Deutsche Bank

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India Equity Strategy

Reiterate Sensex target of 22,000

India's positive momentum should continue
We believe that the market's positive momentum remains on track and reiterate our calendar year-end Sensex target of 22,000. Key risks include: (a) a Lehman-type catalyst globally or (b) an event of significant geopolitical risk (e.g. Kashmir, Ayodhya verdict).

Continuation of the global deflation trade is a key driver
The deflation trade is part of the emergence of a 'New Normal' in the global macro environment - a sharply polarized world with deflation or near deflation in the western world (OECD) and strong growth (albeit inflationary) in emerging markets. Within emerging markets this is altogether more positive for those countries which have: (1) large domestic markets with a positive demographic profile, (2) low reliance on the consumer in developed markets for their goods and (3) deep equity and fixed income markets coupled with an investible universe of well-managed companies with a strong capacity for absorbing the flow of liquidity into 'growth assets'. India satisfies all the above-mentioned criteria, with perhaps the exception of deep bond markets

India well-positioned as a potential global deflation hedge trade
We believe that the Indian economy possesses three key characteristics that allow the country to benefit from global deflation: (1) a distinctive domestic macro model with low reliance on exports, (2) a widening savings investment gap which allows it to absorb foreign flows more productively, and (3) its ability to use the exchange rate as a monetary policy tool. In addition, both its favorable demography and its attractive vibrant consumption story aided by rising middle class incomes offer additional positive investment catalysts.

Macro-economic news flow to remain strongly supportive
In our view, the Indian economy remains in a sweet spot, with macro-economic news flow slated to be very positive. GDP growth momentum is set to remain strong; government tax collection is running well ahead of budgeted estimates; inflation is expected to ease on base effects; sharp widening of current account deficit is well funded by robust capital inflows; and one of the best monsoons in many years is further stimulating already elevated aggregate domestic demand.

Its all about growth; valuations not yet in the 'bubble zone'
A positive macro economic environment is creating a strong platform for corporate earnings growth. We expect Sensex earnings to grow at a CAGR of 26% over FY10-12. The Sensex is currently trading at one-year forward earnings of 16.6x (DB est), which implies just a 7% premium to the past five-year average. Furthermore, on market cap/GDP, the market is just at 1.1x. In 2008, when the Indian market was similarly seeing an influx of foreign capital, the corresponding mkt cap/GDP ratio had reached a level of 1.6x. We continue to prefer consumer discretionary and industrials. Our top Buys are: Axis Bank, Asian Paints, BHEL, HDFC Bank, Infosys, L&T, Maruti, Tata Steel and Zee.

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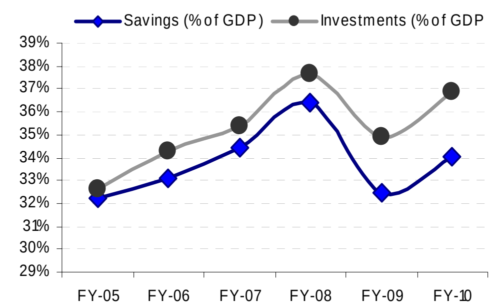
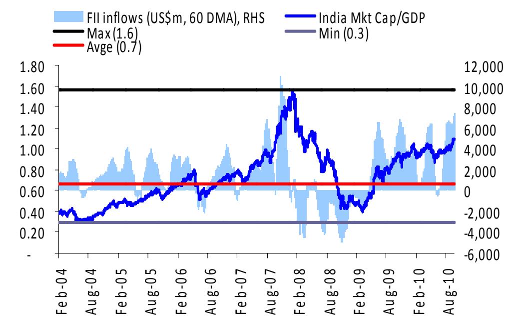
India's Savings & Investment(% of GDP)



