

## India Notes

The political temperature has begun rising steadily as India's 714 million electorate (the largest in any democracy) prepare to go to polls in India's 15<sup>th</sup> parliamentary elections. From April 16<sup>th</sup> to May 13<sup>th</sup> the electorate will be voting on the key issues of growth, employment, development and security. The elected government is expected to be in office by June end.

Similar to past elections results are unlikely to culminate in a clear majority. The market appears to be pricing in a broad coalition government led by one of the two large national parties (Congress or BJP). Recent local elections have produced mixed results and suggest that the elections are too close to call.

In the coming months the market's performance hinges on two key factors, how the world shapes up and the general election results. The former will more or less determine absolute returns while the latter may play a greater role in relative returns in 2009 and beyond.

With most parties on the same page on the policy/reform front, the best case would be a coalition where the dominant party, its allies and their willingness to introduce economic reforms would be a significant catalyst to partly overcome the impact of the global slowdown. A fragmented coalition would raise concerns on stability and policymaking adding to prevailing uncertainty and further dampening recovery.

India has shown resilience during the current global economic downturn and if the economy is to rebound on the back of stronger investment activity the desired outcome is a government that can give business the confidence and the policies will stimulate the economy.

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## Economy & Markets

**Economy Outlook:** The Prime Minister's Economic Advisory Council in its advance estimates for 2008-09, suggested that the Indian economy was set for a 7.1% expansion. The International Monetary Fund (IMF) projects India's growth to moderate to 6.25 per cent in 2008-09 primarily due to a moderation of consumption growth and widening of trade deficit. With India staring at deflation or negative inflation if this trend continues it would weaken economic activity and discourage investments, and in turn affect the economy in the longer term. The government continues to be confident that with the impact of the three installments of fiscal stimulus (December 7, January 2 and February 24) and likely rate cuts by the central bank the growth rate will still be met. The silver lining for India is that at 6.5 – 7 % the growth rate would still make India the second fastest growing economy globally.

Inflation has fallen significantly from its 13 year peak of 12.44% (August 2008) to an all time low of 0.27% (March 2009). However a point to note is the disconnect between the Wholesale Price Index (WPI) and the Consumer Price Index (CPI). The CPI has hovered between 8-10% during the fiscal year, with the latest release for January 2009 pegging it at 9.8%. The reason between the divergence in the WPI and the CPI is the composition of the index. Food articles comprise 57% (vs. 15.4% of the WPI).

**GDP figures:** Most Analysts are maintaining their 5.5% GDP estimates for FY10 as incremental data posts mixed trends. The apparent rebound/sustained strength in demand in some domestic sectors like autos, property and cement has helped boost investor sentiment. There has been a visible pick-up in car sales since Dec-08 (Feb-09 sales 42% above Nov-08), as government actions have helped stimulate demand. Likewise, there has been a discernable revival in new sales of residential property, after a near-freeze in 4Q 2008.

Cement dispatches have sustained at +8% YoY growth, suggesting buoyant demand from semi-urban/rural India.

**Financial Markets:** Though the RBI has cut the repo rate by 400bps (from 9% to 5%) and the reverse repo rate by 250bps (from 6% to 3.5%) since September 2008, an additional 100bps easing in rates is expected in the coming months. However, higher issuances will keep the pressure on bond yields. On the rupee, while medium-term fundamentals are USD/INR supportive (relatively higher growth and improvement in the trade deficit), risk aversion and de-leveraging are near-term determinants.

