

## India Notes

### S&P ups India's outlook to stable

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### India Services Expand for 11th Month, Adding to Price Pressure

India's service industries such as banking, software and hotels, which make up more than half the economy, grew for the 11th straight month, adding to inflation risks. HSBC Holdings Plc and Market Economics' Purchasing Managers' Index was at 58.1 last month compared with 60.9 in February. A reading above 50 indicates expansion.

Economists expect Reserve Bank of India Governor Duvvuri Subbarao to raise benchmark interest rates for the second time in a month in the April 20 monetary policy statement to curb rising prices. India's key wholesale price inflation rate climbed to a 16-month high of 9.89 percent in February.

### Real Estate markets start stabilising

An analysis of launches in the residential segment over Jan-Mar shows that new launches made by developers seem to have seen good response across major markets. NCR has seen the highest number of project bookings both in the middle/high income market. In Mumbai, while there is a general sense that volumes have slowed after sharp price appreciation, new launches done in Ghatkopar (suburbs) and Virar (outer suburbs) have seen healthy take ups. Bangalore continues to show encouraging signs of pick up with developers such as Prestige/Sobha reporting good absorption in their new launches.

## Investor Update April ,2010

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## Economy & Markets

### S&P ups India's outlook to stable

Global ratings major Standard & Poor's (S&P) has finally recognised the India growth story. Citing improving fiscal situation and strong economic growth, S&P revised upward the ratings outlook for India to 'stable' from 'negative'. At the same time, the ratings major affirmed India's long term ratings at "BBB-" and short term ratings at "A-3". However, S&P has also put in a word of caution on high fiscal deficit and government debt, and also the recent high inflation rate. The upward revision in outlook is based on expectations that the Indian economy will grow at 8% in fiscal year 2010-11 (FY11), one of the highest among the major economies in the world. "The revision in outlook reflects our view that India's fiscal position could now begin to recover and that its economy will remain on a strong growth path," an S&P release said. The outlook upgrade is also based on government budget targets of a cut in deficits to 8.3% in FY11 from 9.8% in the current fiscal year.

Earlier, just before the budget on February 26, there were fears among global as well as local investors that in case the finance minister does not contain the fiscal deficit, ratings majors like S&P, Moody's and Fitch could further downgrade India's sovereign ratings. However, post budget, such fears have been allayed and things are looking positive. As a mark of confidence of India's proactive moves to reinstate the economy on the long-term sustainable growth path, FIIs have pumped in over €2.2 bn (US\$3 billion) into the Indian stock market since the budget, Sebi (Securities and Exchange Board of India) data showed.

On India's rising inflation rate, S&P said that this could derail the stable macroeconomic and interest rate environments. "The WPI, India's most widely used inflation index, increased by 10% in February 2010, mainly because of the rise in food prices," the S&P release said.

"We think RBI and the government need to achieve a fine balance between their monetary and macroeconomic policies to contain inflation while maintaining the growth momentum of the economy," it added.

### India Services Expand for 11th Month, Adding to Price Pressure

India's service industries such as banking, software and hotels, which make up more than half the economy, grew for the 11th straight month, adding to inflation risks. HSBC Holdings Plc and Market Economics' Purchasing Managers' Index was at 58.1 last month compared with 60.9 in February, according to an e-mailed report today. A reading above 50 indicates expansion.

Economists expect Reserve Bank of India Governor Duvvuri Subbarao to raise benchmark interest rates for the second time in a month in the April 20 monetary policy statement to curb rising prices. India's key wholesale price inflation rate climbed to a 16-month high of 9.89 percent in February.

Subbarao increased the reverse repurchase rate by a quarter-point to 3.5 percent from a record-low 3.25 percent and the repurchase rate to 5 percent on March 19. The gain in services comes after the Purchasing Managers' Index for manufacturing rose for the 12th straight month in March. Trade data released on April 1 showed imports rose 66.4 percent in February, indicating growing demand in the economy.

India's €883 bn (US\$1.2 trillion) economy may expand as much as 8.75 percent in the year ending March 31 2010, according to Finance Minister Pranab Mukherjee. Faster growth is boosting incomes in the world's most populous nation after China, spurring consumers to spend more on phone services of Bharti Airtel Ltd. and borrow from lenders including State Bank of India Ltd. Salaries in India may grow at the fastest pace in Asia- Pacific this year, according to Hewitt Associates Inc.

