Strategy | INDIA

2011 Outlook

Prabhat Awasthi +91 22 4037 4180 prabhat.awasthi@nomura.com
Nipun Prem +91 22 4037 5030 nipun.prem@nomura.com

NOMURA
NOMURA FINANCIAL ADVISORY AND SECURITIES (INDIA) PRIVATE LIMITED

TOP DOWN

ANCHOR REPORT

Under the weather

We reckon that 2011F will be a year of below-average returns for Indian equities. Market performance is likely to be shaped by a macroeconomic environment punctuated by wage pressures, rising commodity prices, return of inflationary pressures, tight liquidity (in the first half, at least), slowing growth momentum, a hesitant recovery in the investment cycle, below-average earnings growth, downward sticky interest rates, tighter monetary policy and somewhat muted government expenditure — all this in the backdrop of strong domestic consumption and below-trend global economic growth. We favour a defensive bias when approaching sectors for next year. We recommend a relative Underweight stance on rate cyclicals, construction and cement, and a relative Overweight stance on consumer, pharma, power, oil & gas, metals and IT services. Our top BUY calls for next year are Mahindra & Mahindra, Pantaloons, Tata Steel and Cairn. Our top REDUCE calls are Ambuja Cements and HPCL.

① **See a year of below-average returns**

② **Liquidity squeeze and slowing growth momentum**

③ **Inflation déjà vu**

④ **A subpar recovery of the investment cycle**

⑤ **Earnings — potential disappointment to consensus expectations**

⑥ **Sector stance — take a defensive stance**

Nomura Anchor Reports examine the key themes and value drivers that underpin our sector views and stock recommendations for the next 6 to 12 months.

Stocks for action

Our top BUY calls are MM and PF, as consumption and rural demand plays, and TATA and CAIR, for their exposure to global commodity prices. ACEM and HPCL are our top REDUCE calls.

Stock	Rating	Price (INR)	PT
M&M (MM IN)	BUY	789	892*
Pantaloon (PF IN)	BUY	389.5	553
TATA Steel (TATA IN)	BUY	624	846
Cairn India (CAIR IN)	BUY	327	370*
Ambuja Cements (ACEM IN)	REDUCE	137.9	113
Hindustan Petroleum Corp (HPCL IN)	REDUCE	410.2	270

Pricing as of 8 December, 2010; * PT under review

Analysts

Prabhat Awasthi
+91 22 4037 4180
prabhat.awasthi@nomura.com

Nipun Prem
+91 22 4037 5030
nipun.prem@nomura.com

And the India Research Team

Don't miss our companion outlook reports on Asia and Global Economics, published 6 December 2010.

Any authors named on this report are research analysts unless otherwise indicated.
See the important disclosures and analyst certifications on pages 113 to 116.

Strategy | INDIA
2011 Outlook

Prabhat Awasthi +91 22 4037 4180 prabhat.awasthi@nomura.com
Nipun Prem +91 22 4037 5030 nipun.prem@nomura.com

NOMURA
NOMURA FINANCIAL ADVISORY AND SECURITIES (INDIA) PRIVATE LIMITED

TOP DOWN

Action

We expect 2011 to be a year of below-average returns for the market and set our December 2011 Sensex target at 22,100, implying a potential return of around 12%. We see downside risk to the 20% y-y earnings growth in FY12F now being priced in by consensus. We believe this, combined with a likely tightening of the policy environment, could restrict premium expansion for equities. The factors that could dominate policy are the strength of consumer demand and inflation.

Anchor themes

Global commodity prices will likely be key in determining the evolution of inflation, the current account and policy action.

Watch for: 1) labour shortages across industries; 2) slowing growth momentum in 1H11F, 3) the likely return of inflationary pressures in 2H11F; 4) the effect of a tighter policy environment; and 5) the strength of the urban and rural consumer.

Stocks for action

Our top BUY calls are MM and PF, as consumption and rural demand plays, and TATA and CAIR, for their exposure to global commodity prices. ACEM and HPCL are our top REDUCE calls.

Stock	Rating	Price (INR)	PT
M&M (MM IN)	BUY	789	892*
Pantaloon (PF IN)	BUY	389.5	553
TATA Steel (TATA IN)	BUY	624	846
Cairn India (CAIR IN)	BUY	327	370*
Ambuja Cements (ACEM IN)	REDUCE	137.9	113
Hindustan Petroleum Corp (HPCL IN)	REDUCE	410.2	270

Pricing as of 8 December, 2010; * PT under review

Under the weather

① See a year of below-average returns

We judge 2011 to be a year of below-average returns for the market and set our December-2011 Sensex target at 22,100, implying a potential return of around 12%. At the same time, we think the policy environment will likely tighten more than expected, restricting premium expansion for equities.

② Liquidity squeeze and slower growth momentum

Extremely tight systemic liquidity conditions would result in a slowdown in growth.

③ Inflation déjà vu

Rising global commodity prices are becoming a clear and present danger to domestic inflation. Labour shortages are becoming a binding constraint on growth and are further feeding the wage-price spiral.

④ A subpar recovery of the investment cycle

We expect some disappointment in the short to medium term. We see several obstacles to the capex cycle despite strength in demand; reports of government involvement in recent scams will likely impede government decision-making related to infrastructure projects and the reforms process.

⑤ Earnings — potential disappointment to consensus expectations

Amid a tough macroeconomic environment next year, we see downside risk to consensus growth expectations of 20%.

⑥ Sector stance — take a defensive stance

We favour a defensive bias when approaching sectors for next year. We recommend a relative Underweight stance on rate cyclicals, construction and cement and a relative Overweight stance on consumer, pharma, power, oil & gas, metals and IT services. Our top BUY calls are MM, PF, TATA and CAIR. Our top REDUCE calls are ACEM and HPCL.

Analysts

Prabhat Awasthi
+91 22 4037 4180
prabhat.awasthi@nomura.com

Nipun Prem
+91 22 4037 5030
nipun.prem@nomura.com

Sanjay Kadam
+91 22 4037 4187
sanjay.kadam@nomura.com

Contents

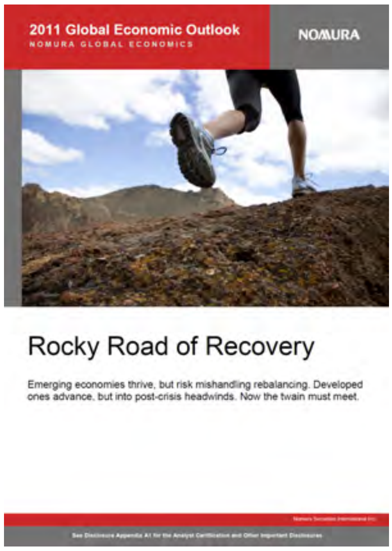
Sector views

Latest company views

Valuation and risks 104

Also see our Anchor Report: Asia Pacific Strategy — *Deflation, inflation and the return of the productive economy* (6 December, 2010)

Also see our NOMURA: 2011 Global Economic Outlook — *Rocky Road of Recovery* (6 December, 2010)



The big picture

Executive summary

A year of below-average returns

We think consensus is expecting a bit too much in view of the risks

We judge the year 2011 to be a year of below-average returns for the market and set our December-2011 Sensex target at 22,100, implying a potential market return of around 12%. We expect some downside to consensus earnings growth expectations of approximately 20% y-y. At the same time, the policy environment will likely tighten more than expected, restricting premium expansion for equities. The factors that will likely dominate policy should be the strength of consumer demand and inflation. We note that a large part of inflation in India is imported and if global commodity prices rally on the back of an easy global monetary policy environment, India's inflation risks could flare up yet again. However, global risk sentiment remains volatile and developments in the Fed's quantitative easing program, China's inflation and the sovereign crisis in Europe could well play an important part in determining the fate of the dollar and commodity prices.

Special focus areas for this year's outlook are: 1) labour shortages across industries; 2) likely return of inflationary pressures in the second half of the year; 3) effect of tighter policy environment on an overall basis, and; 4) strength of both the urban and rural consumer.

Labour shortages are becoming a binding constraint on growth

Skilled labour is tight, good for the trades, bad for the bottom line

We are seeing increasing signs of labour shortages building up, which we think is a common theme across the country in both urban and rural India. Evidence based on field-trips to rural areas by our analysts suggests that the supply of labour has not kept pace with its demand in a rapidly growing economy resulting in higher labour costs. This we think is one of the main reasons why even exceptionally high food inflation did not lead to a significant social unrest in India. The story is very much the same in urban areas. Labour, especially skilled manpower, has become scarce and will likely put profit margins under pressure.

Higher wages and possible rupee strength a double threat to some exporters

We reckon that this theme will become a bit of a drag on growth as the capex cycle picks up further. The beneficiaries of higher wage inflation are largely consumer discretionary and non-discretionary companies. Additionally, as income levels rise non-discretionary spending will make way for aspirational purchases, leading to higher growth in less penetrated categories of consumption expenditure. On the other hand, labour-intensive sectors could suffer as higher employee costs start crimping margins. Key sectors at risk are IT services, construction and real estate. Exporters among these sectors with high labour content will likely struggle to maintain competitiveness in the face of a rising rupee.

Inflation—at risk of rising again

Wages are far from the only inflationary factor out there

There are three reasons for renewed concerns on domestic inflation. First, despite a very good monsoon, agricultural prices have remained firm, and have indeed rallied strongly in some cases. Second, wage inflation would mean that the pass-through in output prices would push inflation higher (wage-price spiral). Third, we note that the Fed's quantitative easing measures are starting to have a positive impact on global commodity prices. So even as base effects for headline inflation have started to become favourable, the factors mentioned above should mean a re-emergence of inflationary pressures, especially in the second half of 2011. The consequences of inflation would essentially show through policy action as rising rates and tight liquidity.

Investment cycle—an uncertain outlook

The investment cycle has been more muted than we expected this year

We have been somewhat disappointed by the slow pick-up in the investment cycle in 2010. This has been because of a host of factors, including muted risk-taking ability on an aggregate basis, uncertainty in the macro environment, problems of resource shortages (difficulties in land acquisition and scarcity of labour) and policy hiccups in infrastructure areas, especially in telecom and roads. The recent slew of scandals and scams implicating the government will also likely impede the investment cycle given that infrastructure has become a primary driver of the investments and government actions should remain cautious for some time, adversely effecting progress in sectors such as roads, telecoms etc. Additionally, some of the larger sectors of the economy such as real estate will likely see soft patches due to the tight policy environment. Finally, we see capex in some of the other larger sectors being constrained by lack of new projects (oil and gas), land acquisition issues (metals, roads etc.) and political problems in the eastern parts of the country (mining).

Earnings—potential disappointment to consensus estimates

We don't think consensus growth expectations will hold up

We reckon that the prospects for corporate profitability next year will be shaped by a macroeconomic environment characterised by wage pressures, rising commodity prices, elevated inflation, tight liquidity (in the first half, at least), downward sticky interest rates, a strong rupee, somewhat muted government expenditure; all this on a backdrop of strong domestic consumption and below-trend global economic growth. Domestic liquidity typically leads industrial production by 4-6 months and factory output is a contemporaneous indicator of corporate profitability. We do not expect liquidity to ease in the coming few months, at least, and consequently industrial production will likely remain below par until the middle of next year, proving a drag on corporate top and bottom lines. We therefore expect consensus earnings growth expectations of 20% in FY12F to see some downward revisions.

Themes

Key themes

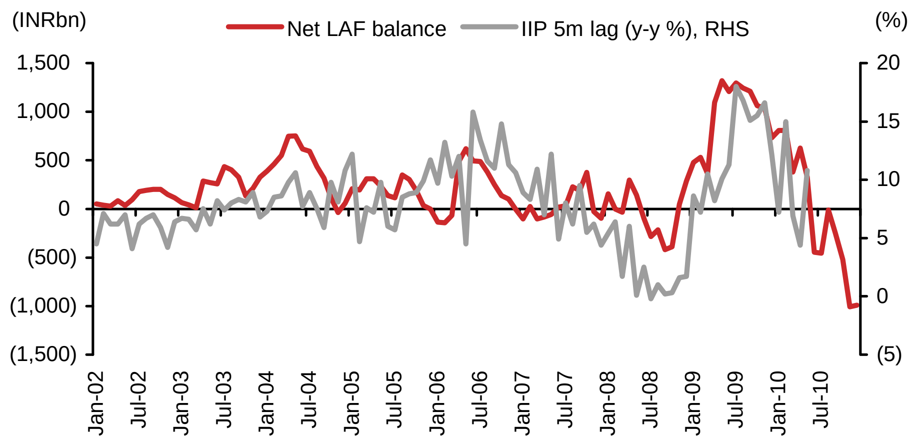
We expect the macroeconomic and earnings environment in 2011 to be punctuated by the following key themes:

Slowing growth momentum

Industrial growth should be muted in the first half of next year in reaction to tight systemic liquidity and adverse base effects

Tight systemic liquidity is expected to take a toll on growth momentum in the near to-short term: Systemic liquidity has been extremely tight over the past six months and has exceeded levels seen at the peak of the crisis in 2008. The Exhibit below plots net LAF balances of the banking system—a measure of banks' net lending to/borrowing from the central bank; a negative balance indicates an injection of liquidity, and vice versa—against the annual growth rate of industrial output. The relationship suggests that domestic industrial activity lags systemic liquidity conditions by about 4-6 months as companies adjust production to availability and cost of funds. We discuss below in a separate section on liquidity the reasons for the currently tight liquidity conditions. But, if this relationship is stable— and monthly data for the past nine years suggests that it is—then we could be headed for a lean patch for industrial output growth in the months to come. Moreover, annual comparisons of the IIP index faces headwinds from an adverse base effect which would likely keep y-y growth figures muted in the first quarter of CY11F.

Exhibit 1. Net LAF balances vs. industrial production



Source: Business Beacon, Bloomberg, Nomura research

GDP on the output side…: Now industry makes up about 28% of India's GDP, agriculture accounts for about 16% and services, at 55%, accounts for the lion's share. The drought in 2009 dented FY10 growth and the favourable base effect will show up in FY11 GDP numbers, limiting the upside to FY12 growth, even under the assumption that monsoons will be normal next year. Fiscal imperatives and limited headroom for the government to undertake significantly higher expenditure next year will likely cap the upside from the fiscal side. However, services, excluding government expenditure, could continue to benefit from continuing strength in consumption.

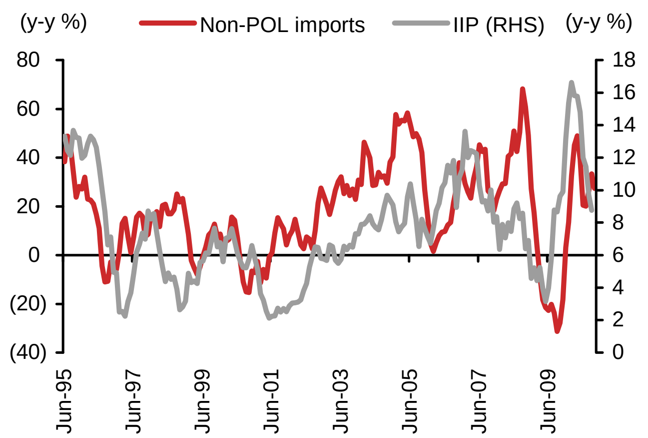
Private consumption will likely be strong. However, a slow ramp-up in the investment cycle, limited scope for meaningful expansion in government spending and uncertainties surrounding external demand likely to cap growth upside

…and on the expenditure side: Looking at prospects for next year from the expenditure side of GDP, we think private consumption growth will likely be healthy next year and continue to inch up towards its pre-crisis trend. Government expenditure will likely be muted in real terms with the government under pressure to stick to its fiscal targets. Rising commodity prices, especially crude oil, is now posing a serious risk on the fiscal front. The investment cycle, which has been disappointing this year, should most likely pick up from its bottom this year but we expect this ramp up to be slow (we present our thoughts on the investment cycle in detail in a separate section on capex below). On the external front, while we had been concerned about the rising trade deficit earlier on this year, the recent turnaround in the momentum of the deficit has been comforting, unless it is symptomatic of a meaningful scaling back of private consumption, resulting from monetary tightening that started in February.

Expect near to short-term headwinds to the investment cycle: On an aggregate basis, we think downward sticky interest rates combined with a likely tapering off of inflation in the first half of next year—we expect inflation to pick up and remain high on a full-year basis, especially after adverse base effects kick in 2H11F and amidst sharply higher commodity prices—implies rising real interest rates, which would be a headwind for the investment cycle. The Exhibit below shows that the annual growth rate of real gross fixed capital formation has a negative relationship with real interest rates; the negative relationship between investment demand and real rates is a fundamental one. The apparent dislocation of this relationship in the few quarters leading up to the crisis in September 2008 happened in the backdrop of severe global stress—investment growth had already started coming off since December 2007 when tremors from of the outbreak of the subprime crisis started resonating globally —and the sharp fall in real interest rates on account of the sharp rise in inflation did not spur investment growth. A more detailed analysis and our thoughts on the capex cycle next year follows a bit later in this report.

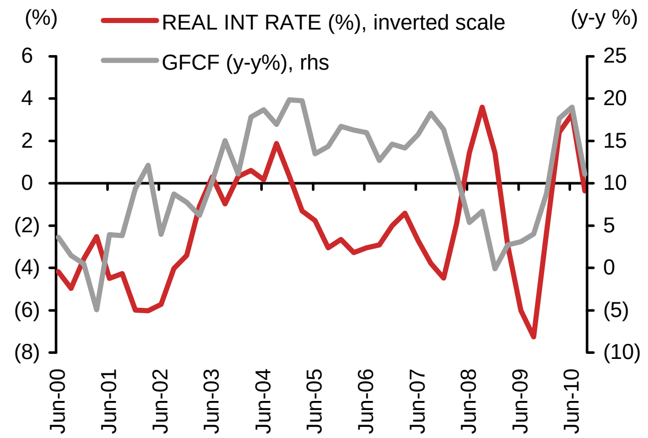
Our economics team has revised growth forecasts downwards and inflation forecast upwards: Our India economics team is expecting moderation in IIP growth to 7.9% in FY12F (from 8.2% projected earlier) vs. an expected average of 8.4% in FY11F. They expect real GDP growth to moderate to 8.0% in FY12F (vs. 8.1% projected earlier) from an upwardly revised 8.7% in FY11F (vs. 8.3% projected earlier). On inflation, they expect WPI inflation to average 7.5% (vs. around 6.5% projected earlier) in FY12F vs. 8.5% in FY11F.

Exhibit 2. Non-oil imports and IIP



Source: Business Beacon, Nomura research

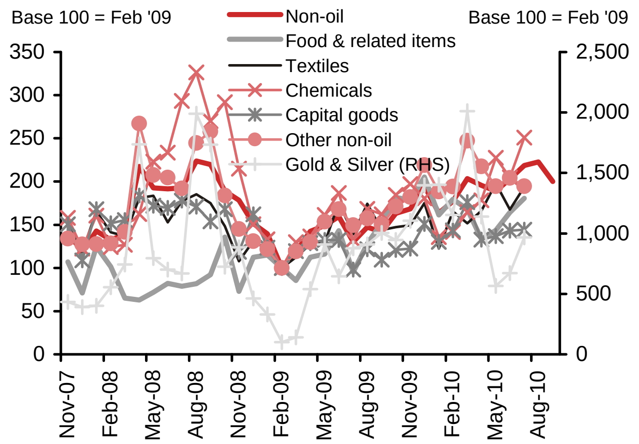
Exhibit 3. Investment growth and real interest rates



Note: The real interest rate is ex-post and is calculated as the 10-year govt bond yield less WPI inflation

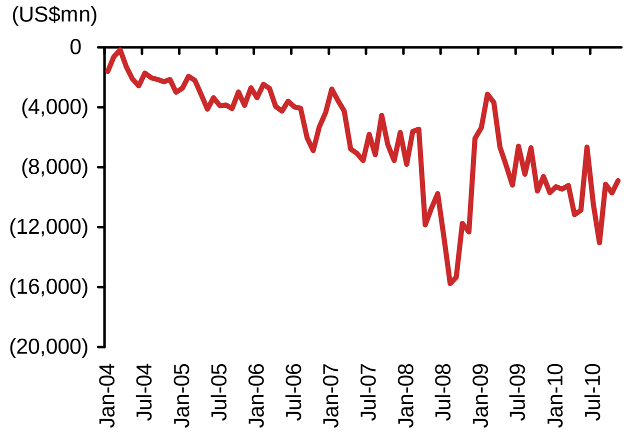
Source: Business Beacon, Nomura research

Exhibit 4. Non-oil import details



Source: Business Beacon, Nomura research

Exhibit 5. Trade deficit



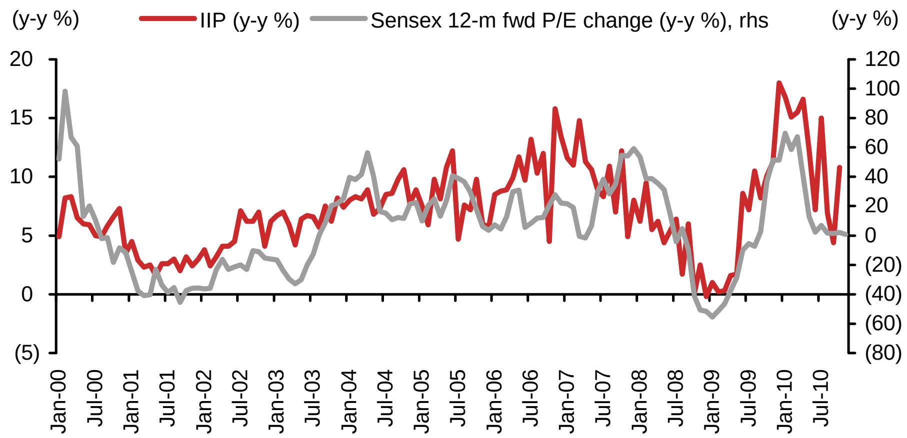
Source: Business Beacon, Nomura research

To sum up: We see headwinds for growth next year because even as private consumption will likely remain strong amidst labour shortages and wage increases, a slow ramp up in the investment cycle, limited spending capacity of the government and potential headwinds on external demand will likely cap meaningful upside to growth from current levels.

Market sentiment takes its cue from reported industrial production numbers: Despite that industry comprises a small part of India's total annual output of goods and services, the market continues to see it as the most important barometer of domestic growth. This is probably because IIP is the only high frequency (monthly) indicator of growth, though it is notoriously volatile. This is can seen in the Exhibit below that plots the year-on-year change in the Sensex 12-month forward P/E multiple against annual IIP growth. The relationship between the two series is contemporaneous as plotted, but because industrial production figures are reported with a lag of more than two months, the market actually reacts to expected weakness in industrial production in advance (through the earnings channel, as we document in the section on earnings below). So, based on our expectation of a scenario of slowing growth momentum in the first half of next year we see downside risk to market moves in the coming months.

We think market sentiment will react to expected weakness in IIP growth numbers through the first half of next year

Exhibit 6. Change in Sensex 12-month P/E multiple vs. industrial production growth

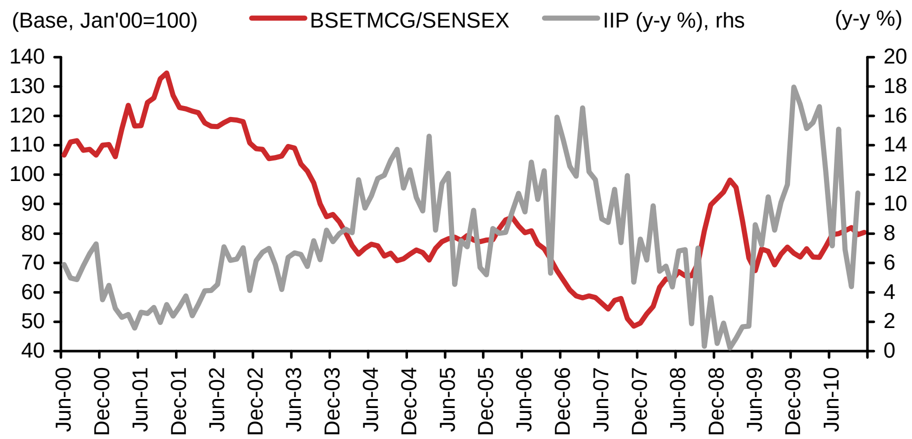


Source: Capitaline, Bloomberg, Nomura research

Consumer stocks – defensive play: Considering our expectation that growth momentum will likely take a hit in the short term, we think the consumer sector will be a good defensive play. This is borne out in the chart below that plots the price performance of the FMCG sector relative to the Sensex against annual growth of IIP.

The consumer sector would be a good defensive play on slowing growth momentum

Exhibit 7. Relative price performance of consumer stocks vs. IIP growth



Source: Bloomberg, Nomura research

Labour market

Labour shortages—a key theme

Labour supply is lagging demand: We believe India is facing widespread shortages of labour that could become a binding constraint on growth with potentially important ramifications for inflation and policy. For national output to continue to expand at the trend growth rate would require that the availability of the key factors of production—labour (man-hours), capital (machinery, equipment, plants and buildings) and land; technology and augmentation of human capital enhance total factor productivity—increase at a commensurate rate. Aggregate demand in India has been underpinned by strong consumption growth driven by rising income levels on the back of strong pick-up in economic output, transfer payments by the government and wealth effects from rising asset prices.

Labour shortages are becoming a binding constraint on economic growth

Government focus on rural development is diverting labour away from the farming sector: Government-sponsored schemes, such as the National Rural Employment Guarantee Scheme (NREGA)—which guarantees 100 days of employment a year per family in rural areas—have led to: a) a floor for the price of labour; and b) a reduction in the availability of farm labour across the country. This has led to the wages of farm labour almost tripling over the past 2-3 years (please see Appendix 1 for a sample of 2010 headlines highlighting the issue of labour shortages).

Strong focus on rural development is creating shortages in farm labour

Exhibit 8. Budget of rural development schemes introduced by the government (INRbn)

Name of scheme	FY08	FY09	FY10	FY10-11
Mahatma Gandhi National Rural Employment Guarantee (NREGA)	163	375	391	401
Swarnajayanti Gram Swarozgar Yojana (self-employment for rural poor)	17	23	24	30
DRDA (District Rural Development Agency) Administration	3	3	3	4
Rural Housing	39	88	88	100
Pradhan Mantri Gram Sadak Yojana (Rural roads)	65	78	120	120
Grants to National Institute of Rural Development	0	0	0	1
Council for Advancement of People's Action and Rural Technology	1	1	1	1
PURA (Provision of Urban Amenities in Rural Areas)	-	-	0	1
Management support to Rural Development Programmes	1	1	1	1
BPL (Below Poverty Line) Census	-	-	-	2
Non-Plan	0	0	0	0
Total: Department of Rural Development	288	569	627	661

Source: Budget documents, Nomura research

Ancillary opportunities in rural areas: Rapid urban growth and improved linkages with rural India through better roads and telecom connectivity have vastly expanded the income and production opportunities of rural consumers. Although higher crop prices, supported by MSPs (Minimum Support Prices) and increased demand for food, have been accompanied by commensurately higher costs of farm inputs (labour, seeds, fertilizers etc), rising total farming incomes of farmers have given them seed capital to diversify into supplemental sources of income like dairy, transport and vehicular movement of construction materials. Rising incomes imply rising demand for goods and services that cannot be satiated without bidding up the price of labour, the key ingredient in labour-intensive rural India.

Positive spill-over effects of rapid urbanisation is boosting income generation and trade opportunities in rural regions

Wealth effects, especially from land price inflation: Over the past three months, six of our research analysts went on a fact-finding mission to rural areas across the country. A common theme that emerged after they compared notes was the 3-4x increase in the price of agricultural land across the country over past five years. The increase in land prices has been higher for tracts of land close to roads, highways and in areas adjoining urban regions identified for residential and commercial real estate development. Inflow of remittances by NRIs (Non Resident Indians) is further bidding up land prices in rural areas. For wealthier farmers, land serves as the vehicle of savings of choice and surplus incomes from agricultural activities gets ploughed back

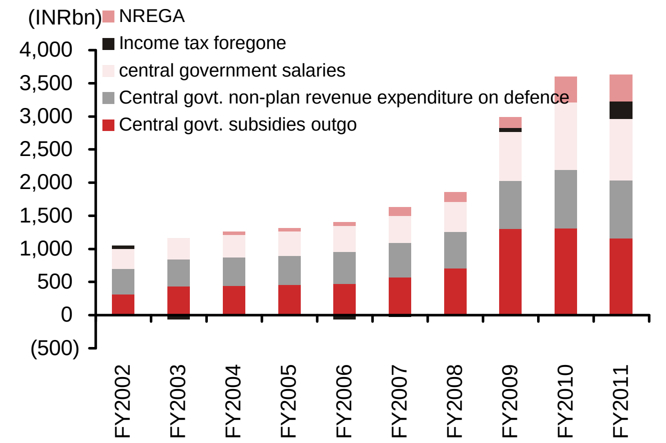
Wealth effects from rising land prices along with higher gold prices are underpinning rural demand

into consolidating land holdings. The wealth effects from strong land price inflation, combined with the increase in gold prices — a key store of savings in rural India — has also boosted consumption.

