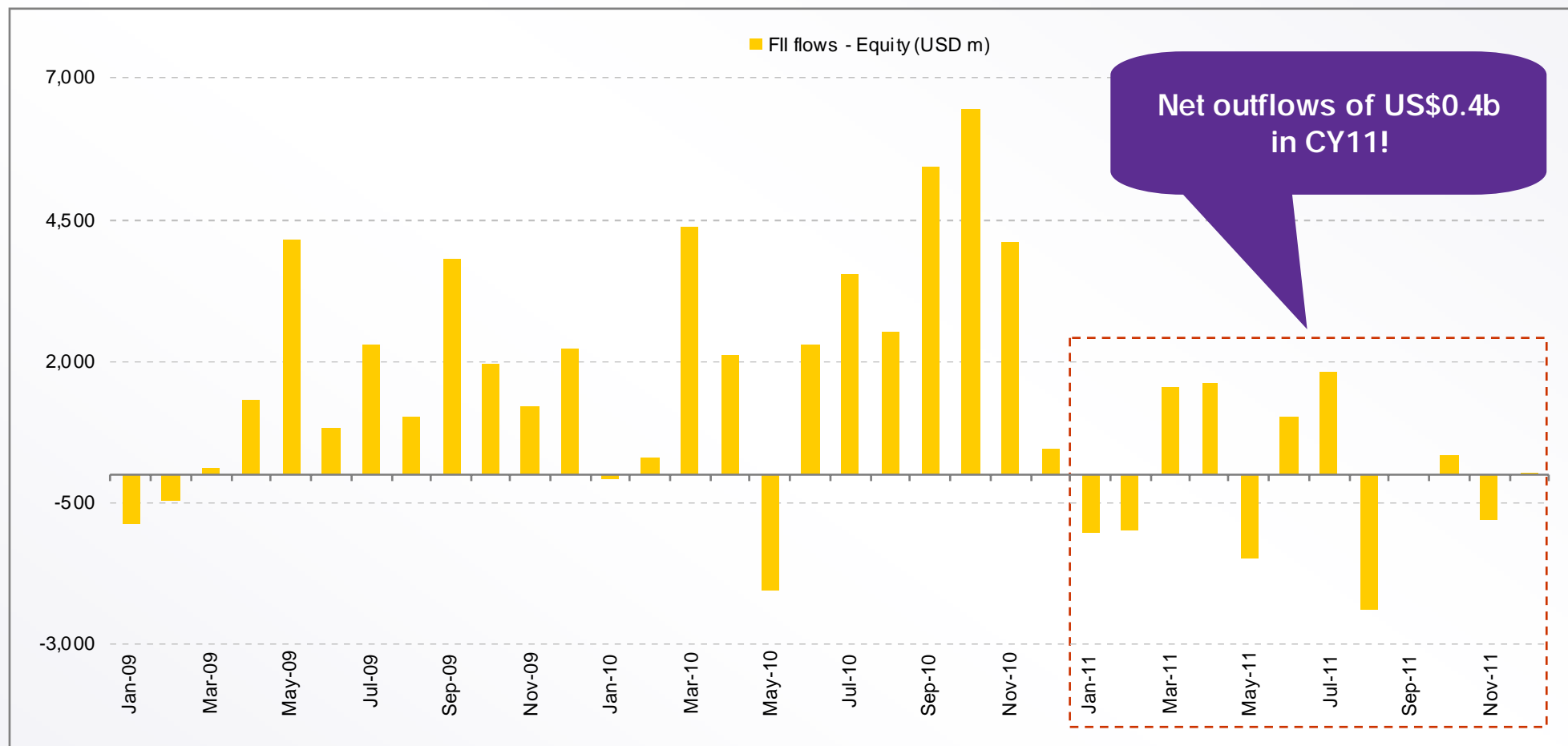
**Retail participation in Indian equity markets
has come off sharply in the last 5 years!**



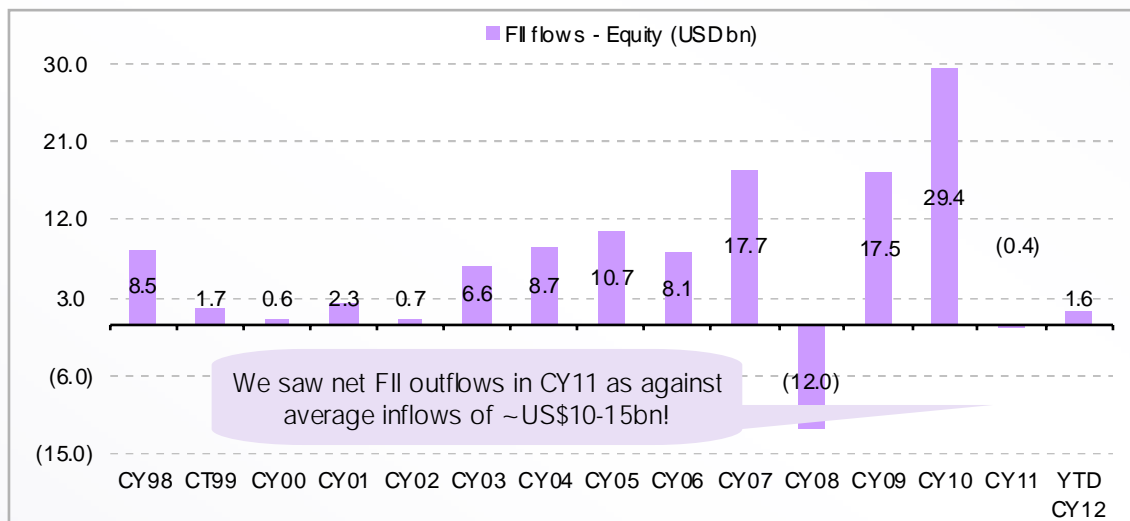
Strategy of downsizing their equity investments and increasing exposure to other asset classes like gold, real estate, debt etc have paid off well for the retail investors!

IDFC FII flows also turns negative in CY11!

After two years of healthy inflows, FII flows turns tepid in CY11!



Institutional investors: *Historically, India has seen FII outflows only once before and that too during a global meltdown!*



Expect 'stability' to set in and flows to normalize in CY12 ; We see net FII inflows of US\$30-40bn in the next 3 years – in turn having a positive rub-off on currency as well!

Retail investors: *Time for reversal?*

With demand for alternative assets likely to taper off, expect incremental flow from retail investors into equities!



Higher prices have already started denting demand



With interest rate reversal on the cards, demand is expected to come off



Lower aggregate demand and falling affordability to impact prices

3 Currency



*“Sabse bada **rupaiya(\$)**...”*



Recent currency swing one of the wildest in 20 years!

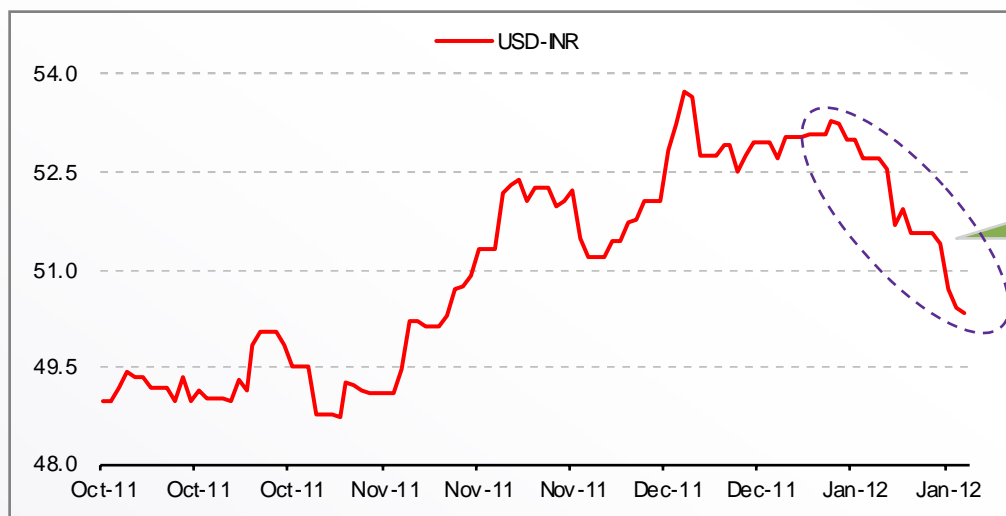


Rising current account deficit, heightened risk aversion due to Euro crisis and threat of large debt redemptions have led to sharp depreciation of the rupee!

While a tad reactive, RBI actions have helped to stem speculative flows...