## India's Bonds Rise as Yields at 18-Month High Draw Investors

India's 10-year bonds rose on speculation yields near the highest level since October 2008 made the debt attractive. Investors had pushed up yields on concern about accelerating inflation and what measures the central bank may take to curb rising prices, which the market has now priced in. Wholesale prices increased 9.89 percent in February, the fastest pace since October 2008, and may have climbed 10.34 percent in March. The yield on the 6.35 percent note due January 2020 dropped two basis points, or 0.02 percentage point, to 8.01 percent. Five-year interest-rate swaps, or derivative contracts used to guard against fluctuations in borrowing costs, were little changed. The rate, a fixed payment made to receive floating rates, was 7 percent.

## Feb FDI inflows up 15%: Govt

Foreign Direct Investments (FDI) into India grew by 15.4% to €1.2 bn (US\$1.72 bn) in February 2010, a government official was quoted as saying. FDI in February 2009 was €1.09 bn (US\$1.49 bn). The major sectors receiving FDI in February included services, computer software, computer hardware, telecommunications, housing and real estate. FDI during April 2009 to Feb 2010, the first 11 months of the current financial year, stood at €18.16 bn (US\$24.68 bn) as against €18.69 bn (US\$25.39bn) in the same period last year, the official said. Commerce & Industry Minister Anand Sharma was quoted as saying that FDI in FY10 is likely to be the same as last year, or a little more. India attracted FDI of €20.10 bn (US\$27.31bn) in FY09, up 11% from €18.09 bn (US\$24.58 bn) in the previous fiscal year. The Government aims to attract €36.81 bn (US\$50 bn) in FDI per year by FY12 and €55.21 bn (US\$75 bn) a year by FY14, Commerce Minister Sharma was quoted as saying.

## Strong IIP Numbers again

The overall Index of Industrial Production - IIP for India has continued to post encouraging growth numbers - growing at 16.7% in Jan '10 after a fifteen years high growth at 17.6% (revised upwards) in Dec '09. The census was around the same levels.

- Though it seems that the growth has come on low base (the IIP was 1.0% in Jan '09), it is not entirely owing to the base impact. Infact, the IIP index rose marginally to 284.8 from 284.6 in Jan '09.

- The uptrend has continued from Jun '09 with quarterly growth for the first three quarters standing at 3.8%, 9.1% and 13.2%. With Jan '10 growth at 16.7% being the fourth double digit growth in succession, the growth is expected to seem to continue, of course with some downside risk.

- The growth is further becoming broad based with across industries - Manufacturing, mining and electricity segment. In the manufacturing group, the growth was led by food products, beverages & tobacco, transport equipments, non-metallic mineral precuts and capital goods. However, labour intensive sectors are still lagging behind its peers.

- Coming to user based industry, the capital goods segment has once again stood out among its peers followed by basic goods and intermediate goods. The consumer durables goods segment has posted positive growth - both on yearly and monthly basis while the consumer non-durable segment has posted negative yearly growth after seven months.

- Going forward, the gradual and coordinated efforts are required from government and RBI to revert back the stimulus so as not to adversely affect the growth recovery. Though the future IIP growth would not be as impressive as it has been in recent months (as it would be affected by gradual stimulus exit, possibly high interest rates and fading base impact from May '10), it would still continue to be strong.

## Foreign Investment in Retail will help tame India Inflation

Wal-Mart Stores Inc., the world's largest retailer, expects prices to reduce by at least 2 percent if India allows overseas investment in retail, helping the government tackle rising inflation. Wal-Mart, Carrefour SA and Tesco Plc are betting that their supply chain network and sourcing ability will allow them to remove middle men and sell products directly to consumers at lower prices. Local laws, aimed at protecting small shop owners, let global companies operate only wholesale stores that sell groceries and goods to retailers and businesses.