Salary hikes for government employees has boosted private consumption further

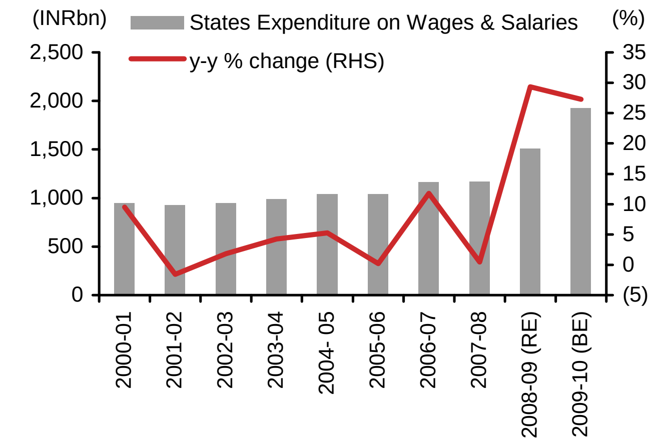
Income transfers to government employees have boosted aggregate demand: The government led salary hikes for both central and state employees has led to a significant income push in the government sector. Salary hikes have also come through in all the Public Sector Undertakings (PSUs). Rise in expenditure on wages and salaries of state-level employees—largely on account of implementation of states' own pay commissions and the Sixth Central Pay Commission—have yielded a further US$25bn in extra total income in FY09 and FY10 over FY08. This is reflected in the increase in states' expenditure on wages and salaries as a percentage of revenue expenditure to 32.6% in FY10 vs. 28.4% in FY08. Do note that even PSUs have upped their salaries, this is not captured in this data. Thus, the total has been north of US$75bn (which is the aggregate of centre and states but does not include PSU salary revisions).

Exhibit 9. Central government spending



Source: Budget documents, Nomura research

Exhibit 10. States' expenditure on wages & salaries



Source: Budget documents, Nomura research

Wages are up some 30-40% in smaller construction companies; anecdotal, yes, but still significant

Construction and real estate activity in India is highly labour intensive: Construction activity in India tends to be highly labour intensive and, as opposed to higher-end industrial capex, construction capex tends to be rich in labour content and pulls in more labour than industrial capex activity does. This is not surprising in the traditionally capital-deficient country with plentiful cheap (and unskilled) labour readily sourced from its rural hinterlands. This is now fast changing as rural development and rising alternative opportunities of employment in rural areas is causing shortages of labour in the construction sector. Anecdotal evidence suggests that the smaller construction companies are coping with 30-40% wage hikes presently.

Resumption of hiring in the tech sector: We have borrowed the Exhibit below from our IT services research team. What leaps out from the data is the significant ramp up of hiring of engineers planned for FY11 and FY12 by the IT sector with incremental hiring of engineers by IT firms accounting for two-thirds of total graduates entering the job market in FY12. We think such aggressive hiring plans could exert significant upward pressure on wages not only in the IT sector but also on salaries across other sectors that absorb engineers.

Exhibit 11. Hiring of engineers by the IT sector

	FY06F	FY07F	FY08F	FY09F	FY10F	FY11F	FY12F
Total engineers employed by IT industry	825,000	1,062,400	1,311,000	1,453,200	1,510,200	1,812,240	2,174,688
growth (%)		*29*	*23*	*11*	*4*	*20*	*20*
Incremental engineering demand from IT		237,400	248,600	142,200	57,000	302,040	362,448
Total engineering graduate output	323,600	372,400	392,400	451,700	497,475	547,223	601,945
growth (%)		*15*	*5*	*15*	*10*	*10*	*10*
Incremental engineering demand from IT industry as a % of supply			67	36	13	61	66

Source: India technology research team

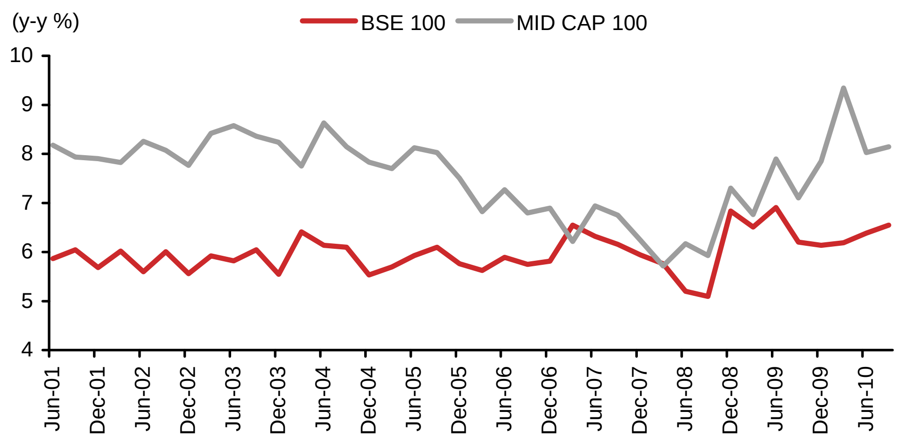
Indeed, wages are rising across a wide range

Post crisis, it was largely government sector employees and rural workers that saw their incomes rise. The broad-based pick up in economic growth since then has meant that hiring is happening across sectors and is now leading to excess demand for labour and putting upward pressure on wages and downward pressure on corporate margins.

Smaller companies face greater headwinds from rising employee expenses

Company profit margins in duress: The Exhibit below shows employee expenses as a percentage of net sales for BSE 100 companies (proxy for larger cap) in comparison to smaller companies in the midcap space. It is clear to us from the pick-up in this ratio post crisis that labour costs are emerging as a distinct drag on corporate margins. However, as top-line growth has been strong and as companies have been able to eke benefits out of operating and financial leverage, the impact on bottom-lines has been muted so far. Going forward, we think there will be little refuge left for companies in operating and fiscal leverage—there are system-wide capacity constraints and interest rates are not expected to fall from here, in our view —and rising labour costs should become more of a drag that in the past. Indeed, as can be seen in the Exhibit below, bigger companies have found it easier to weather the impact from tighter labour conditions over time. We think the extent of the labour supply issue may be a bit greater this time around given the multiplicity of factors that are the cause for this rise in costs.

Exhibit 12. Employee expense as percentage of net sales



Source: Capitaline, Bloomberg, Nomura research

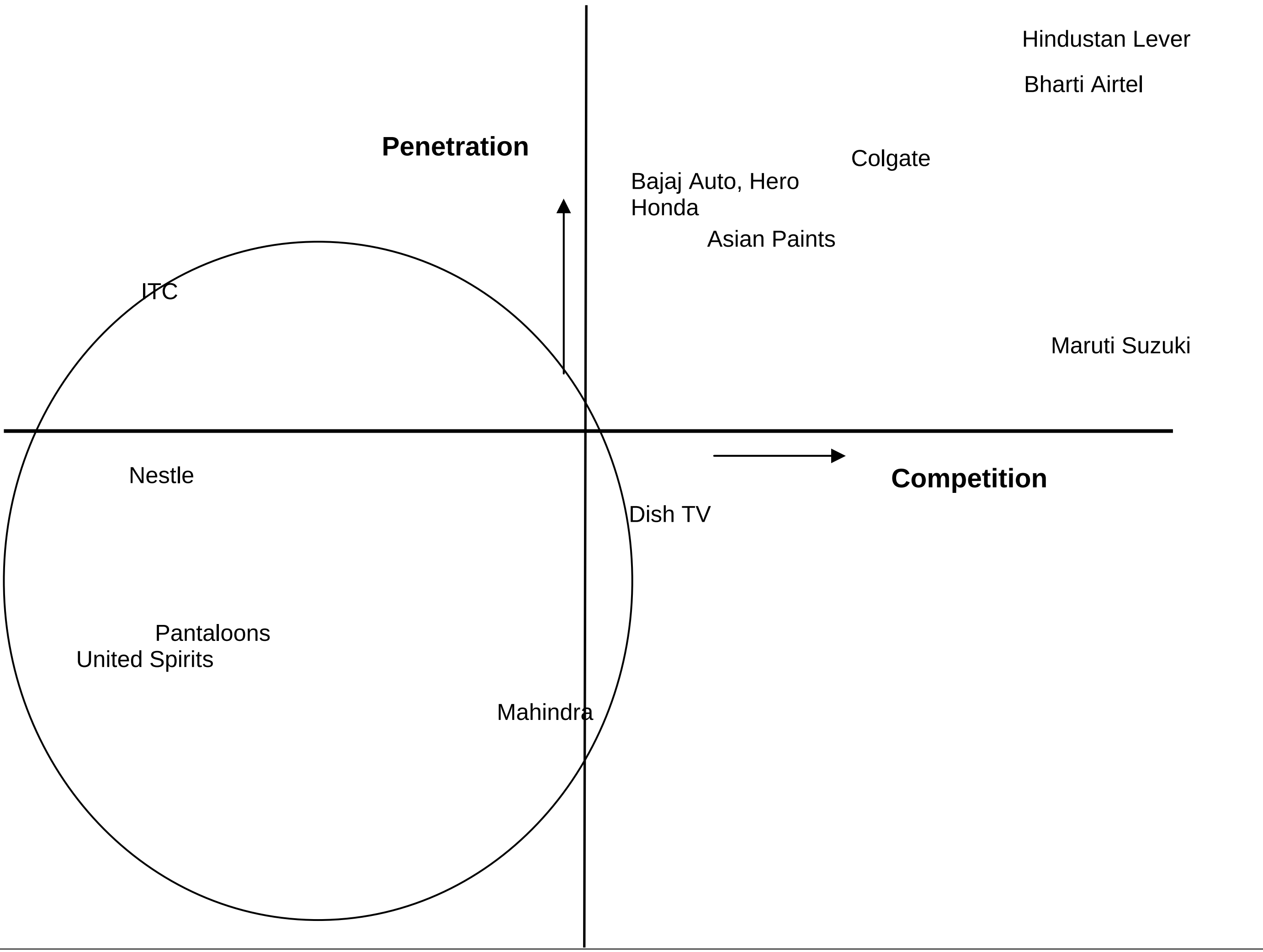
To tap the labour shortages theme, we prefer consumer-facing, less labour-intensive companies with pricing power

So how to tap this theme? Rising labour costs spell higher purchasing power for consumers, even as higher employee costs are negative for the firms that employ these consumers. The system-wide effect will be mixed, in our view, because higher expenditure on goods and services as a result of this greater purchasing power should feed into higher sales growth for firms. We would look to tap this theme by buying stocks with the following three characteristics:

1. Consumer-facing: We prefer those companies whose products have a relatively lower level of market penetration**, and hence more room to grow,** or whose products would benefit from consumers trading up on the back of higher incomes.

2. Strong competitive positions: With rising input costs, companies that have strong competitive positions in their sectors should be best able to exercise pricing power and pass along higher costs to customers, and thereby maintaining margins.

Exhibit 13. Product penetration and competitive position matrix



Source: Nomura research

Labour-intensive sectors such as IT, construction and real estate are more vulnerable to labour shortages

3. Companies that do not have labour as a significant input: In light of the labour shortages, companies with high usage of labour in their cost structures could face margin pressure. Further, it will be tougher for smaller companies to manage wage inflation vs larger counterparts because: 1) they have fewer levers to manage margins; 2) smaller companies should find it more difficult to grow faster in an environment with slowing growth momentum; and 3) larger companies evoke more loyalty from employees via brand value. The table below lists sectors we think could feel the pinch.

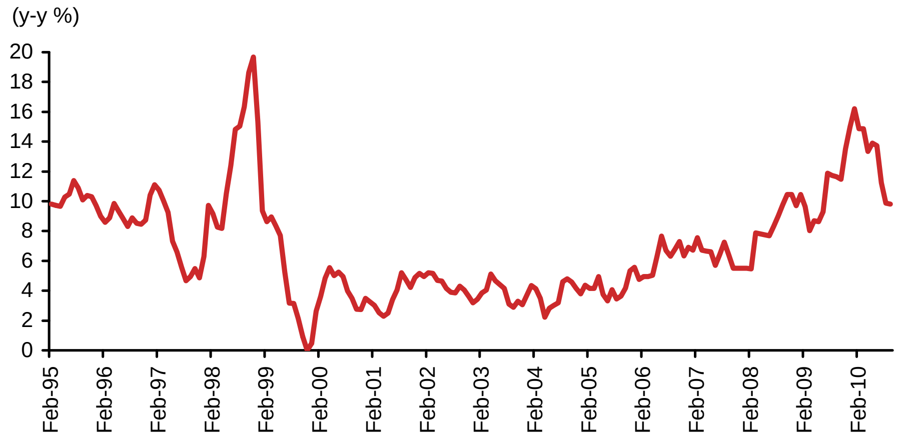
Exhibit 14. Sectors vulnerable to labour shortages

IT and BPO	**Significant shortages emerging. Wage hikes could be much higher than expected**
Construction/Real estate	Skilled workers are in short supply which could lead to growth slowdown. The government may invite foreign competition to bridge the skills gap
Mid caps	In sectors where skilled workers are required, mid-cap companies could face higher wage inflation

Source: Nomura research

The wage-price spiral: The chart below shows CPI inflation in India over the past 15 years. Inflation in the past couple of years has moved to levels seen only in 1998. While food inflation has been a big element of the recent CPI increase—food accounts for more than 46% of the total index—the generalised increased in wages in the past two years has been higher than in the past 10 years on account of government salary hikes and rural income push. Given the labour shortages we are seeing across industries, we think India is passing through a much higher-than-average wage increase cycle, which will mean that policy action will have to address accordingly.

Exhibit 15. CPI (Industrial Workers) general index (y-y %)



Source: Business Beacon, Nomura research

Muted investment cycle

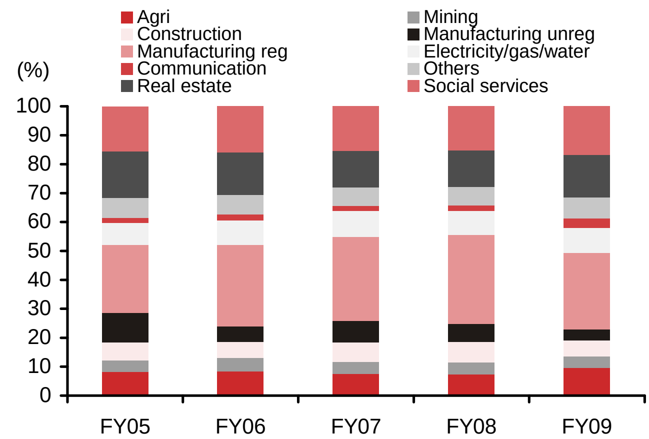
Investment cycle—expect some short-to-medium-term disappointment

Capex has been a disappointment

The need for capex is clear: Rising capacity utilisations across sectors necessitates augmentation of capacity and implies that recovery of the capex cycle will eventually follow. That said, we admit that the pace of recovery of capex so far has negatively surprised us.

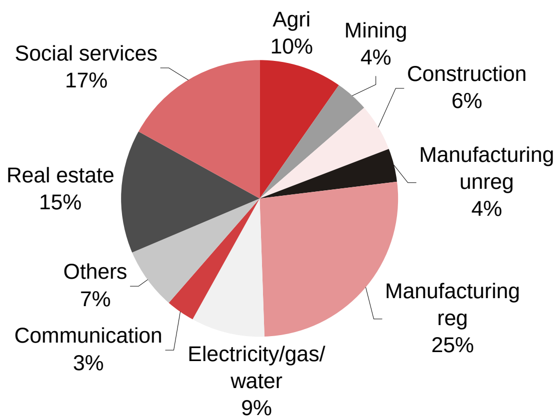
The two Exhibits below show national income accounts data on the evolution of real investment and a snapshot of the contribution to real investment by sector in FY09. The numbers show that the biggest drivers of investment in India have been organised manufacturing, real estate, electricity/gas/water and social services. The latest figures for FY10 with sector-level granularity are not yet available and we are limited to data until FY09, the year of the crisis.

Exhibit 16. Real gross capital formation composition over the years



Source: Business Beacon, Nomura research

Exhibit 17. Decomposition of real gross capital formation by sector in FY09

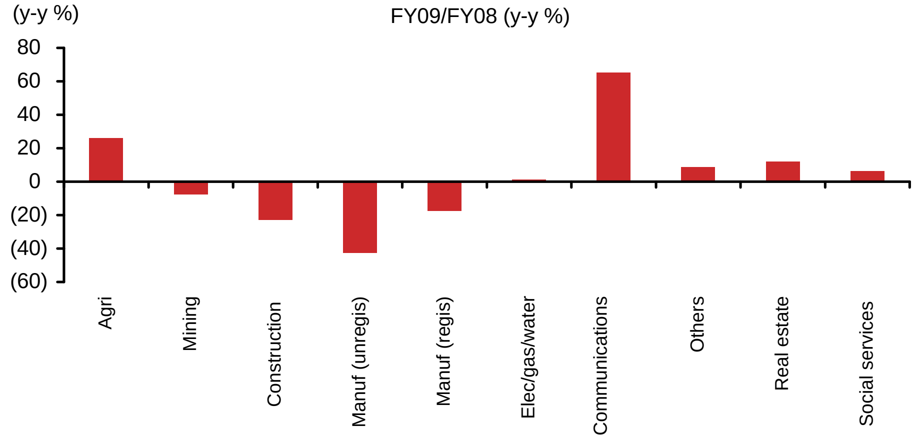


Source: Business Beacon, Nomura research

The unorganised manufacturing sectors suffered the most in an environment of very tight liquidity

Tight liquidity—who suffered the most? In light of the current liquidity squeeze, to get a sense of which sectors are most vulnerable to scarcity of funds, we find FY09 as a good sample to work with because the country faced a massive liquidity crunch in the second half of the year. To place things in perspective, we note that systemic liquidity levels are much tighter today than they were at the peak of the crisis after September 2008. We acknowledge that overall systemic stress levels were much higher then and visibility of demand much poorer in comparison to now. But we also had the tailwinds of a considerable easing of monetary policy backed by a substantial expansion of spending by the government; factors that are not at play now. The Exhibit below shows year-on-year growth in investment by sector in FY09.

Exhibit 18. Growth of investments by sector in FY09 vs. FY08



Source: Business Beacon, Nomura research

We draw three key observations from the data:

1. The much larger decline in investment growth for the unregistered manufacturing sector suggests that smaller companies suffer much more than larger ones when liquidity was tight because of greater costs of funding expansion. These are companies that are operating below the radar for most investors who overlook the effect of tight liquidity on economy-wide corporate investments.

2. Government spending underwrote the decline in investment to some extent; agricultural and social services spending continued to grow in FY09. The current fiscal constraints obviate a push from the government this time around.

3. Surprisingly, real estate investment growth was positive in FY09. An explanation for this seemingly counterintuitive fact, we think, is that this is primarily a reflection of the fiscal stimulus by the government; urban real estate players suffered immensely and incremental activity came to a standstill following the liquidity crunch post crisis. Note here that cement sector volume growth was the first to recover following the crisis; around 60% of cement volumes were absorbed in housing construction. This is also an area of concern for us, as cement volumes have been showing signs of consecutive declines for a few months now.

Real capex growth in the organised manufacturing sector was close to flat in FY09 but declined in FY10

Organised manufacturing—FY10 was worse than FY09: Organised manufacturing, with a 25-30% weight in total capital formation, is the primary driver of corporate capex. An exercise aimed at examining capex trends across subsectors of the economy-wide organised manufacturing sector runs into a roadblock because national accounts do not provide data with such granularity. The next best option is to carry on with the exercise using capex patterns of BSE500 index constituent companies as a representative sample. The Exhibit below shows the breakdown of annual growth rates of corporate capex by sector.

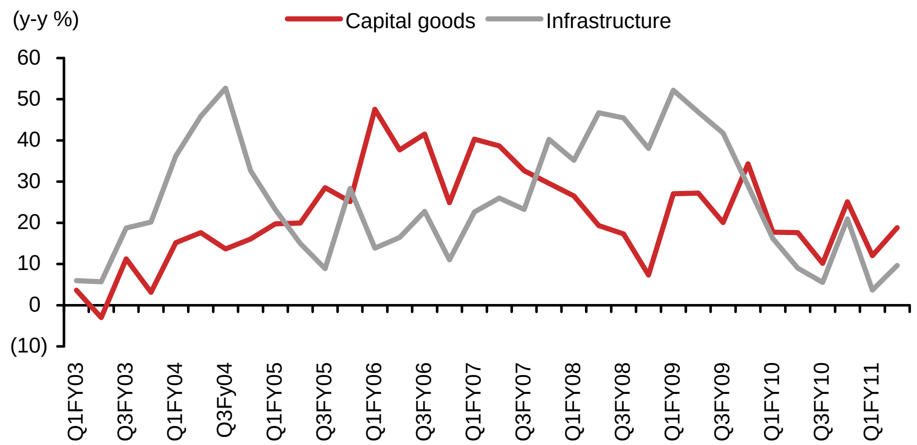
Exhibit 19. Annual growth rates of corporate capex by sector

y-y growth (%)	FY02	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY10
BSE500 ex Banks	**5.1**	**19.1**	**26.6**	**46.2**	**40.5**	**56.8**	**31.1**	**5.5**	**(5.1)**
Automobiles	(38.8)	6.2	4.4	120.7	12.3	133.4	43.5	(6.4)	(26.5)
Capital goods	(12.5)	6.3	81.8	33.5	31.0	35.6	48.6	26.6	(17.0)
Cement	(36.4)	(1.1)	1.6	136.9	(11.7)	204.5	73.4	(1.9)	(16.2)
Construction	59.4	(13.5)	29.8	2.5	181.5	85.8	44.9	14.8	(13.7)
FMCG	(11.9)	(21.9)	(3.6)	38.3	27.6	88.5	16.9	(9.2)	(5.2)
Healthcare	38.2	30.2	18.0	62.2	12.3	15.2	15.6	10.4	(16.5)
IT services	(23.7)	4.9	39.6	77.4	39.0	50.7	12.7	1.6	(27.3)
Metals & mining	32.8	4.2	1.5	39.7	(17.2)	46.8	31.4	20.0	22.4
Oil & Gas	(21.4)	21.6	36.2	41.5	(4.7)	35.2	4.4	17.7	29.3
Petrochemicals	69.9	119.5	24.4	20.7	117.5	110.2	(2.9)	1.6	(10.2)
Shipping	10.3	69.9	124.6	8.8	54.1	3.1	44.9	40.4	(51.6)
Real Estate	79.6	(21.4)	98.2	381.7	(13.3)	178.9	85.2	(66.2)	10.5
Steel	(37.8)	5.8	45.3	115.0	43.3	40.1	76.4	30.1	9.1
Telecom	27.1	(3.4)	19.7	48.4	98.0	101.5	68.0	(17.2)	18.9
Textiles	1.6	(19.5)	62.5	108.0	79.3	17.0	39.3	46.1	(24.7)
Utility	129.4	31.4	23.9	35.4	2.7	36.5	8.2	23.3	0.2
Agrochemicals	(22.8)	17.8	(41.0)	144.2	46.2	102.8	(10.3)	86.1	(30.3)
Others	3.3	8.7	18.8	33.4	152.3	8.0	61.1	(10.9)	(25.7)

Source: Capitaline, Nomura research

These figures show that there was a marked slowdown in the capex cycle post-crisis. Although FY09 showed positive nominal growth, capex was close to flat in real terms. The situation worsened in FY10, which is commensurate with feedback that corporates continued to complete projects that they were already implementing but then shelved most projects that were planned. This ties in well with how sales of capital goods and infrastructure companies have behaved post crisis, as can be seen in the chart below. Companies with large industrial exposure, such as ABB, and construction players have seen a significant slowdown in their sales growth in FY10, unlike in FY09.

Exhibit 20. Net sales growth for capital goods and infrastructure companies

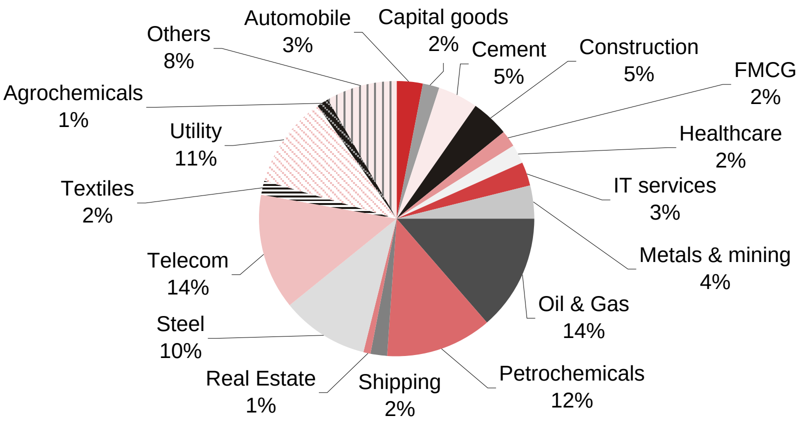


Source: Business Beacon, Nomura research

A few large sectors drive organised manufacturing capex: As the chart below shows, sectors that account for the lion's share of total capex are: 1) telecoms, 2) oil & gas and petrochemicals, 3) steel, metals & mining, 4) utilities, and 5) cement. Note that real estate companies capitalise commercial buildings for sale to gross block while residential buildings are added to working capital as part of inventories (which also includes land at historical cost). This explains why the real estate sector's contribution to gross fixed investment in national accounts is much higher than in corporate capex.

Major capex-heavy sectors: telecoms, oil & gas and petchem, steel & metals/mining, power and cement

Exhibit 21. Composition of FY10 corporate capex for BSE500 index companies by sector



Source: Capitaline, Nomura research

The capex cycle faces a number of headwinds next year

Obstacles to capex cycle despite strength in demand: A number of roadblocks have now emerged that we think are slowing the progress of the capex cycle, despite strength in demand.

1. Liquidity squeeze: The liquidity situation in India has been extremely adverse for about six months now (we discuss this in some detail in a separate section below). The sharp rise in funding costs and interest rates across the spectrum is acting as a severe headwind to the ability of corporates to leverage capital expenditure. The systemic strain is not as overwhelming as was post crisis, but it is being felt most by the smaller firms in the unorganised sector.

2. Land acquisition: Problems and hurdles in acquiring land have come to be a major bottleneck for several sectors. To cite a few examples: metals and mining (Tata Steel, Posco's Orissa steel plant, Vedanta's bauxite mining project in Orissa), Special Economic Zones (the Reliance SEZ), power (the nuclear power plant at Haripur), the railway's freight corridor project and a number of steel, automobile and chemical projects that have been stalled amid agitations by farmers and social rights activists across states.

3. Naxal problem: This issue is causing problems, especially in the natural resources sector. The bulk of India's coal, iron ore and bauxite reserves are located in the eastern part of the country, which has been the most affected by the naxal problem, the internal security threat to the country from far-left radicals. This has not only caused suboptimal utilisation of scarce natural resources but also contributed to a slowing down of mining-related capex.

4. Environmental clearances: Delays in obtaining environmental clearances have always been one of the key reasons that projects move slowly in India, especially in mining, power and process plants. Recent policy action—stoppage of work at HCC's Lavasa project and cancellation of Vedanta's bauxite lease are cases in point—should lead to higher risk weights for these project clearances by lenders and mean that corporates tread even more slowly.

5. Real estate policy: Recent policy changes by the central bank targeting the real estate sector—1) LTV ratio for bank housing loans should not exceed 80%; 2) increase in risk weight for residential housing loans of INR7.5mn and above, irrespective of the LTV ratio, up to 125%; and 3) higher standard asset provisioning by commercial banks for all loans at teaser rates to 2%, from 0.4%—has the potential to cool real estate activity.

6. Completion of projects: Several sectors are likely to see a slowdown in capex activity as older projects have been completed and new projects are not yet at a stage where they will start to add significantly to capex.

7. Government-specific issues: Issues related to central and state governments are yet another factor impeding the pick-up of the capex cycle. The state of government finances at both the state and central levels, especially in the backdrop of rising oil prices, and the need for fiscal consolidation greatly reduces the ability of the government to fund substantial increases in capital expenditure. Further, state-level political issues are a further stumbling block. This is especially true for state such as Andhra Pradesh, which has been a big driver of irrigation spends in the country. Others such as Karnataka, Maharashtra and Delhi are beset by corruption charges—amidst the slew of scams being unearthed regularly—of their own which will likely slow down the decision-making process at the government level.

Outlook for capex in key capex-driving sectors remains muted for next year

Issues with capex-heavy sectors: We see the following issues in the large sectors that traditionally have been the main drivers of capex, contributing to about half of the capex undertaken by the BSE500 index companies:

Exhibit 22. Outlook for capex in the key capex-driving sectors

Cement	**Overcapacity**
Construction/Real estate	State finances in poor health, government expenditures may not grow fast enough because of fiscal imperatives, impact of tight liquidity, tighter monetary policy, banks' unwillingness to lend on account of recent bribery scams
Metals & mining	Land acquisition, naxal issues, environmental clearances, iron ore export ban in Karnataka
Oil & Gas	No fresh momentum, Reliance’s gas project largely finished
Petrochemicals	No large refinery projects to start
Steel	Land acquisition, naxal issues, environmental clearances
Telecom - Services	Policy muddle on account of 2G scam

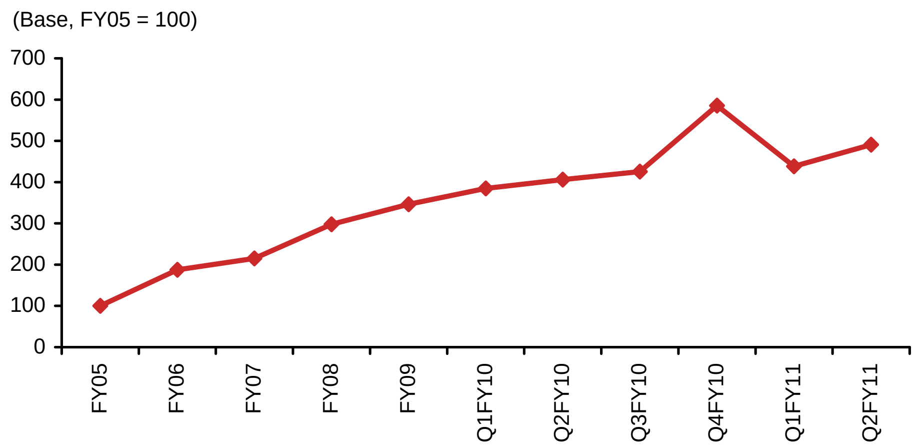
Source: Nomura research

We prefer power-related capex plays. Lower-than-expected order inflows remain a key risk for construction companies

We prefer stocks with exposure to power-related capex; further slippage on order inflows remains a risk for construction companies: Incrementally, we expect some disappointment in the capex cycle in the short to medium term, which would have a negative impact on growth. In terms of the stock market, negative sentiment could affect stocks that rely on industrial capex. Relatively more defensive amid this is likely to be power-related capex in both generation and distribution, in our view.