India's Mkt Cap/GDP



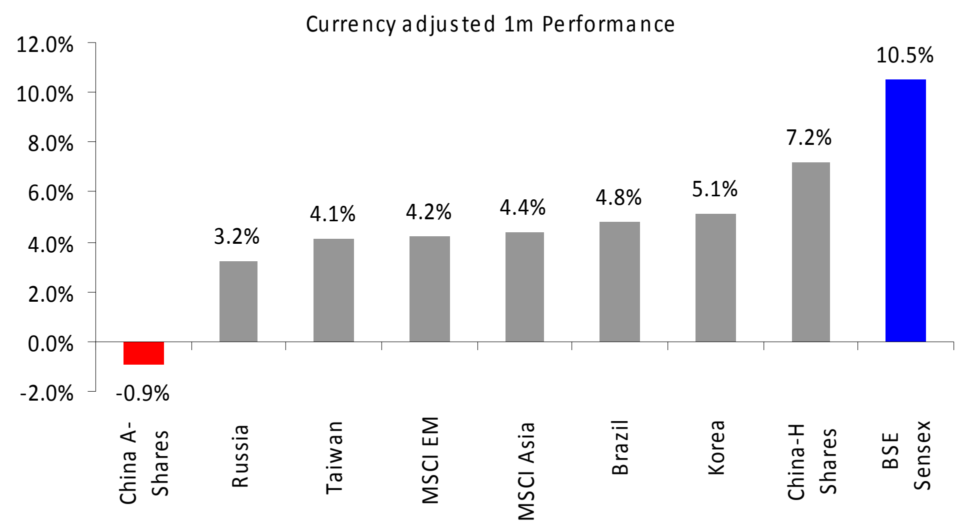
Maintain Sensex target of 22,000

India's positive momentum should continue

We believe that the market's positive momentum remains on track and reiterate our calendar year-end Sensex target of 22,000. Key risks include: (a) a Lehman type of catalyst globally or (b) an event of significant geopolitical risk (e.g. Kashmir, Ayodhya verdict).

The Indian equity market continues to outperform its other emerging market peers. Over the past month, the BSE Sensex has risen by 11% (US$ terms) and outperformed MSCI Asia by 6% and its other emerging market peers like Brazil, Russia and China by 6%, 7% and 11% (China-A) and 3% (China-H) respectively.

Figure 1: 1m performance of Sensex and key Emerging Market peers (US$ terms)

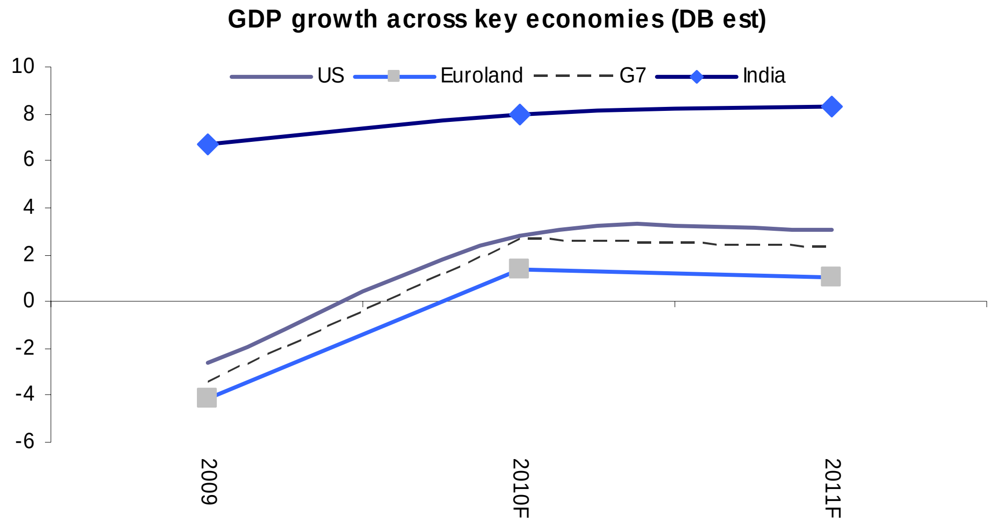


Source: Deutsche Bank, Bloomberg Finance L.P.

Continuation of the global deflation trade is a key driver for India

The deflation trade is part of the emergence of a 'New Normal' in global investing and in the global macro environment. The trend for the next few years is very clear - a sharply polarized world with deflation or near deflation in the western world (OECD) and strong growth (albeit inflationary) in the emerging markets Within emerging markets, this is altogether more positive for those emerging markets which have (1) large domestic markets with a positive demographic profile, (2) low reliance on the consumer in developed markets for their goods (low exports as % of GDP), (3) deep equity and fixed income markets coupled with an investible universe of well managed companies with strong capacity for absorbing the flow of liquidity into 'growth assets'. India achieves all the above-mentioned objectives, with perhaps the exception of deep bond markets.

