YATRA CAPITAL

Solid.Established.Committed.

India Notes

The overall corporate results in 2Q FY10 were in line with analysts expectations.

There were positive volume and revenue surprises for the IT and fast-moving consumer goods (FMCG) sectors and on the margin front for the banking and finance (NIM) and non-financial manufacturing sectors (operating margin). Overall, analysts are now more positive on the earnings outlook for the second half of FY10 and FY11 after the 2Q FY10 results season.

RBI moves to cut excessive real-estate lending

The Reserve Bank of India (RBI) in its monetary policy statement has asked banks to increase the provisioning requirement for loans to the commercial real-estate sector from 0.4% to 1.0%. A large increase in credit to the sector over the past year, and the large number of restructured advances, has resulted in the RBI's actions. Outstanding loans in the sector totalled approximately INR1,100b in August 2009. The current move can be viewed as the first sign of tightening in the sector since October 2008. Developers are likely to continue to face an environment of higher cost funds (the average cost of debt of large developers is still approximately 13%) with the potential onset of interest rate hikes in 2010.

The ongoing recovery in the real estate sector has been faster than expected.

While the residential vertical is in a strong growth phase, analysts expect other verticals such as the retail and commercial sectors to recover faster than expected. At this stage of real estate cycle, well managed mid-cap companies with a city-centric focus, robust financials and strong near-term monetization provide good investment opportunities.

Investor Update
November, 2009

In this issue: ***Pg***

Economy & Markets	***2***
Real Estate	***4***
Market Summary	***5***

Contact Us

Yatra Capital Limited
43/45 La Motte Street
St. Helier
Jersey JE4 8SD
Email: info@yatracapital.com
Website: www.yatracapital.com

Gavin Wilkins
Tel: +44 (0)1534 702 815
Fax: +44 (0)1534 702 870
Email: Gavin.Wilkins@minerva-trust.com

Investment Advisor

Saffron Capital Advisors Limited
Suite 2004
Level 2, Alexander House
35 Cybercity
Mauritius

Ajoy Veer Kapoor
Vijay Ganesh
Tel: +230 4677228
Fax: +230 4654106
Email: vganesh@saffroncapitaladvisors.mu
ajoyveerkapoor@saffronadvisors.mu
Website: www.saffronadvisors.com

Economy & Markets

Macro Economic Policy

In its quarterly monetary policy review, the Reserve Bank India (RBI) decided to leave policy rates unchanged, as per market expectations. However, the central bank also gave a clear indication that the monetary policy reversal is beginning. The monetary policy statement mentioned that the RBI is initiating the first step toward "exit" by discontinuing several unconventional measures that were taken immediately post the unfolding of the credit crisis last year.

This move was in line with analysts expectation that RBI will signal the reversal of monetary policy. While it was expected that the RBI will indicate the beginning of a reversal with a cash reserve ratio hike, it chose to signal it with a withdrawal of unconventional liquidity support measures, some of which were due to expire March 31, 2010. In addition, the RBI also announced an increase in general provisioning requirement for real estate loans to 100bp from the current 40bp and an increase in the loan loss coverage ratio to 70%.

Arguments for and Against Reversal in Monetary Easing

The RBI statement described the policy dilemma that "the challenge for the Reserve Bank is to support the recovery process without compromising on price stability. This calls for a careful management of trade-offs. Growth drivers warrant a delayed exit, while inflation concerns call for an early exit. Premature exit will derail the fragile growth, but a delayed exit can potentially engender inflation expectations."

Based on the consultations that RBI had with the various stakeholders, the monetary policy statement lays the arguments for and against the beginning of reversal in monetary easing.

The key arguments for beginning the reversal in monetary easing are: (a) RBI's inflation expectations survey shows that households expect inflation to increase over the next three months and over 12 months. (b) Large amount of liquidity in the system could potentially result in an unsustainable asset price build-up. Moreover, large overhang of liquidity could engender inflation expectations even if credit demand remains weak.

Similarly, the policy statement highlights that the arguments against the reversal are: (a) the recovery in growth is still fragile and premature tightening will hurt growth impulses; (b) current inflationary pressures are driven by supply-side constraints, particularly food prices – monetary policy (MP) is typically not an efficient instrument for reining in food price inflation; (c) reversal in accommodative stance at this stage will harden yields on G-sec, putting upward pressure on interest rates and dampening consumption and investment demand; and (d) if India tightens ahead of others economies, the wider interest rate differential will become a perverse incentive for even larger capital flows.