For construction companies, order booking rates in 1H FY11 came in below full-year guidance for most companies and provides evidence of a slowing in the capex cycle (see the Exhibit below). We think lower-than-expected inflow of orders remains a key risk for the sector and we see the possibility of further slippages in the short term.

Exhibit 23. Quarterly run-rate of order inflows of construction companies



Note: The chart is based on data for L&T, IVRCL, NJCC, HCC and Punj Lloyd

Source: Nomura India infrastructure & construction team

In the longer-term, however, we believe strength of corporate balance sheets, high capacity utilisations and decent return profiles will get the investment cycle back on its feet. But the process may be more protracted that what the market has come to expect.

Monetary and fiscal policy

The policy environment: tighter monetary policy and fiscal consolidation

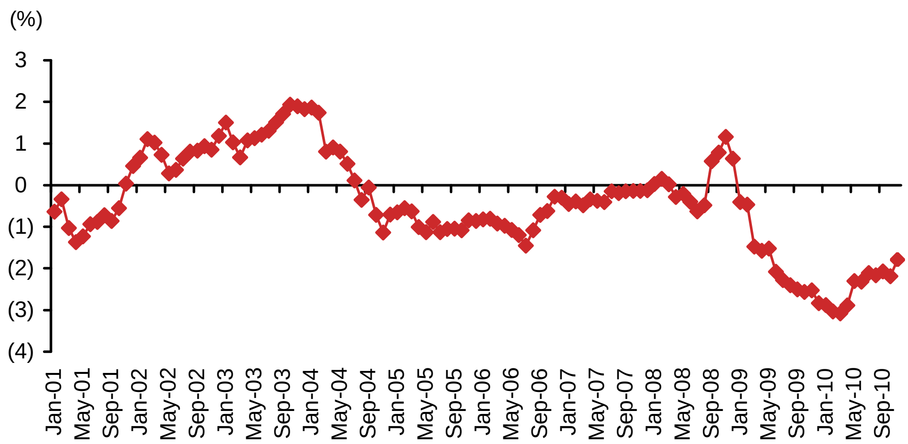
We think the following factors will shape the policy environment for the market in 2011: 1) tighter monetary policy; 2) fiscal consolidation and further normalisation of fiscal policy, and; 3) regarding reform measures by the government, media reports of various scams breaking out as we write this outlook make it likely that execution that involves heavy government intervention and support may be bogged down in the near term, we think.

Policy rates remain accommodative. Expect monetary policy to tighten

Monetary policy to get tighter: That monetary policy will likely get tighter from here is now largely a consensus view, although expectations vary on the extent to which the central bank will tighten. Even though the near-term trajectory for inflation should be down—expectations on how low the headline WPI rate will fall have probably been revised upwards recently given the rise in commodity prices — because of the base effect, fast rising commodity prices and the wage-price spiral imply that inflation will likely remain high and continue to move upwards after bottoming out. Whether this will result in government bond yields moving higher is another issue altogether. The chart below plots the difference between the repo rate (the rate at which banks borrow from the RBI) and the 10-year government bond yield. Judging from the extent of the difference between the two rates, it is clear to us that monetary policy remains far too accommodative and we would expect policy rates to rise much more than the risk-free rate. This could mean pressure on net interest margins of banks.

Our economics team's views on monetary and fiscal policy next year: Our India economics team is pencilling in a 75bps increase in both policy rates in FY12, following an expected 25bps repo rate hike in Jan-11, thus taking the repo rate to 7.25% by Mar-2012. On the fiscal side, the team expects the central government's net market borrowing at Rs3.7-3.8tr in FY12F, higher than the Rs3.45tn budgeted in FY11. They expect the central government's fiscal deficit at 5.2% of GDP in FY12F, above the required target of 4.8%.

Exhibit 24. Repo rate minus the 10-year government bond yield



Source: Bloomberg, Nomura research

A risk to this view comes from a possible global commodity price shock. A move higher in commodity prices, especially oil, would put upward pressure on both inflation and the government fiscal deficit. In such a case, we would expect government bond yields to inch higher along with policy rates.

The RBI will keep asset price inflation under close watch

Central bank to keep an eye on asset prices: The RBI has expressed concern on the recent sharp rise in asset prices and, hence, we think the direction of future policy by the central bank will be to keep asset prices from getting frothy. We have already seen clear policy moves by the RBI on the real estate sector in November as detailed in the table below. Specifically targeted actions aside, we think the central bank will likely continue to run negative liquidity in the system, especially in view of the fact that monetary transmission from rising policy rates has not been that effective in India. However, the currently extreme level of liquidity deficit has led to a sharp rise in interest rates and is proving disruptive to growth.

Exhibit 25. Regulatory measures implemented by the RBI on the real estate sector in November 2010

1. Loan-to-value (LTV) ratio to not exceed 80% in respect of housing loans hereafter
2. Increased risk weight for residential housing loans of INR 7.5mn and above, irrespective of the LTV, to 125%
3. Higher standard asset provisioning by commercial banks for all housing loans with teaser rates to 2%

Source: RBI, Nomura research

Higher commodity prices, especially crude oil, is a key risk on the fiscal side

Limited room for spending on the fiscal side: Our economics team expects fiscal consolidation to continue, albeit at a pace slower than that required under the suggested FRBM Act (Fiscal Responsibility and Budget Management). The critical issue that the government might face next year is to draft fiscal policy in a scenario of rising commodity prices, especially for oil. The subsidy bill for food and fertilisers has already been overshot by a significant amount in FY11. The government is also likely to end up spending more on oil subsidies as well as compared to the budgeted amounts for FY11. The table below was prepared by our oil & gas team and shows a scenario for expected under-recoveries of oil PSUs under various crude oil price assumptions.

Exhibit 26. Scenario analysis of under-recoveries by oil PSUs under different oil price assumptions

Under recoveries (INRbn)	FY09	FY10	FY11F	FY12F		
Brent (US$/bbl)	85	70	83	**85**	**90**	**100**
Petrol	52	61	22	0	0	0
Diesel	523	83	248	87	197	416
PDS Kerosene	282	175	193	156	172	204
Domestic LPG	176	141	196	163	194	256
Total	**1033**	**461**	**659**	**406**	**563**	**877**
Total (US$bn)	**22**	**10**	**15**	**9**	**13**	**20**

Source: Nomura India oil & gas research team

Also, there is unlikely to be a receipts bonanza for the government next year like the telecom spectrum auction money inflows of this year. This means that the government should remain hard pressed to keep spending at elevated levels next year. Additionally, state finances are also in a fairly poor state, yet another headwind for fiscal spending.

Positive developments on reforms should not be a catalyst for the market next year

The muddle at the centre is worrying for policy-related decision-making: Recent revelations of a slew of scams involving the government worry us primarily because of the indirect impact on the overall reforms process. In the very short term, parliamentary business could be adversely affected because of the stalemate between the opposition and the ruling party. Second, stoppage of work on several high-profile projects because of problems with environmental clearances could make corporates that much more cautious when considering capex. “Unpopular” reforms such as those in the oil & gas sector may take a back seat given the amount of negative publicity the government has already had to suffer.

We do not expect positive developments on reforms to be a catalyst for the market next year: Overall, we expect 2011 to be a tepid year for reforms. The market was excited by the prospects of oil sector reforms in 2010 but we think the market is likely to be disappointed on that front in 2011. We think that no "bold" initiative is likely early next year because of recent negative publicity for the government. We reckon that the best reform that the government could come up with next year would be to create a credible plan for fiscal consolidation. That being said, we would not pin our hopes on that one yet either.

Corporate earnings

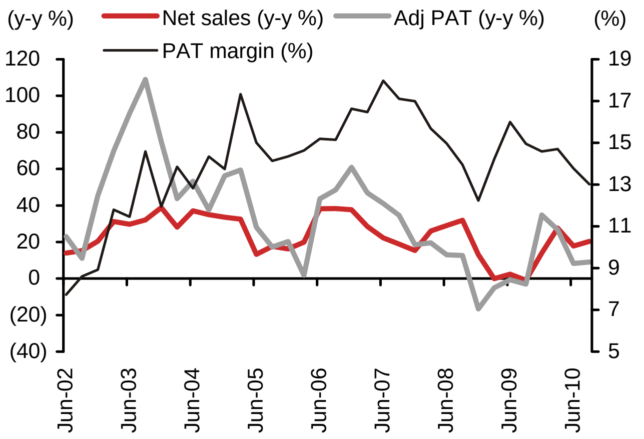
Downside risk to consensus earnings growth expectations of 20% for FY12F

Macro outlook for earnings is tough next year: We reckon that the prospects for corporate profitability next year would be shaped by a macroeconomic environment characterised by wage pressures, rising commodity prices, elevated inflation, tight liquidity (in the first half, at least), downward sticky interest rates, a strong rupee, somewhat muted government expenditure in the backdrop of strong domestic consumption and below-trend global economic growth.

The macroeconomic environment for earnings will likely be tough next year

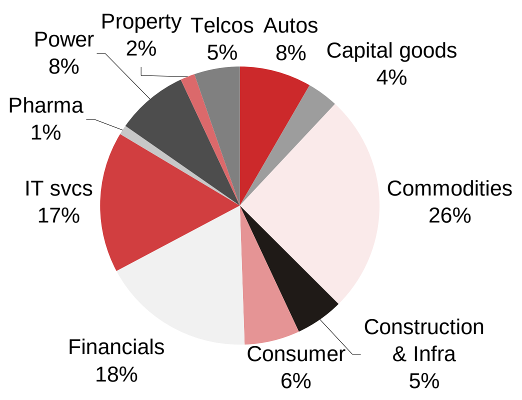
High commodity prices and wage pressures: A broad sense of how earnings could evolve next year can be obtained by examining the impact of prices (prices of labour and commodities) and volumes (real growth) in a policy environment that we think will not be especially beneficial for corporates. We do not think that the government will have much headroom to push for significantly higher expenditure next year in real terms. Meanwhile, policy and economy-wide interest rates are only expected to rise from here and liquidity would most likely remain tight, in the coming months at least.

Exhibit 27. BSE100 ex-oil & gas and banks PAT, sales and margins



Source: Capitaline, Nomura research

Exhibit 28. Sensex decomposition by sector (by non-free float adjusted market cap)

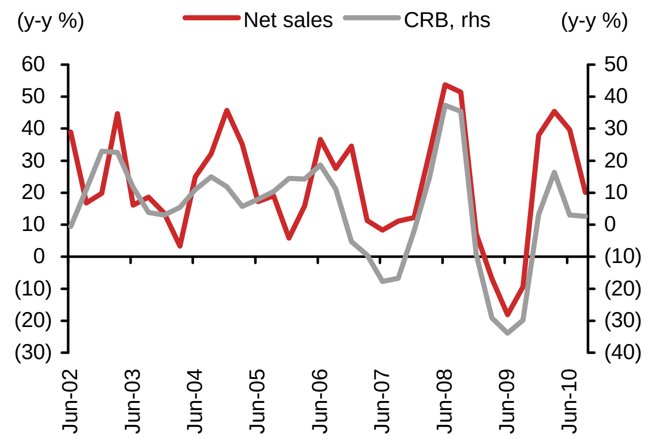


Source: Bloomberg, Nomura research

Capacity constraints = little benefit from operating leverage: Margin pressures on account of higher raw material and fuel prices and wage costs could ease for sectors with high operating leverage when volumes pick up, as was seen during the first three quarters of FY10 post crisis. However, with capacity constraints being felt across sectors—in other cases, slow execution has the same effect—and capacity utilisation rates remaining high, we think that most corporates could struggle to fully benefit next year from high operating leverage.

Rising commodity prices would benefit commodity plays, but hurt the larger manufacturing sector: While we expect domestic wage pressures to intensify across sectors, rising commodity and oil prices would help the top-lines of commodity producers (these dominate the Sensex with 26% weight in terms of market capitalisation, unadjusted for free-float) while increasing the input cost burden of the larger manufacturing sector. As can be seen in the Exhibits below rising commodity prices typically benefit commodity producers (both top-line and earnings) while putting pressure on COGS of the larger manufacturing sector.

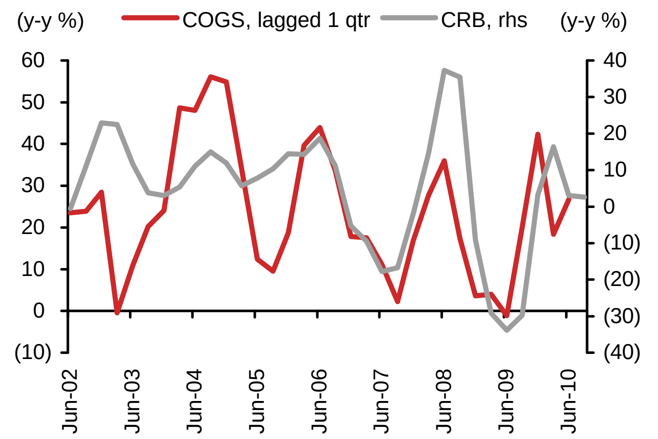
Exhibit 29. BSE100 commodity sector net sales vs. commodity prices



Note: Ex-OMCs

Source: Capitaline, Bloomberg, Nomura research

Exhibit 30. BSE100 manufacturing sector COGS vs. commodity prices

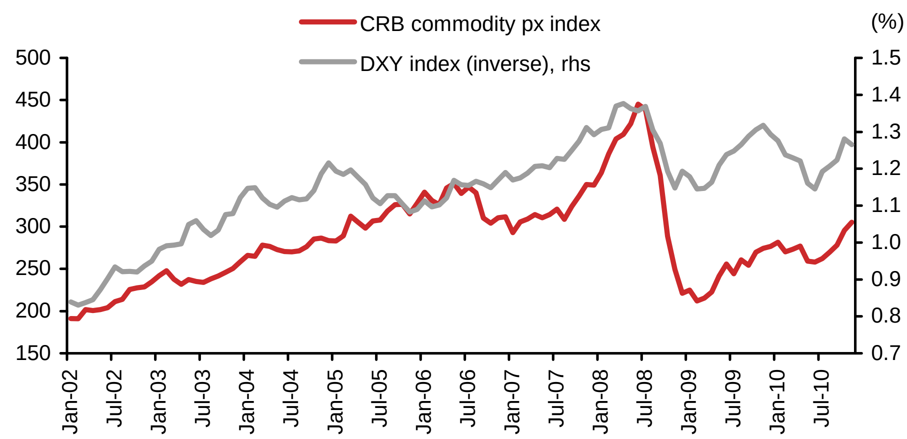


Note: Ex-oil & gas and banks

Source: Capitaline, Bloomberg, Nomura research

Risks to commodity price inflation: We must admit that it is tricky to assess the impact of commodity prices on earnings next year in the volatile risk sentiment that characterises the global landscape presently. First, while most expect the dollar to remain weak because of quantitative easing by the Fed, whether more bond purchases will be required is not certain; our global economics team believes that activity and inflation in the US will improve sufficiently by the middle of next year for the Fed to stop further purchases. As can be seen below, global commodity prices mirror movements in the US dollar and the fate of the dollar will be important in determining the direction of commodity prices.

Exhibit 31. US$ and commodity prices



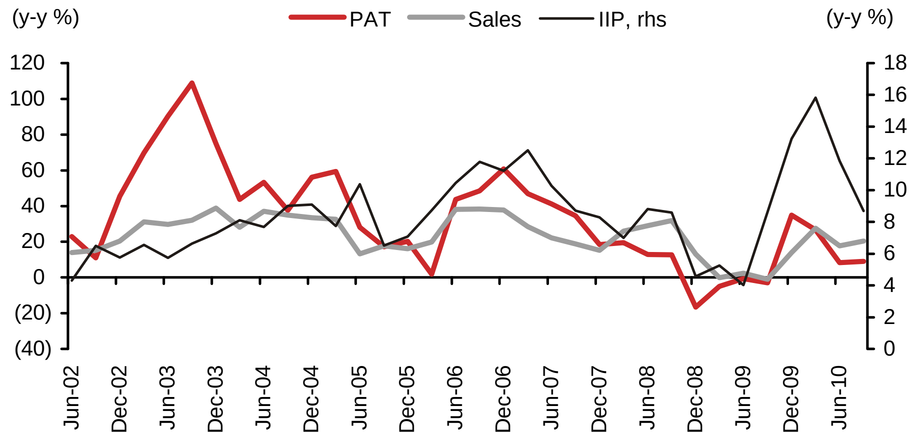
Source: Nomura International (HK) Limited

Second, how inflation plays out in China and how monetary authorities decide to deal with it will be important in determining sentiment towards commodities given China's pivotal role in demand for global commodities. Third, resurgent sovereign fears in Europe could be accompanied by renewed risk aversion, which would benefit the dollar but cause commodity prices to weaken.

A slowdown in growth momentum would be a headwind for sales and earnings growth

Industrial production growth has a strong bearing on revenue and earnings growth: Having looked at the effect of prices—price of labour, fuel and raw materials—on earnings above, we now turn to the effect of real economic activity on sales and profitability. As we discussed in the section on growth above, here we find that real activity (as proxied by industrial production) lags domestic systemic liquidity conditions (as proxied by banks' net lending to/borrowing from the central bank) by about 4-6 months. As can be seen in the exhibit below, industrial production as a barometer of domestic industrial activity strongly influences sales and profits of companies contemporaneously. We note here that IIP pertains to only the industrial sector and does not cover services, which account for more than 50% of GDP; yet we find it useful as a contemporaneous indicator of sales and profits of companies.

Exhibit 32. Industrial production vs. corporate sales and PAT



Source: Capitaline, Nomura research

We discuss our views on systemic liquidity in detail in a separate section below, and believe that liquidity will most likely remain deficient in the near term. Given the lagged relationship between IIP and liquidity and adverse base effects at play, we think industrial production will remain weak until the middle of next year and prove to be a drag on corporate top and bottom lines.

Inflation outlook

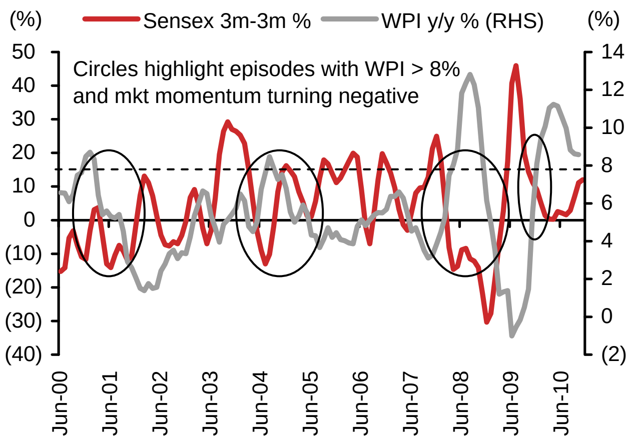
The inflation redux

Inflation—can it again play spoilsport? The simple answer is—yes, it most likely will. But how much and how fast inflation rises next year will largely be dictated by external developments—India's WPI basket is mainly influenced by global commodity prices—affecting the value of the dollar and outlook for demand for commodities driven in large part by China. In our base case scenario, we see upward pressure on global commodity prices on a combination of closing output gaps and quantitative easing-led downward pressure on the dollar.

Rising global commodity prices are a clear and present danger for domestic inflation

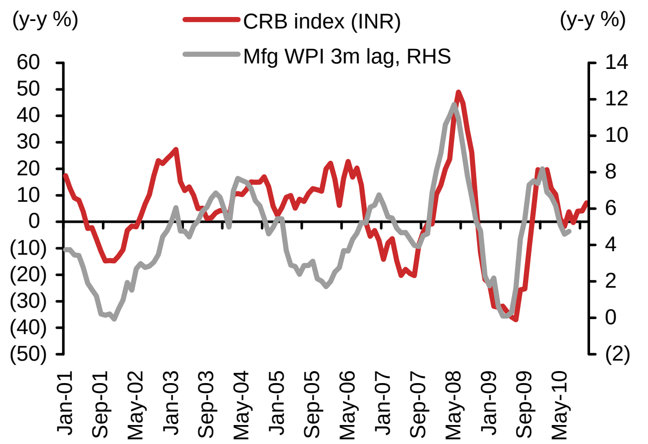
The cyclical and the structural: High food inflation has morphed into a structural issue now as rising urban and rural incomes continue to put upward pressure on food prices with supply constraints and underinvestment in the food supply chain limiting the supply-side response. The cyclical component of food inflation might well respond to the seasonal ebb and flow of sowing and harvesting cycles but the underlying structural shift towards downward sticky food prices will most likely provide a floor for the extent by which food inflation might stabilise next year. Also, base effects should turn unfavourable in the second half of next year as inflation peaked in April this year. Further, we expect wage inflation to emerge as a key theme next year amid rising labour shortages (discussed earlier in detail), and this could present an upside risk to inflation expectations.

Exhibit 33. Inflation and market momentum



Source: Business Beacon, Nomura research

Exhibit 34. Manufactured products inflation and global commodity prices



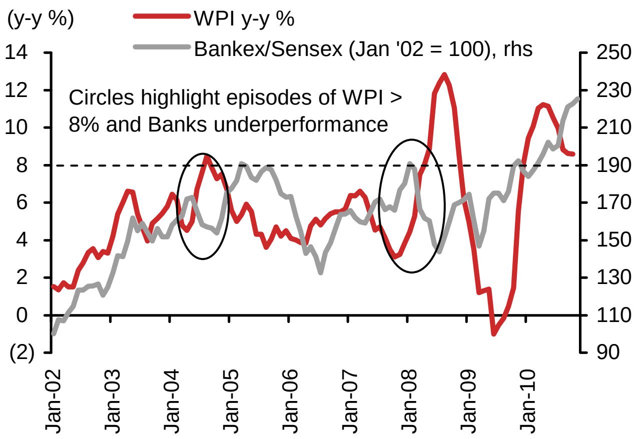
Source: Business Beacon, Nomura research

Market momentum at risk in a high inflation environment: Market momentum has a significant negative contemporaneous relationship with inflation in environments in which inflation is high and rising fast, as was the case late last year and earlier this year on the back of steep food inflation . While risks to inflation next year remain on the upside, we think the trajectory of inflation will most likely be declining in the first half of next year and then rising in the second half with adverse base effects coming into play.

Banks and metals: Banks tend to underperform the market during periods of high inflation (WPI above 8%) in expectation of reactionary monetary tightening; please see chart below. The sector most likely to benefit from high commodity prices would be metals and this is reflected in relative outperformance of the sector during episodes of rising commodity prices (please see Exhibit below).

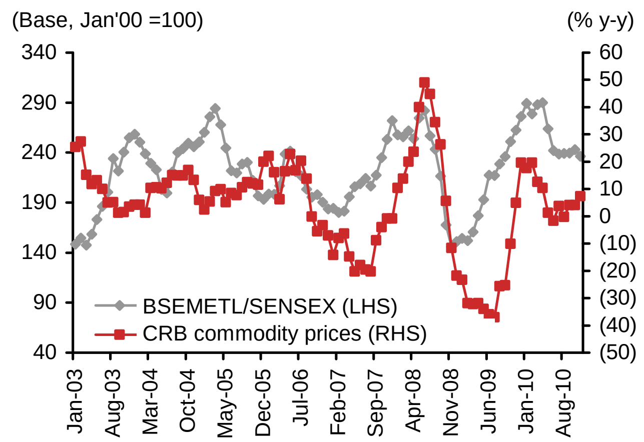
Market momentum could wane; banks at risk of underperformance; metals could benefit

Exhibit 35. Banks relative performance and inflation



Source: Business Beacon, Nomura research

Exhibit 36. Metals relative performance and commodity prices



Source: Business Beacon, Nomura research

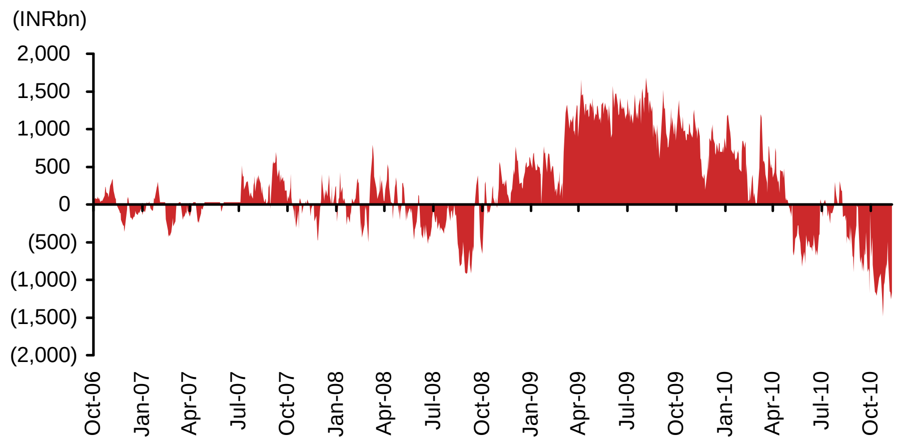
Liquidity and interest rates

Liquidity would be tight in the near term and interest rates downwards sticky

The liquidity squeeze is tighter now than it was at the peak of the crisis in 2008

Seasonal ebb and flow: Systemic liquidity has been in deficit mode since the June this year, after the government impounded RBI receipts from the wireless spectrum auctions instead of spending and putting money back in circulation. In a typical year LAF (Liquidity Adjustment Facility**)** balances exhibit a reasonably predictable amount of seasonality with liquidity becoming tight in the second half of the fiscal year in comparison to the first half. Banks were in lending mode to the RBI during April-June; LAF balances started falling in September and bottomed out in December because high demand for currency from the public during the festival season coincided with advance tax outflows. January saw an increase in liquidity which then started to decline again before bottoming out in March. Typically systemic liquidity is in surplus in September, which provides the cushion for the drain of liquidity in the December-quarter. However, this year has been an exception so far because we started 2H FY11 in deficit mode.

Exhibit 37. Net LAF balances (Banks' borrowing from/lending to the RBI)



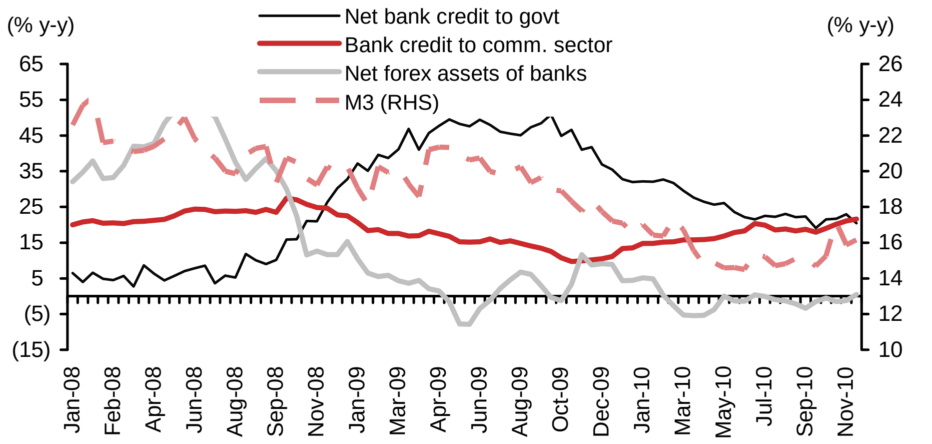
Source: Bloomberg, Nomura research

Lack of government spending has capped systemic liquidity and expansion of broad money supply

Deposit growth has been weak: This tightness of systemic liquidity has been fortuitous for the central bank and expedited the transmission of policy rate hikes to the wider interest rate structure in the economy. As is evident from the Exhibit below, this liquidity deficit is reflected in the weak growth in money supply, driven by the decline in the growth rate of deposits. While slow credit off-take by the commercial sector was responsible for this slow growth in money supply last year, the government has also played an important role. Before we elaborate on this, we would like to note here that lack of forex intervention by the RBI has limited the expansion of forex assets of the banking system, the largest source of money supply.

Lack of government spending has played its part: Fiscal consolidation started in earnest in 4Q CY09 and has been a major headwind for broad money supply expansion (M3), offsetting credit expansion by banks which has picked up after bottoming out at the beginning of this year. In addition, the government, by depositing spectrum auction proceeds with the RBI, has hindered expansion of the monetary base, which in turn has prevented expansion of broad money supply through the money multiplier.