Chain-store sales in India may rise as much as 35 percent a year until 2015 to €59.90 bn US\$80 bn, according to a study by consultant McKinsey & Co. in August 2008. Wal-Mart and other foreign retailers, barred from opening their own retail shops or buying stakes in Indian stores, are starting wholesale outlets in Asia's third-largest economy. Wal-Mart and its local partner Bharti Enterprises Ltd. opened their second wholesale store in the northern state of Punjab yesterday. Bharti-Walmart, an equal joint venture, plans to open seven stores this year and have as many as 15 by March 2012, Jain said. Wal-Mart and Bharti formed the venture in August 2007.

### **India Inc starts hiring again, Hiring index up 28%**

The Indian job market appears to be seeing a steady revival in opportunities over the last three-six months (between August 2009 and February 2010). Doors seem to be reopening for fresh talent, with hiring for middle-level management positions turning active once again. The revival in corporate fortunes, with some help from the Government stimulus, has put profit growth for India Inc back on track; now, there are signs of companies dusting off their expansion plans as well; both are good signs for the jobs market.

Real estate, banking and financial services, pharmaceuticals and automobiles are sectors that have seen a strong improvement. The NaukriJobSpeak index shows that the real estate sector was at its peak hiring (taking the last one year) this February. This sector, with its counterpart — construction — would create around 136,000 new jobs in 2010-11, says the Ma Foi survey (conducted across 1,000 companies covering 11 different industrial segments).

There are opportunities in healthcare, hospitality and travel this year. These will together create around 430,000 jobs in the current fiscal. IT/ITeS would add 97,000 jobs in the next one year. Mumbai and Delhi-NCR stand out with the number of job openings reported by the two cities in January being the highest in the last one year. The Bangalore, Chennai and Hyderabad jobs markets are also showing good recovery now, says Oberoi. All the 13 major cities covered by Naukri.com reported an increase in job listings in February.

### **RBI Hikes Rates but Impact on Developers and End Users Limited**

The Central Bank of India starts its process of gradually withdrawing the stimulus package to reign in inflation. The first step of this withdrawal process has been to reduce liquidity by monetary tightening measures. This is expected to result in higher borrowing costs for Indian Companies. The impact of increase in borrowing costs will likely be limited for developers as risk premiums have declined sharply by 350-400 bps. Therefore, an increase of 125-150 bps in the interest rate would still result in lower borrowing costs for most real estate companies on a yoy basis. Lower risk premiums have accrued on account of a reduction in leverage, improvement in residential sales and general improvement in availability of liquidity to the sector.

Most real estate companies have raised equity to reduce debt in FY2010. Unitech raised €989 mn (Rs44.1 bn) through two QIP issuances and reduced net debt by €633 mn (Rs28.2 bn) in 9MFY10. Similarly, HDIL raised €377 mn (Rs16.8 bn) through QIP and has reduced net debt by €184 mn (Rs8.2 bn). DLF has also seen a decline in net debt of €141 mn (Rs6.3 bn) in 9MFY10.

Lower borrowing is already visible as DLF management highlighted that its average borrowing costs have come down to 10.6% in December 2009 from 11.9% in December 2008 which would save ~ €44 mn (~Rs2 bn) of interest cost annually. This indicates incremental borrowing costs at around 10%, a yoy decrease of 500 bps. Analysts believe real estate developers can borrow at sub-PLR rates once the sector stabilizes, which was the case in the period FY2002-04

RBI's loan outstanding data indicate that current total outstanding credit to real estate (retail and commercial real estate) at 13.8% is at its lowest level since March 2005. Retail housing loans are currently around 10.6% of total credit compared to peak of 13.1% in December 2006. Furthermore, historical % is depressed by around 1% as borrowings from FMPs have become negligible post credit crunch in October 2008. An increment in housing-loan disbursement equivalent to 1% of total credit would indicate an additional disbursement of ~ €4.5 bn (~Rs275 bn) (as of Nov 2009).

## Impact of an increase in interest rates on affordability to be negated by increase in disposable income

End user affordability will likely remain neutral as the negative impact of increase in mortgage rates will be countered by the increase in salaries and the lower personal tax rate in FY2011E. Affordability is a function of (1) selling prices, (2) interest rates and (3) salaries. Increase in mortgage rates of 125 bps from 8.5% to 9.75% will decrease affordability by ~10%.

However, this will be compensated by an increase of ~10% in disposable incomes in FY2011E on the back of salary increases and taxation cuts.

