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Investor Update
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India Notes

Against all consensus estimates industrial production rose by 10.4% YoY in August. On a seasonally-adjusted MoM basis, IIP was up 1.2% vs. -0.4% last month. Apart from a low base effect, trends were supported by: (1) double-digit growth across sectors, with mining up 12.9%, while manufacturing and electricity rose 10.2% and 10.6% respectively; (2) as per the use-based classification, consumer durables posted buoyant trends, on the back of festive demand and government stimulus measures.

The 2Q09 balance of payments (BoP) details show a smart rebound in foreign direct investment (FDI) inflows into India. Outbound FDI was weaker, thereby resulting in an even stronger upturn in net FDI. The jump in FDI is more important trend than the anticipated current account (CA) deficit in 2Q. Net FDI increased to US$6.8bn in 2Q, more than double the US$3.2bn in the prior quarter, and is already an impressive 39% of the full-year outcome for the last fiscal year. Inward FDI jumped to US$9.5bn (up from US$8.0bn in 1Q09), while outbound FDI declined to US$2.6bn from US$4.8bn over the same time.

On the global level there is increasing optimism that economies are likely to come out of recession post stimulus packages infused by the Governments. The inflows from the FIIs have been positive in the Indian capital market with net inflow of Rs729bn (USD 15 bn) YTD.

Overseas borrowing has more to pick up as Indian companies again start factoring in expectations of currency appreciation in their rupee cost of overseas borrowing. The rupee remains a structurally undervalued currency, and the ongoing pickup in capital inflows will increase the pressure for appreciation. Admittedly, shifting global risk appetite will cause volatility but the trend of rupee appreciation should still play out. Analyst's project INR/USD forecast of 46 and 43 for end-December 2009 and end-June 2010.

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Economy & Markets

Double-digit growth IIP

India's industrial sector is back and back with a vengeance. The 10.4% year-on-year rise in August was the first double-digit increase in output since October 2007 and compares with a bottom of -0.2% in December. On a seasonally adjusted basis, analysts calculations suggest that output rose 2.3% on the month and 5.9% in 3 month-on-3 month terms (25.9% annualised). The latter is India's strongest increase since at least mid-1994 and can only be termed a powerful V-shaped recovery.

Part of the improvement reflects stronger exports which were up a seasonally adjusted 13% in the 3 months to August relative to the previous 3 months, while domestic demand also remains robust according to the India manufacturing and services PMI series.

The breakdown of the August release by industry showed mining (12.9%), manufacturing (10.2%) and electricity (10.6%) all registering double-digit growth. By category, the real star was consumer durables, which expanded 22.3% on the year – the strongest rise since October 2001. Meanwhile, basic and intermediate goods were up 10% and 14.3% respectively, with capital goods production rising 8.3%. The last of these remains below the long-term average of 9.8% but is likely to continue trending higher as confidence in the durability of the recovery strengthens over time. Non-durable consumer goods were the only area to show a slowdown (to 3.7% from 5.8%).

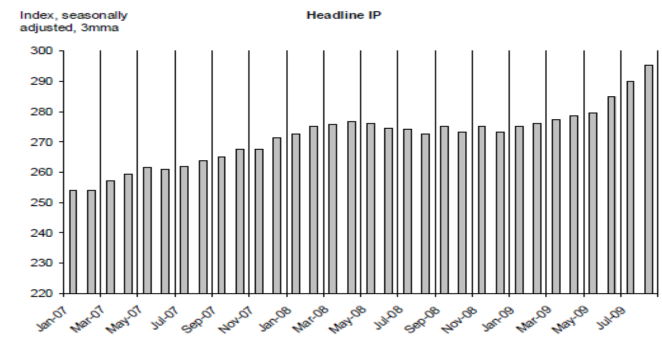
Inevitably the strength of the release will raise concerns that the Reserve Bank of India will move rates higher when it next meets on 27 October. In what has turned out to be a very public debate, it is obvious that while the RBI is thinking hard about the first rate rise, the Minister of Finance (and no doubt most of the government) is strongly against an early move. Analysts continue to expect the first Cash Reserve Ratio hike to come in early 2010, with policy interest rates increasing from the April to June quarter.