Exhibit 38. Money supply and its components



Source: Capitaline, Nomura research

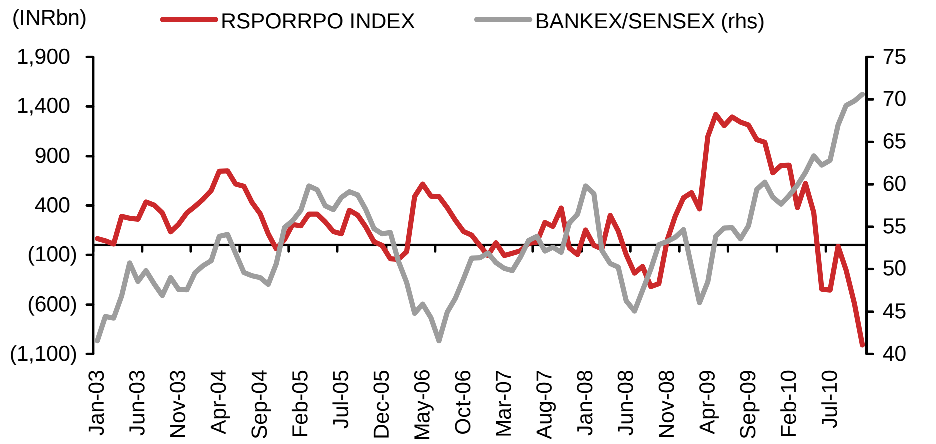
How can this liquidity squeeze ease? That being said, the liquidity situation can change on a combination of the following developments: 1) government spending (the government has limited scope of expanding spending, especially in light of the strain on government finances because of rallying global commodity prices); 2) open market operations (OMO) by the RBI; 3) unsterilised forex intervention by the RBI (the RBI has not intervened since November 2009); 4) CRR cut by the RBI (a policy tool that can be brought into play in the RBI), and; 5) mobilisation of deposits by banks (higher real interest rates, driven by an increase in deposit rates, would provide incentive to the public to invest in higher interest yielding deposits; this would be accompanied by increases in lending rates by banks to protect their interest margins).

Continuing tightness in liquidity could put net interest margins of banks under pressure

Liquidity—the oil that greases the economy: Tight systemic liquidity and excess demand for loanable funds feeds through to short-term interest rates, raises funding costs and impacts industrial output with a lag, thereby putting pressure on corporate top-lines and profits (we have discussed this above in the section on earnings).

An overhang for banks—net interest margins at risk: Sector-wise, an extended period of tight liquidity, we believe, would be an overhang for banks. The Exhibit below plots the performance of banks relative to the market vs. systemic liquidity. The two series typically tend to track each other closely, except for three quarters in 2006. However, banks have outperformed the market even though systemic liquidity got severely squeezed since June this year—banks have, on average been borrowing more from the RBI on a daily basis than they did at the peak of the crisis in September 2008—and the relationship between the two series has never decoupled to such an extent in the past.

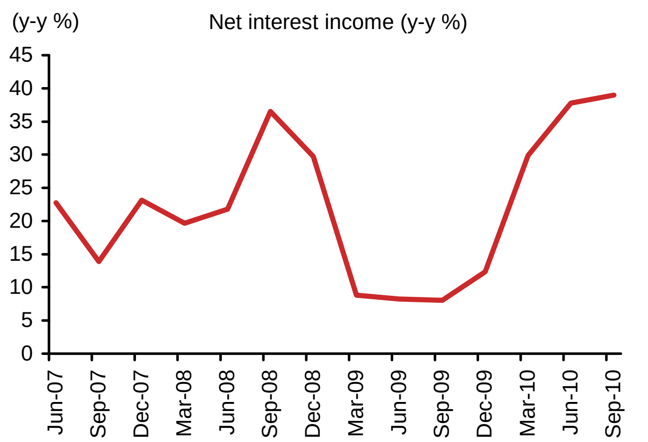
Exhibit 39. Liquidity vs. banks' performance relative to the market



Source: Bloomberg, Nomura research

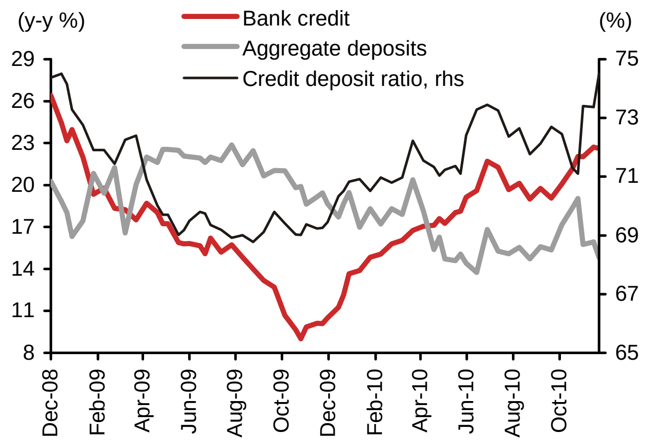
That banks have been able to outperform despite such adverse liquidity headwinds has been, in our view, because core profitability of the sector has remained strong this year and has been underpinned by expectations that the liquidity squeeze is temporary and would ease once the government redeployed funds obtained from spectrum auctions in May this year. Net interest income growth for banks bottomed out in September 2009 and has been rising since because of an expanding credit-deposit ratio, higher investment yields, and benefits from re-pricing of deposits and implementation of the base rate. However, we think headwinds for banks will worsen next year as margin pressures appear because of higher cost of funds as banks raise deposit rates to mobilise deposits. Further, an increase in deposit growth rates from here will likely squeeze the incremental credit-deposit ratio causing NIMs to fall.

Exhibit 40. Banks' net interest income growth (y-y %)



Source: Capitaline, Nomura research

Exhibit 41. Banks' credit and deposit growth



Source: Bloomberg, Nomura research

Currency

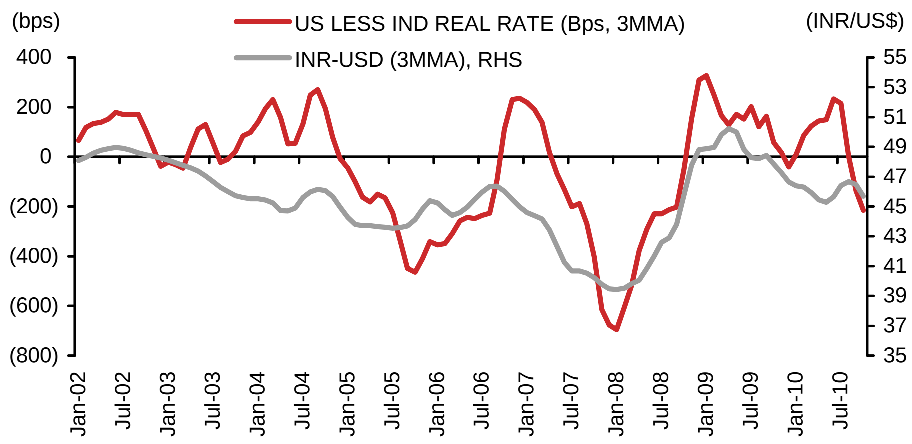
Rupee well supported but global risk environment key

Favourable growth and real rate differentials: Forecasting near-term exchange rate movements is fraught with hazards even in the dullest of times. The task of predicting the fate of the rupee next year is made especially tricky because of the volatile global risk environment we find ourselves in.

Favourable real rate and growth differentials should be positive for the rupee

However, in our base case scenario the rupee will remain supported by strong fundamentals next year with high rate and growth differentials setting the stage for capital flows into the country and attendant rupee appreciation. A high domestic interest rate environment and tightening monetary policy next year will stand in contrast to low interest rates (fuelled by quantitative easing that could be extended) and loose monetary policy in the developed world. We see tailwinds to real rate differentials which we expect to move in India's favour during the first half of 2011 as headline inflation comes off. On growth differentials, even though we expect domestic momentum to slow down in the first half of next year, India should continue to enjoy healthy differentials with respect to the developed countries.

Exhibit 42. Real rate differentials and the rupee



Source: Capitaline, Nomura research

Uncertain global risk environment remains a key risk: That said, we think ongoing sovereign concerns in Europe will be a key risk to our view on the rupee. We saw two episodes of risk flares in Europe this year which derailed the rupee's upward march—Greece in May and then Ireland in November. Another risk is that a significant rise in oil prices could stretch the trade deficit and lead to downward pressure on the rupee.

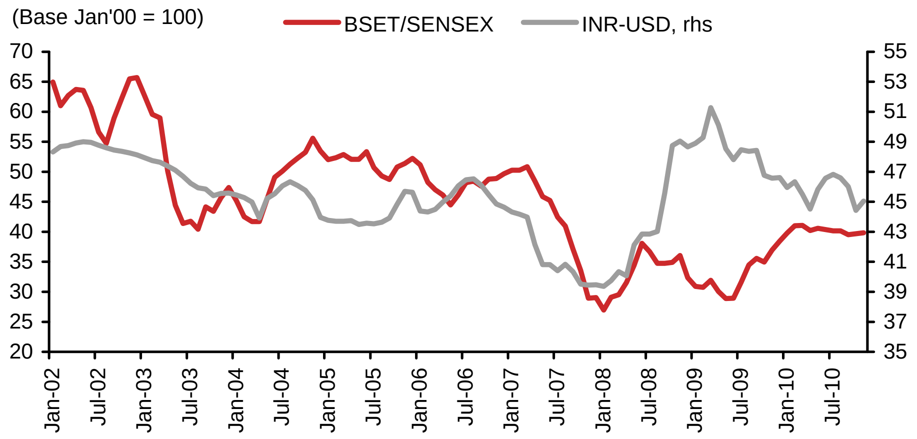
The uncertain global risk environment and a potentially sharp rise in trade deficit on rising crude oil prices are key risks to rupee strength next year

Key exporting sectors at risk from rupee appreciation, especially IT services: All else being equal, rupee strength would be a headwind for major exporting sectors—IT services, primarily, and pharma—and global cyclicals such as oil & gas and metals.

As can be seen in the Exhibit below, IT stocks typically tend to underperform the market in the backdrop of a rising rupee. This relationship has been quite stable in the years leading up to the crisis in September 2008, but we saw a dislocation of this relationship in the post-crisis period. Global turmoil and growth concerns led to a period of rupee weakness and underperformance of IT stocks. Then in the period following June 2009, the sector outperformed amidst rupee strength on growing evidence of the emergence of "green shoots of recovery" in the US, which offset headwinds of rupee appreciation. We have decided to underweight the IT sector next year but are aware of the risk that should the strength of the US recovery surprise on

Rupee strength is a headwind for exporters, especially IT services the upside next year then IT stocks could benefit from that tailwind, especially if this coincides with weak market sentiment on account of inflation and growth concerns.

Exhibit 43. IT sector price performance relative to the market vs. the rupee



Source: Capitaline, Nomura research

Impact on commodity sectors—oil & gas mixed, metals positive: The sector-wide impact on oil & gas would be mixed, in our view, while the US dollar-denominated revenues of Reliance Industries and Cairn would suffer from translation losses, OMCs would benefit from a stronger rupee on lower rupee price of crude. The read-across for rupee strength for metals would be through the adverse impact on domestic pricing power though import-parity pricing. However, to the extent that rupee strength typically tends to accompany rising commodity prices, the upside to metal producers from higher commodity prices could be capped by a stronger rupee.

Valuations

Valuations—not a tailwind for the market

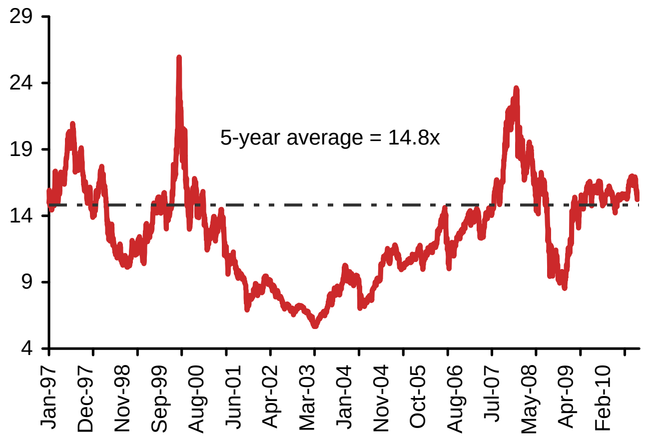
The market, with a 12-month forward earnings multiple of 15.7x, is trading at a 6% premium to its 5-year average of 14.8x. While the market does not seem overly expensive at these levels, we do not think that it is attractively priced either. The difference between the earnings and the bond yield tells a similar story.

Valuations lack earnings support and face headwinds from expected slowdown in growth momentum in the near term

Benchmarking India in a regional perspective gives us further reason to believe that the market does not have solid valuation support at current levels. As can be seen in the charts below, on our estimates, valuations do not look attractive on an earnings or book basis when adjusted for EPS growth and ROE, respectively.

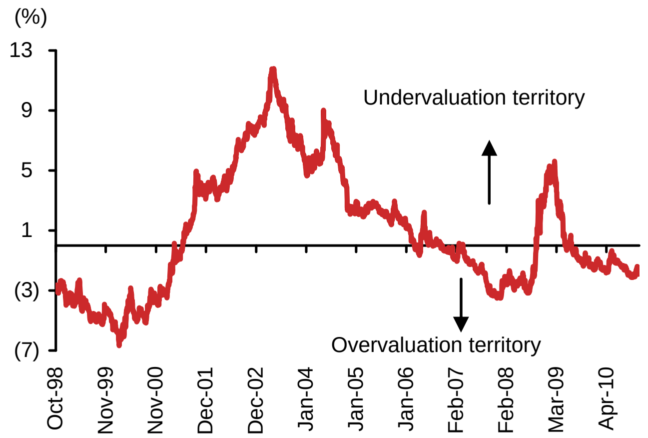
The market also looks expensive compared to major regional peers

Exhibit 44. Sensex 12m forward consensus-based P/E multiple



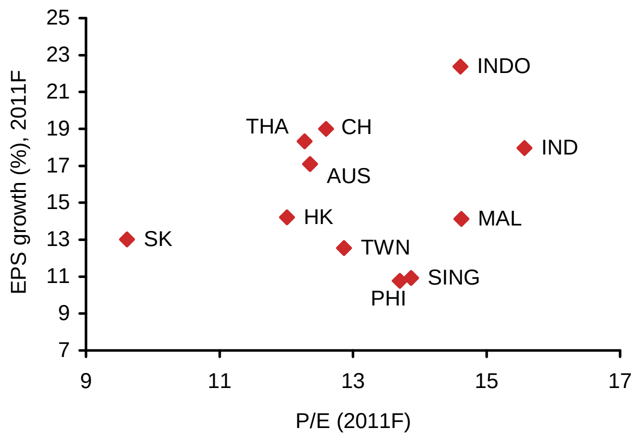
Source: Business Beacon, Nomura research

Exhibit 45. Sensex earnings yield minus 10-year govt nominal bond yield



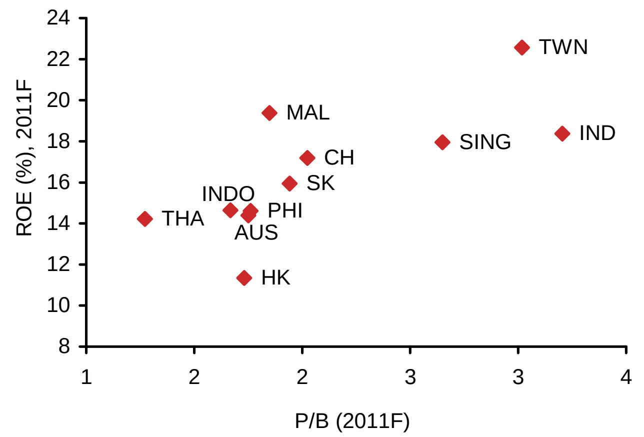
Source: Business Beacon, Nomura research

Exhibit 46. P/E multiple vs. EPS growth in a regional context



Source: Business Beacon, Nomura research

Exhibit 47. P/B multiple vs. ROE in a regional context



Source: Business Beacon, Nomura research

Summary of broad themes

Key themes for 2011

We have elaborated our thoughts in some detail on how we expect key determinants of market and sector performance to play out in 2011. We summarise these key themes in the table below.

Exhibit 48. Key themes for 2011

Key theme	Comments
Growth	Expect near to short-term headwinds to growth. Tight systemic liquidity and adverse base effects will likely lead to weak IIP growth numbers in first half of 2011. Expect strong private consumption, muted government spending, risks to meaningful pick-up in investment cycle and uncertainties on external demand. **Market sentiment will likely take its cue from weakness in IIP growth in 1HCY11F**. **Consumer stocks should be a good defensive play.** However, India should continue to enjoy high growth differentials vs. developed economies.
Inflation	See strong headwinds to inflation on rising global commodity prices. Labour shortages and rising wages could exacerbate the wage-price spiral. Expect some tapering off in 1HCY11F on base effects. **Market momentum at risk amidst rising inflation. See downside risk to banks while metals would likely benefit from rising commodity prices**
Earnings	Macro outlook for earnings would be tough next year: wage pressures, rising commodity prices, elevated inflation, tight liquidity, downward sticky interest rates, strong rupee, government expenditure in the backdrop of strong domestic consumption and below-trend global economic growth. **See downside risk to consensus-based growth expectations of 20% for FY12F.**
Labour shortages	Strong government focus on rural development, salary hikes to government employees amidst high growth has vastly expanded aggregate demand. Labour shortages are becoming a binding constraint on growth and risk compressing margins of companies. **We prefer consumer-facing, less labour-intensive companies with pricing power. IT/BPO, mid-caps, construction and real estate companies are more vulnerable to labour shortages.**
Investment cycle/capex	Expect some disappointment in short to-medium term. See several obstacles to the capex cycle despite strength in demand. With a few large sectors driving organised manufacturing capex, the investment outlook for these key capex-driving sectors remains muted next year. Meanwhile, the unorganised manufacturing sector suffers the most in an environment of very tight liquidity. **We prefer power-related capex plays. Lower-than-expected order inflows remain a key risk for construction companies.**
Policy	Expect monetary policy to get tighter with policy rates still remaining quite accommodative. With limited room for spending on the fiscal side, expect fiscal consolidation to continue. Rising global commodity prices, especially crude oil, remains a key risk on the fiscal side. **We do not expect positive developments on reforms to be a catalyst for the market next year.**
Liquidity	Expect liquidity to remain tight in the near-term and keep short-term interest rates elevated. **Funding costs for corporates would likely remain high, growth momentum of industrial output will likely wane, thereby putting pressure on corporate top-lines and profits. Continuing tightness in liquidity could put net interest margins of banks under pressure.**
Rupee	Favourable rate and growth differentials would be positive for the rupee. The uncertain global risk environment and a potentially sharp rise in trade deficit on rising crude oil prices are key risks to rupee strength next year. **Key exporting sectors at risk from rupee appreciation, especially IT services. The impact on commodity sectors—oil & gas mixed, metals positive.**
Valuation	Valuations lack earnings support and face headwinds from expected slowdown in growth momentum in the near term. The market also looks expensive compared to major regional peers. **Valuations are not a tailwind for the market.**

Source: Nomura research

Sector overview

Sector strategy

Exhibit 49. Sector strategy

Sector	Headwinds	Tailwinds	Relative weighting for asset allocation*
Autos	Rising raw material costs; slowdown in industrial production; tight liquidity and rising interest rates; concerns on CV volume growth; reduced benefits from operational leverage amidst capacity constraints	Strong consumer incomes and rising wages	Underweight
Banks	Margin pressure from tight liquidity, rising inflation and tightening monetary policy	Rising credit offtake, improving asset quality	Underweight
Cement	Subdued pricing environment, margin pressures from higher raw material prices (coal)	Slowing down of capacity additions with incremental supply expected to match incremental supply; expected pick-up in infra and capex cycles	Underweight
Consumer	Margin pressure from higher raw material prices and ad spends due to greater competition	Strong rural and urban consumption	Overweight
Electrical Equipment	Margin pressure from rising foreign and domestic competition and higher raw material and wage costs; shortages of labour; weak recovery in industrial capex	Power-related capex upside; T&D equipment makers to likely witness order revival in 2011	Overweight
Infra & Construction	Weakness in investment cycle; land acquisition, environmental and policy issues; labour shortages	Pick-up in execution; mitigation of working capital concerns; roads and power sector orderflow	Underweight
IT Services	Margin pressures from rising wage costs; rupee appreciation; tailing off of upside from M&A integration, vendor consolidation and pent up spending; higher tax rates with STPI expiry in March 2011	Rebid scenario; potential mix-based pricing increases on discretionary spending increases	Overweight
Media	Margin pressures from high programming costs and competition	Continuing momentum of digitalisation of cable industry to benefit DTH operators and broadcasters; buoyancy in advertising revenues	Overweight
Metals & Mining	Delays in greenfield capacities even though there has been good progress on brownfield; rupee appreciation; China growth and policy environment	Higher commodity prices, captive raw materials (iron ore)	Overweight
Oil & Gas	Under-recoveries and sharing mechanism; Cairn/Vedanta near-term headwind; delays in oil reforms and deregulation of oil prices; rupee appreciation headwinds for RIL and Cairn but would offset pressures on oil PSUs	Upside to gas volumes if gas pipeline infrastructure improves	Overweight
Pharma	Rupee appreciation; regulatory risk	Patent expiries; increasing generic penetration; collaboration with big pharma; secular growth in India and emerging markets	Overweight
Power	Higher-than-expected fall in merchant tariffs, lack of coal supplies under FSAs, execution delays	Potential regulatory easing in terms of auctioning of coal blocks and dilution in 'no-go' mining areas, successful introduction of super-critical technology, continued power demand-supply gap in the near term	Overweight
Real Estate	Debt repayments coming up with weak cash flows; high prices restricting volumes	Improvement in office leasing and possible increase in rents in the latter half of the year; improvement in retail mall leasing; stability in residential segment	Underweight
Telcos	Tough competitive environment; regulatory risk	Continued growth in voice usage, 3G data adoption, Potential exit of some recent entrants following license review	Underweight

Note: relative weightings for asset allocation given here are different from absolute sector ratings given in the sector section of this report

* Relative to BSE100

Source: Nomura research

Long only

Long-only basket

Exhibit 50. Recommended long-only basket

Sector	Stocks	Bloomberg ticker	Rating	Price (8 Dec)	Target price
Automobiles	Mahindra & Mahindra	MM IN	BUY	789.3	892*
	Bajaj Auto	BJAUT IN	BUY	1,565.7	1,810
Banks	ICICI Bank	ICICIBC IN	BUY	1,104.4	1,355
	HDFC Bank	HDFCB IN	NEUTRAL	2,280.5	2,660
Construction	Nagarjuna Constructions	NJCC IN	BUY	135.2	194
	HCC	HCC IN	BUY	44.5	80
Electrical Equipment	Crompton Greaves	CRG IN	BUY	327.9	380
	Cummins	KKC IN	NEUTRAL	768	820
FMCG	ITC	ITC IN	BUY	166.8	200
	Pantaloon Retail India	PF IN	BUY	389.5	553
	United Spirits	UNSP IN	BUY	1,431.2	1800
	Dabur India	DABUR IN	BUY	97.3	116
Metals	Tata Steel	TATA IN	BUY	624.3	846
	Sterlite Industries	STLT IN	BUY	169.4	199
	SAIL	SAIL IN	BUY	178.1	264
Oil and gas	Cairn India	CAIR IN	BUY	327	370*
	Reliance Industries	RIL IN	BUY	1,020.6	1200
	GAIL India	GAIL IN	BUY	507.4	545
	Petronet LNG	PLNG IN	BUY	121.8	145
Pharmaceuticals	Dr Reddy's Laboratories	DRRD IN	BUY	1,842.4	2084
	Glenmark Pharma	GNP IN	BUY	382.5	405
Property	HDIL	HDIL IN	BUY	195.6	366
Technology	Infosys Technologies	INFO IN	NEUTRAL	3,131.2	3200
	HCL Technologies	HCLT IN	BUY	433.1	510
	Mphasis	MPHL IN	BUY	596.6	770
Telecoms	Bharti Airtel	BHARTI IN	NEUTRAL	347.7	332
Utilities	Lanco Infratech	LANCI IN	BUY	61.9	76
	NTPC	NATP IN	BUY	191.0	228
	Power Grid Corp	PWGR IN	BUY	97.9	128

Note: * PT under review; relative weightings for asset allocation given here are different from absolute sector ratings given in the sector section of this report

Source: Bloomberg, Nomura research estimates

Appendix

A collection of recent media headlines on labour shortages in the country

Date	Title
19 Mar 2010	MNREGS has led to labour shortage, higher wages - Rediff.com Business Indeed, while there are no all-India figures, there are enough reports of a shortage of labour for agriculture in several key states in the ... http://business.rediff.com/report/2010/mar/19/mnregs-has-led-to-labour-shortage-higher-wages.htm
21 Apr 2010	NREGA fuels labour shortage in Punjab | India Environment Portal Patiala: Farmers are in a fix over the massive labour shortage ahead of the paddy sowing and transplantation season. www.indiaenvironmentportal.org.in/content/nrega-fuels-labour-shortage-punjab
15 Jun 2010	India farm sector faces severe labour shortage India farm sector faces severe labour shortage. India's farm sector is facing a severe labour shortage. Despite a bountiful harvest www.freshplaza.com/news_detail.asp?id=64807
17 Nov 2010	Address labour shortage, tech issues to compete with China Indian textile and apparel industry urgently needs to address immediate issues like labour shortage and lack of modern technology soon. http://smetimes.tradeindia.com/smetimes/news/top-stories/2010/Nov/17/address-labour-shortage-tech-issues-to-compete-with-china19003.html
3 Feb 2010	India: Power-loom owners confront labour shortage - Textile News Textile News India - Power-loom owners confront labour shortage - Surat's textile industry is confronted with shortage of labour on account www.fibre2fashion.com/news/textile-news/newsdetails.aspx?news_id=81971
18 Mar 2009	Donkeys fetch record prices due to labour shortage - The Times of The economic meltdown may be the monkey on our back, but the donkey market is alive and kicking in Maharashtra. http://timesofindia.indiatimes.com/india/Donkeys-fetch-record-prices-due-to-labour-shortage/articleshow/4279364.cms
14 Jun 2010	India farm sector faces severe labour shortage - Channel NewsAsia Despite a bountiful harvest, farmers will be hit by losses because there are just not enough people to harvest their crops. www.channelnewsasia.com/stories/economicnews/view/1063103/1/.html
12 Feb 2010	Realty Estate Sector Witnessing Labour Shortage - Real Estate India Real estate firms are feeling the pinch of skilled and unskilled labour shortage as infrastructure growth picks up and workers get tapped by www.indianrealtynews.com/real-estate-india/realty-estate-sector-witnessing-labour-shortage.html
31 May 2010	Textile News - India : India - Efforts to overcome labour shortage Textile News - India : India - Efforts to overcome labour shortage in textile mills: The Southern India Mills' Association (SIMA) plans to ... www.yarnsandfibers.com/news/index_fullstory.php3?id=22106
6 Oct 2010	Labour shortage major challenge in rubber sector - NDTV Profit The increasing labour shortage was turning out to be a major challenge confronting the natural ... http://profit.ndtv.com/news/show/labour-shortage-major-challenge-in-rubber-sector-105628
L Harris - 2010	The labour shortage is for real | Education and Professional ... Education and Professional Skills. The labour shortage is for real ... look at the reasons for shortage of labour in the construction industry in India and ... www.rics.org/site/scripts/documents_info.aspx?categoryID=637&documentID=858&pageNumber=6
2 Apr 2010	Migrants land sops as labour shortage grows - The Economic Times Plantation owners in Kerala and Punjab say that to retain the immigrant workforce, they will offer provident fund, gratuity and pension. http://economictimes.indiatimes.com/news/news-by-industry/jobs/Migrants-land-sops-as-labour-shortage-grows/articleshow/5753119.cms
6 June 2010	Handicraft exporters face labour shortage - Hindustan Times Handicraft exporters face labour shortage. Press Trust Of India New Delhi, June 06, 2010. First Published: 14:22 IST(6/6/2010) ... www.hindustantimes.com/Handicraft-exporters-face-labour-shortage/Article1-553907.aspx
13 Jul 2010	Labour shortage hits Himachal's apple harvest Despite an expected record crop this season, apple farmers in Himachal Pradesh are spending sleepless nights. Reason: acute shortage of ... www.business-standard.com/india/news/labour-shortage-hits-himachal%5Cs-apple-harvest/401213/
6 Mar 2010	The Hindu: Front Page : Coimbatore industries face labour shortage The labour shortage has gone up by about 10 per cent during the last one month. Some of the workers who came from North India have gone back ... www.hindu.com/2010/03/06/stories/2010030660440100.htm
3 Mar 2010	INTERVIEW-UPDATE 1-Labour shortage to hit Malaysia's palm output ... Malaysia may miss 18.1 mln t output target on labour woes * Better ... INDIA IN THE NEWS. Skill shortage, poor governance hurdles to growth ... http://in.reuters.com/article/idINSGE62209V20100303
5 Apr 2010	India : Coimbatore textile mills face labour shortage - Textile ... Textile News India - Coimbatore textile mills face labour shortage - Coimbatore, the textiles and engineering hub of South India is since ... www.fibre2fashion.com/news/textiles-association-organization-news/newsdetails.aspx?news_id=84319

Date	Title
22 Jul 2008	NREGA creating labour shortage in Agra | iGovernment.in India's NREGA have contributed to this shortage as the scheme provides jobs to villagers in their villages, thus stopping their migration to ... www.igovernment.in/site/NREGA-creating-labour-shortage-in-Agra
17 Mar 2010	Skilled-labour shortage looms in mining sector | ASPECT: BC's ... Skilled-labour shortage looms in mining sector ... India, for one, is set to overhaul its mining laws in a bid to attract foreign investment ... www.aspect.bc.ca/resources/skilled-labour-shortage-looms-mining-sector
23 Nov 2010	Now, Tirupur faces labour shortage - Tirupur News India Garment Manufacturers, Tirupur Exporter Association, ... Both are facing labour shortage, and the reason—the government's National ... http://tirupurnews.com/tirupur-news/now-tirupur-faces-labour-shortage/
9 Jul 2010	Faced with labour shortage, developers plan project to train work ... Latest news, breaking news - Faced with labour shortage, developers plan ... Confederation of Real Estate Developers' Associations of India ... www.indianexpress.com/news/faced-with-labour-shortage-developers-plan/644221/
13 Jul 2010	India: Labour shortage hits Himachal's apple harvest India: Labour shortage hits Himachal's apple harvest. Despite an expected record crop this season, apple farmers in Himachal Pradesh are ... www.freshplaza.com/news_detail.asp?id=66168
23 Apr 2010	Labour shortage affects grain markets in Punjab - India News ... Low inflow of labour from Bihar coupled with bumper wheat crop due to early ripening has created chaos in Punjab's grain markets that are ... www.dailyindia.com/show/371441.php
9 Aug 2010	Surat diamond industry faces labour shortage – DNA No cutters for diamonds: Though Surat's diamond industry is set to grow after last year's economic recession, the shortage has led to a ... www.dnaindia.com/videos/1421031
13 Jul 2010	Labour shortage hits Himachal’s apple harvest Despite an expected record crop this season, apple farmers in Himachal Pradesh are spending sleepless nights. Reason: acute shortage of ... www.business-standard.com/india/news/labour-shortage-hits-himachal%5Cs-apple-harvest/401213/

India Economic Outlook

The consolidation year

Sonal Varma
+91 22 4037 4087 sonal.varma@nomura.com

Activity: We expect real GDP growth to consolidate at 8% in FY12F (fiscal year ending 31 March 2012) after a strong 8.7% in FY11F due to three factors. First, we expect growth in agricultural output to normalise and year-on-year growth to be pulled lower by adverse base effects. Second, we expect growth in government consumption to slow after above-average increases since the onset of the financial crisis. Third, we expect net exports to be a larger drag on growth as imports pick up in line with improving domestic private demand. We forecast underlying private demand – both investment and private consumption – to remain strong. We expect private consumption to remain supported by rising wages and strong rural demand and investment to be led by infrastructure, real estate and services-sector capex.