For affordability calculations, we factor a 5% increase in salaries while taxation cuts will further increase disposable income by 6-7% for income below Rs1 mn.

Hence, we believe the direction of selling prices will be the key driver of affordability given that interest rates and salaries will counterbalance the impact of each other. Over the past six months, affordability in Mumbai declined by 10% while for the rest of India it increased by 10+% on account of the diverse direction of selling prices.

## Impact of increase in interest rates to be compensated by increase in disposable income Measurement of affordability of housing in India, March fiscal year-ends, 1999-2010E

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	May-09	Current	FY2011E
<b>Housing loan interest rates (%)</b>	<b>14.5</b>	<b>13.9</b>	<b>12.8</b>	<b>12.1</b>	<b>10.4</b>	<b>8.9</b>	<b>8.0</b>	<b>8.5</b>	<b>9.5</b>	<b>10.5</b>	<b>10.5</b>	<b>8.50</b>	<b>9.75</b>
EMI per Rs100,000 on 20 yr loan (Rs)	1,366	1,240	1,160	1,110	995	895	836	868	932	998	998	868	950
Avg annual household income (for households with annual income > Rs200,000)		577,201	606,061	636,364	668,182	701,591	736,671	788,238	843,414	902,453	947,576	947,576	994,955
Income growth (%)			5.0%	5.0%	5.0%	5.0%	5.0%	7.0%	7.0%	7.0%	5.0%	0.0%	5.0%
Taxes	115,440	121,212	127,273	133,636	140,318	147,334	157,648	168,683	180,491	142,136	142,136	142,136	99,495
Post tax income	461,761	484,849	509,091	534,546	561,273	589,337	630,590	674,731	721,963	805,439	805,439	895,459	
<b>Selling prices decline by 30% each in FY2010</b>													
Capital price in Koramangala, Bangalore		<b>1,900</b>	<b>1,800</b>	<b>1,750</b>	<b>1,900</b>	<b>2,350</b>	<b>2,800</b>	<b>4,500</b>	<b>4,750</b>	<b>4,750</b>	<b>3,600</b>	<b>3,600</b>	<b>3,600</b>
Price of 1,500 sq. ft house (Rs mn)		2.9	2.7	2.6	2.9	3.5	4.2	6.8	7.1	7.1	5.4	5.4	5.4
EMI payable assuming 70% LTV		24,738	21,924	20,396	19,850	22,084	24,578	41,013	46,484	49,775	37,724	32,810	35,910
<b>Price/income ratio (X)</b>		<b>4.9</b>	<b>4.5</b>	<b>4.1</b>	<b>4.3</b>	<b>5.0</b>	<b>5.7</b>	<b>8.6</b>	<b>8.4</b>	<b>7.9</b>	<b>5.7</b>	<b>5.7</b>	<b>5.4</b>
<b>Affordability Index (assuming FY2000 as 100)</b>		<b>64</b>	<b>54</b>	<b>48</b>	<b>45</b>	<b>47</b>	<b>50</b>	<b>78</b>	<b>83</b>	<b>83</b>	<b>56</b>	<b>49</b>	<b>48</b>
<b>Affordability Index (assuming FY2000 as 100)</b>		<b>100</b>	<b>84</b>	<b>75</b>	<b>69</b>	<b>73</b>	<b>78</b>	<b>121</b>	<b>129</b>	<b>129</b>	<b>87</b>	<b>76</b>	<b>75</b>
Capital price in Bandra, Mumbai		<b>7,992</b>	<b>8,791</b>	<b>8,000</b>	<b>8,500</b>	<b>8,500</b>	<b>10,000</b>	<b>13,000</b>	<b>16,000</b>	<b>20,000</b>	<b>14,000</b>	<b>18,000</b>	<b>18,000</b>
<b>Affordability Index (assuming FY2000 as 100)</b>		<b>100</b>	<b>98</b>	<b>81</b>	<b>74</b>	<b>63</b>	<b>66</b>	<b>83</b>	<b>103</b>	<b>129</b>	<b>81</b>	<b>90</b>	<b>89</b>

## 100 bps increase in interest rates for 20 yr period results in an increase of ~7% in EMI EMI (Rs/month) per Rs100,000 housing loan for different tenures, interest rates

