

# STRATEGY

## Patience is virtue

India Equity Research | Strategy

Currently, the global scenario is quite grim as growth falters across developing and developed countries and the European debt crisis spreads to core economies. We argue that such a scenario should lead to fall in commodity prices with or without QE3. This should augur well for commodity importing countries like India where we think the growth mix could improve in FY13 as investments pick up. Based on our macro-economic assessment, key themes to play are peaking out of the domestic rate cycle, moderation in consumption growth and a slowdown in global economy. We are thus moving rate sensitive cyclicals to equal weight while trimming our overweight positions in consumers and pharma.

### Global economy: Anxiety abound

Global economy continues to tread an uncertain trajectory with growth faltering in developed economies. The single biggest risk emanates from the Euro zone where leaders remain divided and the ECB dormant. In US too, the political stalemate is adding uncertainty to the already existing weak growth dynamics. Consequently, while the risk aversion could hurt capital flows into EMs, this scenario could also mean a mixed blessing for EMs as commodity prices might come off.

### Indian economy: Growth below trend but mix improving

The outlook for the domestic economy should start improving as inflation eases, interest rates peak out and early signs of investment improvement emerge. The much needed growth rebalancing in favour of investment could begin from FY13 onwards. Notably, the consumption growth is already decelerating and may moderate further as the lagged effect of the past monetary tightening cycle plays out. Meanwhile, elevated crude prices and an impending slowdown in exports would mean a below trend growth in FY12 and FY13.

### Indian markets: better placed than peers

Importantly, a lot of the macro concerns have already been priced in to valuations. On P/B and P/E (both relative and absolute), India is below the five year average. Other valuation indicators such as the Composite Indicator and the Shiller's PE also point at a relative degree of comfort. Earnings downgrades in India YTD has been steeper than its EM peers. Also India's lower export dependency makes it less susceptible to a slowdown in global growth.

### Sectors to play: Turning E/W on rate cyclicals, trimming defensives

Based on our macro-economic assessment, key themes to play are peaking out of the domestic rate cycle, moderation of consumption growth and a slowdown in global economy. Accordingly, we move rate cyclicals such as BFSI, auto and cap goods to equal weight while trimming our over-weight positions in consumers and pharma. Based on our assessment of downside risks to global economy, we move IT sector to an underweight position while maintaining our underweight stance for metals sector.

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### Global economy

The global economy continues to tread an uncertain trajectory. Growth in US continues to falter with most macro-economic indicators pointing to a prolonged period of weakness. Europe suffers a growth crisis of its own, further crippled by lack of political will to rein in the debt crisis. In this scenario, it becomes difficult to envisage a period of sustained global growth. Export oriented countries would be particularly hit while growth concerns will dominate inflation concerns globally. We explore key themes below:

#### US Economy: Growth drivers impaired

Growth remains tepid with monthly indicators such as PMI, consumer confidence, housing index and labour market pointing to a period of sustained weakness in coming months. Worryingly, the reason behind the stalled US economy is quite structural in nature. Consumers are trying to deleverage (given the high debt levels on their balance sheets) while corporates are opting to sit on mounting cash piles (instead of investing), leading to a decline in aggregate demand. In such a scenario, normally, fiscal policy would provide the support to demand as it promptly did during the 2008 recession. However, this time around, due to deep political polarization and high levels of fiscal deficit and government debts, fiscal policy has limited room left to support growth. Moreover, the overtly accommodative monetary policy which played an important role in reviving economic activity is also losing traction after successive rounds of QE.

In the absence of policy support (both fiscal and monetary) with growth drivers remaining impaired, prospects of the US economy look weak. Even though recent statements by the Fed do not rule out QE-3 completely, we do not perceive it highly significant in an already faltering real economy.

#### Europe: A divided union poses dominant risk to global financial stability

Growth in Europe too continues to remain under pressure. Weak growth dynamics, so far contained to the periphery, is spreading to the core of Europe including Germany and France whereas the debt contagion is affecting larger economies such as Spain and Italy as well. However, even amid such a crisis, EU leaders continue to play discordant notes. The ECB is showing reluctance to play the lender of last resort while lender countries are losing appetite for further bail-outs in the middle of the mounting opposition domestically. With majority of the population in creditor nations opposed to bail-outs, politicians are unable to commit steps required to resolve the issues. It is thus disturbing to note that European issues are becoming more political in nature than economic. Given the challenges faced by various stake holders, European debt crisis poses a dominant threat to the stability of Europe and the world at large.

#### Lower global growth to suppress commodity prices

A downturn in developed world implies that export-oriented economies in the emerging world would be particularly hit. The silver lining though could be the associated fall in commodity prices as global growth projections get revised downwards. However, there are concerns that if Fed announces QE-3, commodity prices would run up again. We do not share these concerns and in our view, commodity prices will remain under check owing to the following reasons:

- **QE2 was not really successful:** The run up in commodity prices post the announcement of QE2 was based on the reasoning that it would spur economic growth and accordingly growth expectations began to get revised upwards. However, from Q1CY12 onwards, these growth expectations were retraced as it became clear that QE2 has limited

impact on the real economic growth. Even if QE-3 were to come on board, markets bearing the QE-2 experience would be more cautious in assigning higher growth expectations. As such, we do not think commodity prices would flare up again.

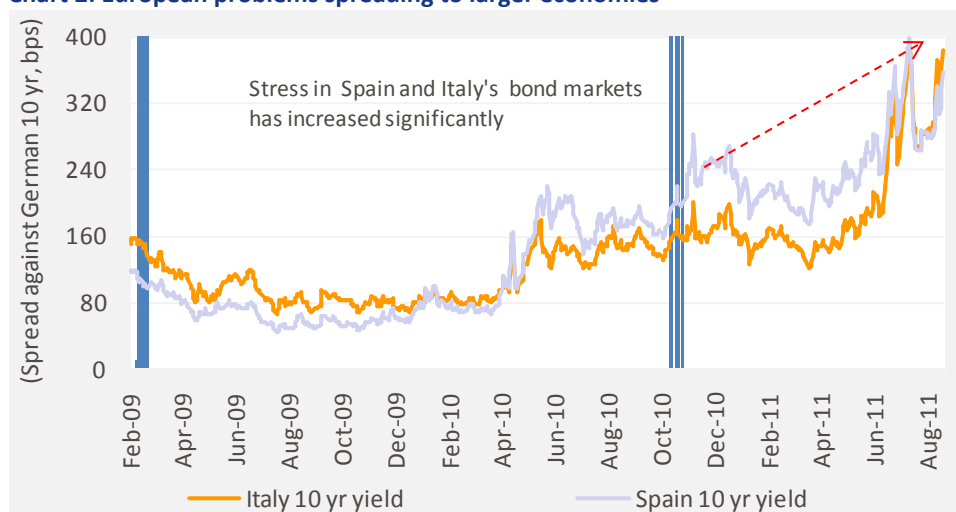
**Chart 1: A sharp markdown in US growth forecasts portrays QE2 as a failure**



Source: Bloomberg, Edelweiss research

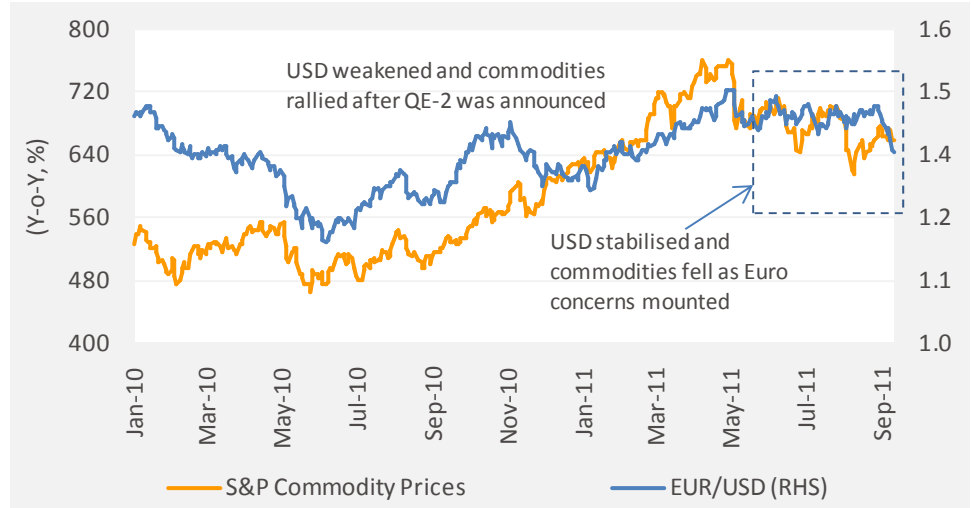
- European problems growing in proportion:** Given the dynamics of the European crisis, it looks unlikely that it would be resolved in the coming months. This would sustain pressure on the Euro while the concomitant risk aversion (arising out of any flare up in debt crisis) would keep the USD buoyant. This upward bias in the US dollar would have a softening impact on commodity prices. Notably, European debt concerns have escalated significantly compared to the period when QE2 was announced (Aug 10) with the crisis now spreading to large European countries of Italy and Spain.