Date	RBI actions
Nov-2011	Increase in FII limits for investment in sovereign and corporate govt bonds
Dec-2011	Deregulation of NRE and NRO interest rates
Dec-2011	Limit on net open currency position – to limit speculative trades
Dec-2011	Curbs on cancellation and rebooking of currency forwards

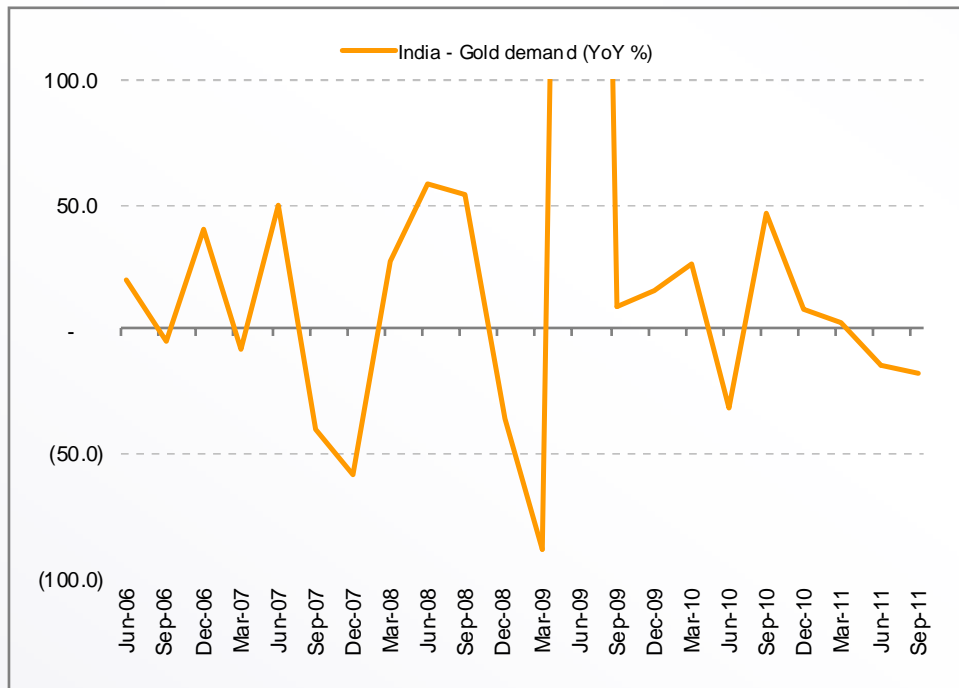
...reflected in the recent pull back in domestic currency!



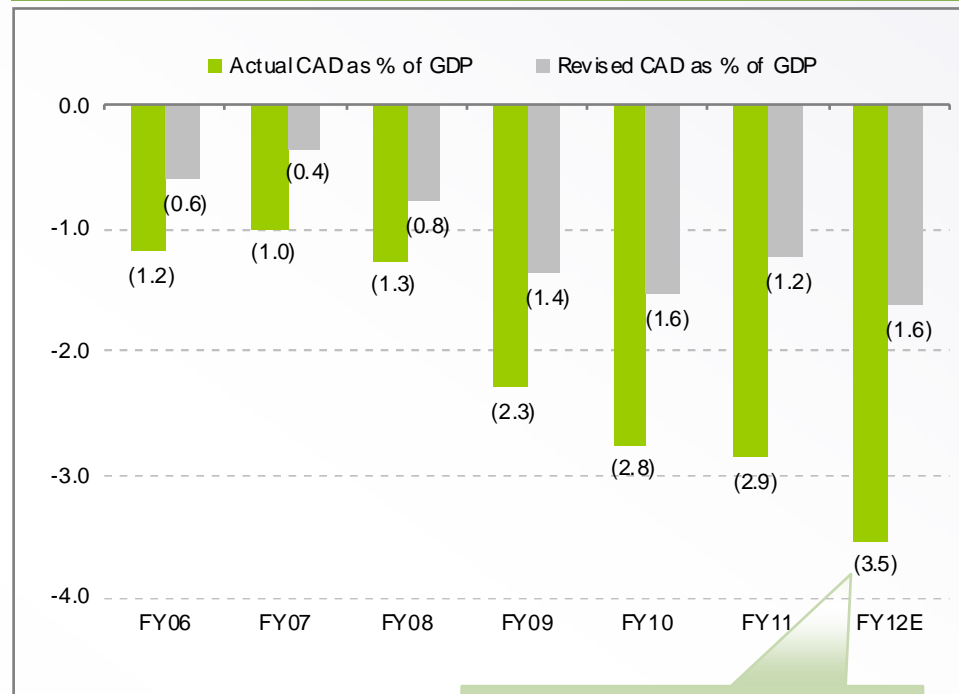
After the recent RBI actions, domestic currency has pulled back by ~6% in January 2012!

RBI actions have put the brakes on speculative activity - 'stabilizing' domestic currency movement!

Further, tapering off of gold demand...



..should moderate current account deficit going ahead!



Adjusted for gold imports, CAD is at a mere ~1.6% of GDP!

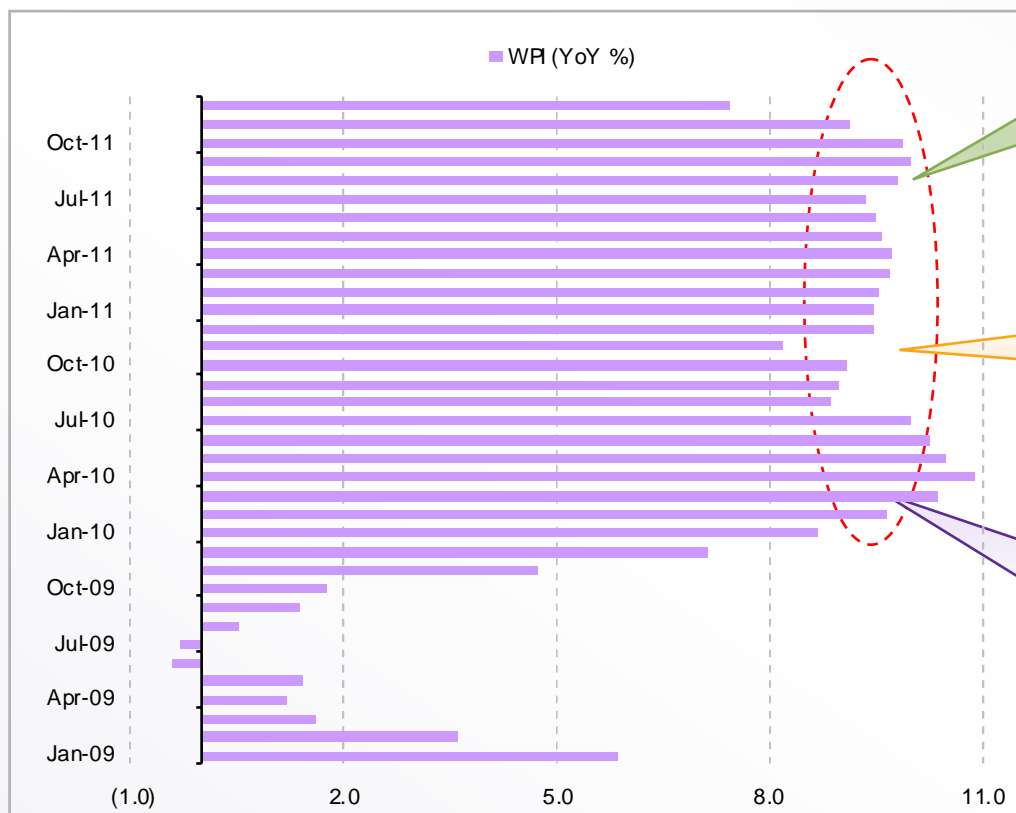
With gold demand coming off, expect CAD to moderate going ahead – aiding rupee appreciation; expect USD/INR to average 49 in FY13!

4 Inflation



*“Kaun kitne **pani** main hain?”*

Inflation has averaged 9.5% for last two years!



While pace of primary articles showed some signs of easing, inflationary pressures spread to 'core inflation' from March 2011!

Non food articles inflation inched up sharply in H2FY11 further fueling high headline inflation!

Headline inflation spiked up from Jan-2010 due to spiraling food prices!

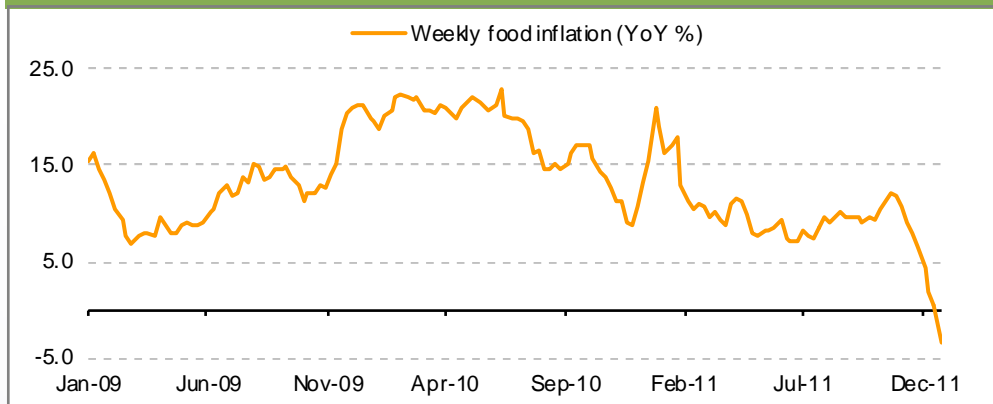
Headline inflation has remained close to 'double digits' despite aggressive monetary policy tightening!