What Key Measures Were Announced

The potential measures from the central bank can be grouped in three key areas, including: (1) policy rates; (2) liquidity measures; and (3) prudential norms. The RBI sequenced the first stage of exit strategy from the current expansionary monetary policy by announcing the following measures, which aim to partially withdraw liquidity support measures and tighten prudential norms.

(1) Policy rates: RBI kept the repo rate (the rate at which RBI infuses liquidity) and the reverse repo rate (the rate at which RBI absorbs liquidity) unchanged at 4.75% and 3.25%, respectively. This was in line market expectations (as per Bloomberg survey). RBI also left the cash reserve ratio (CRR) unchanged at 5% compared to the expectation of a more than even chance of a hike in CRR.

(2) Liquidity support measures: To cushion the impact of the global credit crisis, since mid-September 2008 the RBI has undertaken several measures that augmented actual/potential liquidity in the system to the tune of US$120 billion. In its monetary policy meeting, the RBI announced the reversal of a few of these unconventional liquidity support measures. These measures include:

(a) Increase in the Statutory Liquidity Ratio (SLR) to 25% of net demand and time liabilities (NDTL) of scheduled commercial banks from the current 24% effective the fortnight beginning November 7, 2009.

(b) Reducing the limit for export credit refinance facility to 15% of eligible outstanding export credit from the existing 50%.

(c) Discontinuing with immediate effect the special refinance facility and special term repo facility (for funding to MFs, NBFCs, and HFCs) for scheduled commercial banks that was earlier available up to March 31, 2010. Liquidity available through (b) and (c) above combined to US$19 billion, although note that these facilities were not fully utilized by the banks.

(3) Prudential norms: The measures include: (a) increasing the provisioning requirement for advances to the commercial real estate sector classified as "standard assets" from the current level of 0.4% to 1%. Note that as of August 2009, loans to the real estate sector have been growing at 41.5% YoY. (b) Augmenting the provisioning cushions of banks consisting of specific provisions against NPAs as well as floating provisions, and ensuring that their total provisioning coverage ratio, including floating provisions, was not less than 70%. Banks are required to achieve this norm by end-September 2010. (c) To ensure due diligence of assets generated for the purpose of securitisation, the minimum lock-in period for all types of bank loans was stipulated to be one year before these can be securitised and the minimum retention by the originators would be 10% of the pool of assets being securitised.

Quarterly Results Summary

The overall results in 2Q FY10 were in line with analysts expectations. There were positive volume and revenue surprises for the IT and fast-moving consumer goods (FMCG) sectors and on the margin front for the banking and finance (NIM) and non-financial manufacturing sectors (operating margin). Overall, analysts are now more positive on the earnings outlook for the second half of FY10 and FY11 after the 2Q FY10 results season. The only exception is the telecom sector where a rate war which has been sparked off which should have an impact on the profitability of the companies in the sector.

Margin improvement trend across sectors

The companies have responded well to cost restraints. The prevailing low-to moderate interest rate and lower raw material prices have helped margin performance. The leading IT services companies showed 3-4% sequential revenue growth that came as a moderate surprise. The ferrous metals sector improved its EBITDA margin, mainly supported by improved realizations and a lower contracted raw material price. The realization for ferrous metal rose by 4-6% sequentially. In the infrastructure space, while the companies' order execution showed a mixed trend, the overall company guidance for order inflow and execution for 2H FY10 is quite robust.

Table 1: Result summary for the quarter ended 30th Sep 2009

	Sensex	
	Estimates	Actuals
All Companies:		
Sales Growth	-0.2%	-7.1%
Profit Growth	-17.6%	-19.1%
Excl. Financial Cos:		
Sales Growth	-13.0%	-7.7%
EBITDA Growth	-10.3%	-13.3%
Profit Growth	-25.1%	-25.7%
Excl. Metals:		
Sales Growth	17.8%	7.3%
EBITDA Growth	20.0%	18.2%
Profit Growth	9.4%	9.6%
Excl. Global Commodities:		
Sales Growth	12.8%	9.6%
Profit Growth	13.1%	13.4%