Industrial Production Index in a snapshot

	Aug-09	Jul-09	Jun-09	May-09	Apr-09
Headline IP - % yoy	10.4	7.2	8.2	2.1	1.1
Headline IP - % mom, sa	1.0	0.1	5.1	0.3	0.7
Capital goods IP - % yoy	8.3	1.7	13.3	-3.6	-5.9
Capital goods IP - % mom, sa	1.3	-5.0	15.7	1.7	-3.9
Consumer goods IP - % yoy	8.5	9.8	4.4	-1.1	-4.6
Consumer goods IP - % mom, sa	-2.2	3	4.4	1.5	-0.7

Source: Bloomberg, GS Global ECS Research.

The Industrial Production Index is stronger than pre-crisis levels



Source: Bloomberg, GS Global ECS Research.

Foreign direct investment posts a smart rebound

The latest balance of payments (BoP) details for calendar 2Q09 (also the first quarter of India's fiscal year that ends in March) show a huge positive trend that appears to be ignored: foreign direct investment (FDI) posted a handsome rebound in the quarter. Several commentaries on the BoP trends will again lament on the current account (CA) deficit, the main story in the latest quarterly BoP is the surge in FDI, both on inflows and on net (inflows minus outflows) basis.

Net FDI increased to US$6.8bn in 2Q, more than double the US$3.2bn in the prior quarter, and is already an impressive 39% of the full-year outcome for the last fiscal year. The pickup was due to higher inflows and lower outflows. Inward FDI jumped to US$9.5bn (up from US$8.0bn in 1Q09), while outbound FDI declined to US$2.6bn from US$4.8bn over the time. FDI to India was channelled mainly into manufacturing sector (19.2%), real estate activities (15.6%), financial services (15.4%), construction (12.2%) and business services (11.7%).

Mauritius continued to be the major source of FDI during 2Q09 with a share of 48.9% followed by the US at 12.8%.

Key implications of higher FDI

There are two important implications of this early rebound in FDI 1) It will add to the magnitude of capital inflows into India, which in turn should more than offset the CA deficit, and cause further pressure on the rupee to appreciate. Analysts have forecasted INR/USD in the range 46 and 43 for end-December 2009 and end-June 2010, respectively.

The INR has lagged other Asian currencies in its appreciation against USD. Admittedly, shifting global risk appetite will cause volatility but the broader trend of rupee appreciation should still play out. 2) It will improve the availability and flow of funds for investment activity. The financing for investment is already improving owing to multiple factors such as: (a) higher local bank lending; (b) an increase in equity-related financing; and (c) improving overseas borrowing by Indian companies.

As expectations of further rupee appreciation solidify and global credits markets open up, Indian companies will increasingly be in a position to tap international capital markets. Higher overseas borrowing will further complement other capital inflows into India, and increase the scope for further rupee appreciation.

Current Account Deficit should not be a concern

The issue of India’s current account (CA) deficits has always been a worry with investors. However, it is important to appreciate that India is a capital-starved economy, and its investment rate will exceed domestic saving rate if it has to engineer 7–8% annual GDP growth. The key issue from macroeconomic stability perspective is the size of the current account deficit and how it is funded. Indeed, with its high pace of economic growth, a large stock of foreign exchange reserves, India can manage a CA deficit of 2–3% of GDP without serious challenges.

The current account balance slipped into the red, posting a shortfall of US$5.8bn in 2Q09 after a surplus of US$4.7bn in 1Q09. The key reason for the wider deficit was a bigger shortfall on the trade account that was not offset by the surplus on the invisible balance (which includes software receipts and remittances from Indians working overseas). The slippage on the CA deficit was expected following the seasonal surplus in 1Q09.

Monsoon Update

Monsoon activity has seen a pick-up over the past month. Cumulative rainfall deficiency is now at 21% levels from 29% seen in mid-August. While the damage to summer crop sowing is already done, the improvement in rainfall is encouraging and bodes well for the winter crop, which accounts for ~50% of food-grain output.

Currency Markets

The Indian Rupee faces a surprisingly strong recovery especially during the festive season, as the world psychologically and economically recovers from the crisis. The surge in FII flows in the past week has been responsible for the sharp move in USD/INR. From the 16th of September, Indian Markets have averaged about Rs 1,800 cr of net FII equity investments on a daily basis. USD/INR was rather resilient during these phases of inflows, probably as some argue that there was RBI intervention at that juncture. But finally come October and analysts see USD/INR at sub-47 levels.