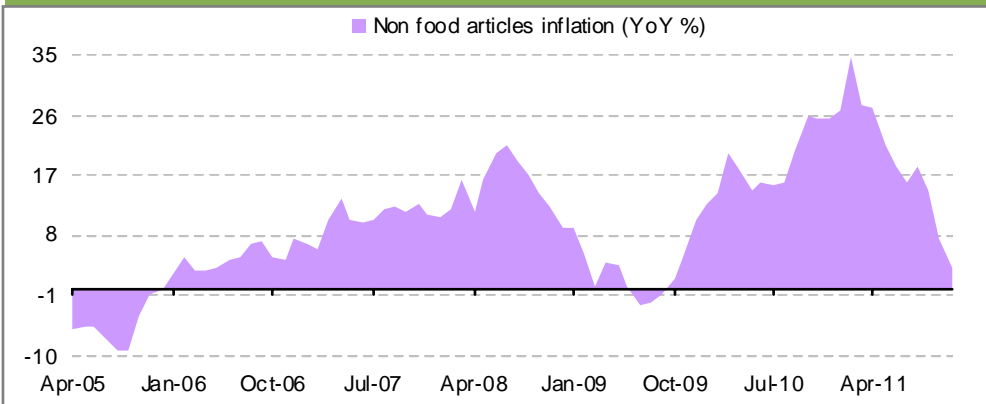
IDFC

...however, inflation has 'finally' peaked out!

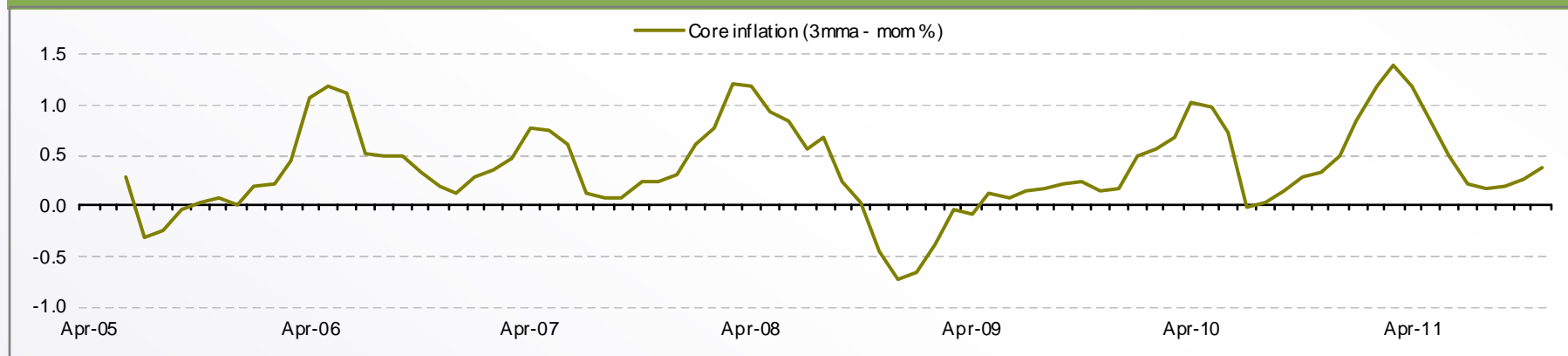
Food inflation has come off sharply in the last month!



Also, expect moderation in non food articles...



...to result in lower 'core' inflation going ahead!



Recent data suggests that inflation is finally showing signs of peaking!

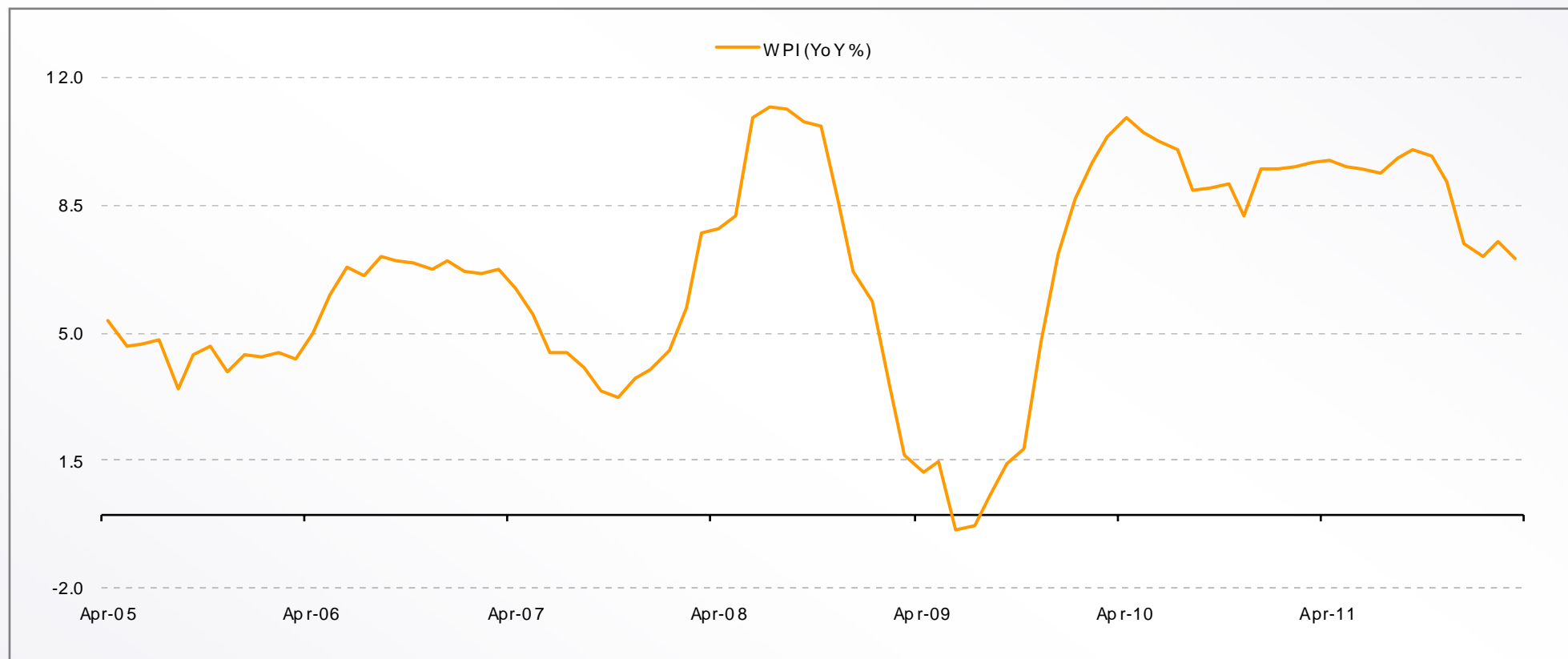


IDFC

Inflation to moderate to 7% by March 2012!

Inflation came off sharply to 7.5% in December 2011...

...to moderate further to 7% by March 2012!



Inflation to further moderate going ahead in turn leading to a more 'accommodative' monetary policy!