**Chart 2: European problems spreading to larger economies**



Source: Bloomberg, Edelweiss research

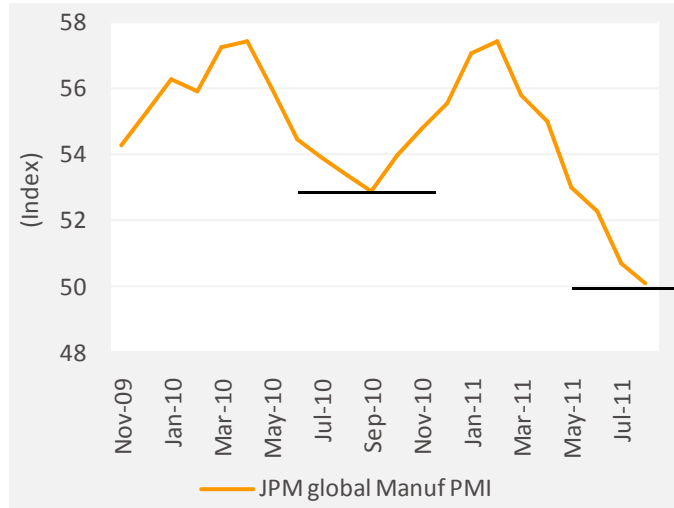
**Chart 3: Euro debt concerns may keep USD stable despite QE3**



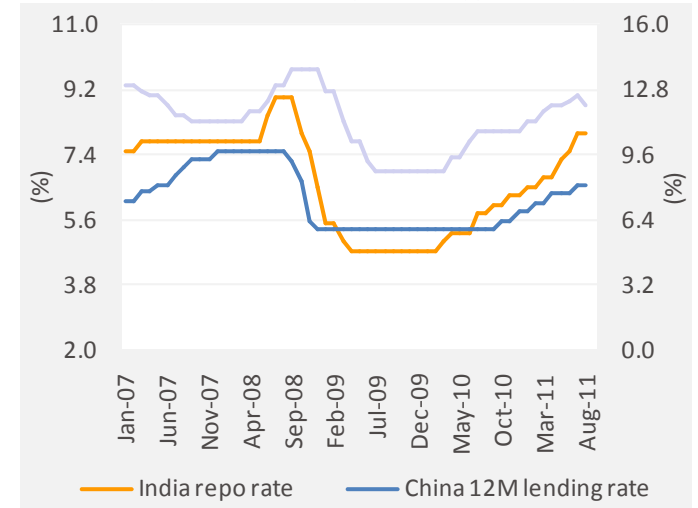
Source: Bloomberg, Edelweiss research

- Economic slowdown pronounced and broad-based:** The current global slowdown is quite pronounced as emerging economies - the main growth engine in recent years - are also showing signs of weakness. One of the main reasons is the aggressive tightening by EMs' central banks to curb inflation. In this backdrop of broad based weakness in global growth, it is quite unlikely that commodity prices would run up again even in the event of QE3. Notably, one of the reasons behind the increase in commodity prices post QE-2 was the strong growth in EMs which is unlikely in the current environment.

**Chart 4: Economic slowdown much more pronounced this time**



**Chart 5: EM policy rates also tightened aggressively**



Source: Bloomberg, Edelweiss research

In a nutshell, we believe that global economy would remain weak in the coming months and accordingly, commodity prices would continue to soften.

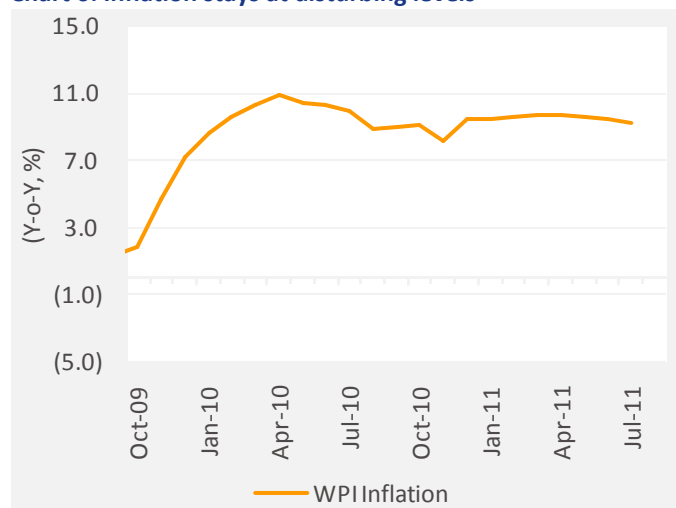
### What does it mean for India?

Softening in the commodity prices would augur well for the import dependent countries like India as it could bring about a meaningful drop in the inflation rates. While domestic growth would continue to remain below the trend, growth mix is expected to get better in FY13 as investments pickup. This pick up would happen as the inflation eases, interest rates are cut, policy momentum picks up and government. paves way for the private investment by continuing on path of fiscal retrenchment.

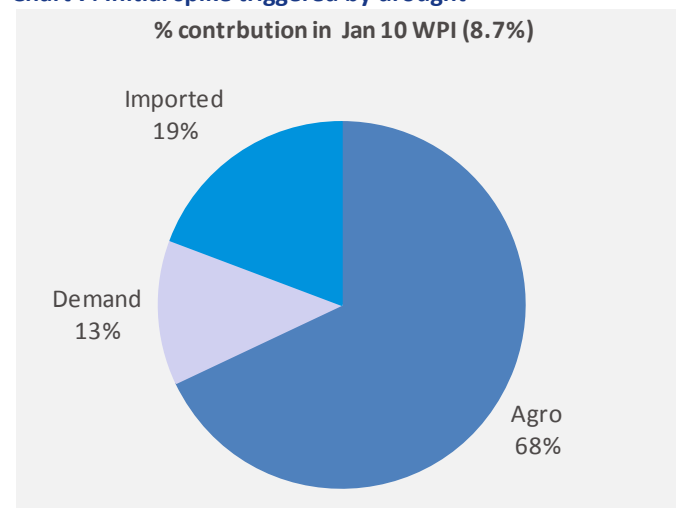
### Inflation: Main drivers easing

Inflation has continued to remain at elevated levels since the previous year. While the drivers of inflation have continued to evolve, its absolute level has remained disturbing. We explain the changing drivers of inflation via our rearranged basket of WPI inflation into agro, imported and demand related. While the initial bout of the inflation was triggered by higher contribution of agro inflation, post Aug'10 and after the initial indication of QE2, the primary driver was imported inflation. In recent months, spill over to demand inflation along with imported inflation has been the main reasons behind inflation.

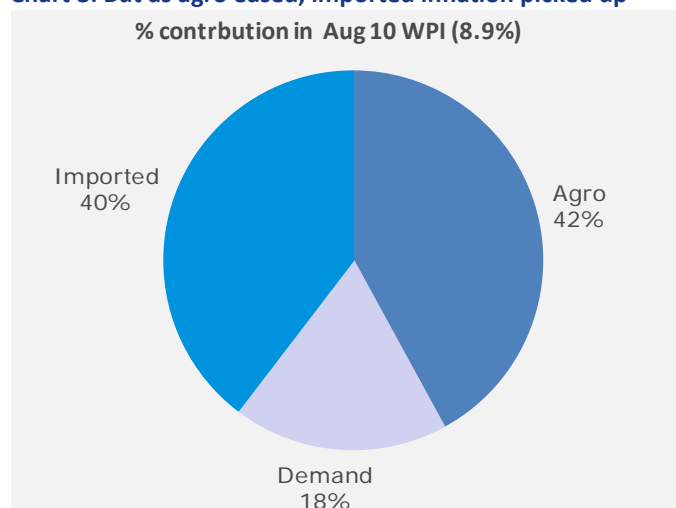
**Chart 6: Inflation stays at disturbing levels**



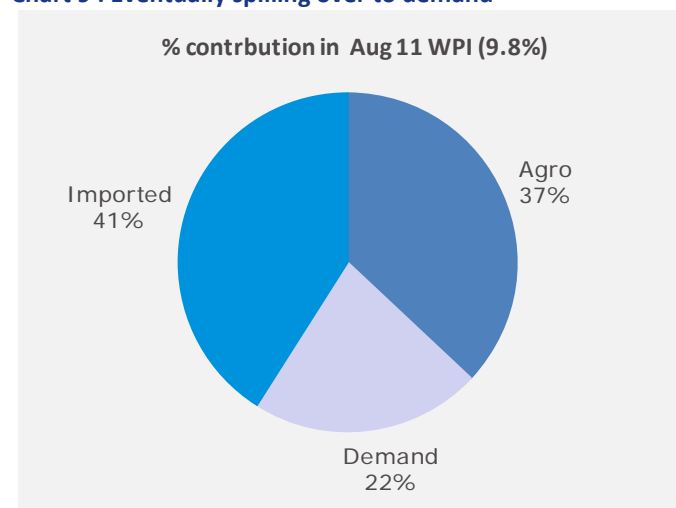
**Chart 7: Initial spike triggered by drought**



**Chart 8: But as agro eased, imported inflation picked up**



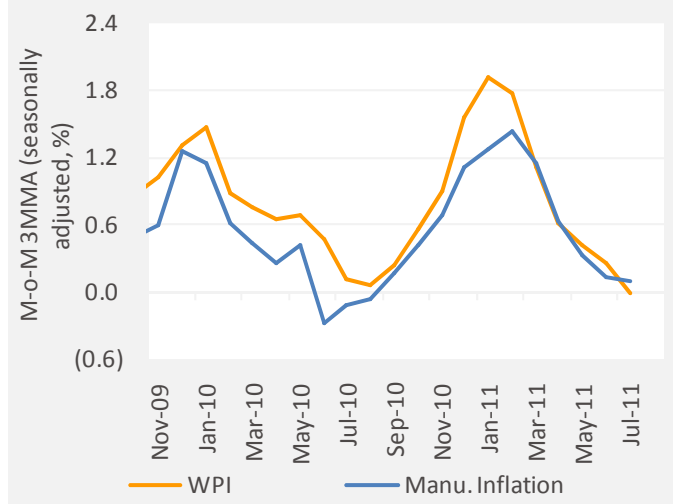
**Chart 9: Eventually spilling over to demand**



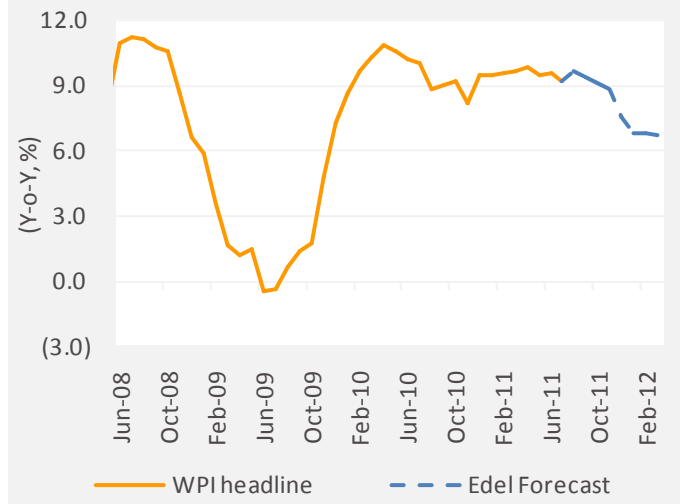
Source: CMIE, Edelweiss research

Going forward, we expect major drivers of inflation to subside as global commodity prices soften and demand pressures in the economy cool off as the lagged effect of the aggressive monetary tightening plays out. Moreover, the sequential momentum of inflation has been softening for some months now. This - in addition to the base effect, favourable in 2H of FY12 – would mean that inflation may moderate to ~7% by March 12.