Source: BofA Merrill Lynch Global Research

Profit growth in-line in most sectors

Industry	Sector Weights	Sales % Growth	EBITDA % Growth	Net Profit % Growth	Variance %
Consumer Discretionary - Autos	5.1%	26.8%	103.5%	91.3%	10.7%
Consumer Staples	5.7%	9.3%	21.4%	15.4%	4.3%
Energy	19.5%	-6.9%	27.6%	33.4%	-4.9%
Financials	21.5%	6.0%	NA	16.8%	-2.3%
Healthcare	3.2%	12.5%	27.4%	58.1%	7.1%
Industrials	8.5%	13.2%	19.0%	8.0%	-9.2%
IT	15.7%	6.1%	11.7%	12.0%	5.0%
Cement	1.6%	10.2%	45.9%	49.8%	0.0%
Metals	5.7%	-28.5%	-55.1%	-70.3%	-11.7%
Telecom	2.2%	8.4%	-2.1%	-45.7%	11.1%
Utilities	6.0%	2.4%	-4.0%	-9.3%	-9.2%
Real Estate	4.1%	-51.4%	-56.0%	-69.8%	-15.0%
Others	1.2%	31.1%	50.7%	302.0%	113.7%
Weighted Grand Total	**100%**	**-3.8%**	**-2.4%**	**-6.4%**	**-1.3%**

Source: BofA Merrill Lynch Global Research

Real Estate Markets

The ongoing recovery in the real estate sector has been faster than expected. While the residential vertical is in a strong growth phase, analysts expect other verticals such as the retail and commercial sectors to recover faster than expected. At this stage of real estate cycle, well managed mid-cap companies with a city-centric focus, robust financials and strong near-term monetization provide good investment bets. The ongoing recovery in the real estate vertical has been primarily strong in tier-1 cities, such as Mumbai, Delhi and Banglore, while recovery is still to gain momentum in tier-2 and tier-3 cities. It is expected that tier-1 city-centric players to outperform those with high concentration in tier-2 and tier-3 cities.

City-centric locations provide higher monetization visibility due to high economic activity, which results in constant job creation and increased demand for office space, residential units and retail malls. City-centric locations also benefit from an increasing trend of urbanization in India. India's Planning Commission estimates that the share of urban population in India's total population would rise to 37% by 2016 from 28% in FY09. Again, most of the mid-cap real estate companies are local or regional players, due to which they have strong contacts with local authorities and a sound understanding of the local market.

These attributes allow them to accumulate upcoming attractive land locations for development at relatively lower costs and be more effective than other players in these markets. The ongoing recovery in the real estate vertical has been primarily strong in tier-I cities such as Mumbai, Delhi, Bangalore and Chennai, while recovery has yet to gain momentum in tier-II and tier-III cities.

It is expected that city-centric players will outperform players with high concentration in tier-II and tier-III cities.

The sharp recovery in the residential vertical implies that consumers are fast regaining confidence to make big ticket purchases. Increasing consumer confidence bodes positively for other real estate verticals such as retail, which is a pure play on the domestic consumption. The demand outlook for commercial offices from IT companies is also improving, with indications of pick-up in hiring, by key IT companies. This trend will gain strength going into FY11.

There has been a sharp increase in launches in the residential vertical in 2009. As per Jones Lang LaSalle Meghraj (JLLM), while the total new launches in 1QFY10 across 7 key metro cities were ~24,400 units, it has been witnessed that ~42,458 units of new launches in 2QFY10. Tier-1 cities of Delhi and Mumbai alone accounted for almost 64% of the launches in 2QFY10.

A sharp pick-up in the residential vertical was driven by aggressive price cuts in the real estate sector led by industry leaders such as DLF, Unitech, HDIL and Lodha. Between July 2008 and March 2009, average prices in key tier-1 cities such as Mumbai and Delhi fell by almost ~20%.

Commercial Office

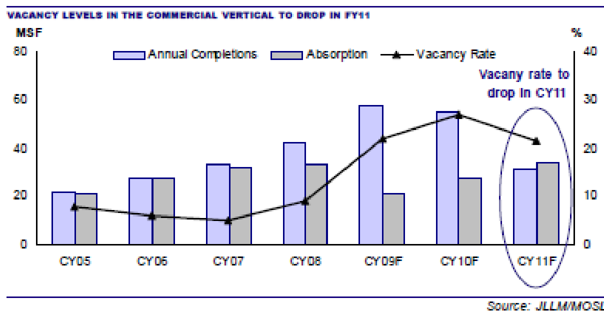
While recovery in the residential vertical has been very strong, recovery in other real estate verticals such as commercial and retail has been lagging. However, subtle signs of recovery are now visible in the commercial vertical. Key projects in Delhi and Mumbai have attracted enquiries over the past few months, largely from non-IT companies and for projects with a completion schedule of less than one year. Again, vacancy rates and rentals are no longer declining and seem to be bottoming out.