Model Real Estate (Regulation of Development) Act

A draft Model Real Estate (Regulation of Development) Act has been circulated among States by the Ministry of Housing & Urban Poverty Alleviation, as documented in press reports. The intention is to create a real estate regulatory authority that will monitor the sector. It is expected that such a move could improve sector transparency in the long run and protect buyers. However, the process of adapting to new regulations may be time consuming. Also, with realty being a State subject, it may be up to State governments to implement and enforce the proposals so it remains to be seen if and when the current proposals, or a watered-down version, are implemented.

Some key points of Model Act as per press reports:
1. Construction of apartments cannot be undertaken without registration with regulatory authority.
2. Promoters cannot advertise project before registration is completed i.e. we believe this could prevent soft launching and selling before approvals are granted.
3. Promoter has to furnish bank guarantee to competent authority, equal to 5% of estimated development cost.
4. No deposit or advance to be taken by Promoter without first entering into an agreement of sale.
5. Regulatory Authority will have all project information on its website
6. Buyers/prospective buyers to be provided with all details such as registration, title, names of sale agents etc.
7. Promoters to compensate buyers that have suffered loss/damage due to misleading advertisements.
8. Any defects brought to notice within two years from date of possession to be rectified by Promoter without charge to buyers.
9. If Promoter fails to give possession on time, will be liable to give refund of amounts already received, with interest/penalties.
10. Failure to comply with provisions of Act will attract penalties.

This proposed regulation is in the draft stage and has been published by the Ministry of Housing as a part of its 100 day agenda. The current draft has been made open to the opinion of people and industry bodies. After having taken the feedback of the people at large and the industry, this will be debated in the parliament and implemented as a law subject being passed by the majority of the voted representatives.

Is the worst over?

Fundamentals of the real estate sector are improving as seen by better liquidity and improved demand in the residential segment. Enhanced affordability, lower mortgage rates and better job security have helped revive demand for homes. The worst seems to be over and the sector is progressively recovering led by the residential segment. Key signs of improvement include: 1) Attractively priced new launches in the residential segment have seen good bookings with some projects being sold out within a few days of launch; 2) Improved balance sheets of developers through infusion of funds from QIPs and sale of nonstrategic assets.

While the residential segment is witnessing a recovery in demand, the office and retail segments are still sluggish and will take some time to recover as the economy gradually gets back on track. Last year's slowdown has caused several developers to rethink their strategies: 1) Focus has shifted to affordable/mid-income housing from luxury housing; 2) In commercial projects, several developers to manage liquidity are moving to 'sale model' rather than leasing space. Some developers are also converting commercial projects into residential, where possible; 3) Developers are exiting low visibility large township projects and are instead targeting strategically located land parcels in and around key cities; 4) Developers are delaying SEZ projects, especially IT SEZs, because of poor demand.

Fund raising transactions completed

Company	US$m	Mth-Yr	Promoter Holding		Comments
			Pre	Post	
QIPs					
Unitech QIP - 1	325	Apr-09	65%	51%	32% equity dilution factoring in both QIPs
Unitech QIP - 2	575	Jul-09	51%	44%	
Indiabulls Real Estate	550	May-09	26%	17%	36% equity dilution
HDIL	350	Jul-09	61%	48%	20% equity dilution
Sobha Developers	110	Jul-09	87%	65%	26% equity dilution
Orbit Corp	30	Aug-09	60%	50%	18% equity dilution
Ackruti City	60	Sep-09	90%	82%	8% equity dilution
Parsvnath Developers	34	Oct-09	80%	75%	7% equity dilution
Promoter Stake Sale					
DLF	770	May-09	89%	79%	Promoters sold 9.9% stake in DLF
Total	**2,803**				
Issue of Warrants to Promoters					
Unitech	230	Jun-09	44%	49%	9% equity dilution. 25% paid upfront and balance on conversion.
HDIL	130	Jul-09	48%	52%	7% equity dilution. 25% paid upfront and balance on conversion.
Anant Raj Industries	35	Jul-09	61%	57%	6% equity dilution. 25% paid upfront and balance on conversion.
Orbit Corp	15	Sep-09	50%	54%	8% equity dilution. 25% paid upfront and balance on conversion.
Ansal Properties	23	Sep-09	57%	63%	12% equity dilution. 25% paid upfront and balance on conversion.
Total	**432**				