5 Interest rates

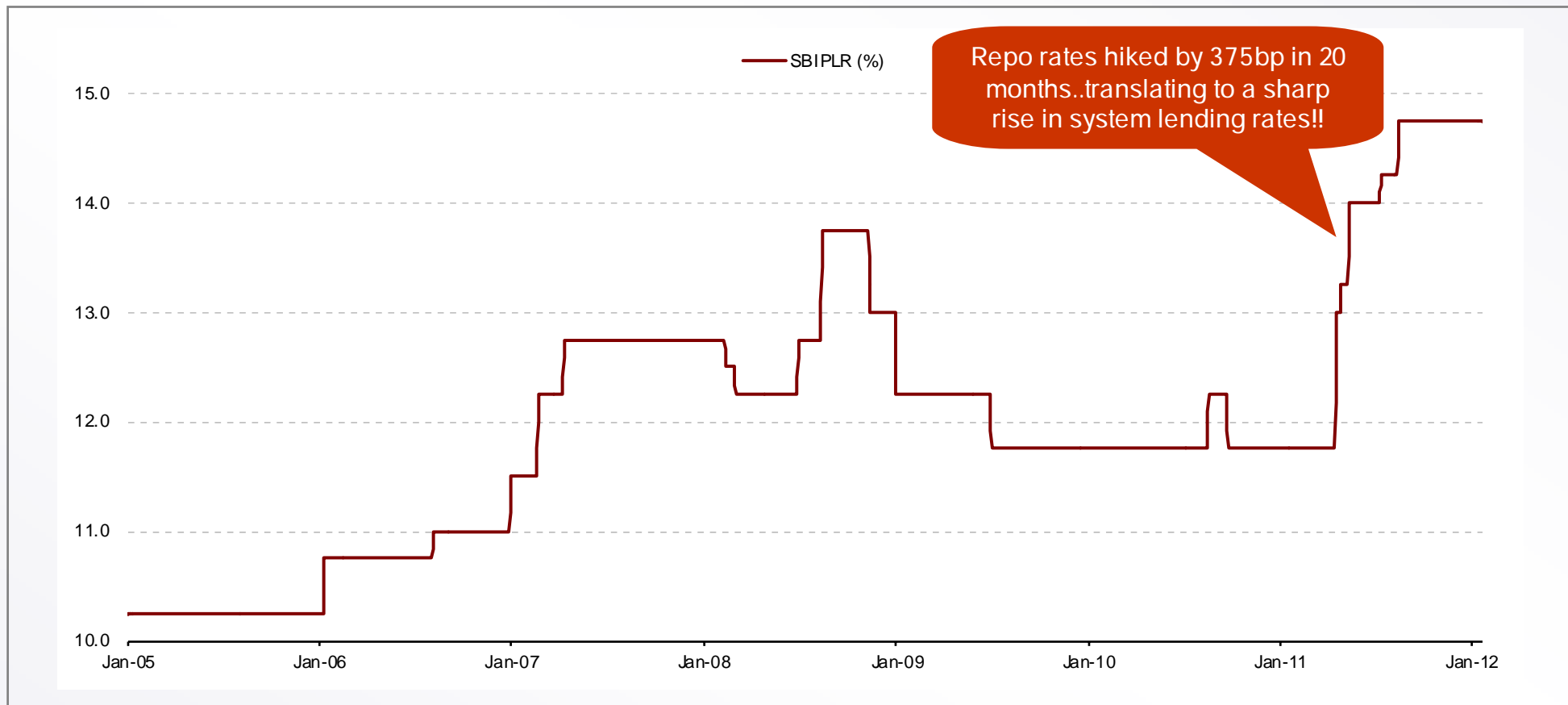


*“Yeh **one way street** hai...”*

IDFC Interest rates at all time high!

Aggressive monetary policy stance by the RBI...

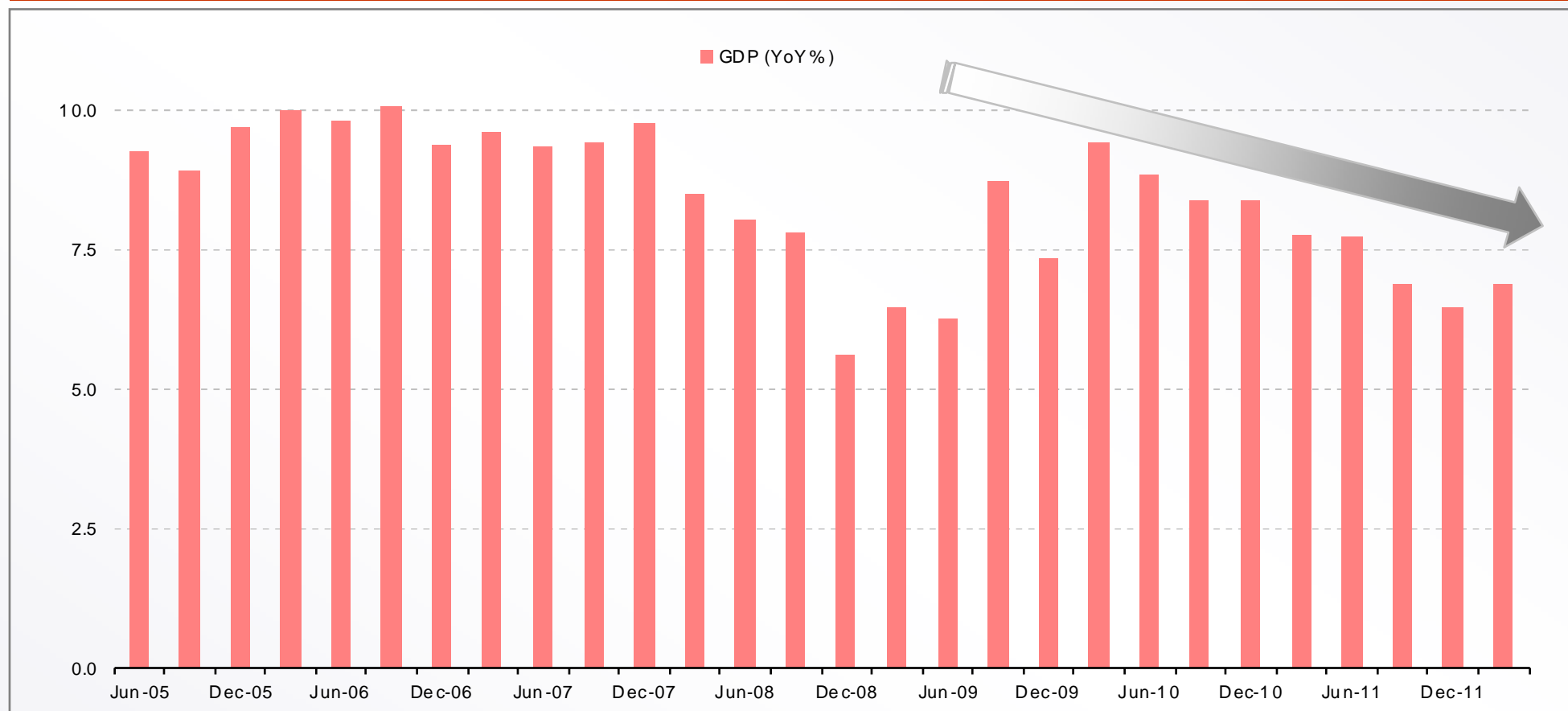
...resulting in sharp rise in system lending rates!



Interest rates have risen sharply in the last one year...significantly impacting growth!



Increasing growth concerns to accelerate monetary easing!



With GDP growth expected to be around 7% for FY12 and FY13...shift in policy stance of RBI likely!



“While inflation remains on its projected trajectory, downside risks to growth have clearly increased...based on the projected inflation trajectory, further rate hikes might not be warranted..from this point on, monetary policy actions are likely to reverse the cycle, responding to the risks to growth”

– Mid quarter monetary policy review

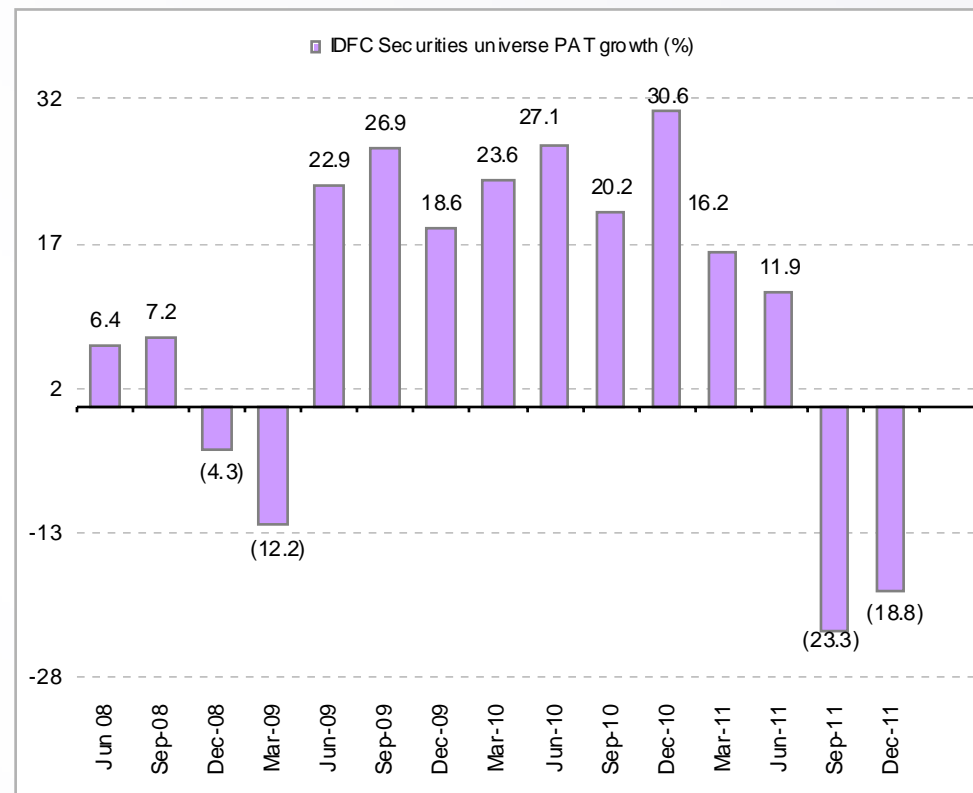
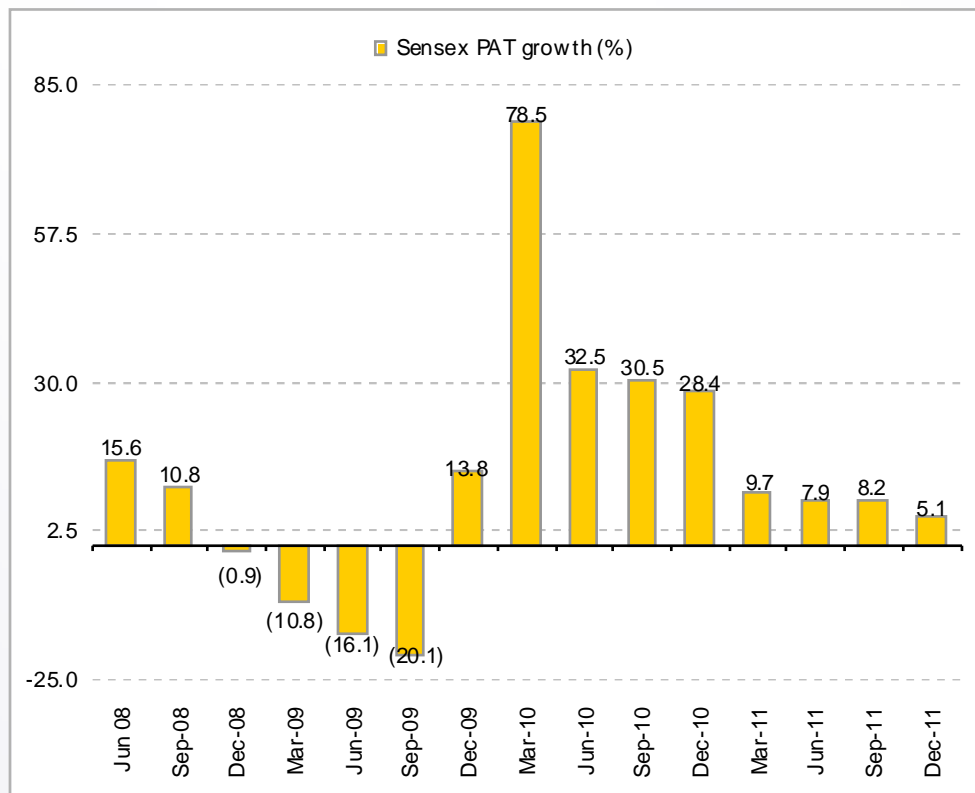
Policy stance of RBI to turn more accommodative...expect repo rate cuts from March 2012!