**Chart 10: Notably, sequential momentum is easing**



**Chart 11: 2H to see substantial easing in Inflation**

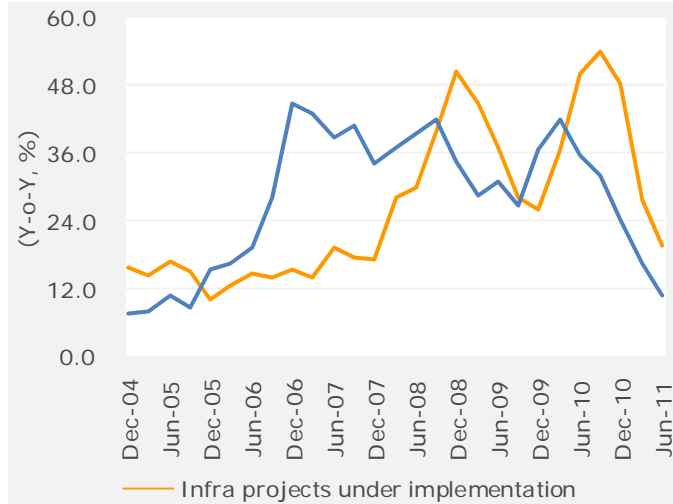


Source: CMIE, Edelweiss research

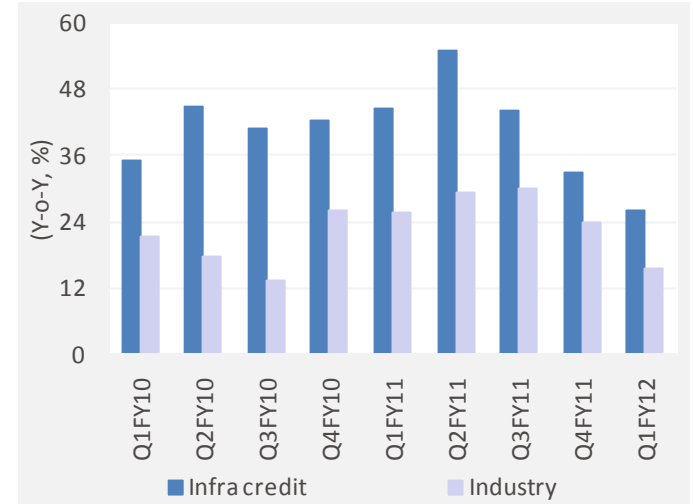
**Investments: Expect gradual improvements by late FY12**

So far, investment cycle has been muted as evidenced from the steep fall in the infra and capex projects under implementation. Further, the decline in credit growth to the infra sector also corroborates the sluggish pace of fixed capital formation in the economy. Higher interest rates and input prices and slow pace of projects approvals are the key reasons contributing to the investment weakness in the economy. Importantly, our lead indicator (EELII) and the PMI are hinting at this trend that would sustain for two more quarters.

**Chart 12: Scale back in infra and capex projects...**

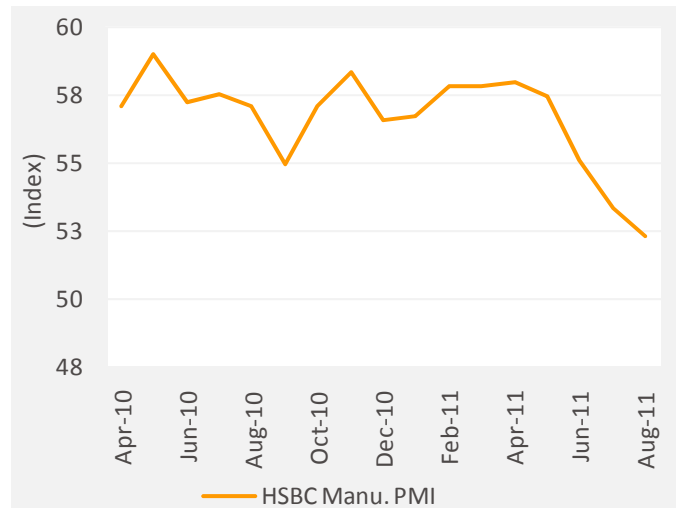


**Chart 13: ... mirrored in credit growth as well**

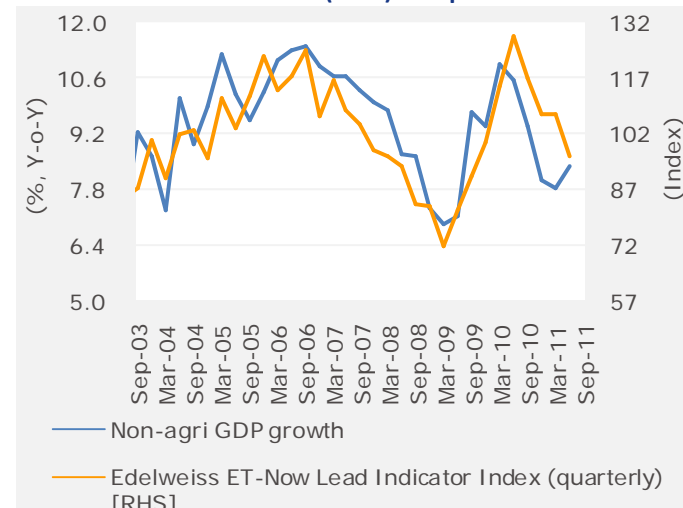


Source: CMIE, Edelweiss research

**Chart 14: PMI shows this trend to continue for some time**



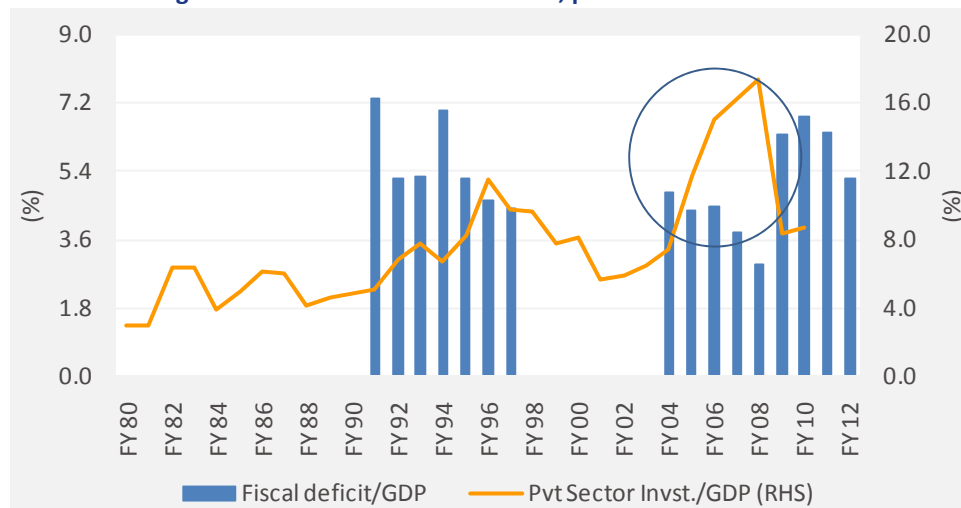
**Chart 15: Our lead indicator (EELII) also points to the same**



Source: CMIE, Edelweiss research

While the investment is expected to remain weak for better part of FY12, factors contributing to the investment weakness should start alleviating in H2 FY12 on the back of peaking out of policy rates once inflation begins to come off. Further, the government approval process is also expected to gain momentum (as seen by recent policy actions like introduction of Land Acquisition Bill, FDI approvals, fuel price hike and a pick-up in NHAI project awards). These factors combined with the gradual fiscal retrenchment carried out by the government will most likely create a conducive environment for a pick up in private investments. Notably, as shown in the chart below, fiscal retrenchment in India is closely related to a boost in private investment as it gets an added impetus from any cutback in government expenses.