Source: Company, Bloomberg, Antique

Revival of Residential demand

After seeing a sharp slowdown in demand in the latter half of 2008, residential demand began picking up from March-April 2009 on the back of better affordability and increased job security. Improved affordability has been a function of lower property prices, smaller apartment sizes and lower interest rates. Several new projects launched since March-April 2009, have seen good demand with many of the projects being sold out within a few days of launch. Demand in the current festive season will be an important indicator of recovery in the residential segment.

Residential prices have declined substantially

Property prices rose rapidly from 2005 to early 2008 and became a deterrent for home buyers resulting in a sharp slowdown in the residential demand. However, since end of 2008 and in early 2009, property prices began correcting and have declined up to 25–30% from their peak levels. This has helped bring back demand in the residential segment. The exceptions to this industry trends have been the cities of Mumbai and Delhi which have seen significant interest at lower prices. Developers have based on limited availability and the interest started raising prices of apartments again.

Focus on affordable housing

From 2005 to 2008, developers were largely concentrating on luxury residential projects. However, with rising property prices and home loan rates and large ticket sizes, residential property became out of reach for the large majority of homebuyers. With affordability adversely impacted, residential demand saw a significant slowdown. To bring back demand, developers shifted focus from luxury to affordable housing with the objective of reducing the overall cost of homes. This was achieved by launching new projects where in addition to lower prices per sq. ft., developers also offered smaller sized homes.

Commercial Space

Leasing in commercial space has not picked up significantly however as per channel checks there has been a significant increase in enquiries from corporate houses for commercial space. Current estimates still suggest that that though transaction activity is yet to pick up interest has risen on stronger business performance and pick up in hiring.

Retail Space

Retail space demand is currently slow with sales activity not having picked up significantly. Retailers are still in cautious mode before embarking on expansions due to cash flow concerns where expansion would mean additional stress on already stretched balance sheets. Retailers who are looking at expanding continue to negotiate revenue shares rather than fixed rate rentals. The festive season should be a crucial as pickup in sales activity should see a return of retailer confidence.