6 Corporate earnings



*“Hum to rangmanch ki **kathputliyan** hain jiski **dor upar wale ke haathon** main hai ...**kab, kaun, kahan uthega** ye **koi nahin janta**”*

Earnings trajectory has clearly decelerated in the last 12 months!

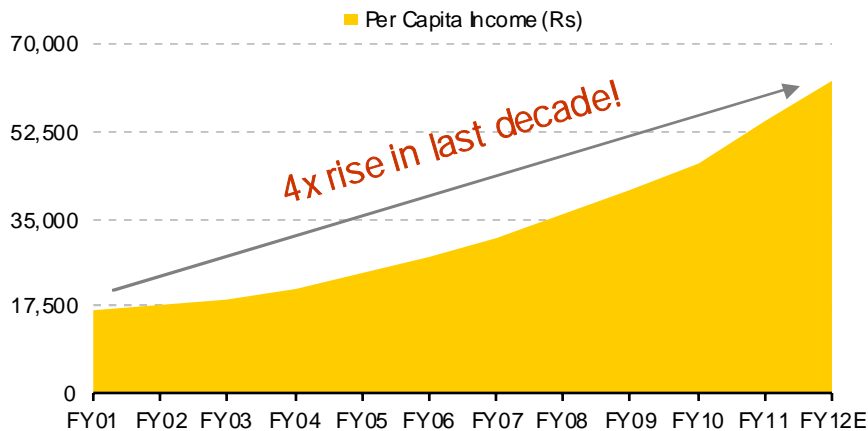


Lag impact of interest rate hikes, policy uncertainties and currency fluctuations have impacted earnings momentum!

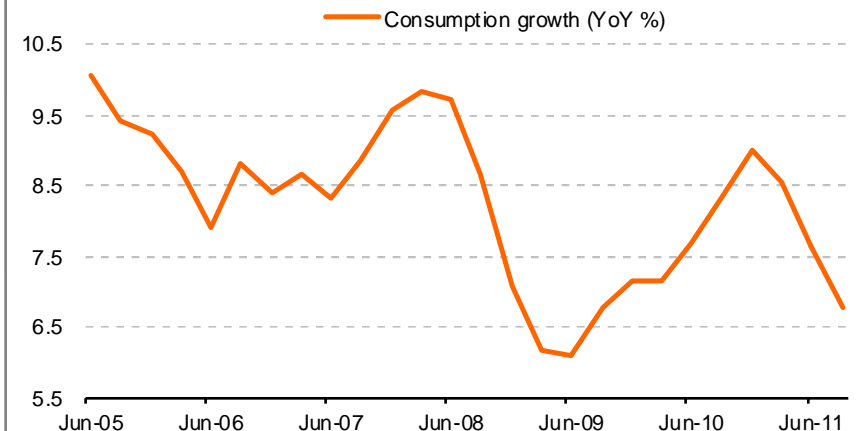
But all is not lost...

IDFC Domestic Demand – The BIG fallback!

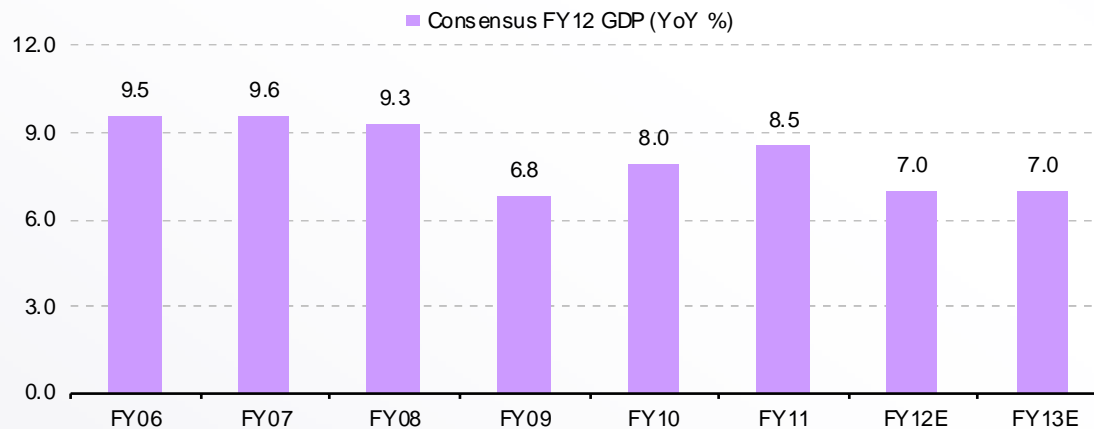
Rising per capita income...



...to sustain consumption momentum...

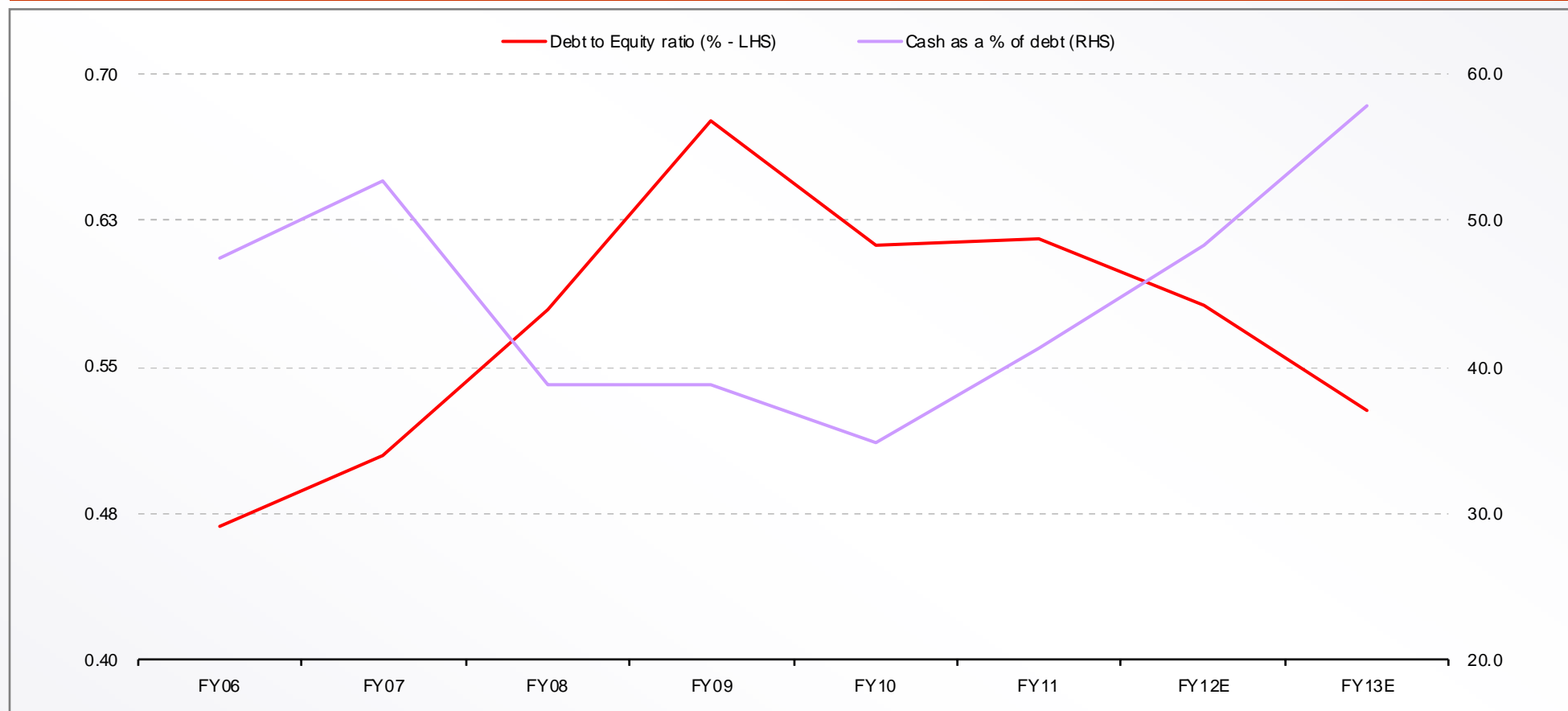


...supporting GDP growth at 7% levels in FY13!