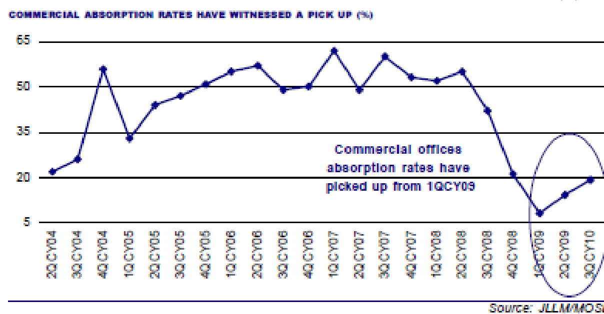
The vacancy levels and rentals are likely to reduce from 2011 onwards, due to the sharp supply curtailment as several key developers have put their commercial projects on hold. Jones Lang LaSalle Meghraj (JLLM) says about 57msf of commercial office space is likely to be operational by 2009, in the top seven cities. Vacancy levels are likely to drop to 20% in 2011 from ~24% currently.

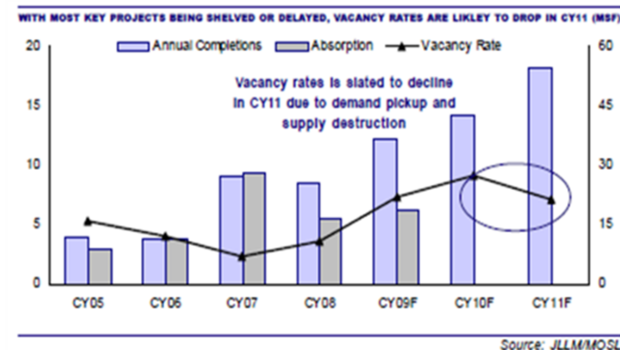
According to JLLM commercial office demand is likely to be driven by sectors like telecom, semi-conductors, autos, KPO, logistics and warehousing. Transaction volumes from non-IT companies have started picking up over the last three months mainly in metros such as Mumbai, Delhi and Bangalore; these metros accounted for ~60% of the absorption in 2QFY10.

Retail

The sharp recovery in the residential vertical implies consumers have regained the confidence to make high value purchase. This bodes positively for the other real estate verticals such as retail, which is highly dependent on consumer spending and consumer confidence.







As per JLLM, retail supply of ~12.6msf is likely to be delivered in CY09, of which, Delhi and Mumbai form ~70% or ~8.9msf. As several developers have altered their retail development plans to residential or mixed-use development, the demand-supply mismatch in 2010 is likely to reduce vacancy rates across key cities in 2011. The vacancy rate across cities is likely to decline to 22% in 2011.

Malls and Main Street rentals stabilize in most regions, but retail vacancy levels still high at 17.5% in 3Q2009, indicates the latest data released by Cushman & Wakefield (C&W). C&W expects, "Major retail markets in India are likely to witness the first rental upswings around mid-2011". Analysts believe pick-up in demand for retail space will lag the recovery in office/IT space (which is still 6-8 months out). However, stablizing rentals is a positive signal, and should help address high vacancy levels over next 12-15 months. To address vacancy concerns, developers are increasingly shifting to a minimum guarantee + revenue sharing arrangement to attract/retain tenants. It is expected that the recovery will be led by key cities like Mumbai, Delhi, Bangalore; and delays in likely supply would be a catalyst for a faster recovery.

Mall/Main Street rentals stabilize – Average retail rentals decline is decelerating, which is encouraging. Sequentially the rentals have fallen 2% in Q3, vs. 7% in Q2 and 13% in Q1. Although the average rentals have remained relatively flat QoQ, sector rentals are down 37% YoY for Main Street and ~26% for Malls in Q3.

New supply on the block – Although the retail segment has been feeling the heat and several developers have expressed a preference for residential expansion in the near-term, new supply entering the markets could still be seen in this quarter. Total supply in Q3 was 1.9 msf, up 16% QoQ. “Over 60% of the anticipated supply in the third quarter was delivered, a marked improvement from the previous months”, stated C&W.

There has been a marked improvement in sentiment in the residential segments as off take improves. The recovery in commercial and retail space is bound to follow slowly as the projects get reconfigured. The potential recovery in these segments is bound to be stretched into the next year.