**Chart 16: Strong correlation between fiscal deficit, pvt. investments**



Source: CMIE, Edelweiss research

**Fiscal deficit: A gradual retrenchment**

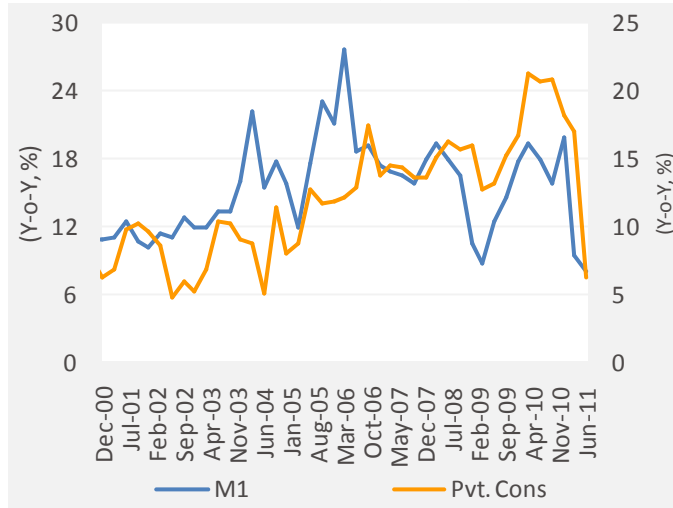
We expect the government to carry the gradual fiscal retrenchment process forward. Accordingly, we expect the fiscal deficit for FY12 to be ~5.2% of GDP compared to ~6.3% (ex-3G) in FY11. Further, we expect the fiscal deficit in FY13 to be much lower than FY12 as:

- Subsidy burden in FY13 is unlikely to rise significantly. On the contrary, it may fall. Even in the likelihood of high crude prices, the growth in oil subsidy could be minimal. Proposed changes in the subsidy regime for urea (awaiting Cabinet nod) and softer commodity prices would lead to lower subsidy burden in fertilizers.
- In FY13, the expected nominal GDP growth is ~14%-15% which will ensure a reasonable revenue growth in contrast to minimal growth in subsidy, leading to lower fiscal deficit in FY13.
- The government remains committed to fiscal consolidation under the FRBM Act. While the FY13 deficit may still overshoot the FRBM target (~4.1% GDP), it would still be lower than the FY12 deficit.
- This gradual fiscal retrenchment would make way for a fresh boost to private investments in coming months.

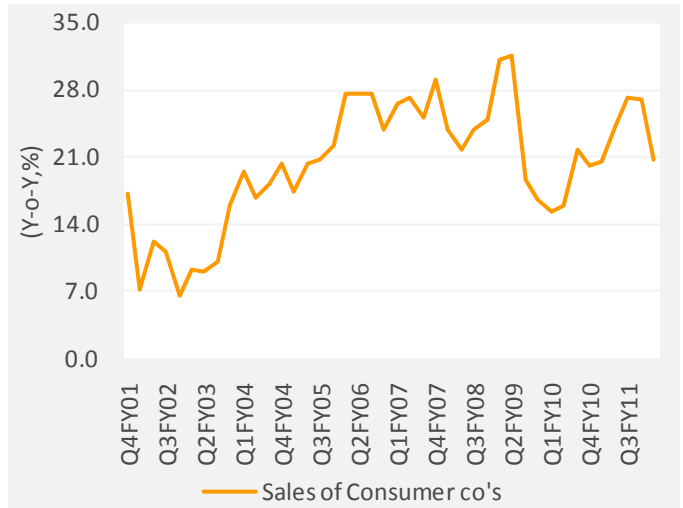
**Consumption: Period of strength behind us**

Consumption meanwhile is moderating owing to the on-going monetary tightening in the economy as evidenced from the deceleration of topline growth of consumer companies, a visible decline in M1 which has foreshadowed consumption growth and a declining momentum in auto sales data. Any discernable uptick in consumption would only be visible post a pause in monetary tightening, while the fiscal consolidation process by the government would also keep consumption growth in check.

**Chart 17: Slowdown visible through falling M1**



**Chart 18: Top line of consumer companies also decline**



Source: CMIE, Edelweiss research

Chart 19: Declining sales in interest rate sensitive sectors...

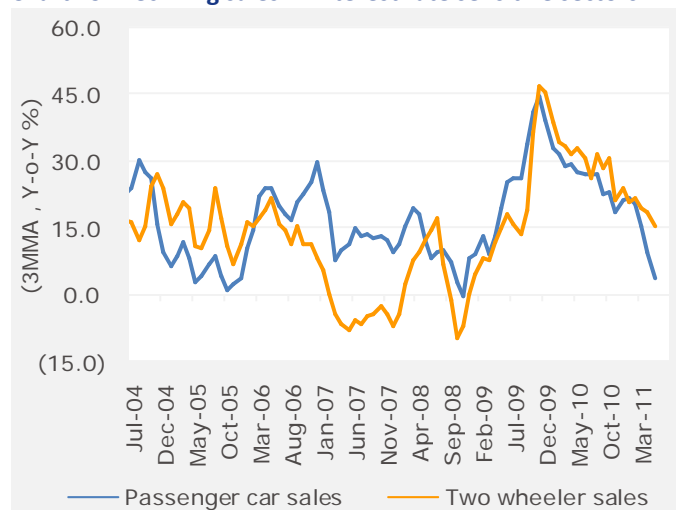
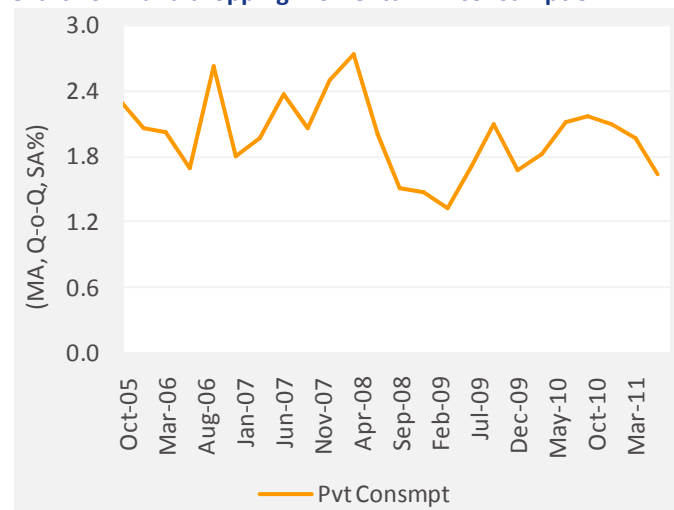


Chart 20: ... and dropping momentum in consumption



Source: CMIE, Edelweiss research

**External Sector: Global weakness to hurt exports**

Currently, the growth in exports has been buoyant as seen by an increase in exports as a proportion of GDP. However, export growth is expected to moderate as global economy weakens. Further, the expected softening of commodity prices would lead to a slowdown in exports as presently ~50% of the growth is due to commodities exports, possibly reflecting increase the price.

Chart 21: Exports as % of GDP at historic levels

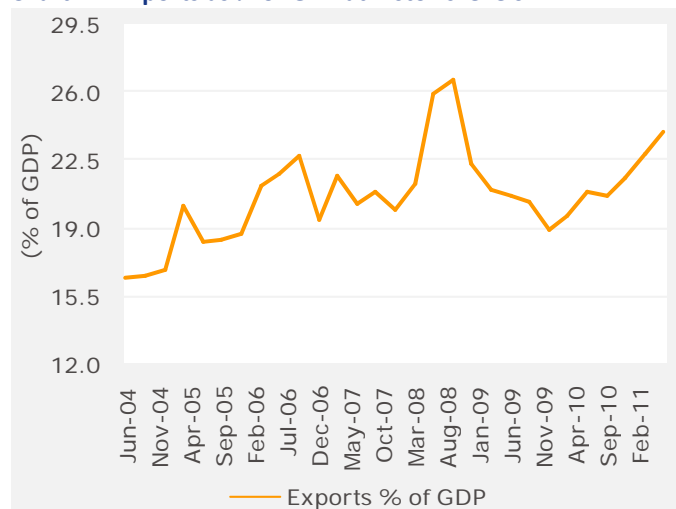
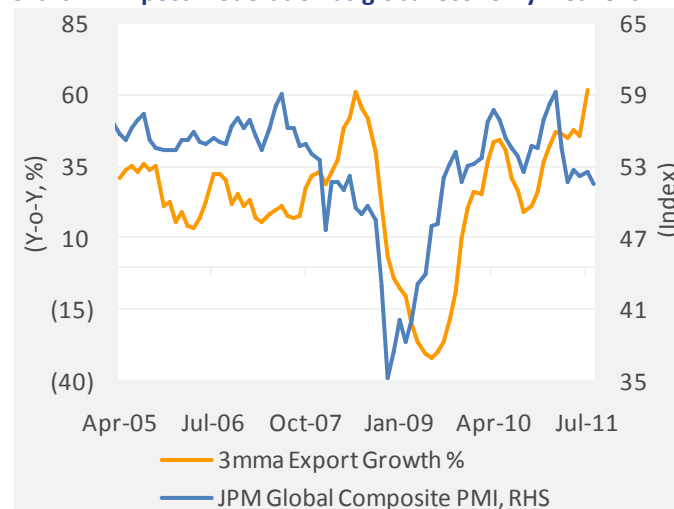


Chart 22: Expect moderation as global economy weakens



Source: CMIE, Edelweiss research

**Table 1: Softening commodity prices to affect exports**

Contribution to Y-o-Y exports	Oct-10	Nov-10	Dec-10	Feb-11	Apr-11
Exports, YoY	19.4	35.0	55.2	49.6	34.7
Commodity-based products*	9.0	26.3	26.5	24.5	17.8
Manufactured products	5.9	7.5	23.9	14.2	4.3
Petroleum and crude products	4.6	1.3	4.8	10.9	12.6

~50% of exports growth explained by commodities; possibly reflecting price rise

Source: CMIE, Edelweiss research

Overall, we argue that while the GDP growth in India for FY13 would remain below trend and not significantly better than FY12, its mix is improving with the investment growth improving. This augurs well for inflation and medium term growth prospects, leading to the creation of additional capacities and alleviation of supply side constraints in the economy. Such a pick-up in investment, as argued earlier, would be due to continued fiscal retrenchment, likely monetary policy easing in FY13 and supportive policy momentum.