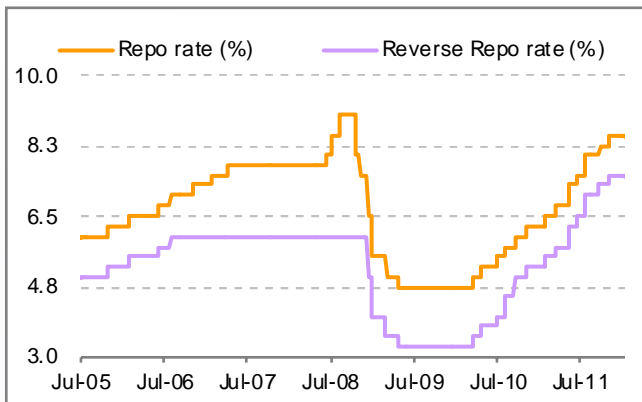
Lower gearing and higher cash on books for Indian corporates!



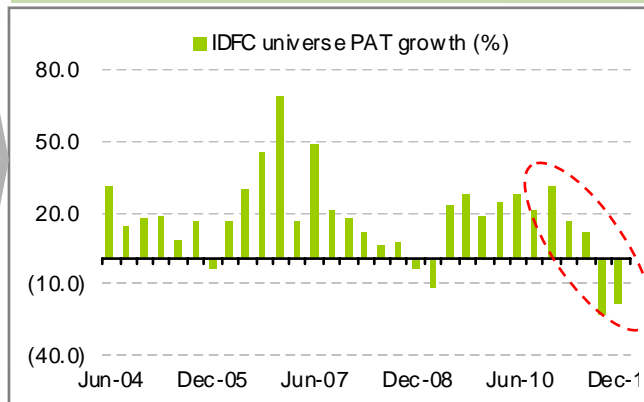
Indian corporates more resilient to withstand economic shocks than in previous downturn!

IDFC Market re-rating to precede earnings uptick

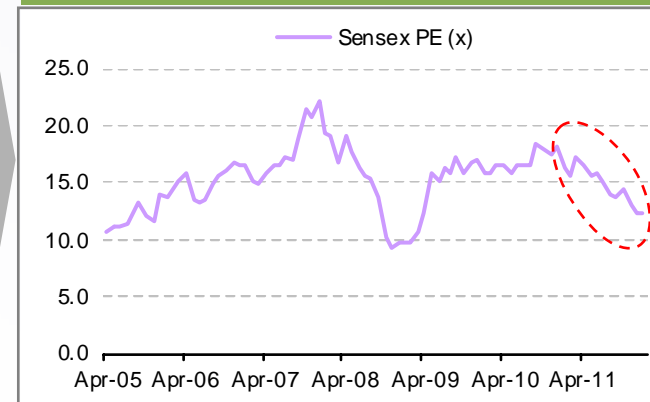
Hike in policy rates from March 2010!



Weak corporate earnings!



Significant de-rating of markets!



While policy rates started rising from March 2010, slowdown in earnings growth was seen with a 2-3 quarter lag..leading to an eventual de-rating of equity markets!

When interest rate cycle reverses...expect market re-rating to occur first...

followed by earnings uptick!!!

Interest rate cuts from March 2012!

Re-rating of equity markets!

Uptick in earnings momentum!