	Interest rate (%)									
	7.5	8	8.5	9	9.5	10	10.5	11	11.5	12
<b>10</b>	1,187	1,213	1,240	1,267	1,294	1,322	1,349	1,378	1,406	1,435
<b>15</b>	927	956	985	1,014	1,044	1,075	1,105	1,137	1,168	1,200
<b>20</b>	806	836	868	900	932	965	998	1,032	1,066	1,101
<b>25</b>	739	772	805	839	874	909	944	980	1,016	1,053
<b>30</b>	699	734	769	805	841	878	915	952	990	1,029
<b>40</b>	658	695	733	771	810	849	889	928	968	1,008
<b>50</b>	640	679	719	759	799	839	880	921	961	1,003

## Revival of big ticket land deals in Mumbai....but marked by caution

The first two-and-a half months of 2010 have seen closure of land deals worth €897 mn (Rs40bn); the largest being bid to develop a 250-acre plot in Kharghar (Navi Mumbai) for €343 mn (Rs15.3bn) (won by a consortium of Bhushan Steel and Subhash Chandra's Essel Group). The others were the €128 mn (Rs5.71bn) deal by the Wadhwa group to buy 18.18 acres in the Ghatkopar suburbs from Hindustan Composite, and Sheth Developers bought Golden Tobacco Company's property in Vile Parle for €132 mn (Rs5.91bn).

More mega-deals are expected: 1) Jet Airways is said to be close to signing a deal to sell the land (bought for €193 mn Rs8.26bn in BKC 2-yrs ago) in a joint development project; 2) Government agencies like the Railway Land Authority (RLDA), National Textile Corporation (NTC) and Mumbai Metropolitan Region Development Authority (MMRDA) are planning to auction their lands this year. Leading the pack is RLDA (the nodal agency for developing surplus land of Indian Railways), which starting April is planning to raise around €1.01 bn (Rs45bn) from selling 25 sites covering 172 acres. P D Sharma, a member of planning and infrastructure, RLDA, said RLDA received 20 requests for qualification (RFQ) from well-known developers for its Sarai Rohilla plot in Delhi and 14 expressions of interest (Eoi) for the Bandra land. NTC is also planning to sell two or three more defunct Mumbai mills to developers. Most land buyers in Mumbai are planning to build premium residential apartments to make the most of their expensive investments. Wadhwa group has already pre-sold 0.5msf out of 1.6msf of space in the Ghatkopar residential project and Sheth Developers is planning premium residential apartments on its newly acquired land. DLF, is also said to have recently changed its plans and now building high-end residential complex in Lower Parel on its 17-acres mill land (acquired in 2005 for €157 mn (Rs7.02bn)).

That said, this time, the revival in land deals is marked by caution – evidence is MMRDA's recent land auction when none of the developers turned up because the agency's quoted price of €6734 (Rs0.3 mn) per square metre was considered too high.

**Home prices up most in cities...trend to impact Volumes** Residential property prices across India rose considerably in 2H09, as healthy absorption rates and positive buyer and investor confidence kept demand growing. In a 13-city study conducted by property consultants Mumbai, Thane and Navi Mumbai experienced the maximum price hikes in the affordable, mid- and premium-housing segment; the hikes being 30% in affordable housing, 15% in premium segment and about 11% in mid-income. The average price hike in the region was over 20%, as there was a strong recovery in volumes in the first half.

Hikes have been higher in completed projects than in new ones. Overall across India too, affordable housing witnessed the maximum price appreciation, followed by premium housing and mid-segment housing. In NCR, the prices remained stable on account of the large number of launches and heavy competition – DLF recently priced its phase-III of housing project in Delhi 60% higher than its phase-II on increased buyer confidence; Gurgaon's premium housing experienced 20% price hike as the IT and BPO job scenario in the region improved. In Bangalore, Chennai and Hyderabad, prices remained largely stable – with Chennai witnessing a 6% price hike. Developers in 2009 were only focusing on affordable housing to play with volumes, but recently, they started launching luxury projects in a phased manner. Gurgaon and Noida have seen launches of >34msf in Jan-Sept 2009. Most brokers, estate agents believe that if the price appreciation continues with the trend as recorded over H2 2009, it may have negative implications on the off-take in the residential real estate market.