**Fig. 1: Growth Outlook: Macro mix improving**

	FY11	FY12	FY13
Fiscal deficit	* High ~6.3%	Consolidating ~5.2%	Continued retrenchment
Investment	* Weak	Weak	Pick up
Consumption	* Strong	Moderating	Moderating
Inflation	* High	Peaking out	Contained
Monetary Policy	* Gradual tightening	Aggressive tightening	Monetary easing
Policy momentum	* Stalled	Early signs of pick-up	Supportive
GDP growth	* ~8.6%	~7.60%	~7.70%

**Key risk to the outlook**

**European debt problems are growing in proportion:** EU leaders continue to play discordant notes even as European debt crisis spreads to larger economies. This lack of coordination poses the biggest threat to the stability of Europe and therefore to the global financial system.

**Crude oil prices have been sticky:** Persistently high crude prices would undermine the fiscal consolidation process. It also jeopardizes the inflation outlook and current account deficit.

**Govt policy momentum:** If the govt approval/reform process remains sluggish, we are unlikely to see a turnaround in investment anytime soon

### Markets

The Sensex has corrected by about 21% YTD and about 10% since August alone. Macro economic headwinds such as high inflation, lack of momentum in government policy and higher interest rates have dented market sentiments this year. Earnings estimates have also seen sharp cuts resulting in lack of positive traction on valuations as well. Owing to this correction, valuations, both on a relative as well as absolute basis have begun to look attractive.

#### Relative valuations beginning to look attractive

On a relative basis, India's valuations are beginning to look attractive. The premium which India commands over EM universe on the book multiple has dipped to 1.5x from 1.7x from the beginning of CY11, and is substantially below its trailing five year average of 1.76x. On a relative earnings multiple as well, India is no longer expensive as compared to peers. With respect to both the EMs and developed markets, the relative premium which India commands is below the five year average.

Chart 23: India's relative P/B below 5-Yr avg.

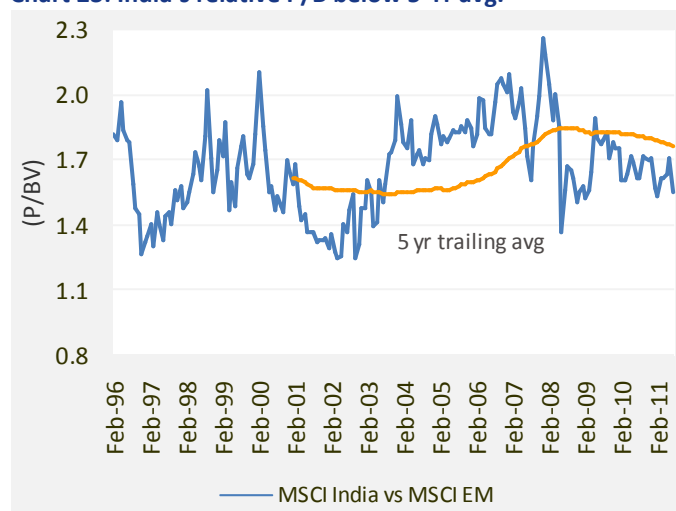


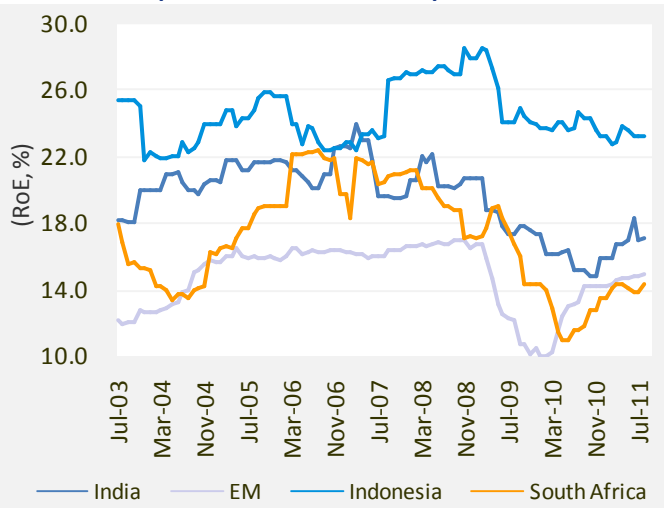
Chart 24: On a relative P/E, India not expensive either



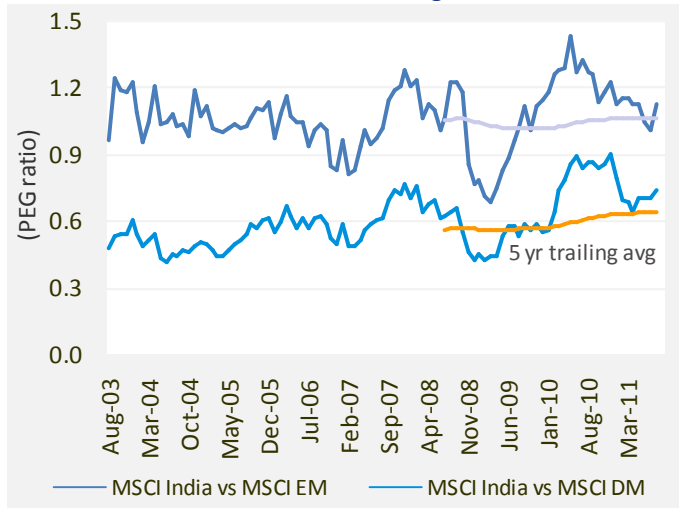
Source: Bloomberg, Edelweiss research

Historically, too, India has enjoyed a premium on valuation multiples over other EMs, driven by factors such as a structurally higher RoEs. On an average India clocked an average RoE of ~20% before FY08 as compared to a corresponding 15% for the EM peer set. However post the crisis, this advantage faded away leading to mild erosion in the valuation premium. However over the last two quarters, we have seen some uptick in India's RoE relative to EMs. Meanwhile on the PEG ratio, the premium which India commands with respect to EM and developed world peers is slightly higher than the long term average. However, we also draw comfort from the fact that, globally in a scenario of growth scarce environment, countries such as India will continue to command premium valuations.

**Chart 25: ROE profile better than most peers**



**Chart 26: PEG ratio to be favourable in growth score scenario**

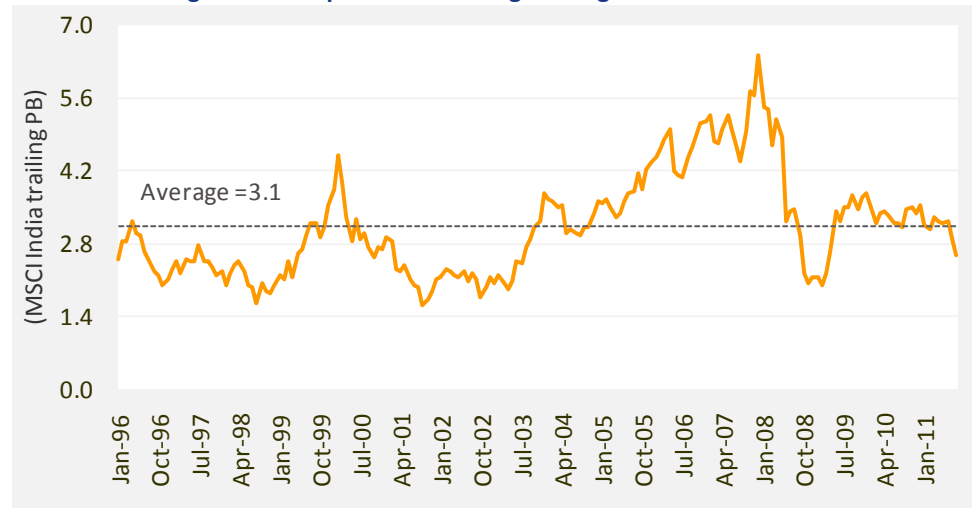


Source: Bloomberg, Edelweiss research

**Absolute valuations turn inexpensive**

Given the sharp correction in markets, valuations now provide a fair degree of comfort. Compared to its own history as well, India's valuations appear inexpensive. On the trailing book, India is trading at 2.6x, which is the lowest since April 2009 and far below the long term average of 3.1x.

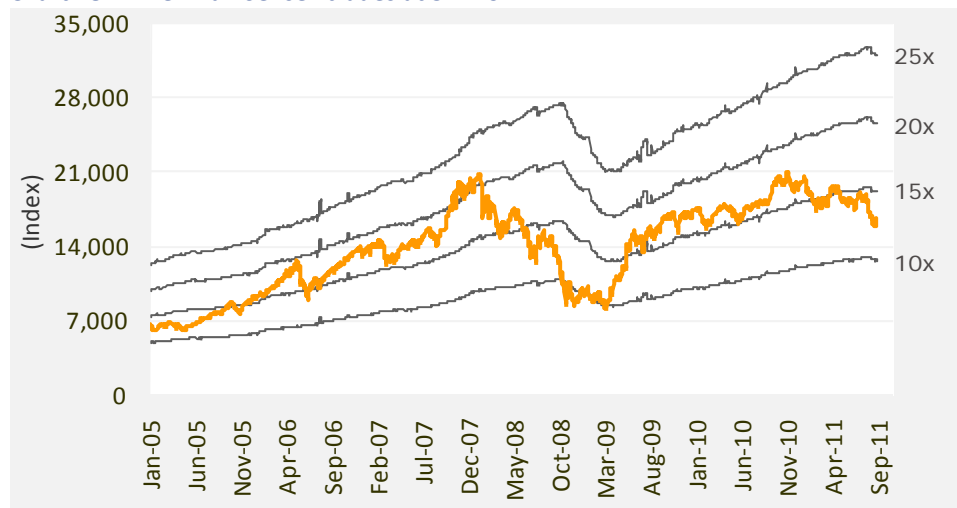
**Chart 27: Trailing book multiple below its long run avg.**



Source: Bloomberg, Edelweiss research

On the forward PE multiple, India, at 13.2x, is trading at close to five year lows, save the immediate period after the Lehman bankruptcy.