Performance of new launches

Developer	Project	City	Location	Launch Mth/Year	Base Price INR/sq.ft.	~Units launched	~Units sold
Unitech	Uniworld Gardens II	Gurgaon	Sector 47	Mar-09	2,995	800	Sold Out
Unitech	The Residences	Gurgaon	Sector 33	Apr-09	3,295	1,200	Sold Out
Unitech	Sunbreeze	Gurgaon	Sector 69	Aug-09	2,764	1,000	600
Unitech	North Town Ananda	Chennai	Perambur	Apr-09	3,000	504	Sold Out
Unitech	North Town Brahma	Chennai	Perambur	Apr-09	3,000	572	Sold Out
Unitech	Unihomes Phase I	Noida	Sector 117	Jun-09	2,895	900	Sold Out
Unitech	Unihomes Phase II	Noida	Sector 117	Aug-09	2,960	1,200	75% Sold
Unitech	Uniworld Gardens	Noida	Sector 117	Aug-09	3,395	168	50% Sold
Unitech	Unihomes - Plots	Gr Noida	Nr Pari Chwk	Aug-09	1,778	360	Almost Sold Out
Unitech	The Residences	Mumbai	Chembur	Apr-09	5,225	110	Sold Out
Unitech	Unihomes	Chennai	Nalambakam	Aug-09	1,845	425	70-75% Sold
Unitech	Unihomes Phase I	Mohali	Sector 105	Aug-09	1,978	45	Almost Sold Out
Unitech	Vistas	Kolkata	Rajarhat	Apr-09	2,745	252	170
Unitech	Unihomes	Kolkata	Kona Expr	Aug-09	2,190	104	30
DLF	Capital Greens - Phase I	Delhi	Shivaji Marg	Apr-09	4,500-5,500	1,389	Sold Out
DLF	Capital Greens - Phase II	Delhi	Shivaji Marg	Sep-09	6,250-7,500	1,250	Sold Out
DLF	West End Heights	Bangalore	Bannerghatta	Feb-09	1,850-2,000	800	Sold Out
HDIL	Premier Residences	Mumbai	Kurla	Mar-09	5,450	950	85% Sold
HDIL	Metropolis	Mumbai	Andheri	Mar-09	7,650	414	95% Sold
HDIL	Galaxy Apartments	Mumbai	Kurla	Apr-09	4,250	450	65% Sold
IBREL	Indiabulls Greens	Chennai	OMR	Nov-08	3,000	400	296
IBREL	Centrum Park Phase I	Gurgaon	Sector 103	Mar-09	1,950	192	Almost Sold Out
IBREL	Central Park	Indore	Swadeshi Mls	Feb-09	2,000	128	50% Sold
IBREL	Central Park	Ahmedabad	Himadri Mills	Feb-09	1,412	288	182
IBREL	Vatika	Ahmedabad	DudeshwarRd	Jul-09	1,725	200	80
Puravankara	Cosmo City PH 1	Chennai	NrSisureriITPark	Jan-09	1,720	518	Sold Out
Puravankara	Cosmo City PH 2	Chennai	NrSisureriITPark	Apr-09	1,820	530	>75% Sold
Puravankara	Welworth City	Bangalore	Doddaballapur	Aug-09	1,760	1,024	637
Emaar MGF	Emerald Floors	Gurgaon	Sector 65	Jun-09	2,400	900	Sold Out
BPTP	Park Elite Floors	Faridabad	Sector 85	May-09	1,240	1,000	Sold Out
Jaypee Group	Jaypee Greens Aman	Noida	Sector 151	May-09	2,100	3,000	Sold Out
Nahar Group	Laurel/Jonquille	Mumbai	Chandivali	May-09	5,500	704	Sold Out
Lodha Dev	Casa Bella	Mumbai	Dombivali	Mar-09	2,241	3,500	2,000

Source: Company, Business Standard, www.allcheckdeals.com, Antique

Recent project launches in the affordable/mid-income segment

Developer	Project	CityLocation	Min unit size (sq.ft.)	Base Price (Rs/sq.ft)	Min unit cost (Rs m)
Vatika	Iris, Emilia, Primrose	GurgaonSector 82	1,092	1,966	2.1
ILD	Spire Greens	GurgaonSector 37C	910	2,100	1.9
Orris	Carnation Residency	GurgaonSector 85	1,050	1,980	2.1
Unitech	Unihomes	NoidaSector 117	580	2,960	1.7
Jaypee Group	Jaypee Greens Aman	NoidaSector 151	850	2,100	1.8
Omaxe	New Heights	FaridabadSector 78	850	1,904	1.6
BPTP	Park Elite Floors	FaridabadSector 85	1,296	1,240	1.6
Unitech	The Residences	MumbaiChembur	673	5,225	3.5
Lodha Developers	Casa Bella	MumbaiDombivali	585	2241	1.3
Lodha Developers	Casa Royale	MumbaiThane	585	3735	2.2
IBREL	Indiabulls Greens	MumbaiPanvel	683	2200	1.5
Puravankara	Provident Welworth City	BangaloreDoddaballapur	845	1760	1.5
Nitesh Estates	Hyde Park	BangaloreBannerghatta Road	688	2290	1.6
Ajmera Group	Infinity	BangaloreElectronic City	820	2200	1.8
DLF	West End Heights	BangaloreBannerghatta Road	1,085	2000	2.2
Unitech	Unihomes	ChennaiNallambakkam	700	1,845	1.3
ETA Star	Rosedale	ChennaiOMR	789	2500	2.0
Puravankara	Provident Cosmo City	ChennaiNear Sisureri IT Park	848	1820	1.5
Unitech	Unihomes	KolkataKona Expressway	800	2190	1.8
Srijan Group	Srijan Midlands	KolkataJessore Road	824	1700	1.4
Eden Group	Eden Exotica	KolkataOff EM Bypass	876	2400	2.1
DLF	The Summit	HyderabadGachibowli	1,185	2000	2.4
Indu Projects	Indu Skies	HyderabadShamshabad	882	2100	1.9

Source: Company, www.allcheckdeals.com, Antique