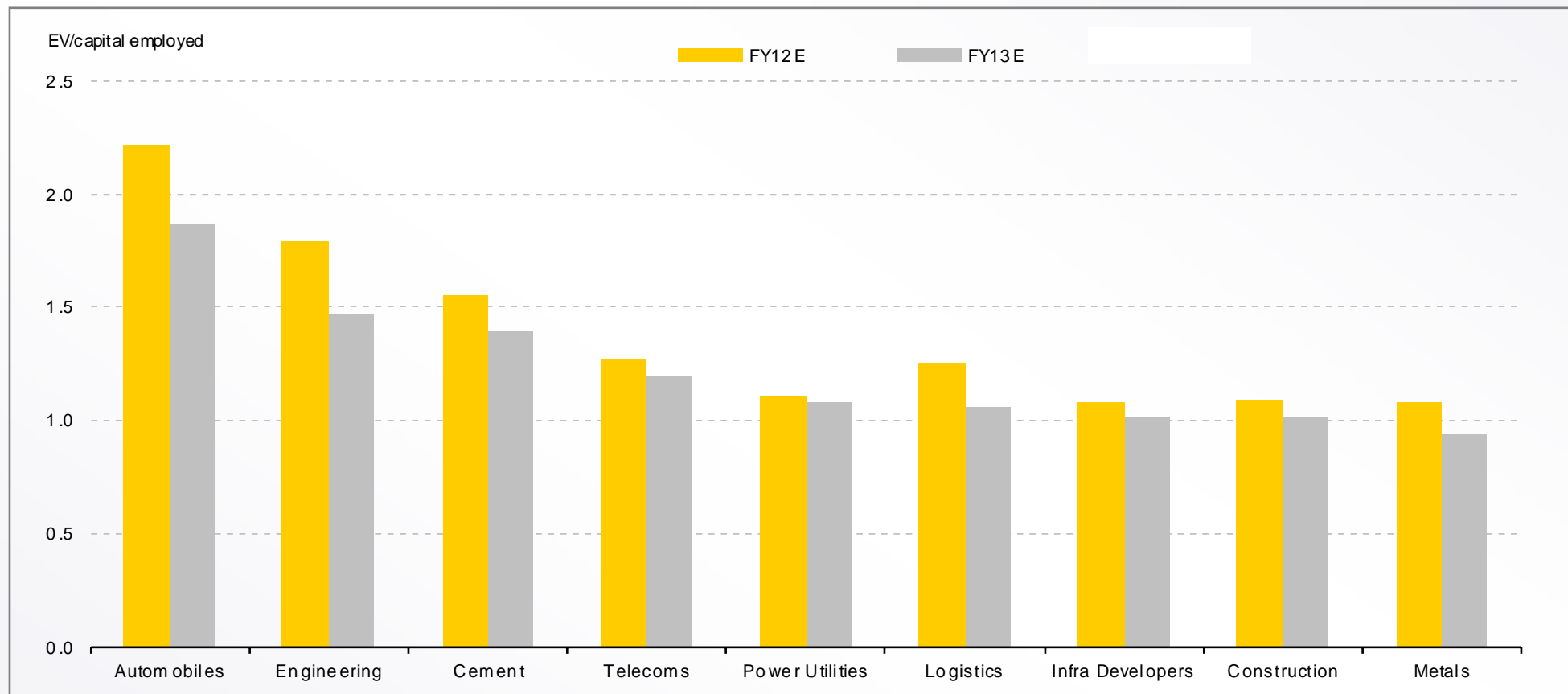
7



*“Najdiki **fayda** dekhne se pehle...door ka **nuksaan** sochna chahiye”*

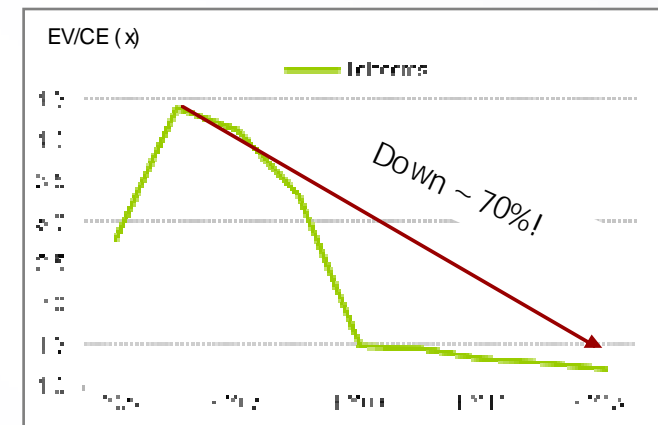
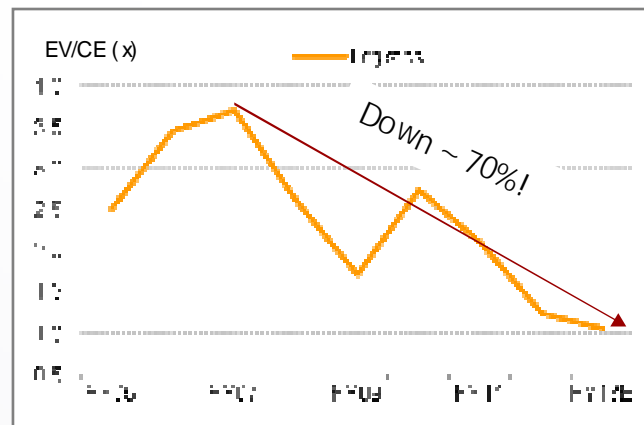
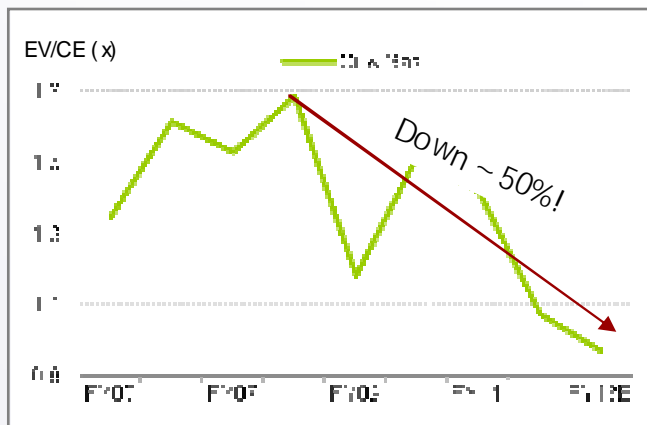
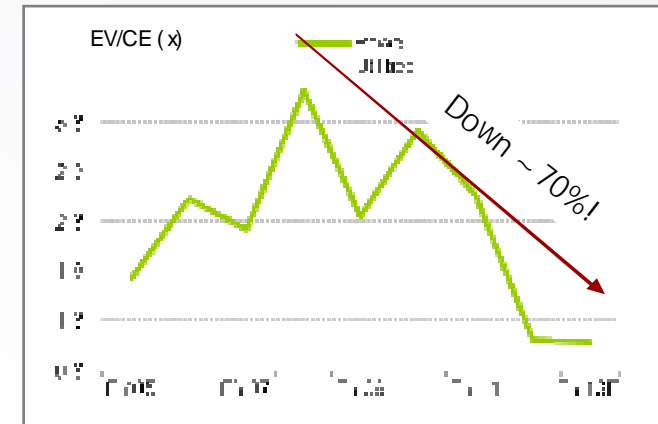
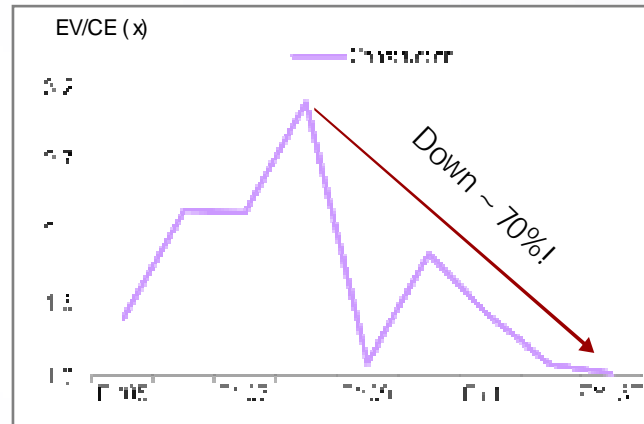
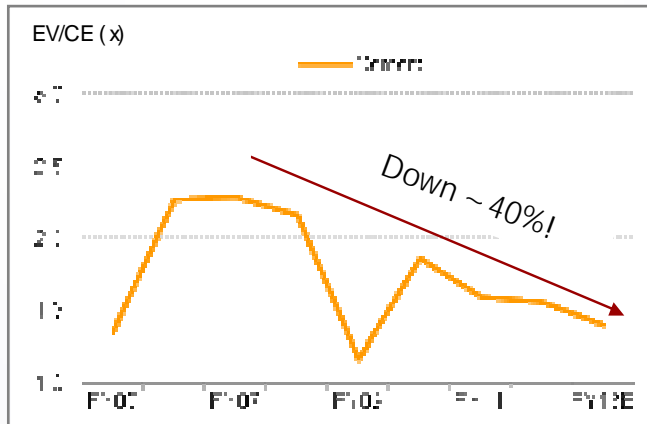


1/4th of corporate India is trading at less than capital employed!



Over 50% of the companies are at index levels of 8000 with more than 25% trading at less than capital employed; implies that valuations are at par with promoters!

Valuation of most sectors are trading at ~50-70% discount to peak valuations!



With valuations at all time lows, believe valuations have become extremely attractive!



IDFC

'Strategic' value unlocking to be the 'key' driver

Inherent value



RIL share buyback

Sharp **price correction**...

RIL slumped ~35% in 2011 as against ~25% correction in sensex!

...has prompted **share buyback!**

Share buyback at a maximum price of **Rs870** amounting to **US\$~2bn** (~4% of cash on books) – Largest ever buyback by any corporate!

Strategic value



Strides Arcolab's sale of overseas generic business

Focus on '**core portfolio**'...

agila

Generic business

...has led to **stake sale in generic business** ...



Watson

Stake sale for **US\$393m!**

... enabling **deleveraging of balance sheet!**

Stake sale enables the company to reduce debt on books by ~**US\$250m!**

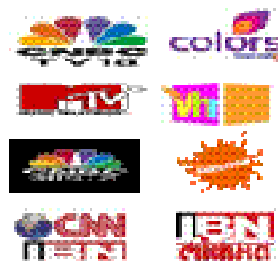
Acquisition value



Network 18

Network 18 – RIL deal

Best **properties**...



...however highly **leveraged!**

Gross debt at **Rs28bn** (~5x its market cap!)

Interest cost > EBITDA!

RIL turns the **white knight!**



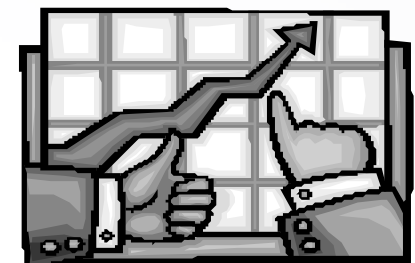
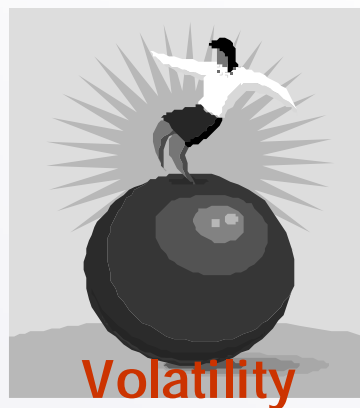
Rs17bn cash infusion!

Network 18

Recent transactions suggests 'value' has emerged!

Market call

*“Main apni **favourite** hoon...”*



We are positive on markets and favor bottom-up play in 2012!