**Chart 28: Ex-Lehman Sensex trades at 5 Yr low**



Source: Bloomberg, Factset, Edelweiss research

We also conducted a scenario analysis to gauge the effect of earnings downgrades on valuations. Interestingly, the exercise reveals that despite the 6%-7% cut in FY12 and FY13 estimates seen in this year, the market has the ability to withstand another round of downgrades without becoming seemingly expensive. Even if the earnings were to decline by 5% to 10%, markets at current levels would be trading at 14.0-14.50x forward earnings, in-line with the long term average.

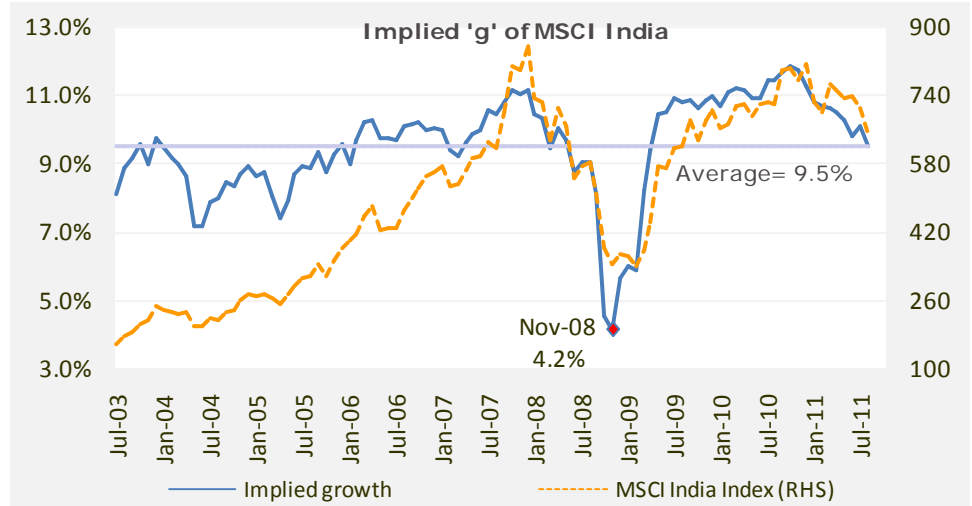
**Table 2: Scenario analysis suggests a relative degree of comfort**

PE		Forward 12 months' EPS						
		-15%	-10%	-5%	Current level	5%	10%	15%
Price	-15%	13.0	12.3	11.6	11.1	10.5	10.1	9.6
	-10%	13.8	13.0	12.3	11.8	11.1	10.6	10.2
	-5%	14.5	13.7	13.0	12.4	11.8	11.2	10.7
	Current level	15.5	14.6	13.8	13.2	12.5	12.0	11.4
	5%	16.1	15.2	14.4	13.7	13.0	12.4	11.9
	10%	16.8	15.9	15.1	14.4	13.6	13.0	12.4
	15%	17.6	16.6	15.7	15.0	14.2	13.6	13.0

Source: Bloomberg, Edelweiss research

Some of the other valuation indicators also point to a relative degree of comfort. Towards Q3FY11, stock markets were pricing in an implied growth rate of ~11.0%, one of the highest in the decade. Given the regime of high and volatile input costs, such an assumption seemed aggressive and the market was clearly ignoring the risks of further earnings downgrade. However, post the recent correction, the implied growth expectations have fallen off steadily and at current levels of 9.2% it is in-line with the decadal average.

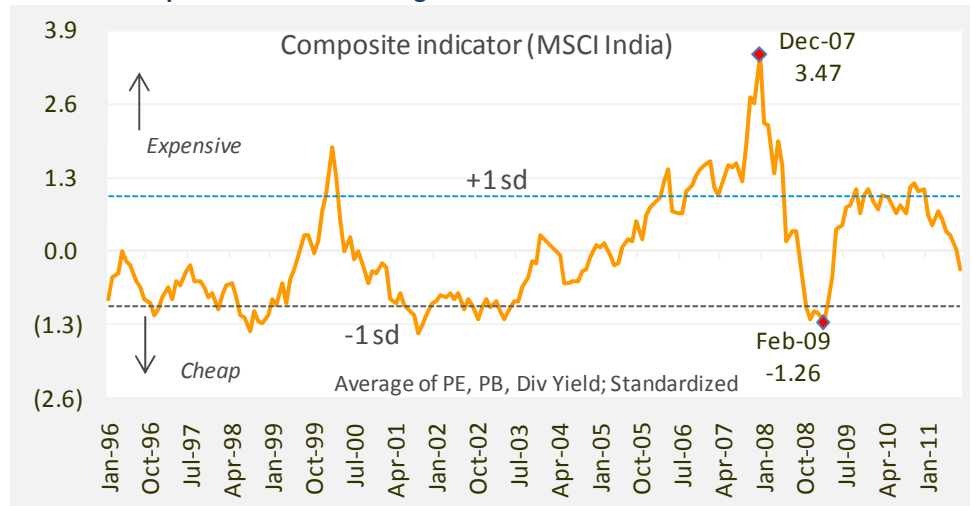
**Chart 29: Growth expectation coming off**



Source: Bloomberg, Edelweiss research

Our composite indicator - a standardized average of PE, PB and div yield - is also beginning to turn down. At current levels, it is implying that equities are at their cheapest levels since the crisis in FY09 and significantly off the fairly valued zone observed in Aug 2010. On a cross-asset reference as well, equities are beginning to look inexpensive in comparison to bonds.

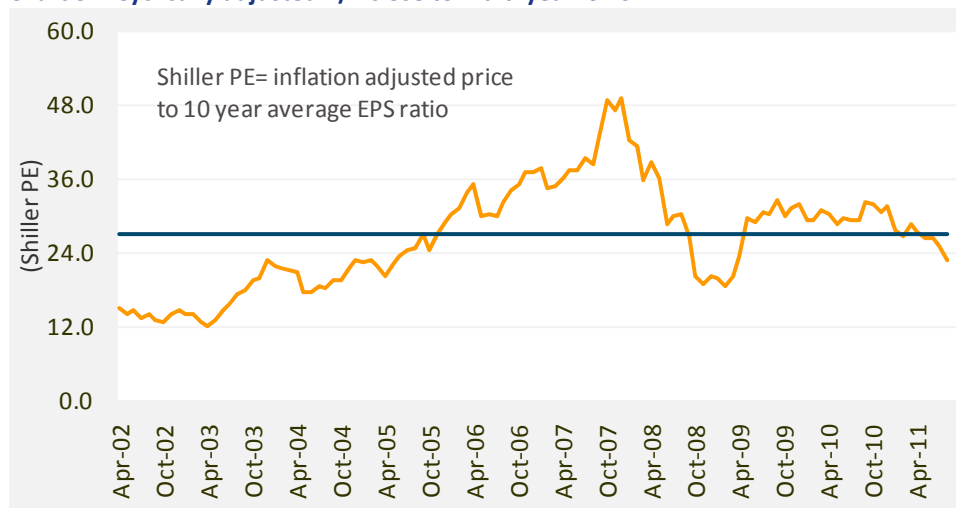
**Chart 30: Composite indicator turning down**



Source: Bloomberg, Edelweiss research

Meanwhile, Shiller's PE (inflation adjusted price to 10 year average EPS ratio) has dipped well below its average levels (current Shiller PE of 23x as compared to long term average of 27x). Overall, while we may not have seen the trough in valuations, incrementally narrowing premiums on valuation metrics do offer a relative degree of comfort.

**Chart 31: Cyclically adjusted P/E close to multi year lows**



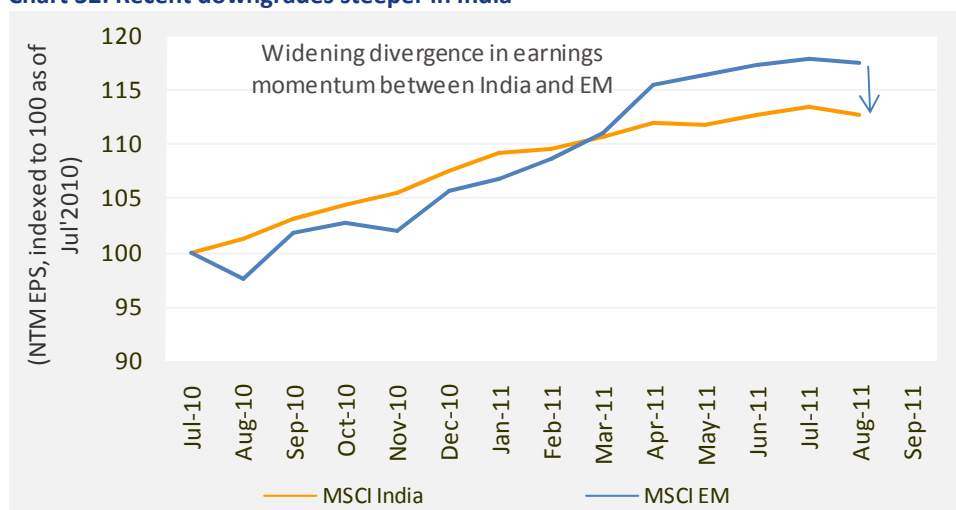
Source: BSE, Robert Shiller

**Earnings momentum - India already ahead in downgrades**

The recent downgrade cycle in India has been steeper than that of peers - FY12 and FY13 earnings estimates continued to be revised downwards since the beginning of this year while the revisions ratio (upgrades-downgrades) has remained decisively weak since May. Consensus estimates for Sensex EPS for FY12 and FY13 stand at INR 1190 and INR 1370 respectively and are down 6%-7% since the beginning of this year, mainly on back of rising input costs and increasing margin headwinds.