Inflation: We expect headline WPI inflation to remain elevated, averaging 7.5% in FY12F, despite favourable base effects. We see inflation remaining sticky, due to what we see as a structural rise in commodity prices (we build in a 15% rise in the CRB index) and a closing output gap, which should result in greater demand-side inflation. We expect inflation to bottom in 4Q FY11F and start to climb from the 6%-handle in 1H FY12F to above 7.5% in 2H FY12F.

Policy: We expect inflation to persistently exceed the Reserve Bank of India's (RBI) comfort zone of 5.0-5.5%, prompting 75bp of rate hikes in FY12F. This will come on top of the aggressive 150bp of hikes in CY2010, shifting the monetary policy stance to modestly tight. In terms of profile, we expect the RBI to deliver a 25bp rate hike in January 2011, followed by a pause, before resuming with a 25bp hike each in 2QFY12, 3QFY12 and in 4QFY12. On the fiscal front, with less scope for proceeds from asset sales and high subsidy burden, we expect the central government's fiscal deficit at 5.2% of GDP in FY12F, above the required target of 4.8%.

Risks: A reversal in capital flows and lack of an investment revival are downside risks. A sharper-than-expected global rebound and falling commodity prices are an upside risk to our growth outlook.

Exhibit 51. Details of the forecast

% y-y growth unless otherwise stated	2QFY11	3QFY11	4QFY11	1QFY12	2QFY12	3QFY12	4QFY12	FY11F	FY12F
Real GDP (sa, % q-q, annualized)	**10.7**	4.6	8.1	8.5	8.5	8.1	8.6		
Real GDP	**8.9**	8.9	8.1	7.9	7.6	8.2	8.4	8.7	8.0
Private consumption	**9.3**	9.5	10.0	7.0	7.0	8.0	7.0	9.2	7.3
Government consumption	**9.2**	2.0	3.0	2.5	2.5	2.0	4.0	5.4	2.8
Fixed investment	**11.1**	11.5	9.5	12.0	15.0	15.5	13.5	12.5	14.0
Exports (goods & services)	**9.7**	10.0	10.5	14.0	15.5	13.5	14.0	10.2	14.2
Imports (goods & services)	**6.5**	11.0	11.5	12.0	17.0	15.0	15.5	9.9	14.9
Wholesale price index	**9.1**	7.8	6.6	6.8	7.7	7.9	7.5	8.5	7.5
Consumer price index	**10.3**	9.0	7.4	8.3	9.2	8.8	9.8	10.0	9.0
Current account balance (% GDP)								(3.7)	(4.0)
Fiscal balance (% GDP)								(5.2)	(5.2)
Repo rate (%)	**6.00**	6.25	6.50	6.50	6.75	7.00	7.25	6.5	7.25
Reverse repo rate (%)	**5.00**	5.25	5.50	5.50	5.75	6.00	6.25	5.5	6.25
Cash reserve ratio (%)	**6.00**	6.00	6.00	6.00	6.00	6.00	6.00	6.0	6.00
10-year bond yield (%)	**7.90**	8.10	7.90	7.70	7.90	8.10	8.20	7.9	8.20
Exchange rate (Rs/US$)	**45.9**	44.6	44.1	43.4	42.9	42.3	41.8	44.1	41.8

Note: Numbers in bold are actual values; others forecast. Interest rate and currency forecasts are end of period; other measures are period average. CPI is for industrial workers. Fiscal deficit is for the central government. Table last revised on 6 December 2010.

Source: CEIC and Nomura Global Economics

Key economic themes

Investment cycle to move to trend

Sonal Varma
+91 22 4037 4087 sonal.varma@nomura.com

Despite India's impressive V-shaped recovery, concerns persisted in FY11 about lacklustre investments. In our view, the below-trend investment growth should not be a surprise, as it takes about three years for investments to get back to trend. By this metric, investments should revert back to trend in FY12F. We forecast fixed investment growth of 14.0% in FY12F compared with an average of 8.2% for FY09-FY11F.

We expect investments to be supported by infrastructure, real estate and services sector capex

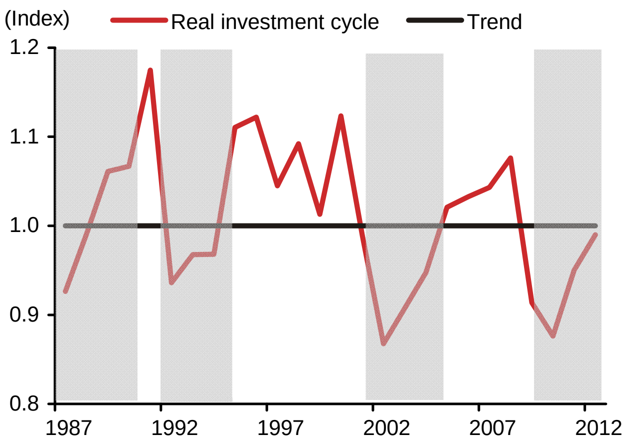
Unlike FY03-FY07, when manufacturing held the key to the capex revival, we expect the non-manufacturing sector to play a bigger role. First, we remain bullish on infrastructure led by power and roads construction activity. Our power analyst expects electricity capacity to rise by 12% to 196GW in FY12F, while our construction analyst expects annual national highways road construction of 3,500-4,000km in FY12F vs 2,500-3,000km in FY11F. Second, since residential sales have improved over the last 18 months, real estate construction activity and execution should pick up steam.

Third, we believe that the role of services sector (45% of total investments in FY09) in driving capex is under-estimated. During the financial crisis, strong services sector investment growth was one of the reasons why overall investment didn't collapse. Investment projects for health services, wholesale & retail trading, transport services and information technology are likely to keep overall services sector investment robust.

Manufacturing capex outlook is mixed due to cost pressures and domestic substitution

The outlook for manufacturing sector capex is much more mixed. Business confidence has improved, but global uncertainties still persist. Spare capacity is tight, but the recovery is still narrow, led largely by consumer sectors. Margin pressures – interest rates, input costs and labour costs – are much higher today. More importantly, "domestic substitution" is a growing threat. In some cases, such as in coal and oil, it is due to resource constraints. But where capacity can be augmented – such as in metals, project goods, chemicals, textiles – there is a growing threat of imported products potentially displacing domestic production. In our view, delays in land acquisition, delays in mineral allocation (for steel) and infrastructure constraints are beginning to bind on the ability of the manufacturing sector to continue to expand.

Exhibit 52. Real investment cycles



Source: CEIC and Nomura Global Economics

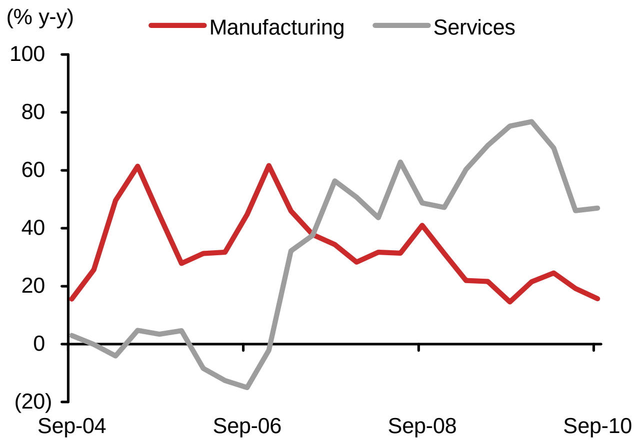
Exhibit 53. Share in projects under implementation*

	Manufacturing	Infra	Services	Construction & real estate
	% of total projects under implementation			
FY05	43.3	57.7	(2.2)	1.2
FY06	44.3	60	(4.6)	0.3
FY07	39.3	31.2	7.5	22
FY08	23.8	41.2	8	27
FY09	14.1	61.7	10.4	13.8
FY10	14.2	53.8	13.8	18.2
FY11 (1H)	7.4	61.2	13.8	17.5

* Share in incremental projects under investment

Source: Business Beacon and Nomura Global Economics.

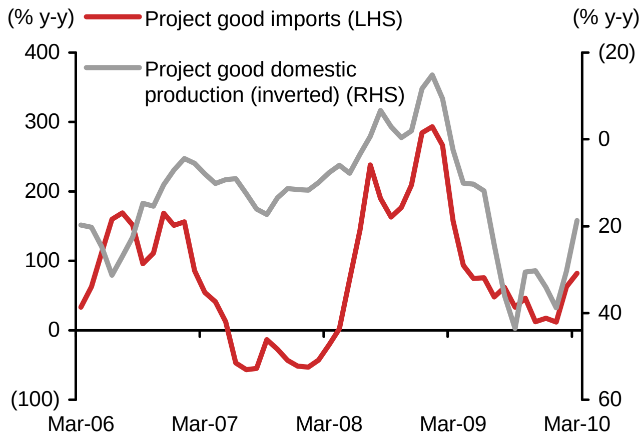
Exhibit 54. Manufacturing vs. services investments*



* Outstanding projects under implementation

Source: Business Beacon and Nomura Global Economics

Exhibit 55. Imports vs. production of project goods



Source: CEIC and Nomura Global Economics

Private consumption holding up

If FY10 was led by rural consumption and FY11 by urban consumption, we expect both rural and urban consumption to keep consumption robust in FY12F. However, as real government spending moderates, we expect real final consumption expenditure growth to moderate to 6.5% in FY12F from an estimated 8.5% in FY11F.

Both rural and urban consumption prospects look promising

We remain bullish on rural demand in FY12F, as the rebound in agriculture during the last cycle along with firm food prices should add to a host of other factors buttressing rural demand, such as improving connectivity, diversification away from agriculture, multiple sources of income and the government's rural programmes that are putting money in the hands of the consumers through higher rural wages.

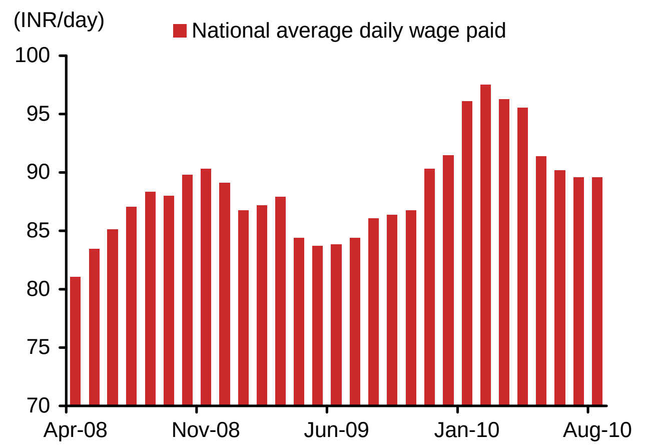
Despite higher inflation, we expect strong job prospects and wage increases to support higher urban consumption. The RBI's employment survey shows job prospects are back to their peak. In addition, positive wealth effects and resurgence in retail credit – particular housing and consumer durables loans – will be a positive.

Real government consumption growth will be a dampener in FY11F

However, we expect government consumption to be a dampener. Real government consumption has risen at an average of 13.5% y-o-y over the last three years, thanks to pre-election splurge and fiscal stimulus. With inflation running high and limited fiscal leeway, we expect a meagre real increase of 2.8% in FY12F.

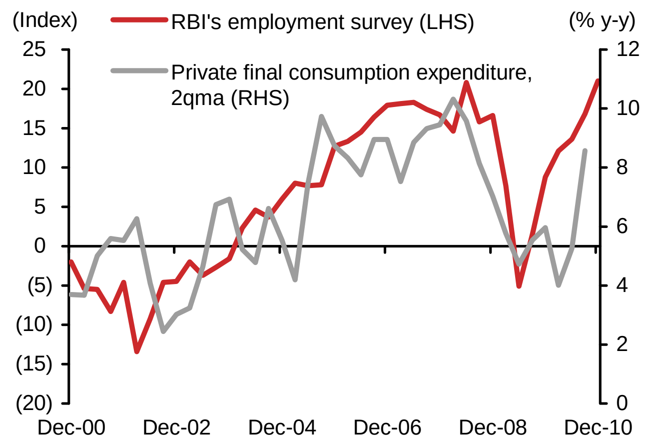
Can slower government spending derail private consumption? The co-movement between government and private consumption was indeed very close between FY99 and FY06, but has broken since then. We believe that fundamental factors such as income growth, and not government transfers, have been playing a more pivotal role in driving private consumption demand over the last four years, and this should hold true next year as well. However, after the scorching private consumption growth of 9.2% in FY11F, we expect a more modest, but still robust, growth of 7.3% in FY12F.

Exhibit 56. Wages paid under NREGA



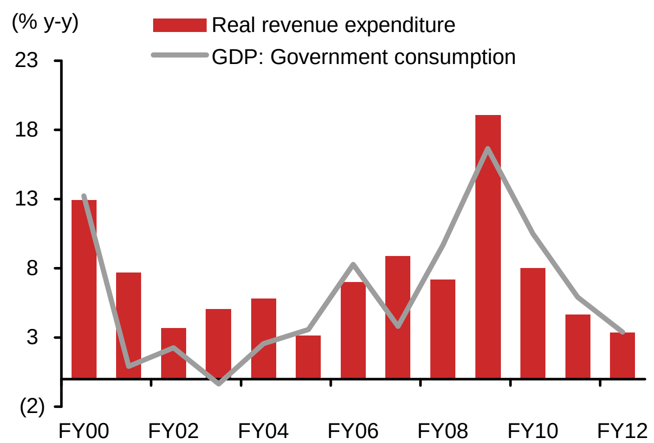
Source: NREGA and Nomura Global Economics

Exhibit 57. Employment and private consumption



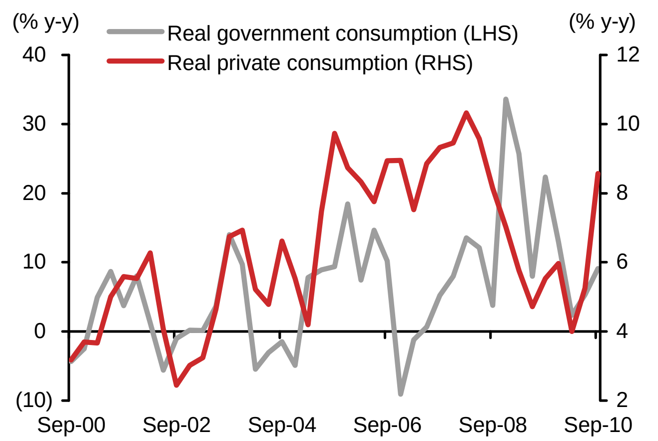
Source: RBI, CEIC and Nomura Global Economics

Exhibit 58. Government consumption expenditure



Source: CEIC and Nomura Global Economics estimates

Exhibit 59. Government and private consumption*



* Two-quarter moving average

Source: CEIC and Nomura Global Economics estimates

Downward rigidity in inflation

Inflationary concerns have dominated policymaking in FY11 and a fall in the headline inflation rate may offer some comfort in early-FY12F. However, the structural nature of food inflation, higher commodity prices and closing output gap suggests that this relief will be transitory. We expect inflation to remain above the RBI's projection of 5.5% throughout next year, with inflation resurging in 2H FY12F. On an average, we see the wholesale price index (WPI) inflation at 7.5% in FY12F versus 8.5% in FY11F.

We expect inflation to remain sticky due to high commodity prices and closing output gap

Food price inflation has become structural in India. Recent research by the RBI identifies a structural rise in the price of proteins – pulses, milk, egg, meat & fish – due to rising demand and low per-capita availability. However, the trend increase in food prices is not restricted to India. Globally, rising incomes in developing countries, supply constraints, climate changes, interventionist policies and increasing use of bio-fuels are likely to result in a sharp rise in food prices in the coming years, in our view (see Nomura Special Report http://www.nomura.com/research/getpub.aspx?pid=390252: The coming surge in food prices).

A de-composition of the inflation sub-components into seasonal, cyclical and trend series, confirms that trend inflation has shifted higher for a number of components. Within food, the trend inflation is higher for inputs such as protein-rich items, sugar and condiments & spices, resulting in higher output prices for bakery products, canning, preserving & processing of food, dairy products, processed manufactured products and tea & coffee processing. Within non-food components, the trend is higher in fibres and other non-food articles such as wood, hides, rubber, fodder and tobacco, resulting in higher output price of textiles, wood products and beverage & tobacco products. Therefore, while we expect the cyclical WPI inflation rate to remain in line with the historical averages, the components with higher trend inflation are unlikely to come off sharply, in our view, adding to the downward rigidity in overall inflation.

Trend inflation has shifted higher across both food and non-food products

Exhibit 60. Trend inflation in select WPI components

(% y-y)	Weight in WPI (%)	2005	2010
Food components			
Bakery products	0.4	1.6	6.6
Canning, preserving & processing of food	0.4	1.4	7.6
Dairy products	0.6	2.8	10.8
Egg, meat & fish	2.4	4.8	20.1
Milk	3.2	3.3	17.1
Other manufacturing (processed)	0.9	2.5	9.6
Condiments & spices	0.6	12.5	20
Sugar, Khandsari and Gur	2.1	0.7	21.4
Tea & coffee processing	0.7	1.8	10.2
Non-food components			
Fibres	0.9	0.1	11.6
Other non-food articles	1.4	4.6	16.1
Textile products	7.3	0.1	5.2
Wood & wood products	0.6	5.9	7.5
Beverage & tobacco	1.8	5.2	6.8

Note: We have eliminated the cyclical component of each product to estimate the trend in the series. Trend for 2005 calculated for Apr-Dec and for 2010 for Jan-Oct data, as per the new WPI index.

Source: CEIC and Nomura Global Economics estimates

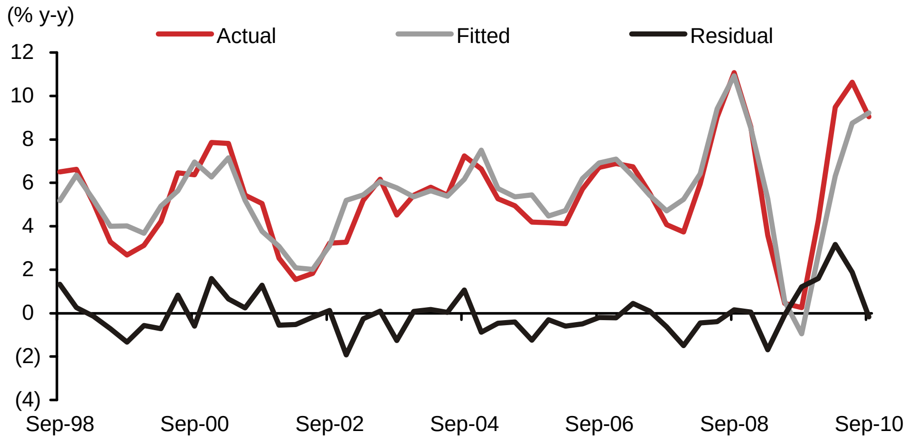
Our forecasts are reinforced by regression analysis on the WPI. Our fitted WPI inflation rate tracks the actual inflation rate closely. The results show a high persistence of inflation and the statistically significant role of commodity prices in driving WPI inflation. We expect the output gap to close, real effective Rs appreciation and a 15% rise in the Reuters Jefferies CRB index in FY12F. The scenario analysis shows that unless commodity prices remain unchanged for the next twelve months, the headline inflation is unlikely to fall below 6.0-6.5%. Therefore, we expect the inflation trajectory to pan out in two phases:

Phase I (4QFY11F-1QFY12F): Base effects will moderate the headline inflation to around 6.6% in 4QFY11F. We expect this to mark the trough and the headline inflation to start inching higher thereafter. Both food and non-food inflation should ease during this period.

Base effects will lower headline inflation in 4QFY11, but we expect a rebound in 2H FY12

Phase II (2H FY12F): Closing output gaps, adverse base effects, higher commodity prices and downward rigidity in the structural components are likely to push the headline inflation above 7.5% in 2H FY12F. We expect food inflation to surge to double digit and non-food manufactured inflation to rise to 6% by end-FY12F. Therefore, the fall in inflation is likely to be transitory.

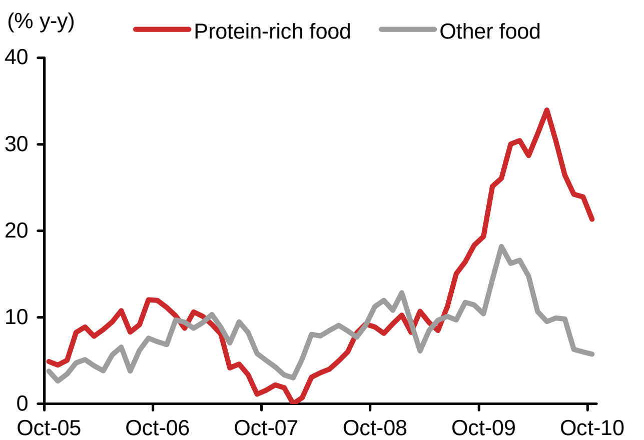
Exhibit 61. WPI inflation regression model results



Note: Independent variables include lagged output gap, auto regressive component of WPI, money supply, CRB index and REER. Regression estimated using data from Q2 1996 to Q3 2010 with an adjusted R-square of 0.81.

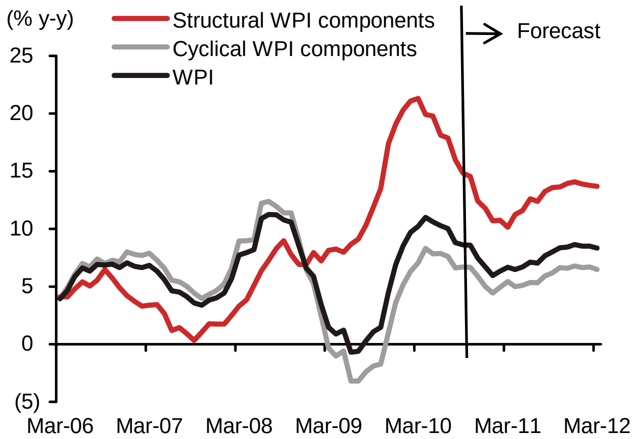
Source: CEIC and Nomura Global Economics estimates

Exhibit 62. Food inflation: protein vs. others



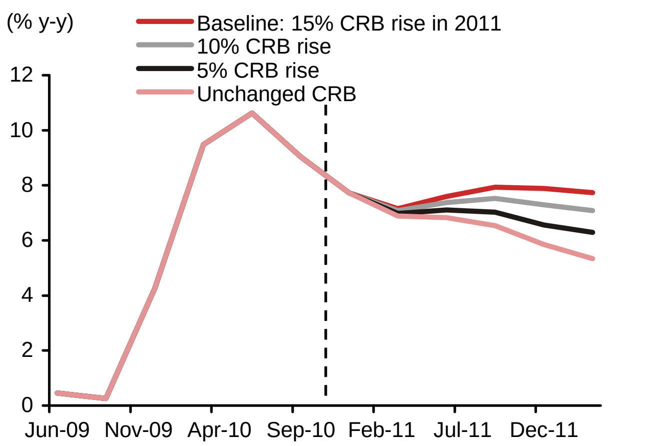
Source: CEIC and Nomura Global Economics

Exhibit 63. Structural versus cyclical components



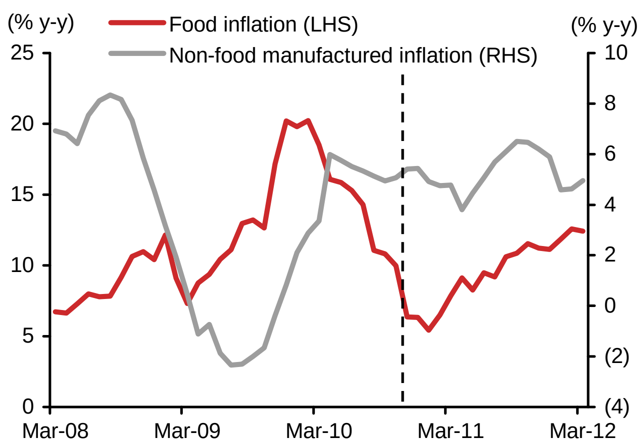
Source: RBI, CEIC and Nomura Global Economics

Exhibit 64. WPI forecast scenarios



Source: Nomura Global Economics estimates

Exhibit 65. Food and non-food manufactured WPI



Source: CEIC and Nomura Global Economics

Interest rates to inch higher

We expect pressure on interest rates to continue in FY12F due to sticky inflation, tight liquidity, lagged effect of high deposit rate on lending rates and continued pressure from government borrowing.

We expect 75bp of policy rate hikes in FY12F and systemic rates to continue to inch higher

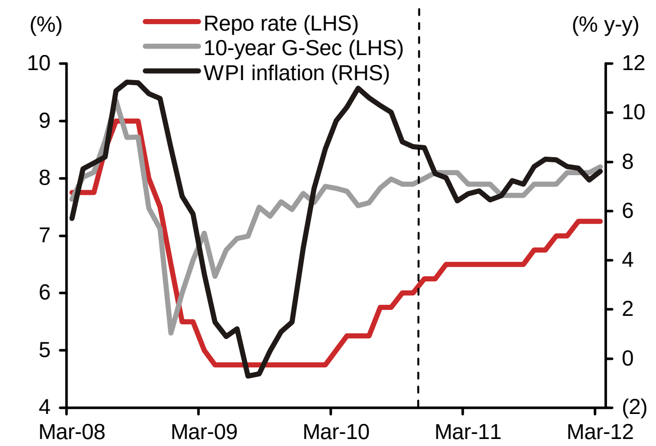
Re-emergence of input cost pressures and robust 1H FY11 real GDP growth of 8.9% suggests that both inflation and growth risk surprising on the upside in FY11F. This should lead to a 25bp rate hike in January 2011. For FY12F, we expect the repo rate to be hiked by 75bp to 7.25%, with no hike in 1Q FY12F and 25bp rate hikes each in the remaining quarters. The trajectory is based on our view of lower inflation until 1Q FY12F and a pickup in demand-side pressures in the second half. Despite the hikes, real policy rates will remain negative and we believe that the RBI will have to tolerate higher inflation because it cannot influence food prices, it can risk derailing the capex cycle and due to the risk of attracting even higher capital inflows.

Fiscal consolidation may take a pause in FY12F as one-off factors fade

Commercial interest rates should also move higher. Between Jul 2010 and Nov 2010, banks have increased their base lending rates by only 25bp, despite a 75bp hike in deposit rates. This suggests that the transmission of the higher funding costs to lending rates will occur in the coming quarters. Higher deposit rates should propel deposit growth to 18-19% in FY12F, but we expect credit growth to remain around 20% due to crowding out and substitution from external financing. This should allow banks some room to invest in government bonds.

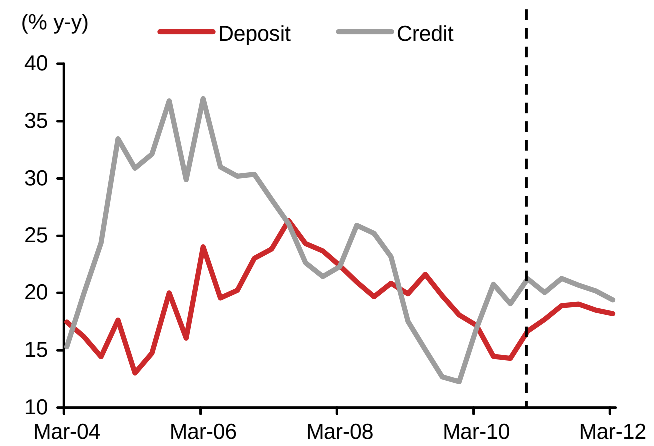
However, we expect fiscal policy to surprise negatively after the bonanza from asset sales in FY11F, with the budget deficit likely at 5.2% of GDP in FY12F, higher than the required target of 4.8%. High inflation should benefit the government through robust tax revenues, but it will also increase expenditure due to higher interest costs and subsidy burden. In this scenario, a reversal of the indirect tax cuts announced post crisis will be necessary. We expect the central government's net market borrowing at Rs3.7-3.8tr in FY12F, higher than the Rs3.45tr budgeted in FY11. In this tug-of-war, our rate strategy team expects the 10-year government bond yield to rally to 7.7% by June 2011, due to lower inflation, but to rise back to 8.2% by March 2012 as the rate cycle re-commences.