India Macroeconomic Summary

Year to 31 March	FY04	FY05	FY06	FY07	FY08	FY09E	FY10E
Real GDP growth (%)	8.5	7.5	9.5	9.7	9.0	7.1*	5.5
Agriculture growth (%)	10.0	0.0	5.8	4.0	4.9	2.6	3.0
Industry growth (%)	7.4	10.3	10.2	11.0	8.1	4.8	3.6
Services growth (%)	8.5	9.1	10.6	11.2	10.9	9.6	7.0
Fiscal Deficit (Cent+State)	8.5	7.5	6.7	5.6	5.3	9.0	10.0
Current Account Deficit	2.3	-0.4	-1.2	-1.1	-1.5	-3.7	-1.9
WPI (Average)	5.5	6.5	4.4	5.4	4.7	8.5	2.0
INR/USD (Average)	45.9	45	44.3	45.2	40.2	46.0	48.0

Source: CSO, Citi estimates

\*CSO's advance estimates

Composition of WPI and CPI (%)

CPI		WPI	
Article	Wt Article	Article	Wt
Food Items	57.0	Primary Articles	22.03
Betelnut /Tobacco	3.1	Food Articles	15.4
Fuel & Light	6.3	Non Food Articles	6.14
Housing	8.7	Minerals	0.49
Clothing	8.5	Fuel Group	14.23
Misc	16.4	Manufactured Prods	63.75

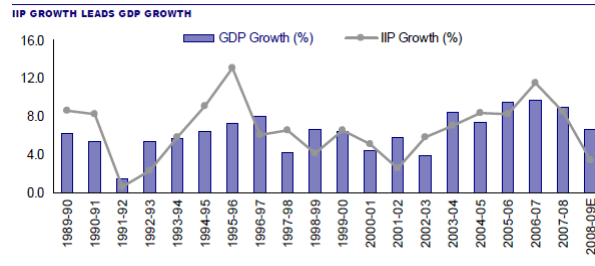
India's 3QFY09 BoP data saw a further widening in the current account deficit (CAD) to US\$14.6bn v/s US\$12.8bn in the previous quarter. However, this was largely in line with expectations and with the 9MFY09 CAD at US\$36.5bn, and most analysts maintained their FY09 CAD estimate of US\$43.7bn (3.7% of GDP). Capital flows in 3QFY09 were in the red, due to portfolio outflows and banking capital, which resulted in an overall BoP deficit of US\$17.9bn. With the outlook for capital flows remaining bleak analysts expect an overall deficit of US\$24.6bn for the full year.

**FX Reserves:** Revaluation accounts for over 60% of decline — During 9MFY09 forex reserves declined from US\$309bn to US\$254bn, a fall of US\$53.7bn. However, as seen below, financing of the CAD and portfolio flows accounted for 38% of the decline, with the balance due to revaluation of reserves

Overall decline in reserves during 9MFY09 US\$54bn, v/s US\$76bn during last year (of this, US\$33.4bn was due to currency valuation changes)

	April-Dec FY08	April-Dec FY09
<b>1. Current Account Balance</b>	<b>-15.5</b>	<b>-36.5</b>
<b>2. Capital Account (net) (a to f)</b>	<b>82.7</b>	<b>16.1</b>
a. Foreign Investment (i+ii)	40.2	4.0
(i) Foreign Direct Investment	6.9	15.4
(ii) Portfolio Investment	33.3	-11.3
b. External Commercial Borrowings	17.4	7.1
c. Banking Capital	5.9	-0.1
of which: NRI Deposits	-0.9	2.1
d. Short-Term Credit	10.7	0.5
e. External Assistance	1.3	1.9
f. Other items in capital account*	7.2	2.7
<b>3. Valuation Change</b>	<b>9.0</b>	<b>-33.4</b>
<b>Total (1+2+3)</b>	<b>76.1</b>	<b>-53.8</b>

**Manufacturing:** Manufacturing accounts for over 25% of India's GDP and ~1.5% of India's GDP growth (barring few aberrations), and has been an important contributor to economic growth. The growth in GDP is broadly correlated to the growth in IIP; IIP growth always moves ahead of the direction of GDP growth. Even in the current cycle, IIP growth rate had declined ahead of the decline in GDP growth.



**Agricultural:** Agricultural GDP has seen four consecutive years of growth for the first time in India's history. This has strengthened the rural economy significantly, providing a boost to overall consumption in the recent times. In the past 15 years, a key swing variable for decline in GDP growth has been agriculture. In years of sharp decline in GDP growth, agriculture growth has been negative. After four years of positive agriculture growth till FY09, FY10 growth for agriculture will be a key factor in influencing overall GDP growth.