This is in contrast to that of the EM universe where earnings downgrades have been milder. On the forward earnings basis, there is a clear divergence between the momentum in India and EMs. While India's earnings momentum continues to decelerate June onwards, earnings momentum of EMs still remains stable.

**Chart 32: Recent downgrades steeper in India**

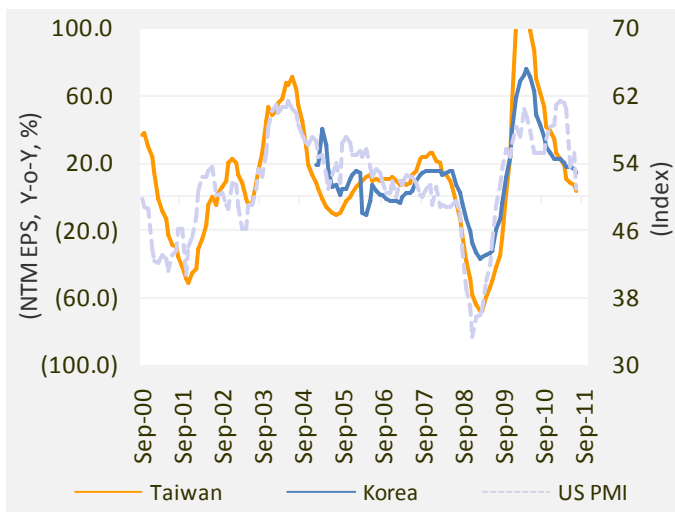


Source: Bloomberg, Edelweiss research

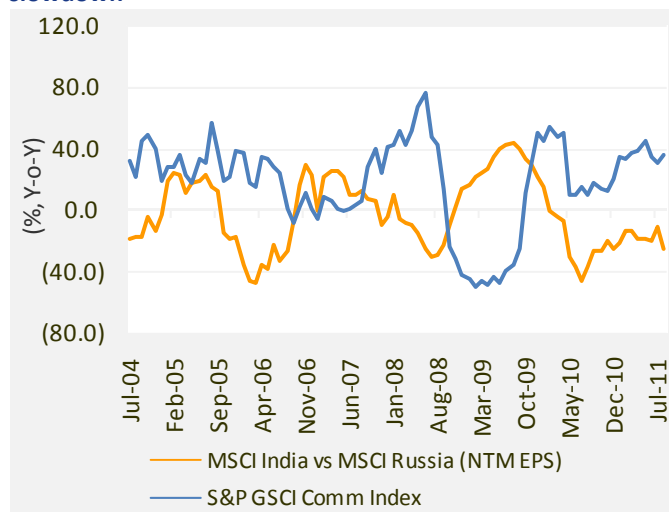
However, as we have observed in the past, it is during times of global slowdown that India's earnings trajectory is less susceptible than EMs. Not only the export oriented peers (e.g.

South Korea and Taiwan) but also the commodity exporting countries (e.g. Russia) are susceptible to global growth slowdown. With growth projections being revised downwards, we expect the earnings revisions for EMs to be retract. In such a scenario, India could emerge as a relative outperformer on the basis of its earnings strength, making it an attractive destination for FII flows away from export oriented peers.

**Chart 33: Export oriented peers ...**



**Chart 34: ...and commodity exporters susceptible to slowdown**



Source: Bloomberg, Edelweiss research

### What to play?

Given the macro-economic concerns, in our August strategy update, we had highlighted that the relative risk-reward ratio remained heavily stacked in favor of defensive sectors with inflation-growth dynamics still being unfavorable for rate sensitive sectors. However, given our revised macro economic outlook, we are moving rate cyclical sectors such as BFSI, auto and cap goods to an equal weight position. We still maintain our bullish stance on defensives though we are trimming our overweight positions in consumers and pharma, expecting consumption growth to moderate from current levels. Based on our assessment of downside risks to global economy, we move IT sector to an underweight position while maintaining our underweight stance for metals sector. Meanwhile, we continue to favor telecom as we believe tariff hikes and cost rationalization will continue to support margin expansion. In balance, based on our macro economic assessment, key themes to focus on are:

- Peaking out of domestic rate cycle (moving BFSI, auto and cap goods to neutral weight)
- Moderation in consumption growth (reducing OW positions in consumers and pharma)
- Slowdown in global growth (UW on global plays such as materials and IT)

**Peaking out of domestic rate cycle:** So far, rising borrowing costs have acted as a significant headwind to business sentiments. This is evident from the fact that RBI has tightened its key policy rate by 400 bps since March last year. This has resulted in interest coverage ratio for India Inc (at 6.5x in Q1FY12) to drop to its lowest since the financial crisis. However, with the rate cycle close to peaking out, we believe that rate cyclicals will incrementally stand to benefit. As we have seen in the previous cycle as well, even a flattening interest rate trajectory is conducive for rate cyclical sectors to outperform. We are thus moving BFSI, autos and cap goods to neutral weight from under weight.

**Moderation in consumption growth:** We believe that the period of strength for consumption growth is behind us. The momentum in private consumption has begun to wane off and we are also witnessing initial signs of discretionary spending moderating. Sector valuations have also begun to look rich. On a forward earnings basis, consumer staples trades at a premium to 1.9x to the market which is way above the historical average of 1.4x. The pharma sector has outperformed the Sensex by 10% in CY11 so far. The sector is trading at 40% premium to the market, higher than the historical range of 15%-20%. Although any multiple expansion remains capped due to a slowdown in earnings momentum, we believe that pharma will continue to enjoy its 'safe-haven' status. Accordingly, we are trimming our overweight positions in consumers and pharma.

**Slowdown in global growth:** Global growth dynamics are turning extremely weak. One of the sectors to be the most affected is the metals sectors which could undergo a significant de-rating if global growth falters. IT sector too could face headwinds from slower topline growth. While rupee depreciation could provide some respite it is unlikely to offset the slowdown in topline growth arising out of sharp downward revisions to IT budgets.

## Top picks

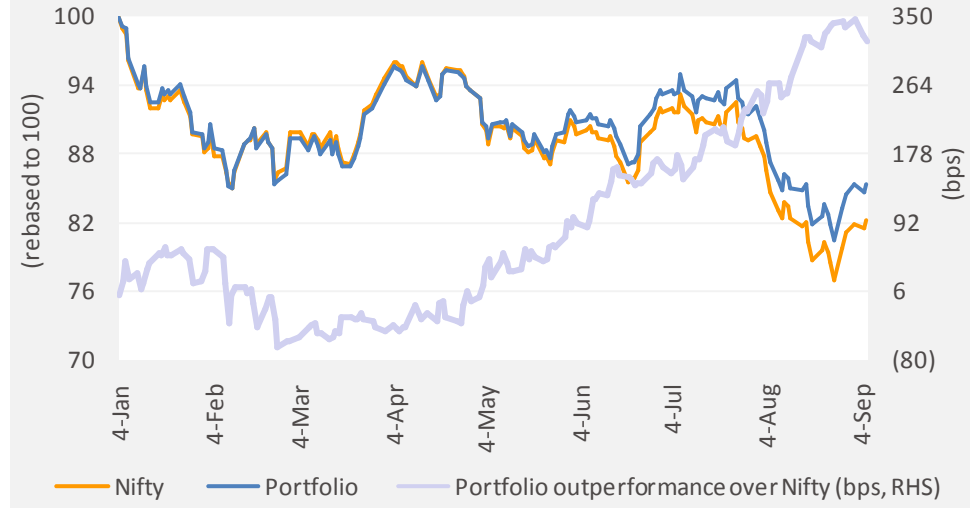
	Current market cap	CMP	P/E (x)		P/B (x)		ROE (%)		Div yield (%) FY12E
	USD bn		INR	FY12E	FY13E	FY12E	FY13E	FY12E	
<b>Large-caps</b>									
RIL	55.9	806	11.2	10.3	1.5	1.4	14.4	14.1	1.0
Coal India	50.5	378	13.7	12.0	5.2	3.9	43.7	37.2	1.4
Bharti Airtel	31.0	386	17.8	12.6	2.7	2.2	15.9	19.1	0.3
L&T	21.3	1,645	19.9	16.2	3.4	2.9	18.7	19.7	1.0
ICICI Bank	21.1	862	16.1	13.3	1.7	1.5	10.7	12.0	1.5
M&M	10.2	783	16.7	14.2	3.9	3.2	25.5	24.8	1.5
Bajaj Auto	9.6	1,573	14.5	12.1	6.8	5.2	54.0	48.7	2.5
Power Grid Corp	9.2	94	15.6	13.8	1.8	1.7	12.2	12.7	1.6
HCL Tech	5.5	378	12.3	10.2	2.5	2.1	23.2	23.2	1.2
Zee TV	2.4	118	18.7	15.7	3.3	2.9	18.9	19.7	1.6
<b>Mid-caps</b>									
LIC HF	2.1	208	9.1	7.5	2.0	1.6	23.7	23.8	2.1
Crompton Greaves	2.0	146	14.6	11.2	2.5	2.1	18.3	20.6	1.0
Coromandel Int	1.8	294	12.0	9.4	3.4	2.7	31.6	32.4	2.4
Federal Bank	1.3	367	9.3	8.0	1.1	1.0	12.5	13.2	1.8
Pantaloon	1.3	275	24.1	17.4	1.7	1.6	7.3	9.4	0.5
Havell	0.9	342	11.8	9.7	4.4	3.1	44.8	37.8	1.3
Supreme Industries	0.6	210	13.1	9.7	3.9	3.1	33.0	36.0	2.4
Sadbhav Engineering	0.4	135	6.2	5.5	2.6	2.1	22.4	20.8	0.4
Gateway Distriparks	0.3	140	13.4	10.3	2.0	1.8	15.5	18.1	2.9
PI Industries	0.3	600	15.4	10.7	4.2	3.1	34.3	33.2	0.4