Exhibit 66. Inflation and interest rates



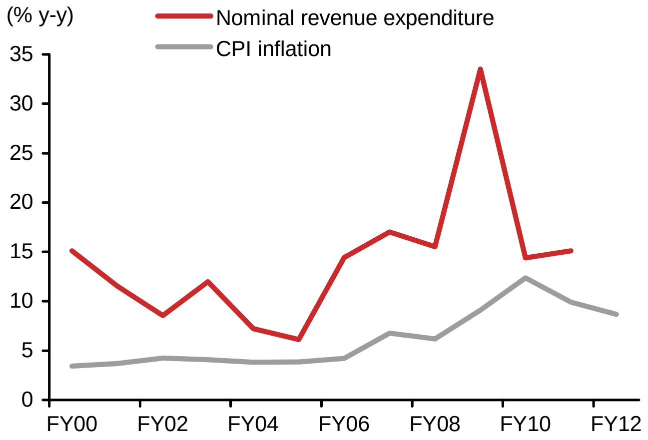
Source: CEIC and Nomura Global Economics

Exhibit 67. Deposit and credit growth



Source: CEIC and Nomura Global Economics

Exhibit 68. Revenue expenditure and inflation



Source: CEIC and Nomura Global Economics.

Exhibit 69. Fiscal at a glance

(Rs tr)	FY10 RE	FY11 BE	FY11 Nomura	FY12 Nomura
Revenue receipts	**5.8**	**6.8**	**7.7**	**8.0**
Net tax revenue	4.7	5.3	5.5	6.7
Non-tax revenue	1.1	1.5	2.2	1.2
Capital receipts	**4.4**	**4.3**	**4.3**	**5.1**
Disinvestment	0.3	0.4	0.4	0.5
Total receipts/expenditure	**10.2**	**11.1**	**12.0**	**13.1**
Revenue expenditure	**9.1**	**9.6**	**10.5**	**11.5**
Interest payments	2.3	2.5	2.5	2.8
Subsidies	1.3	1.2	1.6	1.7
Capital expenditure	**1.2**	**1.5**	**1.5**	**1.5**
Fiscal deficit (% of GDP)	**6.6**	**5.5**	**5.2**	**5.2**

Source: Nomura Global Economics estimates

External sector on a razor thin edge

In an environment of weak global growth and strong domestic growth, India's current account deficit is acquiring a structural character. We expect enough capital inflows to finance the deficit, but vulnerability to a sudden reversal is high.

We expect the current account deficit to widen to 4% of GDP in FY12F from 3.7% in FY11F

A key reason for the elevated current account deficit is the increasing dependence on commodity imports. While oil is the biggest import, the share of non-oil commodities such as coal, fertilisers and metals is also rising. On our assumption of a continued rise in global commodity prices and strong domestic final demand, we expect the current account deficit to widen to 4% of GDP in FY12F. Imports are now 1.7x exports and a massive export boom is required to improve this deficit.

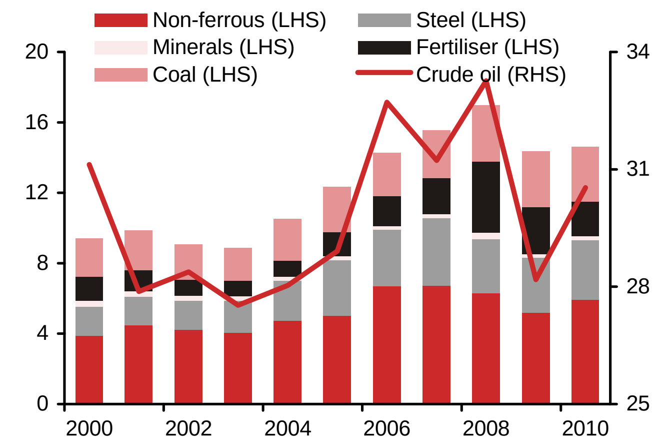
We don't see financing as a concern. Interest rate differentials have been an important driver of debt inflows and we expect this trend to be reinforced in FY12F, due to elevated local financing costs. FDI inflows have been stable and we remain bullish on portfolio inflows given large growth differentials. Therefore, we expect net capital inflows of US$90bn in FY12F, inching close to the all-time highs of FY08, but resulting in a much lower balance of payment surplus this time.

Net capital inflows will be enough to finance the deficit, but rising debt inflows are also a risk

India's US$290bn worth of FX reserves provides a cushion, but the rise in debt capital inflows is also a risk. Short-term debt with residual maturity less than one year is now at US$116bn or 42% of the total external debt (versus 30% a year ago). This highlights the liquidity needs of the economy over the next one year and the dependence on continued availability of global liquidity to service this debt. Therefore, the RBI either has to engineer a sharp slowdown to reduce the current account deficit or remain open to capital inflows to finance this deficit, but prevent a rapid debt build-up at the same time. It is the latter that increases the risk of imposing some forms of capital controls on short-term debt inflows if they are too strong. The balancing act is tough in FY12.

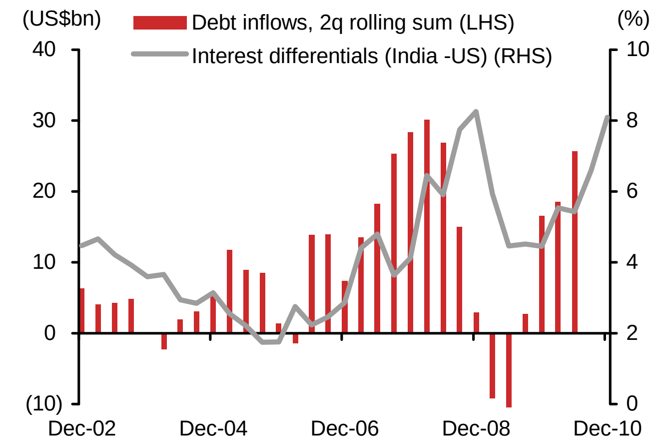
On our base-line view of strong capital inflows, our FX strategy team expects Rs/US$ to appreciate to 42.3 by December 2011. In their view, the Indian rupee is unlikely to perform without a positive risk backdrop and will be an under-performer in the region.

Exhibit 70. Commodity imports (% of total imports)



Source: CMIE and Nomura Global Economics

Exhibit 71. Debt inflows and rate differentials



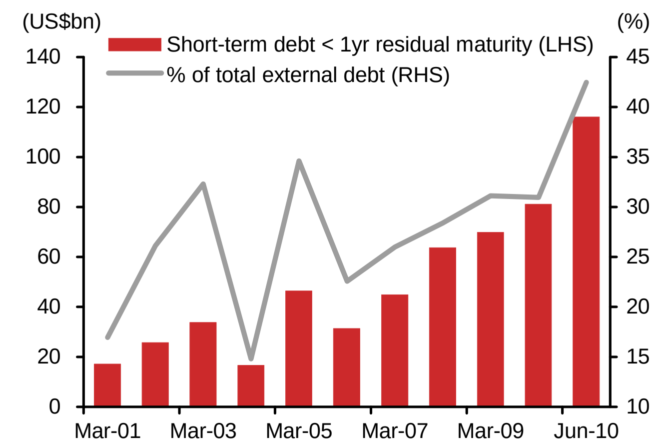
Source: CEIC, Bloomberg and Nomura Global Economics

Exhibit 72. Balance of payment forecast

(US$bn)	FY10F	FY11F	FY12F
Current account	**(38.4)**	**(59.3)**	**(78.5)**
Merchandise	(117.3)	(152.6)	(189.2)
Invisibles	78.9	93.3	110.7
Software services	48.2	53.7	61.8
Non-software	(14.0)	(7.2)	(2.6)
Transfer	52.1	52.7	55.5
Capital account	**53.6**	**80.3**	**90.6**
Net FDI	19.7	15.0	20.0
Portfolio investment	32.4	35.0	30.0
Commercial borrowings	2.5	7.0	12.0
Short term loans	7.7	15.0	15.0
Banking capital	2.1	7.0	8.3
Other capital	(10.8)	1.3	5.3
Overall balance	**13.4**	**21.0**	**12.1**
CA deficit (% of GDP)	(2.9)	(3.7)	(4.0)

Source: Nomura Global Economics estimates

Exhibit 73. Short-term debt by residual maturity



Source: Finance Ministry, CEIC and Nomura Global Economics

Autos

NEUTRAL

Action

We maintain our Neutral stance on the Indian auto sector. We expect slower but steady volume growth for FY11F. Mahindra & Mahindra is our top pick for 2011F as the company benefits from low availability of farm labour and relatively subdued competition. We also like Bajaj Auto, given its sound product mix and potential to outgrow the industry.

Catalysts

Volume growth will likely be a key catalyst for the sector.

Anchor themes

We prefer stocks centred around the consumption and rural growth themes. These companies stand to benefit from the government's focus on rural development and rural job creation.

Stocks for action

We have Mahindra & Mahindra and Bajaj Auto as our top picks, as both are exposed to our preferred themes of consumption and rural development for 2011F.

Stock	Rating	Price	Price target
Mahindra & Mahindra (MM IN)	BUY	789	892*
Bajaj Auto (BJAUT IN)	BUY	1,565	1,810

Pricing date 8th Dec 2010

* PT under review

Consumers to drive the sector

① Slower but steady growth ahead

From the end of FY11F, we think the Indian auto sector will likely see two continuous years of 20%-plus growth, even in relatively well penetrated categories like two-wheelers. We believe the growth outlook is underpinned by: 1) government initiatives to develop the rural economy. The rural development budget has grown from INR288bn at the end of FY08 to INR661bn at the end of FY11F, and this has led to a sharp upswing in employment opportunities and the number of cash-rich consumers; 2) the sharp upswing in industrial growth has spurred a revival in the urban job outlook and salaries. It has also led to a shortage of trucks in the system. The auto sector thus continues to benefit from an upturn in both urban and rural growth. In FY12F, we expect the government's focus on inclusive growth to continue and thus we remain optimistic about growth – especially in consumer-focused sectors such as cars (+15.5% y-y) and two wheelers (+12%y-y). We don't expect a big upswing in incremental IIP and thus expect much slower growth for commercial vehicles in FY12F (+8% y-y).

② Margins to remain stable

Margins at most players are near all-time highs. We note that with all companies operating at close to full capacity, the benefits of operating leverage may be much less pronounced than in the past. We expect demand to remain relatively stable and cost pressures low. Hence, we think most companies should be able to maintain margins. In some company-specific cases, like MSIL (MSIL, REDUCE), we expect greater cost pressures due to appreciation in the yen.

③ Don't expect changes in taxes and duties

We saw a 2% increase in excise duties in February 2010 to 10%. The government plans to implement a goods and services tax (GST). The rate and timeline have not been fixed, but we think the GST will most likely be implemented from FY13F and may lower the tax on automobiles. Hence, we don't expect taxes to increase in FY12F either.

④ We prefer stocks around the consumption theme

As a theme for 2011 we prefer stocks exposed to the consumption theme because we expect government policies to continue to favour the consumer. In view of the continued impact of policies regarding rural development, we have Mahindra & Mahindra as our top pick for 2011F. We like Bajaj Auto in the two-

Analyst

Kapil Singh
+91 22 4037 4199
kapil.singh@nomura.com

wheeler space. We maintain our REDUCE rating on Maruti Suzuki India Limited, as we see cost headwinds due to yen appreciation and increasing competition.

In our view, growth in commercial vehicles will be much slower in 2011 and thus we do not prefer it as a theme. We find that commercial vehicles now account for only 30% of the value of Tata Motors (TTMT IN, NEUTRAL); hence, we believe the risk to the company from the commercial vehicle cycle has declined.

Exhibit 74. Domestic volume forecasts

('000 units)	FY06	FY07	FY08	FY09	FY10	FY11F	FY12F
Total domestic sales	**8,546**	**9,727**	**9,284**	**9,370**	**11,834**	**14,364**	**16,176**
Passenger vehicle	**1,142**	**1,380**	**1,536**	**1,524**	**1,901**	**2,449**	**2,831**
Cars	882	1,077	1,202	1,219	1,527	1,981	2,294
Utility vehicles	260	303	334	305	374	467	537
Commercial vehicle	**351**	**468**	**498**	**409**	**585**	**697**	**780**
Heavy	207	276	271	182	245	306	330
Light	145	192	227	227	340	391	450
Two wheelers	**7,052**	**7,879**	**7,250**	**7,437**	**9,349**	**11,218**	**12,564**
y-y (%) Change							
Total auto sales	**12.6**	**13.8**	**(4.6)**	**0.9**	**26.3**	**21.4**	**12.6**
Passenger vehicle	**7.6**	**20.8**	**11.3**	**(0.7)**	**24.7**	**28.8**	**15.6**
Cars	7.6	22.0	11.7	1.5	25.2	29.8	15.8
Utility vehicles	7.9	16.5	10.0	(8.6)	22.7	25.0	15.0
Commercial vehicle	**10.2**	**33.4**	**6.4**	**(17.8)**	**42.9**	**19.2**	**11.9**
Heavy	4.0	33.6	(1.8)	(32.9)	34.4	25.0	8.0
Light	20.6	33.0	18.1	0.1	49.7	15.0	15.0
Two wheelers	**13.6**	**11.7**	**(8.0)**	**2.6**	**25.7**	**20.0**	**12.0**

Source: Nomura Research

Exhibit 75. Valuation comparison: Indian auto sector coverage

					Earnings	P/E (x)		
Stock	**Ticker**	**Price**	**Currency**	**Rating**	**CAGR FY10-12F (%)**	**FY10**	**FY11F**	**FY12F**
Maruti Suzuki India	MSIL IN	1,417	INR	REDUCE	1.5	15.6	16.6	15.2
Hero Honda	HH IN	1,758	INR	NEUTRAL	10.3	16.3	14.5	13.4
Bajaj Auto	BJAUT IN	1,566	INR	BUY	30.0	24.9	17.3	14.7
TVS Motor Company	TVSL IN	75	INR	BUY	47.0	28.6	18.0	13.2
Ashok Leyland	AL IN	71	INR	BUY	24.9	22.2	17.1	14.2
Tata Motors	TTMT IN	1,336	INR	NEUTRAL	81.2	23.9	8.9	7.3
Mahindra & Mahindra	MM IN	789	INR	BUY	17.3	16.1	12.9	11.7
Exide Industries	EXID IN	172	INR	BUY	22.9	25.1	19.3	16.6
Bharat Forge	BHFC IN	376	INR	BUY	548.4	868.0	39.5	20.6
Average					**87.8**	**127.1**	**19.4**	**15.0**

Pricing as of 8 Dec, 2010.

Source: Nomura Research estimates

Banks

NEUTRAL

Action

We are now Neutral on banks and recommend being selective going forward, with a bias towards large private banks, on the back of stronger loan growth with stable margins and declining credit costs. Continued asset quality issues, uncertainty over pension liability and margin pressures for PSU banks could trigger earnings downgrades for most of the PSU banks.

Catalysts

We believe a pick-up in broad-based credit growth, decline in credit costs and stable margins will be key drivers for private banks.

Anchor themes

With moderating loan growth and rising deposit rates leading to margin pressures, we recommend banks with a strong deposit franchise and stable margins. ICICI Bank and SBI are our top picks.

Stocks for action

We recommend SBI for its strong deposit franchise and ICICI Bank as a potential turnaround play.

Stock	Rating	Price	Price target
SBI (SBIN IN)	BUY	2,808	3,765
ICICI Bank (ICICIBC IN)	BUY	1,106	1,355

Note: Stock prices as of 8 December 2010

Time to be selective

① Inflation can be a spoilsport

The Bankex has outperformed the Sensex by 25% YTD. While the macro picture remains favourable, so far, inflationary concerns would likely lead to a tighter policy environment, exerting pressure on margins. We might not see the same outperformance by banks in CY11F (vs. CY10), with valuations being stretched and credit growth to moderate at 20% levels due to base effect coming into play and concerns on microfinance, telecom and real estate scams resulting in banks being more cautious and selective on lending. In addition, margins are at a peak and are likely to trend down as funding costs increase with tighter policy and peaking of the C-D ratio. Hence, we recommend banks with strong deposit franchises and stable margins.

② Slack in deposit growth not a big concern

Even though deposit growth remains tepid and liquidity remains tight, credit growth is likely to be at around 20% in CY11F. The increase in deposit rates, along with inflation cooling off marginally (real interest rates turning positive), should help deposit growth to pick up to 18-19% levels. Also, moderation of credit growth and an increase in government expenditure towards the end of FY11 should help ease out the liquidity crunch.

③ Margins to moderate before stabilising; credit costs to decline

CY2010 recorded a robust expansion in NIMs for the sector, but with an increase in deposit rates, tighter liquidity and no further benefit arising out of C-D expansion, margin pressures (which is better managed by private banks) are likely, we believe. Deposit rates have increased by over 150-350bps, compared with a 50-100bps increase in lending rates over the past few months, which points to margin compression in the coming quarters, especially for PSUs due to larger ALM mismatches. Private banks, on the other hand, are relatively better off and would also see a sharp decline in credit costs with expected improvements in asset quality which would support bottom-lines for private banks.

④ Our top picks

Our top picks remain ICICI bank and SBI.

Analysts

Prabhat Awasthi
+91 22 4037 4180
prabhat.awasthi@nomura.com

Amit Nanavati
+91 22 4037 4361
amit.nanavati@nomura.com

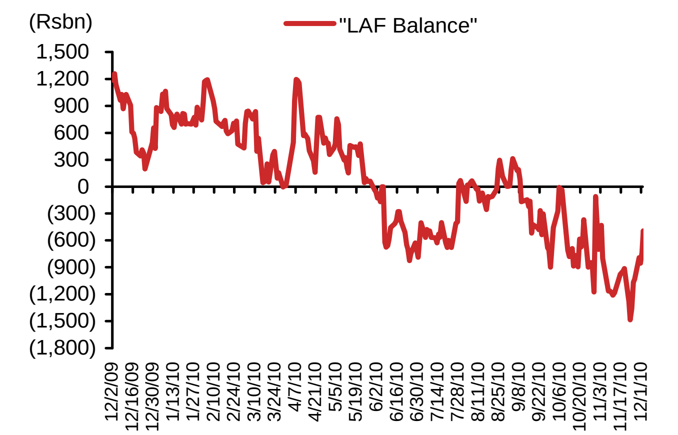
ICICI Bank (BUY; PT INR1,355)

The bank's fundamentals remain sound and, we believe, ICICI Bank's turnaround is gathering momentum. We expect its loan growth to pick up with a slowdown in retail repayments and increase in disbursements of project loans going ahead, and a decline in loan loss provisions to 1.4% of average loans in FY11F and 1.1% in FY12F from 2.2% in FY10 owing to improvements in asset quality. ICICI bank's RoA and RoE expansion, along with investors shifting from PSU banks to private banks with better management, should help the bank to outperform its peers, we believe. We value the core ICICI bank at 2.6x FY12F P/BV. Risks: Downside risks include slower-than-expected economic growth, a rapid increase in bond yields owing to rising fiscal deficit and increasing global stress could hurt ICICI's international book.

SBI (BUY; PT INR3,765)

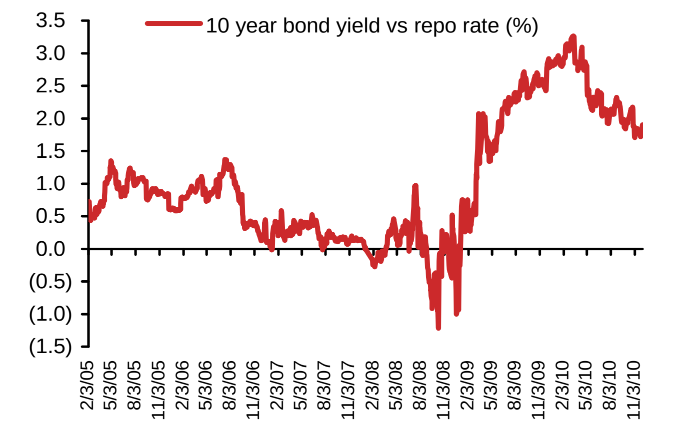
SBI's deposit franchise remains amongst the best in the industry, with the proportion of CASA deposits having improved to 47% in FY10 from 41% in FY06. The bank has shown strong core performance over the past few quarters and, is expected to continue to do so at the core level. NPL accretion which is likely to stay high in FY11F, is showing signs of peaking out and will slow down with a reduction in slippages from restructured loans, thus helping reduce SBI's credit costs going forward. In addition, a lack of pension liability overhang, strong fee income and stable margins give SBI an edge over other PSU banks. We value the parent SBI bank at 2x FY12F P/BV. Risks: Faster-than-expected increases in rates or slower-than-expected loan growth are key risks to our rating and price target for the bank.

Exhibit 76. Liquidity starts to ease-off, but may remain tight to contain inflation



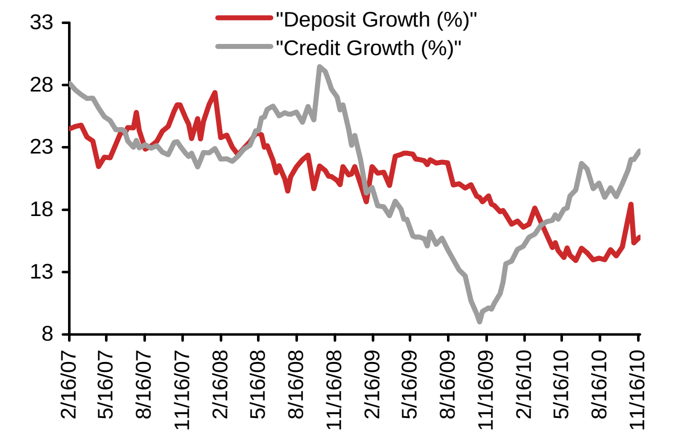
Source: Bloomberg

Exhibit 77. 10-year bond yields and repo rate differential to narrow down with further rate hikes



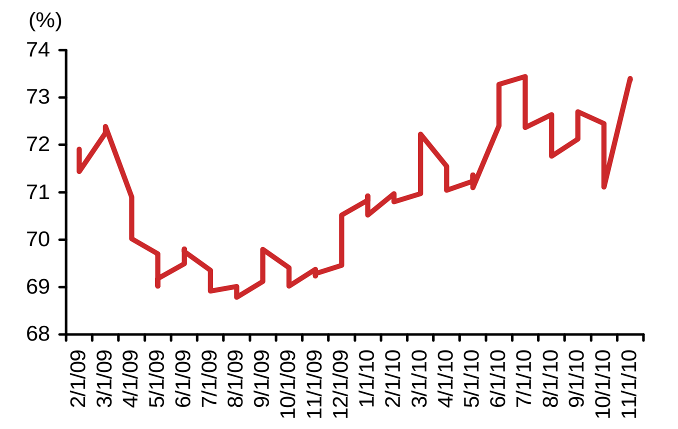
Source: Bloomberg

Exhibit 78. Higher base to check further credit growth; deposit growth to catch up



Source: Bloomberg

Exhibit 79. C-D ratio peaks out, indicating no further C-D expansion benefit to arise



Source: Bloomberg

Construction materials (cement)

BEARISH

Action

We believe the downcycle that the sector has entered is here to stay for a while and that the demand-supply mismatch will not improve significantly by FY13F. We do not expect any pricing discipline to sustain for long, given the fragmented nature of the industry. We think valuations have some more room for corrections to adjust to the lower profitability regime that the sector is facing. We maintain our Bearish stance on the sector.

Catalysts

Low pricing power due to adverse demand-supply equation resulting in lower profitability for the sector should keep valuations in check.

Anchor themes

Cement companies saw high profitability during FY07-FY10, delivering record high ROCEs on a tight demand-supply equation, which resulted in solid pricing. FY11-FY13 may be the opposite but valuations have yet to adjust to this, in our view.

Stocks for action

Ambuja Cement and India Cement are our top REDUCE ideas for their relatively high valuations (adjusted for the returns that their assets generate).

Stock	Rating	Price	Price target
Ambuja Cement (ACEM IN)	REDUCE	137.9	113
India Cement (ICEM IN)	REDUCE	106.5	89
Ultratech (UTCM IM)	REDUCE	1,100.3	897
ACC (ACC IN)	REDUCE	1,010.5	917

Pricing as of 8 Dec 2010

No meaningful recovery in 2011

① We expect the pain to continue

Unlike the Street we are not so optimistic on the prospects of the Indian Cement sector for 2011, as we believe the demand-supply mismatch will continue to be severe as the capacity that was added in 2010 stabilises and incremental capacity additions keep pace with incremental demand.

② Pricing discipline unlikely to be sustained

We do not believe that the industry will be able to tide over the current phase through pricing discipline, as it is too fragmented. Also, the current arrangement would result in new capacity generating sub-par returns for a long time.

③ Return ratios to deteriorate

The Indian cement industry has enjoyed a very high ROCE during the FY07-FY10 period, as delayed capacity resulted in high pricing power and higher profitability. Over the next three years, we expect the industry's average ROCE to deteriorate significantly on continued overcapacity.

④ Valuations to see more correction, in our view

We expect Indian cement companies to generate very low returns in FY11-FY13F compared with the past four years. Valuations, on the other hand, have yet to adjust to this reality, and we see room for a correction in most of the stocks.

⑤ Maintain Bearish stance; ACEM and ICEM top REDUCE ideas

We maintain our Bearish view on the sector and retain REDUCE on Ambuja Cement, India Cement, ACC and Ultratech. Ambuja Cement and India Cement are our top REDUCE ideas for their relatively high valuations (adjusted for the returns that their assets generate). We rate Shree Cement and Grasim as NEUTRAL on relatively inexpensive valuations.

Analyst

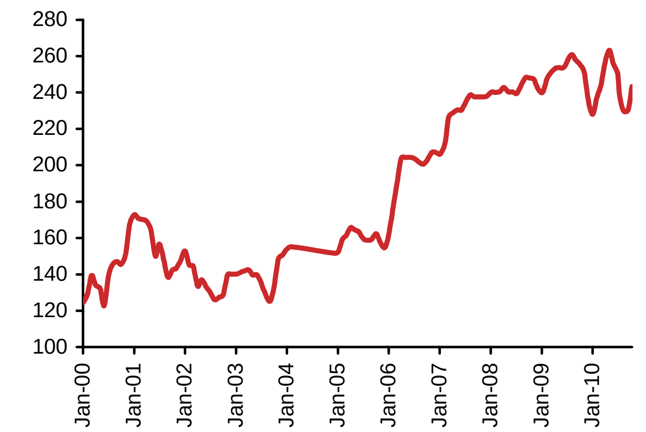
Jamil Ansari
+91 22 4037 4192
Jamil.ansari@nomura.com

Valuation parameters (FY12F / CY11)

Company	EV/EBITDA	P/E	ROCE (%)
ACC	7.9	15.0	20.2
Ambuja Cement	8.5	14.6	25.0
Ultratech	8.5	16.3	17.9
Shree Cement	4.6	16.2	14.3
India Cement	7.5	16.9	7.7

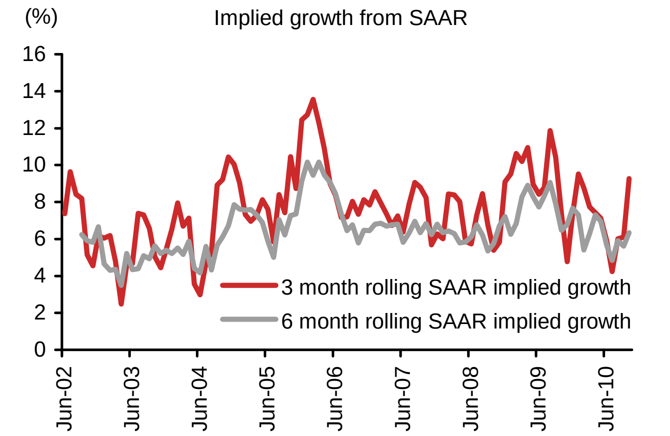
Source: Bloomberg, Nomura

Exhibit 80. Average cement prices in metro cities – INR / bag (50kg)



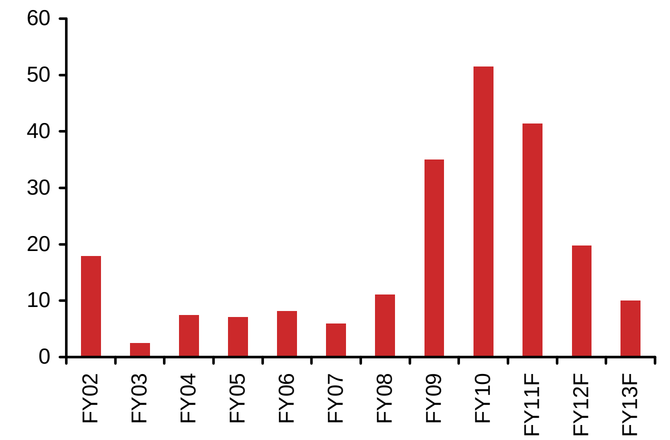
Source: CMA

Exhibit 81. Cement demand growth



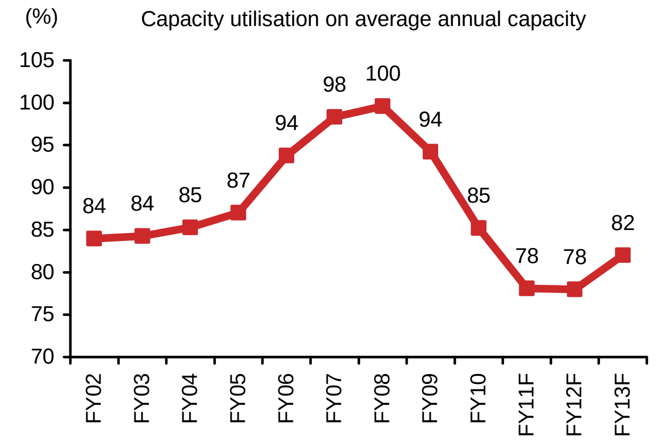
Source: KAMA, Nomura International Limited (Hong Kong), Seoul Branch

Exhibit 82. Capacity additions FY02-FY13F – INR / bag (50kg)



Source: KAMA, KAIDA

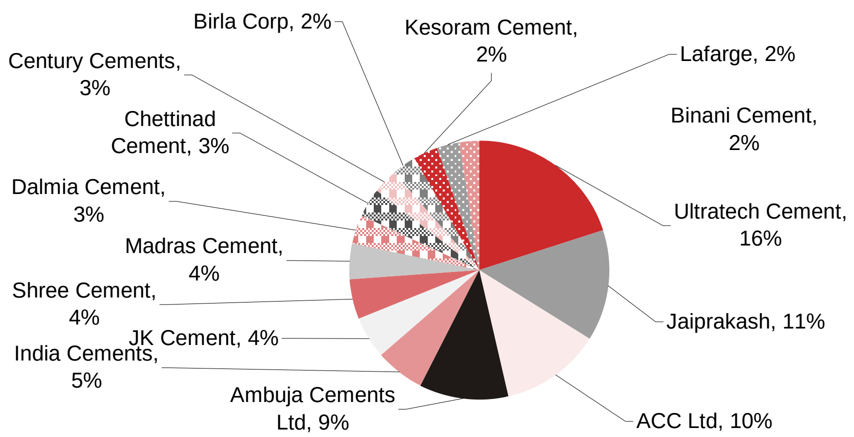
Exhibit 83. Capacity utilisation trend



Note: January-August 2007; for vehicles priced at more than W45,000,000

Source: KAMA

Exhibit 84. India Cement – Market share



Source: Company data, Nomura research

Consumer

BEARISH

Action

With input cost pressures rising, competition continuing to remain strong and sector valuations towards the top end of the long-term average, we are cautious on the sector into 2011. However, we believe there is value in select stocks such as ITC, Asian Paints and Pantaloon, where we see pick-up in operational performance in H2FY11. Hindustan Unilever and Marico are our top REDUCE calls.