**Banking:** The banking sector in India is very well positioned, with 1) highest ever capital adequacy ratio (CAR), 2) ~1% net non-performing assets (NNPA) and 3) manageable credit growth of 25-30%. State-owned banks that were prone to credit quality deterioration due to directed lending in the past have recovered well – their NNPA's have declined from 11% in FY94 to 1% in FY08. Given the liquidity surplus in the system and higher CAR, banks are in a better position to achieve 25-30% growth.

Several other sectors that reported significant drop in business momentum in 3QFY09, have witnessed a strong recovery in 4QFY09. This is reflected in higher QoQ earnings estimates for most of these sectors. While part of this uptick is a reflection of the pre-election spending and completion of projects, the various stimulus packages and RBI measures have also aided the positive surprises in volumes.

## Real Estate

**Residential demand at a price:** Developers in certain areas have accepted reality and have started cutting prices. Large regional & national developers Like DLF, Unitech, Ansals, Parsvanath, Lodha and Runwals have announced price cuts in the region of 15-35% and some of the projects have seen good interest. The trend does indicate that there exists a demand at the right price. Footfalls to property fairs announced for mass selling of projects have increased substantially. The residential mortgages rates have softened about 300 basis points to about 9% to 10%. The reductions in the mortgage financing rates have increased affordability for residential projects.

**Commercial projects higher vacancies; falling rentals:** Commercial rentals have started softening as the inventory increases and vacancy rates are climbing. The demand for office space has slowed significantly and this year commercial leasing should be in the region of 20 million sq ft as compared to 50 million sq ft last year. Tenants are waiting for the markets to stabilize before they take any further calls on expansion of facilities. Demand is expected to pick up towards the end of the year as the fiscal stimulus packages take impact and the global financial crisis has an element of clarity around it.

**Retail innovation & modernisation is the key:** The retail business is transitioning as organised retail formats are facing slower sales and cash flow management issues. This has led to many retail mall projects being either postponed or cancelled and should translate into a significant advantage for projects where financial closure has been achieved.

Malls are moving towards revenue share models and are modernizing their data collection and management systems to adapt to the latest trends in the industry. The retail industry will continue to see challenging times as markets evolve and demand picks up.

**New FDI Norms:** The Indian government has issued new guidelines for calculation of total foreign shareholding in Indian companies. The new guidelines define ownership and control in the following manner:

*Owned entities:* Beneficial ownership of more than 50% equity interest

*Controlled entities:* Where the foreign investor has the power to appoint a majority of directors on the board but does not include private equity investments with significant veto rights

The definition of indirect investment now includes Foreign Direct Investment (FDI), Foreign Institutional Investor (FII), Non-Resident Indian (NRI), Global Depository Receipts (GDR), American Depository Receipts (ADR) and Foreign Currency Commercial Borrowings (FCCB), convertible debentures and convertible preference shares.

Under the new rules direct Investment by a non-resident entity into an Indian company resulting in a shareholding of more than 50% will be considered foreign investment.

In the case of downstream investments by a company owned or controlled by non-resident entities, the entire investment by the company in downstream companies will be considered foreign investment.

## The scenario till now

FDI is allowed through the automatic route in several sectors subject to various conditions:

Townships, Housing built-up infrastructure, construction development

- projects are subject to conditions of minimum area and capitalization.
- Hotels – 100% FDI allowed.
- Industrial parks – 100% FDI is permissible subject to certain conditions related to the number of units and allocable area.
- Special Economic Zones – 100% FDI is allowed subject to the SEZ Act.

As a result FDI was restricted to projects that satisfied the minimum area and capitalization requirements.