Figure 2: GDP growth expectations for India and key developed economies



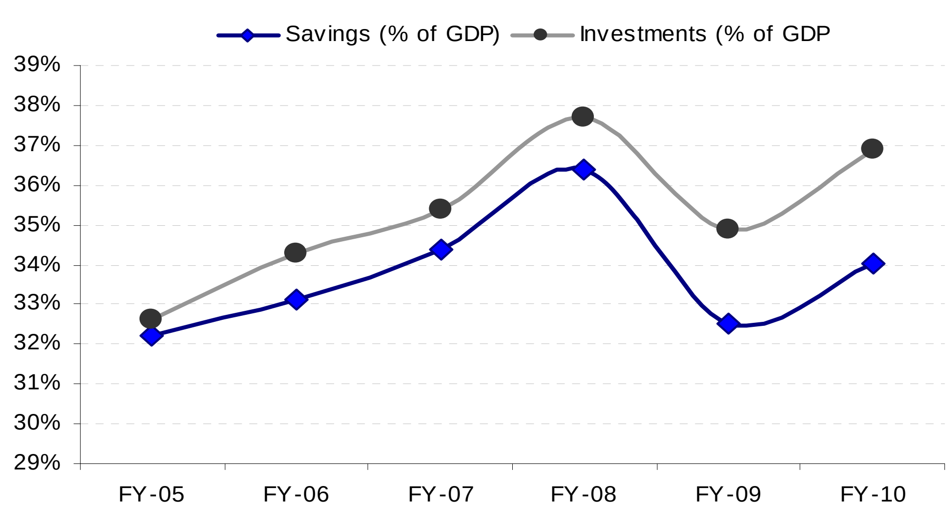
Source: Deutsche Bank

India well-positioned as a potential global deflation-hedge trade

We believe that the Indian economy possesses three key characteristics that allow the country to benefit from global deflation: (1) a distinctive domestic macro model with low reliance on exports, (2) a widening savings investment gap which allows it to absorb foreign flows more productively, and (3) its ability to use the exchange rate as a monetary policy tool. In addition, both its favorable demography and its attractive vibrant consumption story aided by rising middle class incomes offer additional positive investment catalysts.

Further, owing to its low correlation with the developed world, largely aided by its reliance on domestic investing, we see India as well-positioned for deflation-wary investors looking for a hedge from developed markets.

Figure 3: Savings- investment gap is widening

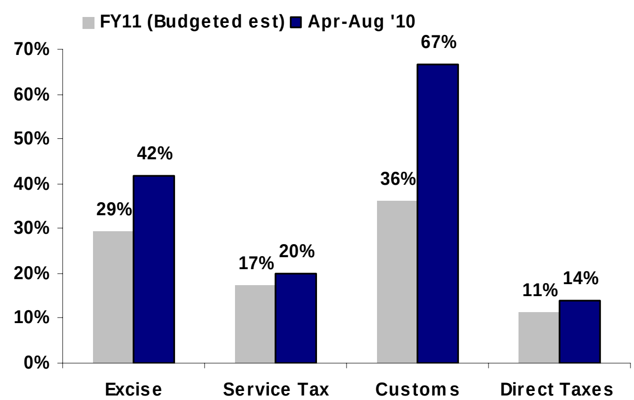


Source: Deutsche Bank, CMIE

Macro-economic news flow to remain strongly supportive

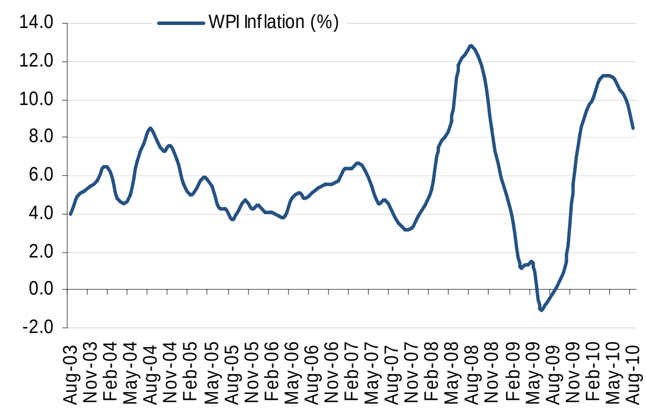
In our view, the Indian economy remains in a sweet spot, with macro economic newsflow slated to be extremely positive. GDP growth momentum is set to remain strong (trajectory of 8-9% growth); government tax collections are running well ahead of budgeted estimates; 3G auctions have yielded revenues 3x of what was expected (which assuages concerns over runaway fiscal deficit); inflation will be trending downwards after remaining sticky for a long period (largely on account of base effect, but will be optically lower); sharp widening of current account deficit remains well funded by robust capital inflows; and one of the best monsoons in many years is fuelling aggregate demand and a consumption boom across the country and also leading to a record harvest, reducing inflationary pressures on foodgrains. With inflation trending down and oil prices remaining range-bound, we expect considerable pressure to be taken off the Reserve Bank of India leading to low risk of knee-jerk policy error. We see the RBI moving on its calibrated approach to containing inflation.