## Model portfolio

Stocks	Mkt Cap (USD bn)	Price (INR)	Portfolio wt (%)	Nifty wt (%)	Rel wt (bps)	P/E (x) FY12E	P/E (x) FY13E	P/B (x) FY12E	P/B (x) FY13E	RoE (%) FY12E	RoE (%) FY13E	Div Yld (%) FY12E
<b>Telecommunication Services</b>			<b>6.0</b>	<b>3.5</b>	<b>250</b>							
Bharti Airtel Ltd	31.0	386	4.1	3.1	100	17.8	12.6	2.7	2.2	15.9	19.1	0.3
Idea Cellular Ltd	6.9	99	1.0	0.0	100	34.7	21.8	2.5	2.2	7.5	10.7	0.0
Reliance Communications Ltd	3.5	80	0.9	0.4	50	13.1	10.7	0.4	0.4	3.2	3.8	0.5
<b>Consumers</b>			<b>11.0</b>	<b>9.5</b>	<b>150</b>							
ITC Ltd	32.3	196	7.1	7.1	0	24.6	20.8	8.5	7.5	36.3	38.7	2.6
Hindustan Unilever Ltd	15.8	346	2.4	2.4	0	31.6	26.6	21.9	17.8	77.2	73.8	2.1
Zee Entertainment Enterprises Ltd	2.4	118	0.7	0.0	70	18.7	15.7	3.3	2.9	18.9	19.7	1.6
Pantaloon Retail India Ltd	1.3	275	0.8	0.0	80	24.1	17.4	1.7	1.6	7.3	9.4	0.5
<b>Health Care</b>			<b>5.3</b>	<b>4.0</b>	<b>130</b>							
Dr Reddy's Laboratories Ltd	5.2	1,454	2.7	1.2	150	20.2	16.1	4.6	3.6	34.7	29.3	1.0
Cipla Ltd	5.0	291	1.0	1.0	0	20.1	16.5	3.1	2.7	16.4	17.6	1.1
Torrent Pharmaceuticals Ltd	1.1	598	1.5	0.0	150	14.4	11.1	3.8	3.0	29.8	30.4	1.2
<b>Energy</b>			<b>15.1</b>	<b>14.0</b>	<b>110</b>							
Reliance Industries Ltd	55.9	806	9.2	9.2	0	11.2	10.3	1.5	1.4	14.4	14.1	1.0
Coal India Ltd	50.5	378	3.6	0.0	360	13.7	12.0	5.2	3.9	43.7	37.2	1.4
Oil & Natural Gas Corp Ltd	47.3	261	2.4	2.4	0	8.5	7.3	1.7	1.5	21.4	21.8	3.9
<b>BFSI</b>			<b>26.4</b>	<b>26.4</b>	<b>0</b>							
State Bank of India	25.1	1,863	2.3	3.2	-90	9.9	8.5	1.6	1.4	17.4	17.7	2.4
HDFC Bank Ltd	23.2	469	5.7	5.7	0	22.4	18.0	3.8	3.2	17.9	19.3	0.8
ICICI Bank Ltd	21.1	862	7.7	6.7	100	16.1	13.3	1.7	1.5	10.7	12.0	1.5
Housing Development Finance Corp	20.4	654	5.8	5.8	0	23.4	20.7	4.8	3.9	22.1	21.0	1.3
Axis Bank Ltd	9.2	1,052	2.8	1.8	100	10.8	9.1	1.9	1.6	19.3	19.6	1.5
LIC Housing Finance Ltd	2.1	208	1.0	0.0	100	9.1	7.5	2.0	1.6	23.7	23.8	2.1
Federal Bank Ltd	1.3	367	1.0	0.0	100	9.3	8.0	1.1	1.0	12.5	13.2	1.8
<b>Industrials</b>			<b>8.7</b>	<b>8.7</b>	<b>0</b>							
Larsen & Toubro Ltd	21.3	1,645	5.9	5.9	0	19.9	16.2	3.4	2.9	18.7	19.7	1.0
Bharat Heavy Electricals Ltd	17.7	1,710	0.7	1.8	-110	13.2	11.6	3.4	2.8	28.4	26.3	2.1
Crompton Greaves Ltd	2.0	146	0.5	0.0	50	14.6	11.2	2.5	2.1	18.3	20.6	1.0
Havells India Ltd	0.9	342	0.6	0.0	60	11.8	9.7	4.4	3.1	44.8	37.8	1.3
Sadbhav Engineering Ltd	0.4	135	0.5	0.0	50	6.2	5.5	2.6	2.1	22.4	20.8	0.4
Gateway Distriparks Ltd	0.3	140	0.6	0.0	60	13.4	10.3	2.0	1.8	15.5	18.1	2.9
<b>Autos</b>			<b>8.0</b>	<b>8.0</b>	<b>0</b>							
Mahindra & Mahindra Ltd	10.2	783	3.2	2.4	80	16.7	14.2	3.9	3.2	25.5	24.8	1.5
Bajaj Auto Ltd	9.6	1,573	2.1	1.4	70	14.5	12.1	6.8	5.2	54.0	48.7	2.5
Tata Motors Ltd	9.2	146	1.7	1.7	0	9.9	6.4	2.1	1.6	23.7	29.9	1.9
Maruti Suzuki India Ltd	6.5	1,068	1.0	1.0	0	13.4	12.1	1.9	1.7	15.4	15.0	0.7
<b>Utilities</b>			<b>4.1</b>	<b>4.1</b>	<b>0</b>							
NTPC Ltd	28.3	162	1.4	1.4	0	14.2	12.9	1.8	1.7	13.3	13.6	2.5
Power Grid Corp of India Ltd	9.2	94	1.3	0.9	40	15.6	13.8	1.8	1.7	12.2	12.7	1.6
Tata Power Co Ltd	5.0	995	1.4	1.1	30	12.1	12.3	1.6	1.5	13.8	12.3	1.7
<b>Information Technology</b>			<b>10.5</b>	<b>12.2</b>	<b>-170</b>							
Tata Consultancy Services Ltd	40.9	986	3.4	3.4	0	18.2	15.9	5.9	4.7	36.5	33.0	1.4
Infosys Ltd	26.7	2,198	6.1	7.1	-100	16.1	13.7	4.1	3.4	27.6	27.2	1.9
HCL Technologies Ltd	5.5	378	1.0	0.6	40	12.3	10.2	2.5	2.1	23.2	23.2	1.2
<b>Metals &amp; Materials</b>			<b>4.9</b>	<b>6.8</b>	<b>-190</b>							
Tata Steel Ltd	9.2	455	2.0	2.0	0	8.2	5.9	1.1	1.0	13.5	16.8	3.2
Sterlite Industries	8.9	125	1.2	1.2	0	6.4	4.8	0.9	0.8	14.8	16.9	0.7
Coromandel International Ltd	1.8	294	0.6	0.0	60	12.0	9.4	3.4	2.7	31.6	32.4	2.4
Supreme Industries	0.6	210	0.6	0.0	60	13.1	9.7	3.9	3.1	33.0	36.0	2.4
PI Industries Ltd	0.3	600	0.6	0.0	60	15.4	10.7	4.2	3.1	34.3	33.2	0.4
<b>Cement</b>			<b>0.0</b>	<b>2.3</b>	<b>-230</b>							
<b>Real Estate</b>			<b>0.0</b>	<b>0.5</b>	<b>-50</b>							
<b>Model Portfolio</b>	<b>571</b>		<b>100</b>	<b>100</b>	<b>0</b>	<b>14.0</b>	<b>11.6</b>	<b>2.5</b>	<b>2.1</b>	<b>17.6</b>	<b>18.4</b>	

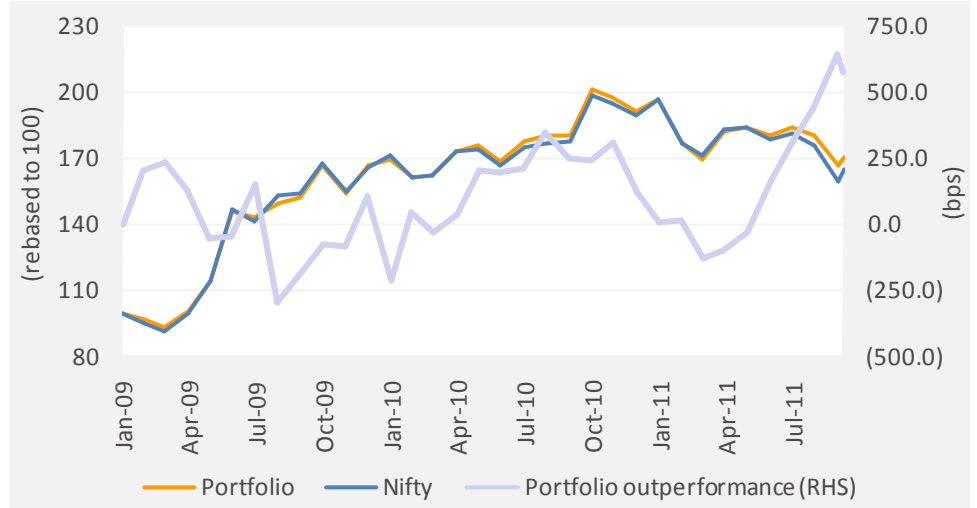
**Performance of model portfolio**

**Our model portfolio has outperformed Nifty by 300 bps for CY11**



Source: Bloomberg, Edelweiss research

**Since inception it has outperformed Nifty by 570 bps**



Source: Bloomberg, Edelweiss research

Note: Data for above chart on a monthly basis

**Note: The data for all charts is updated as of 12<sup>th</sup> Sep, 2011**

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