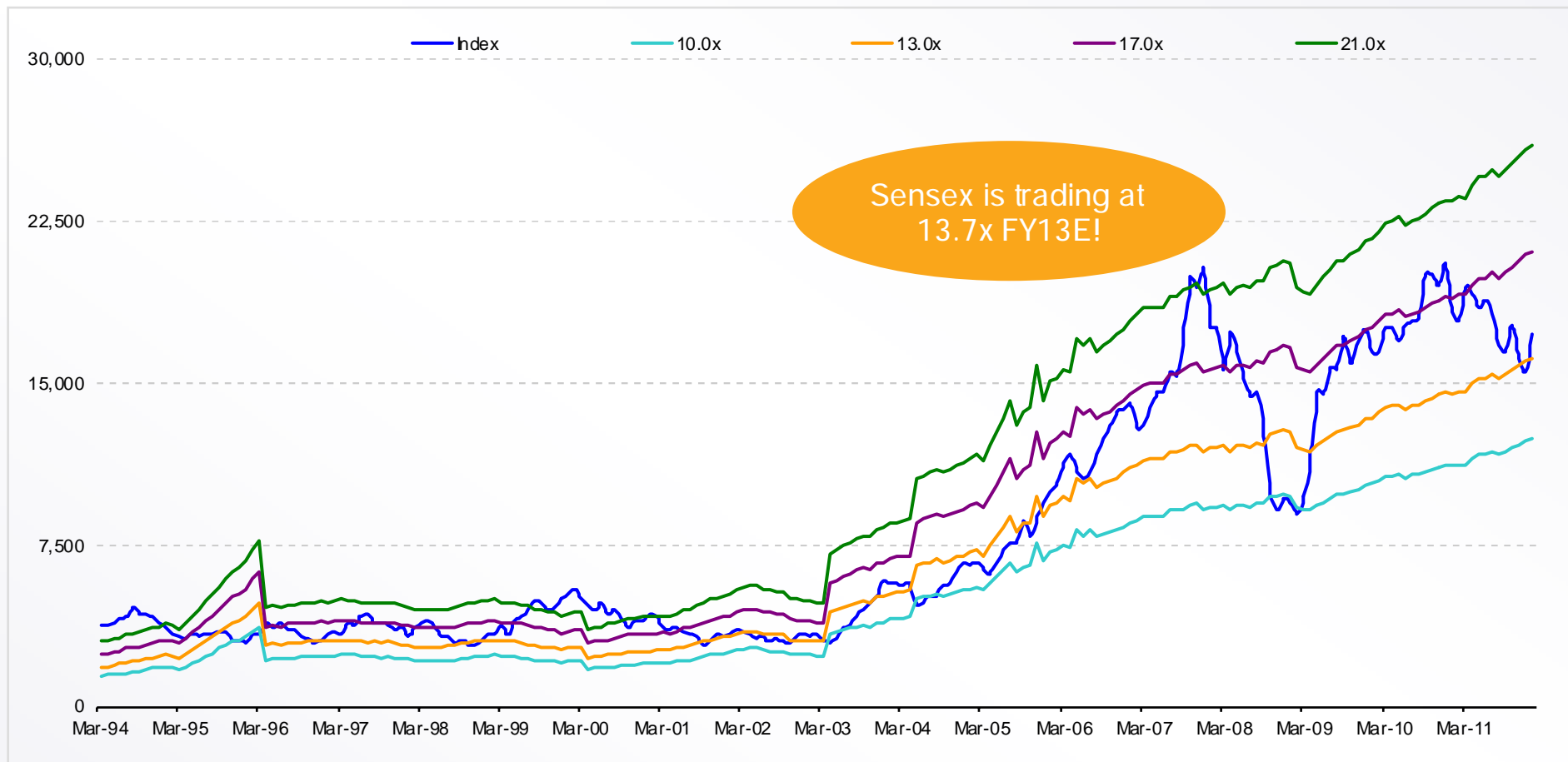


(% yoy)	Net Sales			EBITDA			Profit After Tax		
Sector	FY11	FY12E	FY13E	FY11	FY12E	FY13E	FY11	FY12E	FY13E
Automobiles	30.5	17.8	15.4	50.4	10.5	19.9	68.7	3.2	21.7
Construction	18.6	19.3	13.1	16.9	8.2	12.8	(25.4)	15.1	14.4
Consumer goods	14.3	16.1	14.1	12.0	21.0	18.6	15.2	18.4	18.2
Financials	25.6	21.5	21.2	16.4	17.8	21.0	16.5	26.7	25.4
IT Services	20.5	25.7	14.6	17.3	23.1	14.2	14.6	21.9	16.4
Metals	17.1	12.4	0.5	34.3	1.6	19.5	87.4	(11.2)	10.6
Oil & Gas	27.9	26.6	(0.5)	18.4	6.7	1.3	23.7	3.8	10.2
Pharmaceuticals	21.0	18.8	16.2	15.0	27.8	18.2	16.6	20.4	16.8
Power Equipment	26.5	19.8	4.5	44.6	11.7	1.2	38.8	15.1	(3.1)
Power Utilities	12.1	13.9	15.2	3.9	(4.1)	16.4	10.1	(2.3)	17.8
Real Estate	28.8	4.6	2.6	6.9	19.0	0.6	(15.0)	(1.2)	11.4
Telecoms	42.3	19.8	13.3	21.1	18.5	19.9	(27.7)	(7.8)	51.7
Sensex Index	23.9	19.6	7.3	23.2	11.5	14.7	24.5	9.4	17.5

Our Sensex EPS stands at Rs1076 for FY12 and Rs1264 for FY13

IDFC Valuations below long term averages

Sensex PE band



Source: Bloomberg, IDFC Securities Research

Our sense is that 16,000 levels for sensex is an extremely strong base (comfort on valuations!); remain positive on markets with a 12 month target of 19000 (15x FY13E)!

Sector	Sensex	Aug-11	Jan-12	Top picks
Automobiles	9.7	6.0	7.5	M&M, Tata Motors, Exide, Apollo Tyres
Construction/Power Equipment	6.9	11.0	13.0	L&T, JP Associates, Adani ports, GPPL, KEC International
Consumer goods	10.6	11.0	10.5	ITC, HUL, Nestle, AgroTech foods
Financials	24.3	25.0	27.0	ICICI Bank, Axis Bank, SBI, Yes Bank, ING Vysya Bank
IT Services	15.6	11.0	8.0	Infosys, Wipro
Metals	7.9	5.0	3.5	JSPL, Tata Steel
Oil & Gas	14.9	10.0	9.0	BPCL, Oil India, Petronet LNG
Pharmaceuticals	2.8	5.0	5.0	Cipla, Dr Reddy's, Strides, IPCA
Power Utilities	3.2	5.0	2.5	Lanco Infratech, Jaiprakash Power
Real Estate	0.6	0.0	0.5	Sobha Developers
Telecoms	3.5	2.0	2.5	Bharti Airtel
Others	-	9.0	11.0	United Phosphorus, Den networks, Educomp, Hathway cables, Jain Irrigation, PI Industries
Sensex Total	100.0	100.0	100.0	

With interest rate reversal on cards, we suggest moving to interest sensitives like Infrastructure, Financials and trimming positions in global plays like IT services, Metals, Oil & Gas etc!

IDFC Top buys – Large cap

Companies	Price (Rs)	Mcap (Rs bn)	EPS (Rs/share)	Earnings CAGR FY11-13E	P/E (x)	EV/EBITDA (x)	P/BV (x)	RoE (%)	RoCE (%)
Infosys Technologies	2,743	1,566.9	147.3	19.8	18.6	12.3	4.8	28.1	33.2
ITC	202	1,561.3	7.6	18.6	26.4	17.1	9.0	35.6	47.2
Bharti Airtel	361	1,372.1	15.8	18.3	22.9	8.4	2.5	11.3	9.1
Larsen & Toubro	1,345	818.7	76.7	14.1	17.5	12.1	3.3	20.4	16.9
Jindal Steel & Power	576	538.3	41.4	1.4	13.9	10.0	3.0	23.8	17.4
Adani Port & SEZ	144	288.3	5.9	34.5	24.6	18.7	5.5	24.7	15.3
Cipla	349	280.4	15.1	21.2	23.1	17.0	3.7	17.1	16.0
Jaiprakash Associates	73	154.5	6.3	(8.3)	11.5	10.2	0.2	7.8	7.2
						P/Adj. BV (x)			RoA (%)
State Bank of India	2,078	1,319.3	179.5	35.1	11.6	1.4	1.8	16.4	0.9
ICICI Bank	890	1,025.0	55.0	21.7	16.2	1.7	1.7	11.1	1.4
Yes Bank	336	116.7	28.1	32.6	12.0	2.5	2.5	23.2	1.4

Note: Based on FY12E, Prices as on 1 February 2012

IDFC Top buys – Mid cap

Companies	Price (Rs)	Mcap (Rs bn)	EPS (Rs/share)	Earnings CAGR FY11-13E	P/E (x)	EV/EBITDA (x)	P/BV (x)	RoE (%)	RoCE (%)
Petronet LNG	165	123.4	13.8	33.0	11.9	8.6	3.4	32.8	22.3
United Phosphorus	147	67.8	13.8	24.2	10.6	5.9	1.6	15.9	18.3
IPCA Laboratories	319	39.9	22.6	15.2	14.1	9.2	3.1	23.8	24.4
Sobha Developers	263	25.8	17.2	9.7	15.3	12.2	1.3	8.6	8.2
Gujarat Pipavav	59	24.8	0.9	n/a	62.8	17.9	3.2	5.2	7.6
Educomp Solution	221	21.1	32.9	8.8	6.7	5.5	0.8	12.3	13.6
KEC International	55	14.2	6.9	0.1	8.0	6.7	1.3	17.5	15.4
Den Network	78	10.2	2.7	19.9	29.3	9.6	1.2	4.3	6.5

Note: Based on FY12E, Prices as on 1 February 2012

Companies	Price (Rs)	Mcap (Rs bn)	EPS (Rs/share)	Earnings CAGR FY11-13E	P/E (x)	EV/EBITDA (x)	P/BV (x)	RoE (%)	RoCE (%)
Reliance Industries	831	2,718.0	64.8	4.2	12.8	7.2	1.6	12.9	9.9
Cairn India	347	658.6	46.2	6.2	7.5	4.5	1.4	20.0	24.5
BHEL	256	625.6	27.9	5.6	9.2	6.1	2.5	30.3	36.0
Hero MotoCorp	1,932	385.9	119.0	19.2	16.2	11.2	9.8	68.9	48.9
IDEA Cellular	93	307.7	2.4	36.5	38.3	8.5	2.4	6.3	8.4
Tata Power	110	261.4	4.7	22.6	23.4	17.0	2.4	10.5	4.4
Ambuja Cement	163	249.2	8.1	6.0	20.0	11.2	3.1	16.2	19.0
Zee Entertainment	131	127.8	6.2	12.1	21.2	15.4	4.1	19.4	25.2
Tech Mahindra	656	80.9	63.1	15.9	10.4	8.6	2.0	20.0	16.6
Voltas	96	31.6	6.7	(10.9)	14.3	11.5	2.1	15.2	14.4

Note: Based on FY12E, Prices as on 1 February 2012

Thank you

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