Catalysts

Longer-term opportunity in the sector will be driven by robust GDP growth, rising incomes and wider product availability.

Anchor themes

The Indian consumer sector remains attractive in the long term, given favourable demographics, rising disposable income and increasing urbanisation. With penetration levels still low across several categories, we are positive on the sector in the longer term. We prefer food names vs HPC.

Stocks for action

With sector valuations towards the top end of the long-term average and the operating environment continuing to remain tough, we prefer stocks whose H2FY11 performance could surprise on the upside. Prefer Pantaloon, ITC and Asian Paints.

Stock	Rating	Ticker	Price	Price target
Pantaloon	BUY	PF IN	389.45	553
ITC	BUY	ITC IN	166.75	200
Asian Paints	BUY	APNT IN	2,658.05	3,050
United Spirits	BUY	UNSP IN	1,431.15	1,800
Hindustan Unilever	REDUCE	HUVR IN	296.40	222
Marico	REDUCE	MRCO IN	124.80	118

Analysts

Manish Jain
+91 22 4037 4186
manish.jain@nomura.com

Anup Sudhendranath
+91 22 4037 5406
anup.sudhendranath@nomura.com

Near-term concerns outweigh long-term attractions

① Tough operating environment …

Operational environment remains tough for consumer companies going into 2011, as rising commodity costs and continuing competitive pressures are likely to put pressure on profitability. With valuations towards the top end of the long-term average, we remain cautious on the sector.

② … however, long-term attractions do remain

The industry growth rate has averaged 11% over the past decade (Booz and Co. estimates); however, the industry has the opportunity to grow at a much faster trajectory over the next decade, in our view. An aggressive management mindset, opportunity to convert non-users into consumers, the creation of newer categories, resolution of supply-chain issues and growth of modern retail could strengthen the growth trajectory of the industry to ~17% over the next decade, according to our estimates.

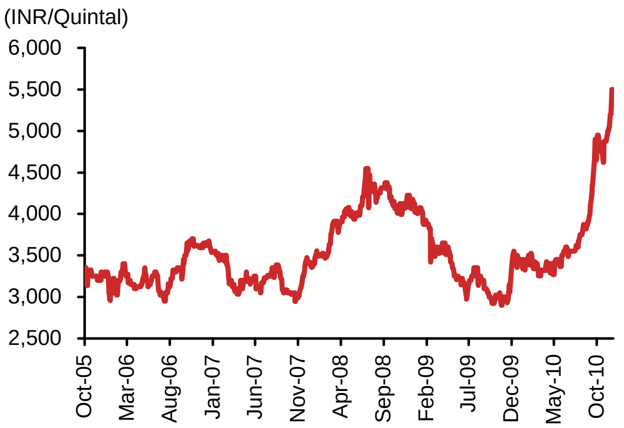
③ Inorganic is the way to grow

Over the past few months, we have witnessed a trend of companies looking aggressively at overseas markets for acquisitions: Dabur has done two, GCPL four and Marico one. We believe that this trend is likely to continue over the medium term, as consumer assets in India continue to remain expensive. Moreover, we see this as consumer companies preparing for the second leg of growth 5-10 years down the line by venturing into emerging markets such as Africa and South Asia. This may be positive in the longer term; however, integration may be a risk.

④ ITC, Asian Paints and Pantaloon are high conviction BUY ideas

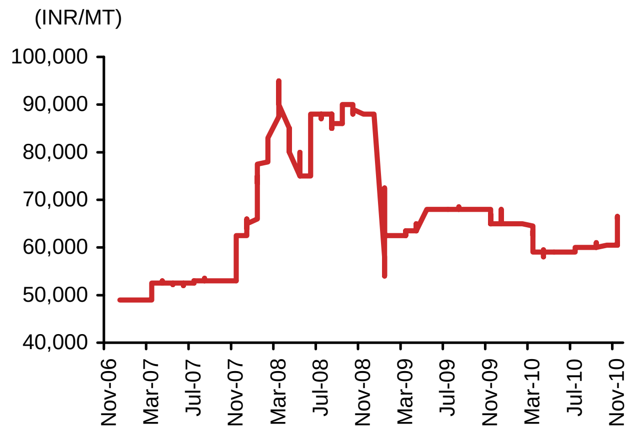
We maintain ITC, Asian Paints and Pantaloon as our top BUY ideas post this results season. For ITC, we believe cigarette business volume growth will trend back into positive territory in H2, which will help improve profitability. We expect Asian Paints to see a strong recovery after a one-off weak Q2FY11 and Pantaloon to benefit from robust festive season demand. Valuations are more supportive on these stocks as well vs FMCG and retail universe.

Exhibit 85. Domestic Copra prices



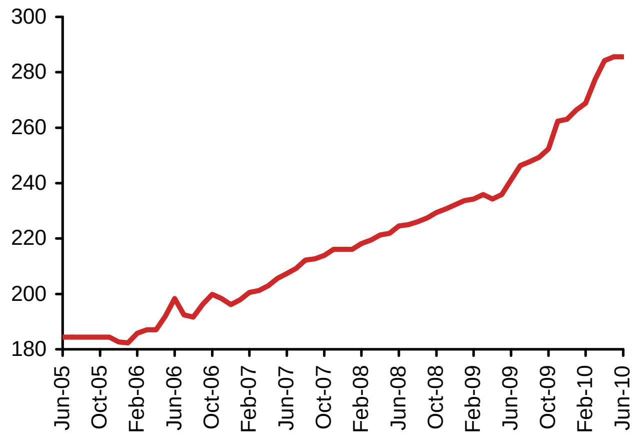
Source: Bloomberg, Nomura Research

Exhibit 86. Domestic Kardi prices



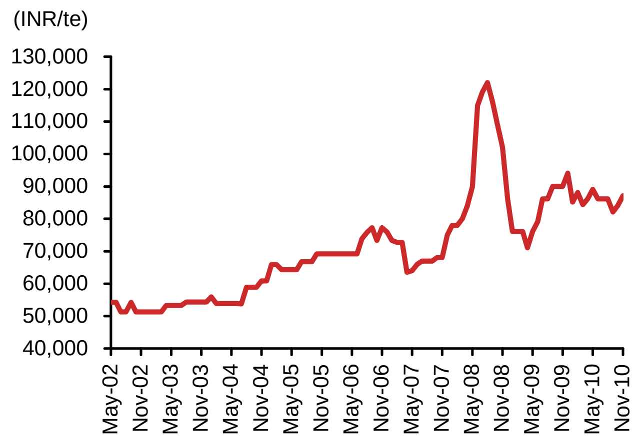
Source: Bloomberg, Nomura Research

Exhibit 87. Domestic milk price index



Source: Bloomberg, Nomura Research

Exhibit 88. Domestic LAB prices



Source: Bloomberg, Nomura Research

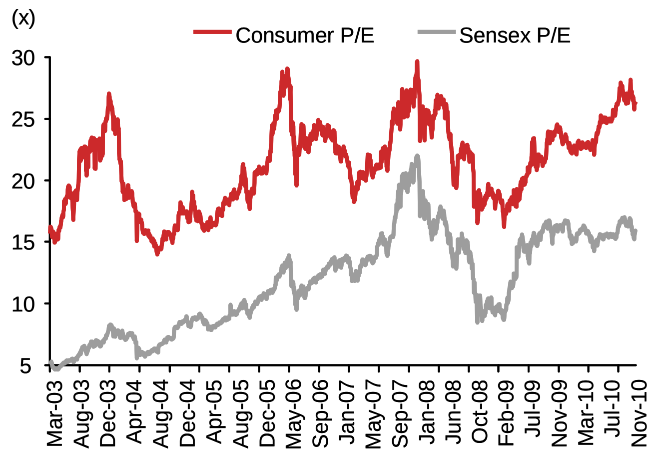
Exhibit 89. Consumer sector valuations

Company	Ticker	Rating	Price (INR)	P/E (x) FY11F	P/E (x) FY12F	PEG FY12F (x)
Asian Paints	APNT IN	BUY	2,658	28.1	24.0	1.3
Colgate Palmolive	CLGT IN	REDUCE	850	25.8	23.5	3.4
Dabur	DABUR IN	BUY	97	27.7	21.8	1.0
Godrej Consumer	GCPL IN	NEUTRAL	409	27.7	21.5	0.6
Hindustan Unilever	HUVR IN	REDUCE	296	30.4	26.4	3.2
ITC	ITC IN	BUY	167	26.1	22.4	1.3
Marico	MRCO IN	REDUCE	125	27.0	22.8	1.3
United Spirits	UNSP IN	BUY	1,431	33.6	23.4	0.4
Tata Global Beverages	TGBL IN	NEUTRAL	115	15.3	13.9	1.0
Titan Industries	TTAN IN	REDUCE	3,573	47.3	37.6	1.3
Nestle*	NEST IN	REDUCE	3,742	43.8	34.6	1.6
Average				**30.2**	**25.1**	**1.3**

* Nestle valuations are for CY10; Pricing as of December 8, 2010

Source: Bloomberg, Nomura Research

Exhibit 90. Consumer sector valuations



Note: Nestle valuations are for CY10 and CY11
Source: Bloomberg, Nomura Research

Electrical equipment

BEARISH

Action

We continue to see the opportunity in the sector being driven by power capex, as we expect industrial capex to revive only modestly and gradually. While competition and margin pressures will likely increase in the generation space, we expect it to abate in the T&D space. We highlight Crompton Greaves as our preferred pick in the space, while we remain bearish on BHEL. We remain positive on Cummins India, but the stock has significantly outperformed over the past 18M.

Catalysts

Stronger-than-expected recovery, speedier clearances on land and environment and early finalisation of key orders will be key triggers for the capital goods stocks.

Anchor themes

Decades of under-investment followed by a march towards building sufficient power for the nation promises significant opportunities for T&D equipment makers but rising competition will hurt generation equipment makers.

Stocks for action

Crompton Greaves remains our only pick in the sector while ABB India is our top REDUCE.

Stock	Rating	Price	Price target
Crompton Greaves	BUY	328	380
ABB Ltd	REDUCE	792	745

Pricing as of 8 December, 2010

Power play

① Significant opportunity in the power equipment sector

We believe the Indian electrical equipment sector is poised to benefit from a strong pipeline of potential order inflows in the power sector over the Twelfth and Thirteenth Five Year Plans. Of the planned additions in the Eleventh Plan, most orders have already been placed across the sector, though Twelfth Plan-related ordering is yet to gain momentum, especially in the transmission and distribution (T&D) and balance-of-plants (BOP) areas. We also expect a slow but gradual pick-up in industrial capex momentum that should pave way for growth for other capex-dependent equipment manufacturers.

② But generation equipment makers are past their peak

BHEL is already benefiting from a record high book-to-bill ratio, which provides strong visibility on near-term growth. However, we are concerned about market share losses and margin risks due to growing competition in the sector. Several new players and the trend of larger developers placing bulk orders with Chinese companies are bound to exert pressure on sector margins.

③ T&D equipment makers likely to see order revival in 2011

While the long-term opportunity for T&D appears robust, near-term order inflow for the sector has been a concern. While slow order activity from Power Grid was the main reason, the poor financial health of state utilities also added to the woes. However, our channel checks suggest Power Grid is likely to pick up order activity in 2011. We also believe that 2011 could witness increasing privatisation in the T&D space both at the Central and State levels, which should alleviate some of the concerns on state spending on T&D capex.

④ CRG remains our only BUY in the space; REDUCE BHEL

Stocks for most of the companies in the sector are already pricing in the anticipated recovery, in our view. However, we highlight those that will likely be winners over the next 5-7 years rather then just those benefiting on near-term earnings strength. On this count we continue to like Crompton Greaves (BUY) and Cummins India (NEUTRAL). We remain bearish on BHEL as we expect further stock de-rating on concerns over market share, margins and operating cashflow.

Analyst

Amar Kedia
+91 22 4037 4182
amar.kedia@nomura.com

Recommendation summary

Stock	Price (INR)	PT (INR)	Rating
BHEL (BHEL IN)	2,240	2,210	REDUCE
Crompton Greaves (CRG IN)	328	380	BUY
ABB Ltd (ABB IN)	792	745	REDUCE
Cummins India (KKC IN)	768	820	NEUTRAL
Thermax Ltd (TMX IN)	856	725	REDUCE

Pricing as of 8 December, 2010

Source: Nomura

Valuation summary

Stock	FY11F P/E	FY12F P/E
BHEL	18.8	15.5
Crompton Greaves	23.1	19.1
ABB Ltd	116.9	35.7
Cummins India	22.7	18.1
Thermax Ltd	28.5	21.3

Source: Nomura

Sector valuation comparisons

Exhibit 91. India Electrical Equipment sector valuation comps

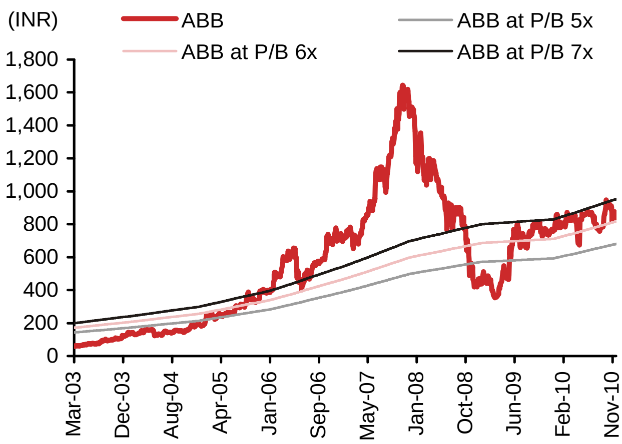
	ROE (%)		P/E (x)		P/BV (x)		Price performance		
	FY11F	FY12F	FY11F	FY12F	FY11F	FY12F	1m (%)	3m (%)	6m (%)
BHEL	32.6	31.6	18.8	15.5	5.5	4.4	(11.3)	(8.2)	(1.6)
Cummins India	39.4	41.7	22.7	18. 1	8.3	7.0	(3.1)	4.9	35.6
Thermax	29.5	31.7	28.5	21.3	7.7	6.1	(4.1)	7.3	22.8
ABB India	4.1	17.3	116.9	35.7	6.7	5.8	(8.9)	1.1	(7.1)
Crompton Greaves	31.5	29.3	23.1	19.1	6.4	5.0	1.0	6.7	37.5
Average*	**27.4**	**30.3**	**23.3**	**18.6**	**6.9**	**5.7**	**(5.3)**	**2.4**	**17.4**

* P/E Average does not include ABB India

Prices as of 8 December, 2010

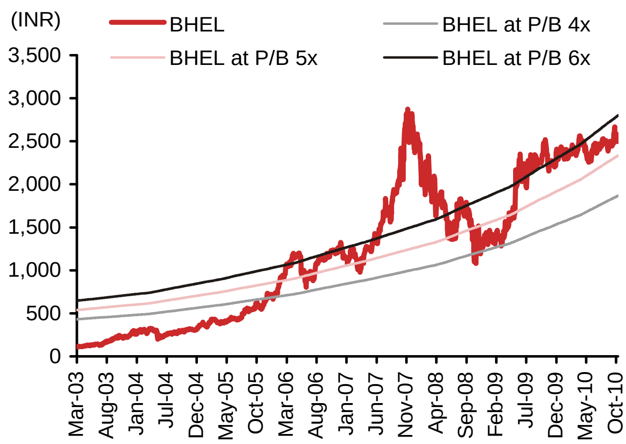
Source: Bloomberg, Nomura estimates

Exhibit 92. ABB India 1 year fwd P/E chart



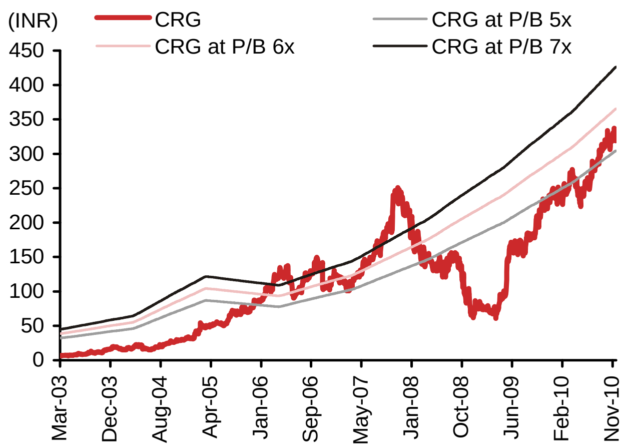
Source: Bloomberg, Company data, Nomura estimates

Exhibit 93. BHEL 1 year fwd P/E chart



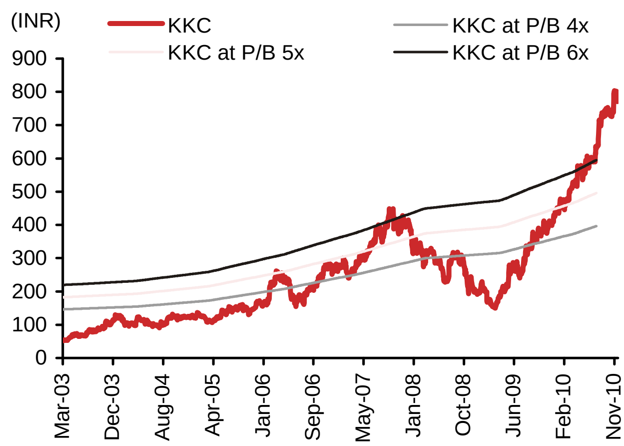
Source: Bloomberg, Company data, Nomura estimates

Exhibit 94. Crompton Greaves 1 year fwd P/E chart



Source: Bloomberg, Company data, Nomura estimates

Exhibit 95. Cummins India 1 year fwd P/E chart



Source: Bloomberg, Company data, Nomura estimates

IT services & software

NEUTRAL

Action

We expect FY12F to see strong but moderating revenue growth compared with FY11F on the tailing off of one-offs, such as for M&A integration, pent-up spending, vendor consolidation gains and base effects. Supply-side risks, limited operational scope and increased taxation should moderate flow through of growth to earnings. We remain NEUTRAL on the sector. HCL Tech is our top large-cap pick, while we prefer Mphasis among the mid-caps. Among our NEUTRAL calls we prefer Infosys.

Catalysts

Surge in discretionary demand and rebid wins could provide upside to revenue. Rupee appreciation and greater MNC offshoring remain downside risks.

Anchor themes

Aggressive MNC offshoring trends could blunt the competitive advantage of Indian IT vendors, leading to a reduction in margin differentials and valuation premiums.

Stocks for action

Our top picks in the sector are HCL Tech and Mphasis.

Stock	Rating	Price	Price target
HCL Tech (HCLT IN)	BUY	433	510
Mphasis (MPHL IN)	BUY	597	770
Infosys (INFO IN)	NEUTRAL	3,131	3,200
TCS (TCS IN)	NEUTRAL	1,079	1,000
Wipro (WPRO IN)	NEUTRAL	435	450
Tech Mahindra (TECHM IN)	NEUTRAL	664	690
Patni (PATNI IN)	NEUTRAL	464	460
Cognizant (CTSH US)	NEUTRAL	69	68

Prices as of 8 December 2010; local currency.

Moderation ahead

① Demand upswing likely to moderate heading into CY11

We believe tier-1 companies will likely report strong growth of 27.6% on average in FY11F, aided by a pickup in discretionary spending and a rebound in lagging segments such as telecom and manufacturing. We believe such demand strength is unlikely to continue in FY12F, however, as one-offs such as bank M&A projects, vendor consolidation benefits and pent-up demand trail off within the next two quarters. Pricing increases too are likely to be marginal and more a result of a shift in revenue mix rather than billing rate increases. We look for 21.5% revenue growth for tier-1 companies in FY12F. We see positive surprises likely in: 1) Infosys − if discretionary spending improves significantly; and 2) HCL Tech − if the company continues to gain market share from MNC vendors in deal re-bid contracts on account of its infrastructure management services (IMS) strength.

② Margin bias downwards on wage pressures and sales investments

We expect FY12F to see elevated hiring levels, last seen during the previous high growth years of FY07 and FY08, which could lead to double-digit wage inflation and likely fresher wage inflation (last seen in FY08 at ~30-40%). Increased sales investments to target large rebid deals, and limited utilisation scope due to high attrition could further exert pressure on margins, in our view. We think margins will have a downward bias in FY12F, which makes us cautious on the sector. HCL Tech has the best operational scope among the tier-1 companies, in our view.

③ Upside limited by valuations and muted earnings growth

We expect limited upside to stocks as 1) we estimate valuations are at or higher than five-year averages for most companies and 2) earnings growth is muted relative to revenue growth over FY10-12F. YTD, most stocks under our coverage have seen only single-digit consensus earnings upgrades (except for TCS).

④ HCL Tech and Mphasis are our top picks in the sector

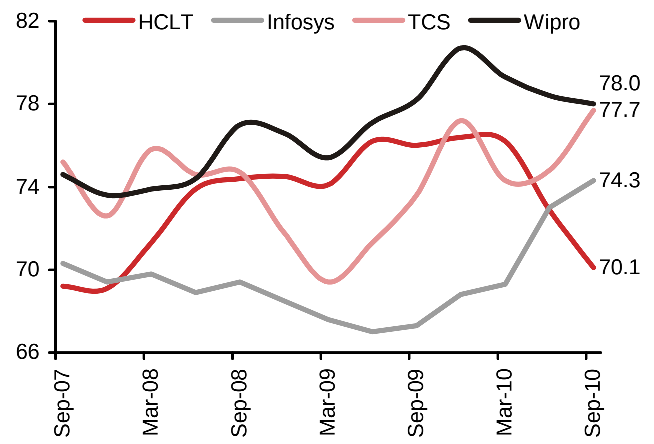
HCL Tech is our top large-cap pick on its ability to compete with MNC players in large deal rebids, best-in-class earnings growth and attractive valuations. Mphasis is our top mid-cap pick on being a clear play on MNC offshoring and upside from inorganic growth.

Analysts

Ashwin Mehta
+91 22 4037 4465
ashwin.mehta@nomura.com

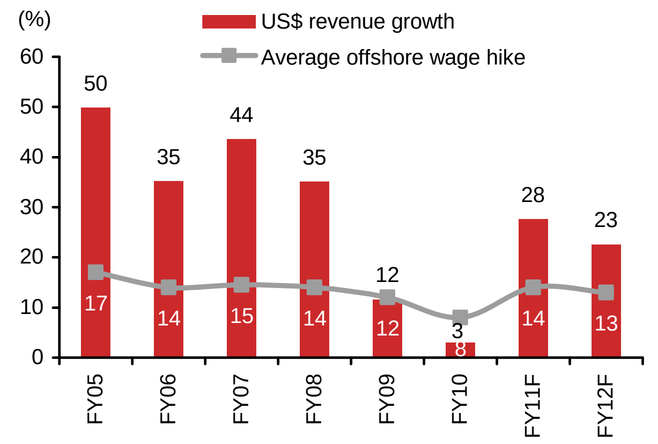
Pinku Pappan
+91 22 4037 4360
pinku.pappan@nomura.com

Exhibit 96. Utilisation including trainees (%) near peak values



Source: Company data, Nomura research

Exhibit 97. Offshore wage hike for Infosys, in double-digits for five of the past six years



Source: Company data, Nomura research

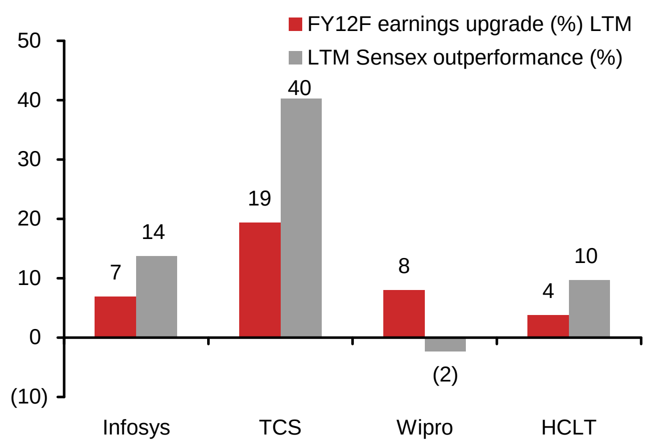
Exhibit 98. Engineering graduate demand to see elevated levels, as in FY08

	FY08	FY09	FY10F	FY11F	FY12F
Total engineering graduate supply ('000s)	392	452	497	547	602
Growth (%)	5	15	10	10	10
Total engineers employed in the IT industry ('000s)	1311	1453	1510	1812	2175
Incremental engineer demand ('000s)	249	142	57	302	362
Incremental engineering demand from IT industry as a % of supply	67	36	13	61	66

Note: E represents NASSCOM estimates, F represents Nomura estimates; we have assumed 40% of professionals employed in the BPO and domestic IT market to be engineers.

Source: Bloomberg, Nomura estimates

Exhibit 99. SENSEX outperformance ahead of consensus earnings upgrades



Source: Bloomberg, Nomura research estimates

Exhibit 100. Current 1 year forward P/E above five-year average for most companies under coverage

PER	TCS	Infosys	Wipro	Cognizant	HCLT	Mphasis	TechM	Patni
5-year max	26.9	30.6	31.5	39.5	23.8	27.0	83.4	19.7
5-year avg	17.9	20.1	19.2	23.7	16.4	13.0	19.2	11.1
3-year avg	15.0	17.5	15.5	17.6	13.8	8.8	13.0	8.9
1-year avg	19.2	21.6	19.3	21.6	16.5	12.5	16.8	12.7
Current	24.1	22.2	18.7	25.9	15.8	11.7	13.0	12.4

Source: Bloomberg, Nomura research estimates

Infrastructure and construction

BULLISH

Action

We believe the Indian construction companies have underperformed the broader market YTD CY10 on concerns over low execution rates, increase in working capital, rising interest rates and company-specific issues regarding investments and receivables. However, we remain positive on execution and improvement in working capital in CY11F. We believe valuations are attractive and maintain our Bullish stance on the sector.

Catalysts

A pick-up in execution and an improvement in working capital are potential catalysts in the near term.

Anchor themes

The Indian construction sector is a play on improvement in corporate capex and investment in infrastructure. We expect order-booking momentum and revenue/earnings growth to accelerate in 2H FY11.

Stocks for action

We find the Indian construction sector attractive. IVRCL is our top pick in the sector.

Stock	Rating	Price	Price target
Larsen & Toubro (LT IN)	BUY	1,994	2,310
IVRCL Infra (IVRC IN)	BUY	124	220
Nagarjuna Constr (NJCC IN)	BUY	135	194
HCC (HCC IN)	BUY	44.5	80

Pricing as of 8th December, 2010; local currency

At the cusp of a turnaround?

① Execution to pick up by CY11F

We expect execution to pick up in 2H FY11F (3Q CY10F) on the back of a strong order backlog and start of execution of BOT projects won in 2H FY10. In our view, construction companies could report 20-30% growth in revenue in 2H FY11F and FY12F. A pick-up in execution would impact margins positively as operating leverage comes into play, we believe.

② Working capital likely to improve

Working capital for most companies has gone up in FY10 and 1H FY11. We expect working capital to come down in the next few quarters as projects in the mobilisation stage move into a stable execution phase. An increasing proportion of private projects (including captive BOT projects) should also help improve working capital, in our view.

③ Risks: interest rates and lower-than-expected order inflows

We expect interest rates to remain high, but we don't expect any disruptive increase in interest rates. A 150bp increase in interest levels could negatively impact construction companies' FY12F EPS by 2-18%, on our estimates. The order booking rate in 1H FY11 has been largely below full-year company guidance. Although there could be some slippage in the near term, we do not see this as an immediate concern as the current order backlog ratio is high, at 3-5x trailing 12-month sales, presenting near-term growth visibility.