## Key benefits of the new guidelines

- Opens up all categories of developers for FDI and will result in an overall boost to the real estate sector as smaller developers would also be able to access FDI.
- Reduces the ticket size of investments for real estate funds and allows for diversification by investing in smaller projects.
- Flexibility to cherry-pick good investments and put them in a single SPV for investment by real estate funds.

## Market Activity

Investor	Investee	Investment in €	Description
Roop Madan	Unitech	33.54 million	Sold its 200 room hotel in Gurgaon – Courtyard Marriott
ILFS Realty Fund	Infrastructure Ventures India	0.58 million	Stake in SPV to develop residential housing for the Mumbai Police department
Sun Apollo Real Estate Fund	Keystone Developers	43.75 million	Enterprise level investment in Keystone developers
Housing Development & Infrastructure Limited			Launched a 0.6 million square feet residential project in Central Mumbai at EUR 76.30 per square feet
Unitech			Launched a residential project in Gurgaon, Uniworld Garden & 1 million Square feet commercial project in Mumbai
Anant Raj			Allotted 750 acres of land to develop an educational city in Gujarat
DLF			Reduced prices for two residential projects in Bangalore and Chennai
BPTP			Launched affordable housing project in Gurgaon

Source: Media reports  
Conversion rates: 1EUR = INR 68.57

## Yatra News

### We are here for the long term

Sir Nigel Broomfield, Chairman of Yatra Capital's board of directors was on a brief visit to India mid-March and visited the projects in Pune.

In Mumbai, Sir Nigel was interviewed by CNBC-TV18, India's premier business news channel on the *Markets at Midday* show. Edited excerpts from the interview...

**CNBC:** I don't know how closely you follow the money that has been invested in India, but are some of the projects stuck for want of more funds because the real estate market in the last one-year has passed through some fairly severe reverses and credit squeeze?

**Sir Nigel:** Overall, the market has had a very sharp correction. You are absolutely right but we came into this market with a long term view. We told our investors you're with us for a seven-year ride and we stayed with them. We talked to them and mainly the investors who came with us were people who invested in the real estate market and knew the cycles. A lot of people who invested in real estate unfortunately went in because they saw the wonderful figures. They didn't understand the fundamentals. We have invested on the basis of two things. Firstly, diversify. We have the geographic spread. We have invested in Mumbai, Kolkata, and north India, and spread the asset classes to hotels, shopping malls, residential properties and offices. So, be diverse and be very careful about your partners.

**CNBC:** You spoke about time cycles. You said you've told your investors you're in for seven-years. Last time around when the real estate prices started falling around 1995-96 – they peaked off 1996 - and then we didn't see them rising back perhaps up until 2003. What kind of cycle are you looking at now?

How long and how deep from here on can the downturn be?

**Sir Nigel:** If I knew the answer to both of these questions, I wouldn't be sitting next to you but making a fortune somewhere else. The answer is the cycle is not easy to guess. My own guess is that there will be more pain to come but the fundamentals here are good. This is a young country with 45% of the population below 30 years. There is a huge amount of demand. People have become more use to Western consumption. I was born in India and I went to school here and I have been back quite often. I have seen India growing in a different way. You are now part of the global economy, a very important part of the global economy. People now expect many of them to own motorcars to their houses, cell-phones. So, there is a different aspect to the demand curve in India now and I see it coming back. I really do.

There is a lot of money around but what is different now is that people are very unconfident. I go around and was in Pune yesterday. The word that people say is affordability and that means a whole lot of things to different people but it means am I going to have a job? Am I going to have a secure future? Can I really afford to do that now or should I wait a bit to see if the price comes down?

**CNBC:** When do you see you yourself getting the next tranche of investments? When would you consider the market attractive?

**Sir Nigel:** At the moment we still have some balance sheet left, so we have to use that. We will take a careful look (at raising further capital) probably early next year but again we will be looking in the long-term and again we will be going to investors who are people who understand the real estate market and the real estate cycle.

*The interview is available on Yatra Capital's website:*  
<http://www.yatracapital.com/News/NewsDetailPage.aspx?ID=100>