Figure 4: Government of India's tax collections are running ahead of budgeted estimates for FY11



Source: Deutsche Bank, Ministry of Finance, Govt of India,

Figure 5: WPI inflation although elevated is finally showing some signs of easing



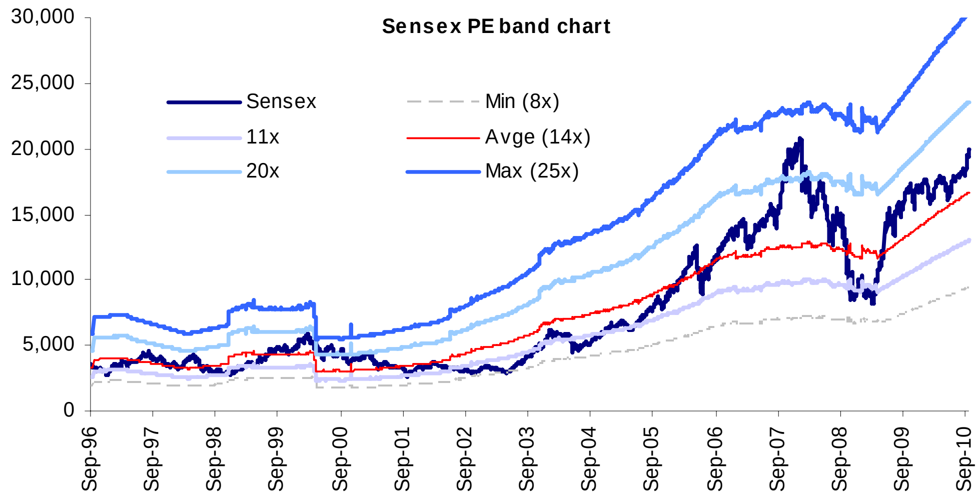
Source: Deutsche Bank, Bloomberg Finance L.P.

Its all about growth; valuations not yet in 'bubble zone'

A positive macro economic environment will create a strong platform for corporate earnings growth. Our analysts are forecasting a 26% earnings CAGR over FY10-12. At these levels, the Sensex is trading at one-year forward earnings 16.6x, which does not look steep as the Sensex has traded at an average of 15.5x over the past five years. MSCI India is also trading at 17x one year forward earnings and a 430bps premium to MSCI Asia. However we note that over the last five years MSCI India has anyway traded at an average valuation of 16.5x and at a 330bps premium to MSCI Asia. We also allude to the Market cap/GDP ratio to assess investor activity. The market is currently trading at 1.1x Mkt cap to GDP, which does not yet look like we are in the 'bubble zone'. In 2008, when the Indian market had been similarly seeing an influx of foreign capital, the corresponding mkt cap/GDP ratio had reached a level of 1.6x. We continue to prefer consumer discretionary and industrial sectors.

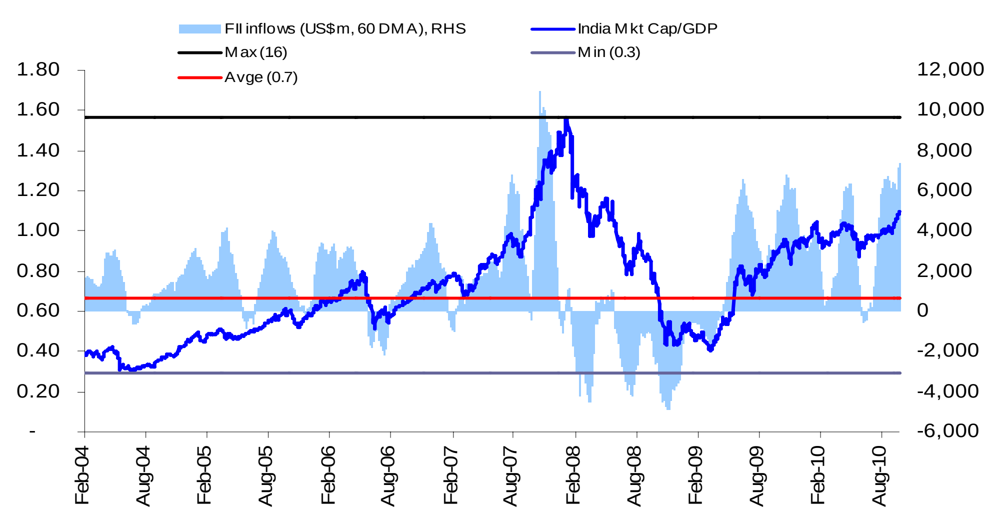
Our top Buys are: Axis Bank (INR 1,531), Asian Paints (INR 2,816), BHEL (INR 2,479), HDFC Bank (INR 2,471), Infosys (INR 3,059), L&T (INR 2,040), Maruti (INR 1,413), Tata Steel (INR 615) and Zee (INR 294).

Figure 6: Sensex PE band – valuations still much below the euphoric level seen in 2008



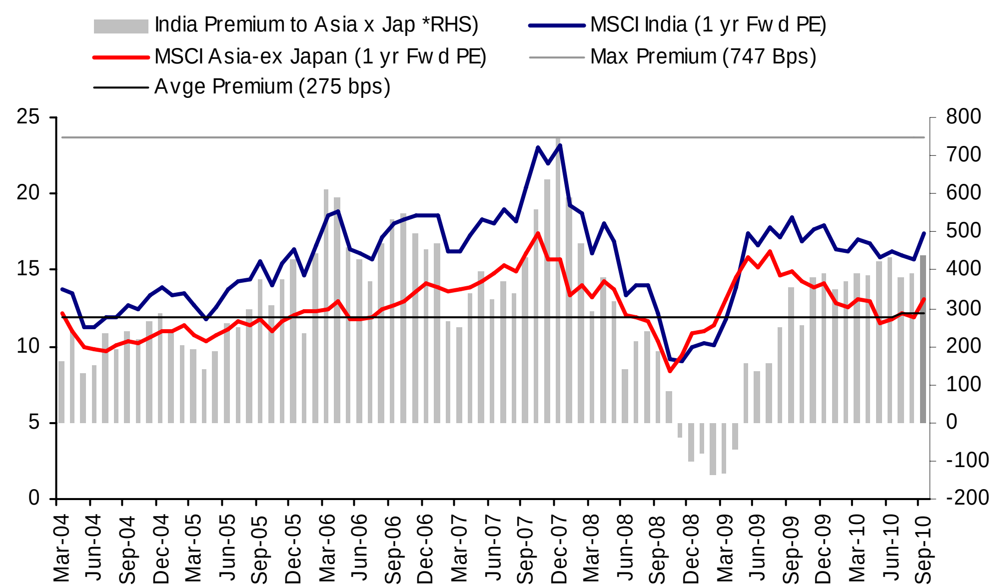
Source: Deutsche Bank, Bloomberg Finance L.P.

Figure 7: Market Cap/GDP also does not seem to be in the 'bubble zone'



Source: Deutsche Bank, Bloomebrg Finance L.P.

Figure 8: MSCI India has mostly tended to trade at premium to MSCI Asia ex Japan



Source: Deutsche Bank, Bloomberg Finance L.P.

Appendix 1

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Additional information available upon request

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Buy: Based on a current 12- month view of total share-holder return (TSR = percentage change in share price from current price to projected target price plus projected dividend yield) , we recommend that investors buy the stock.
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2. Ratings definitions prior to 27 January, 2007 were:
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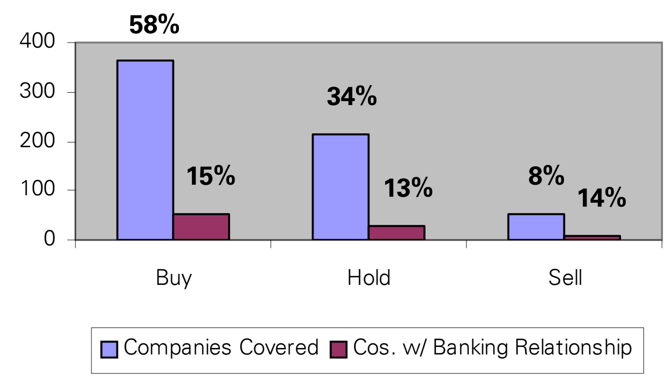

Asia-Pacific Universe

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