④ We prefer pure-play contractors to developers

We see contractors as being best placed to benefit from the secular growth opportunity in infrastructure due to their ability to diversify across sectors. Lower risk of foreign competition and lower requirement of capital vs developers are other positives, in our view.

⑤ Valuations attractive; we reaffirm Bullish stance

Adjusted for subsidiary valuations, the mid-tier BUY-rated stocks under our coverage are trading at 6.6-7.2x FY12F adjusted earnings while L&T is at 19.8x. The risk/reward looks favourable and we reaffirm our Bullish stance. Our top pick is IVRCL.

Analysts

Saion Mukherjee
+91 22 4037 4184
saion.mukherjee@nomura.com

Harish Venkateswaran
+91 22 4037 4028
harish.venkateswaran@nomura.com

Exhibit 101. Valuations attractive at 6.6-7.2x FY12F adj EPS for BUY-rated mid-caps

		Adj P/E		Adj EV/EBITDA		Adj EV/order book	
(x)	Ticker	FY11F	FY12F	FY11F	FY12F	FY11F	FY12F
L&T	LT IN	24.48	19.77	16.98	13.57	0.72	0.56
IVRCL Infra	IVRC IN	9.75	6.67	5.87	4.53	0.15	0.11
Nagarjuna Const	NJCC IN	8.34	7.21	5.55	4.79	0.20	0.16
HCC	HCC IN	NM*	NM*	3.67	3.01	0.10	0.09
Punj Lloyd	PUNJ IN	39.12	9.58	13.58	6.92	0.21	0.19

Based on prices as of 8 December, 2010. Note: Adj P/E = (Current Price - target price of subs) / Standalone Earnings, Adj EV/EBITDA = (Current EV - target price of subs) / Standalone EBITDA, Adj EV/Order book = (Current EV - target price of subs) / Order book. *HCC adj P/E is not meaningful as our subsidiary valuation is greater than total market cap

Source: Nomura estimates

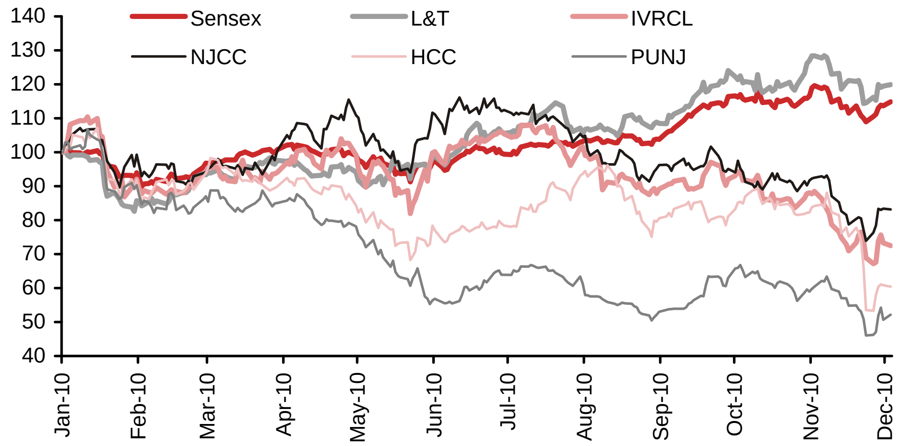
Exhibit 102. Mid-caps are trading at discount to visible net worth

(x)	Price/visible net worth
L&T	2.12
IVRCL Infra	0.85
Nagarjuna Const	0.91
HCC	0.53
Punj Lloyd	0.96

Based on prices as of 8 December, 2010. Note: Visible net worth = Current Price Current net worth + Profit expected from current order book + Value of subsidiaries

Source: Nomura estimates

Exhibit 103. Construction stocks have underperformed Sensex (except L&T) in YTD CY10



Source: Bloomberg, Nomura research

Metals

BULLISH

Action

We expect steel prices to remain strong, driven primarily by high raw material prices. Therefore, we continue to prefer integrated steelmakers. TATA Steel and SAIL are our preferred picks in the sector. TATA Steel is our top pick on account of: 1) 2.9mn tonne expansion to drive earnings growth in FY13F, 2) sustainability of Corus' turnaround and 3) raw material projects to start production in 12 months.

Catalysts

We believe strong steel prices coupled with news on capacity additions will be potential key catalysts for the stocks.

Anchor themes

We are Bullish on steel and prefer Indian steel companies over non-ferrous due primarily to: 1) high volatility in non-ferrous metal prices, 2) India as a net importer of steel and exporter of aluminium and zinc — two major non-ferrous commodities that India produces and 3) attractive valuations for steel companies.

Stocks for action

TATA Steel and SAIL are our preferred picks on account of captive iron ore and significant capacity addition post FY12F. With Corus turnaround and overseas raw material investments progressing well, TATA Steel is our top pick.

Stock	Rating	Price	Price target
TATA Steel (TATA IN)	BUY	624	846
SAIL (SAIL IN)	BUY	178	264

Pricing as of 8 December, 2010; local currency

Raw material integration the key

① Despite improving demand 2010 was a challenging year

The global steel scenario has improved greatly in 2010 with demand at 2008 levels and global utilisation rising above 80%, according to World Steel Dynamics. However, margins of steelmakers globally have remained under pressure as: 1) demand is still in recovery mode — although utilisation in 2010 YTD has improved from 2009 levels, it was not enough to return pricing power to steelmakers; 2) raw material prices continued to head higher — iron ore and coking coal prices have increased nearly 100% and 50%, respectively, in 2010 YTD; 3) iron ore prices are volatile — with raw material contracts signed on a quarterly basis (from annually previously), spot market volatility is reflected in contracts as well. Globally, the steel industry has yet to adjust to this as sales contracts, which are largely on a yearly and half yearly basis, are taking time to shift to shorter term. Although steelmakers have shown remarkable production constraint, they have not been able to gain pricing power to pass the raw material hike fully. This has strained margins for non-integrated steelmakers.

② Strong demand and high raw material prices to support prices

We expect global steel capacity utilisation to reach 85-90% in 2011F. With limited capacity additions in the developed world, we estimate that 5-6% demand growth will help to improve capacity utilisation to more than 85%. At the same time, we expect raw material prices to remain high — 4Q FY11 contracts signed at 8% q-q higher rates for coking coal reaffirm our view. With raw material prices remaining high, we expect the marginal cost of production to remain at US$550-600/t; hence, we expect steel prices to remain strong in 2011F. However, we continue to prefer integrated steel makers.

③ Indian steel players have natural advantages

Indian steelmakers have a natural advantage on: 1) captive iron ore – iron ore costs for TATA Steel and SAIL are US$15-20/t compared with US$140-150/t for non integrated players, according to company data. It gives them an advantage of US$200/t and 2) availability of low-cost skilled labour in India. Hence, Indian steelmakers are among the lowest cost producers globally. Indian steel makers like SAIL are also looking to modernise operations and plan to improve efficiency.

Analysts

Alok Kumar Nemani
+91 22 4037 4193
alokkumar.nemani@nomura.com

Prabhat Awasthi
+91 22 4037 4180
prabhat.awasthi@nomura.com

Domestic demand strong — India remains net importer

India remains a net importer of steel owing to strong domestic demand outpacing supply. We expect Indian steel demand to post a CAGR of 10% over the next 3-4 years (there can be upside risks if execution picks up), but capacity additions have not caught up — most additions are brownfield expansions; greenfield plans remain caught in the web of land acquisition and environmental issues. Therefore, we expect net imports to go up in the next one to two years to 8-10mn tonnes. Indian steelmakers will continue to operate at rated capacity, in our view.

We prefer TATA Steel and SAIL

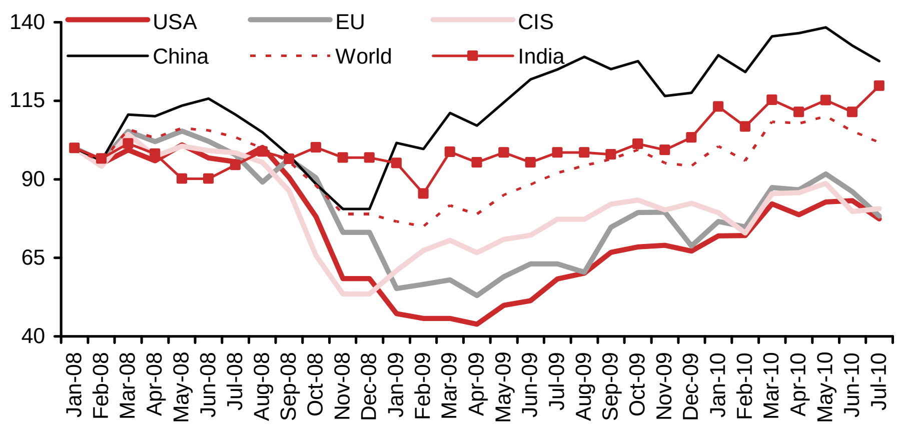
TATA Steel is our top pick and SAIL is our next preferred pick. Both have captive iron ore and fit our preference for integrated steelmakers. We prefer TATA Steel because: 1) of its 2.9mn tonne expansion likely by Dec 2011; 2) sustainability of Corus operations and 3) we believe leverage concerns should ease with improved cashflows.

Non-ferrous commodities – high price volatility; detached from fundamentals

Non-ferrous commodities have shown high volatility in prices, due to: 1) movements in US dollars and 2) high liquidity in the system, which has led them to behave like financial instruments rather than commodities. We believe high LME prices have led to excess production and inventories remain high for both aluminium and zinc. At the same time, with energy costs remaining high, production costs have also risen.

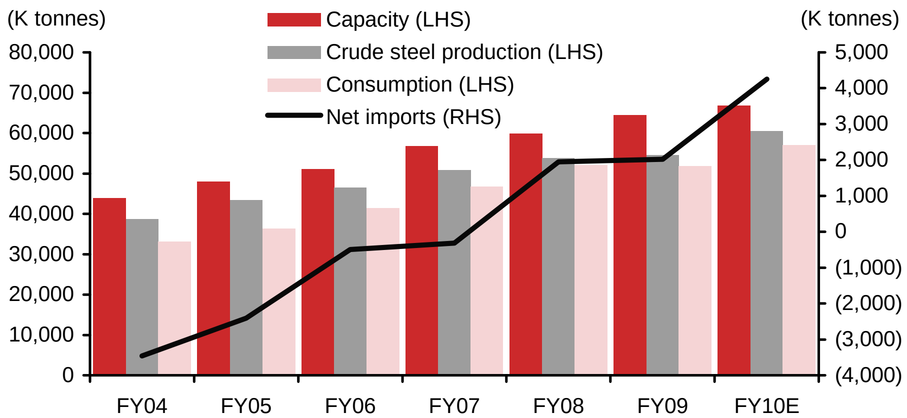
We have a BUY rating on Sterlite Industries purely on valuations. However as explained above, we continue to prefer ferrous companies.

Exhibit 104. Global capacity utilisation up with improvement in demand



Source: World Steel organisation, Nomura Research

Exhibit 105. India remains net importer of steel



Source: Joint Plant Committee, Nomura Research

Oil & gas/chemicals

BULLISH

Action

For 2011F, we are Bullish on oil, and expect refining margins to be on the uptrend, and think petchem will enter a golden age. Reliance, an integrated play, will likely benefit and is our large-cap pick. As clarity emerges on its ownership issue, Cairn India will re-emerge as a pure oil play. Despite a strong 2010, we remain Bullish on the gas story, with PLNG as our preferred pick for 2011F, but continue to like GAIL, GSPL and IGL.

Catalysts

Continued strength in refining and chemical margins, Early clarity on the govt's decisions on the Cairn-Vedanta deal and early easing of pipeline bottlenecks.

Anchor themes

We believe oil prices would strengthen further, driven by QE-2 and improving demand. As India imports ~80% of its oil needs, higher prices would put pressure on the economy, and likely derail any plans for further reforms / deregulation.

Stocks for action

We like RIL and Cairn India among the large-cap oil stocks. In the mid-cap gas space, PLNG is our preferred pick for 2011, but we continue to like GSPL and IGL.

Stock	Rating	Price	Price target
Reliance Industries (RIL IN)	BUY	1,021	1,200
Cairn India (CAIR IN)	BUY	327	370*
PLNG (PLNG IN)	BUY	122	145
GSPL (GUJS IN)	BUY	112	150
IGL (IGL IN)	BUY	329	440

* PT under review

Prices as of 8 Dec 2010

All eyes on government actions

① Bullish on oil; Bearish on oil PSUs

The weakness in US dollars, abundant money supply and potentially higher inflation expectations that could come with QE-2, plus strengthening oil fundamentals could fuel higher oil prices, in our view. We believe oil prices could reach US$100/bbl in 2011F. Higher oil prices would be positive for Cairn India and Reliance Industries. Although there are expectations that some positive action will be taken before the planned equity offering of ONGC/IOC, we think high oil prices could play spoilsport. The ad-hoc nature and non-transparency of the entire subsidy mechanism could continue to haunt oil PSUs in 2011F as well.

② All eyes will remain on government actions

Apart from its action on oil sector reforms/de-regulation, the government's decision on the Cairn-Vedanta transaction will be keenly watched. Gas price hikes for nominated blocks were a key positive step by the government in 2010. There are growing expectations that a more rational pricing methodology would emerge for pricing of new exploration licensing policy (NELP) gas in 2011F. Also, the government seems to be contemplating pooling gas prices, which we continue to believe would be a retrograe step.

③ Refining/petchem – strength likely to continue

We believe Asian refining margins are poised for modest gains in 2011F, on slowing capacity additions and a tightening diesel balance. We see continued strength in petchem and believe that the sector is poised to enter a golden age, benefiting from rising demand and restrained capacity additions. Reliance, as an integrated play, is likely to be a key beneficiary, in our view.

④ Gas pipeline bottlenecks to ease – we continue to like gas names

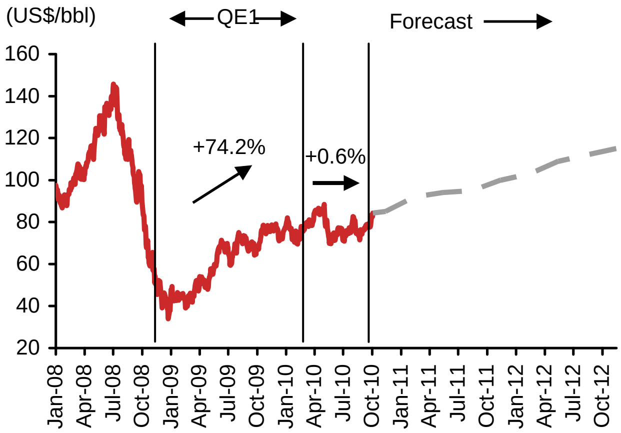
Gas consumption through most of 2010 was constrained by pipeline bottlenecks, particularly at GAIL's Hazira-Vijaipur-Jagdishpur (HVJ) system. However, we expect the situation to ease in 2011F, as GAIL first de-bottlenecks the old Dahej-Vijaipur pipeline and then commissions a new 48" Dahej-Vijaipur pipeline. With a delayed ramp-up at the KG-D6 block, and relatively benign global LNG markets, we think PLNG could surprise in terms of higher LNG imports, once pipeline bottlenecks ease.

Analysts

Anil Sharma
+91 22 4037 4338
anil.sharma.1@nomura.com

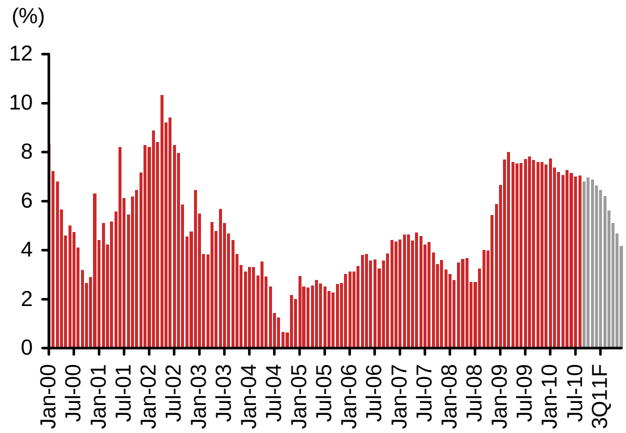
Ravikumar Adukia, CFA
+91 22 4037 4232
ravikumar.adukia@nomura.com

Exhibit 106. Crude oil price



Source: Bloomberg, Nomura estimates

Exhibit 107. OPEC space capacity



Source: IEA, Nomura estimates

Exhibit 108. Likely under recoveries at different oil prices – woes continue

Under recoveries (INRbn)	FY09	FY10	FY11F	FY12F		
Brent (US$/bbl)	85	70	83	**85**	**90**	**100**
Petrol	52	61	22	0	0	0
Diesel	523	83	248	87	197	416
PDS Kerosene	282	175	193	156	172	204
Domestic LPG	176	141	196	163	194	256
Total	**1,033**	**461**	**659**	**406**	**563**	**877**
Total (US$bn)	**22**	**10**	**15**	**9**	**13**	**20**

Source: Petroleum Planning & Analysis Cell (PPAC), Nomura estimates

We assume optimistic further price hikes of INR2/lit in diesel, INR3/lit in PDS kerosene and INR35/cyl in domestic LPG in FY12) …

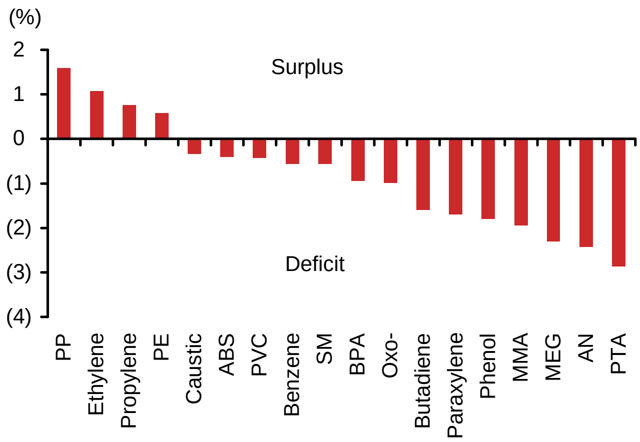
… yet, under-recoveries are a problem for industry, which we estimate will increase to US$20bn in FY12F at our oil price forecast of US$100/bbl for FY12F

Exhibit 109. Singapore refining margins

(US$/bbl)	2008	2009	2010F	2011F	2012F
Gasoline	13.7	12.5	10.8	10.2	9.5
Jet	27.7	8.2	11.0	13.0	12.0
Diesel	25.9	7.3	11.5	13.5	12.5
Fuel oil	(14.7)	(7.5)	(7.0)	(5.0)	(6.0)
Naphtha	(4.2)	(1.6)	0.5	0.5	1.0
LPG	(27.2)	(15.3)	(14.0)	(14.0)	(14.0)
Singapore complex	6.2	3.7	4.2	5.0	4.4
Singapore simple	0.4	0.7	0.8	1.0	0.7

Source: Reuters, Nomura estimates

Exhibit 110. Petrochemicals — Global supply *less* demand growth (2011F)



Source: Nomura estimates

Power & utilities

BULLISH

Action

Given a likely 60% (>100GW) rise in capacity by FY15F, we like IPPs with a front-ended capacity pipeline, credible execution ability, adequate fuel security (sourcing, pricing) and a healthy offtake mix. Lanco is our top IPP pick (it scores highest in 'our milestone risk matrix'), along with NTPC (reasonable risk-reward). PWGR, a hedged play on capacity growth, offers 30%-plus potential upside on our estimates.

Catalysts

Strong latent demand growth, regulatory developments (eg, auctioning of coal blocks, dilution in 'no-go' mining areas) and reduction of T&D losses.

Anchor themes

As the electricity demand-supply gap narrows, merchant tariffs trend lower and the domestic fuel shortage intensifies, developers able to minimise fuel security risks (sourcing, pricing) should be long-term winners. A 150GW+ pipeline by FY17F offers growth visibility in transmission. Health of SEBs remains a key concern.

Stocks for action

Our top BUY calls are PWGR (a hedged play on India's generation capacity growth and a defensive option) and Lanco (scores best among IPPs on our project milestone risk matrix).

Stock	Rating	Price (INR)	PT (INR)
Lanco Infratech (LANCI IN)	BUY	61.9	76.0
NTPC (NATP IN)	BUY	191.0	228.0
Power Grid (PWGR IN)	BUY	97.9	128.0
Reliance Power (RPWR IN)	REDUCE	156.7	136.0

Pricing as of 8 Dec 2010

The power of execution

① Sector offers strong growth opportunities

India's power sector offers a compelling macro perspective for attracting private sector investments – an electricity-deficit scenario where demand is 'restricted' by available supply, and a progressive regulatory regime which now allows varied business models that we estimate could yield equity IRRs of 15-60%.

② 'Restricted' demand-supply to reach parity by FY15F

We expect India's power generation capacity to rise by 60% from 167GW as of October 2010 to 272GW by FY15F, with demand likely to grow in tandem with real GDP growth of around 8% pa. Latent demand may well be the surprise factor.

③ Fuel security is the key differentiator; captive coal will rule

We believe a combination of the cost of generation and offtake mix (cost-plus, bid tariffs, spot) will determine long-term profitability for the IPPs in India. The yawning coal deficit is a major concern, in our view.

④ Spot/short-term tariff realisations to fall 30% by FY15F

In tandem with high growth in 'untied' capacity and a stronger, extensive inter-regional transmission system, we expect net merchant tariffs to drop to Rs3.5/kWh by FY15F, or to a level that allows a reasonable profit spread to yield 20-30% ROE.

⑤ PWGR and Lanco our top BUYs, RPWR our lone REDUCE

PWGR is a hedged play on India's 156GW generation capacity addition pipeline; we expect an FY11-17F EPS CAGR of 16%. A catch-up in the capitalisation rate and removal of equity overhang are potential catalysts. Lanco scores highest among India IPPs in our 'milestone risk matrix'; our forecast of a normalised 50%-plus EPS CAGR for FY10-13F and normalised multiples look inexpensive. NTPC offers a favourable risk-reward at current levels; we believe the lower earnings trajectory is priced in. RPWR's plans keep getting bigger, but it remains a waiting game. JSW Energy scores low on fuel security and its capacity additions are back-ended. Adani Power offers a compelling growth story, but this looks reasonably priced in, in our view.

Analysts

Anirudh Gangahar
+91 22 4037 4516
anirudh.gangahar@nomura.com

Nishit Jalan
+91 22 4037 4362
nishit.jalan@nomura.com

Exhibit 111. India: ‘Restricted’ electricity demand vs. supply

Generation capacity (MW)	FY06	FY07	FY08	FY09	FY10	FY11F	FY12F	FY13F	FY14F	FY15F
Supply										
Installed capacity (MW)	**124,287**	**132,329**	**143,061**	**147,965**	**159,398**	**175,184**	**196,315**	**213,087**	**240,613**	**271,769**
Capacity addition		8,042	10,732	4,904	11,433	15,785	21,131	16,772	27,526	31,156
y-y (%)		6.5	8.1	3.4	7.7	9.9	12.1	8.5	12.9	12.9
Demand										
Requirement (bn kWh)	**631.6**	**690.6**	**739.3**	**774.3**	**830.3**	**899.4**	**972.0**	**1,056.1**	**1,140.6**	**1,231.9**
y-y (%)	6.1	9.3	7.1	4.7	7.2	8.3	8.1	8.7	8.0	8.0
Availability (bn kWh)	578.8	624.5	666.0	689.0	746.5	825.7	910.1	1,001.6	1,105.8	1,247.9
y-y (%)	6.1	7.9	6.6	3.5	8.3	10.6	10.2	10.1	10.4	12.9
Deficit (bn kWh)	(52.7)	(66.1)	(73.3)	(85.3)	(83.8)	(73.8)	(61.9)	(54.6)	(34.8)	16.0
Base deficit (%)	(8.4)	(9.6)	(9.9)	(11.0)	(10.1)	(8.2)	(6.4)	(5.2)	(3.1)	1.3
Peak demand	**93,255**	**100,715**	**108,866**	**109,809**	**119,166**	**128,097**	**137,398**	**148,101**	**158,764**	**170,195**
y-y (%)	6.1	8.0	8.1	0.9	8.5	7.5	7.3	7.8	7.2	7.2
Peak capacity [demand met]	81,792	86,818	90,793	96,785	104,009	109,685	122,721	136,246	152,150	173,401
y-y (%)		6.1	4.6	6.6	7.5	5.5	11.9	11.0	11.7	14.0
Peak deficit	(11,463)	(13,897)	(18,073)	(13,024)	(15,157)	(18,412)	(14,678)	(11,855)	(6,614)	3,206
Reserve margin (%)	(12.3)	(13.8)	(16.6)	(11.9)	(12.7)	(14.4)	(10.7)	(8.0)	(4.2)	1.9

Source: CEA, Nomura estimates

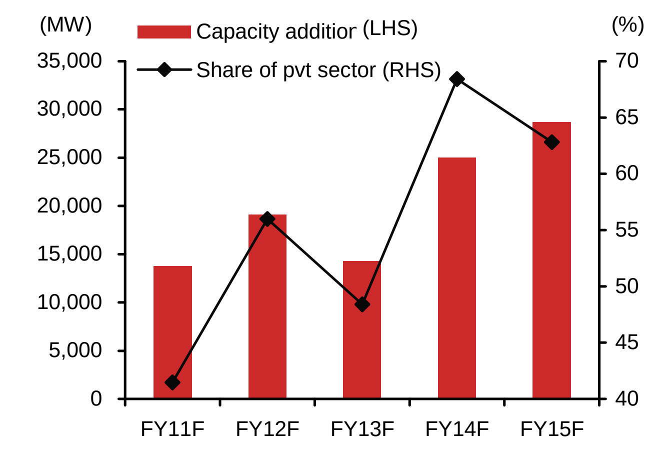
Exhibit 112. Indian utilities: valuation comparison

	B’berg	Nomura	Mkt cap	Closing	Price	Upside	P/E (x)			P/BV (x)			ROE (%)			EV/EBITDA (x)		
Name	**ticker**	**rating**	**(US$mn)**	**price**	**target**	**(%)**	**11F**	**12F**	**13F**	**11F**	**12F**	**13F**	**11F**	**12F**	**13F**	**11F**	**12F**	**13F**
Adani Power	ADANI IN	NEUTRAL	6,238	129.0	148	14.7	33.8	10.7	7.3	4.3	3.0	2.2	13.4	33.3	35.3	34.2	10.7	6.8
JSW Energy	JSW IN	NEUTRAL	3,603	99.1	100	1.0	13.5	8.6	9.9	2.7	2.1	1.7	22.4	27.3	19.0	11.5	6.4	7.5
Lanco (Base case)	LANCI IN	BUY	3,303	61.9	76	22.9	19.2	18.6	16.1	3.6	3.0	2.5	20.8	17.7	17.2	9.8	7.5	6.9
Lanco (Alt. case)							13.4	9.0	8.9	3.4	2.5	1.9	28.8	31.5	24.4	9.8	7.5	6.9
NTPC	NATP IN	BUY	34,922	191.0	228	19.4	18.2	16.0	13.9	2.3	2.2	2.0	13.7	14.0	14.9	13.4	11.4	10.0
Power Grid	PWGR IN	BUY	10,048	97.9	128	30.8	16.2	14.3	12.4	2.1	1.9	1.8	14.9	14.1	14.9	10.9	9.7	8.9
Reliance Power	RPWR IN	REDUCE	9,746	156.7	136	(13.2)	51.6	45.4	17.7	2.6	2.4	2.1	4.9	5.5	12.8	137.4	52.9	17.2
Average							**20.2**	**13.6**	**11.9**	**3.0**	**2.4**	**2.0**	**17.0**	**21.3**	**20.3**	**16.0**	**9.1**	**8.0**

Note: Priced on 8th Dec, 2010; Average excludes RPWR; Base case = Depreciation calculated on WDV basis; Alt. Case = Depreciation calculated on SLM basis; Ratings and Price Targets are as of the date of the most recently published report (http://www.Nomura.com) rather than the date of this document.

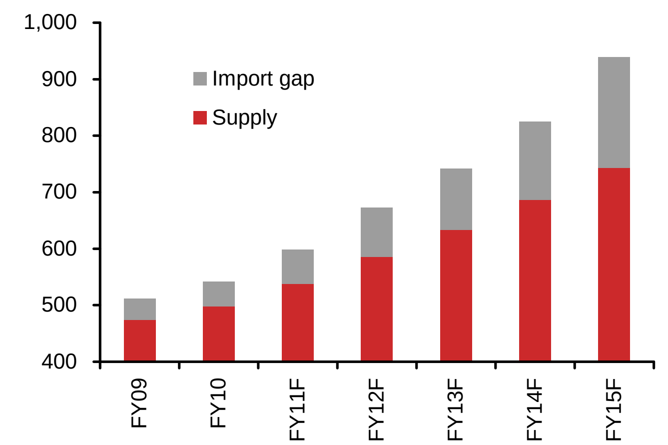
Source: Bloomberg, Nomura estimates

Exhibit 113. Capacity addition – Share of Pvt sector



Source: CEA, Nomura estimates

Exhibit 114. Coal – rising dependence on imports



Note: Figures (in mn tons) for thermal coal; import quantity mar vary with GCV

Source: Ministry of Coal, Nomura estimates

Pharmaceuticals

BULLISH

Action

The Healthcare Index (BSEHTC) has outperformed the SENSEX by 20% YTD. Despite the outperformance, we believe the risk-reward for the sector remains favourable. We expect the earnings upgrade cycle to continue going into FY13F as sales for products going off-patent in the US peak and the sector's premium valuations continue.

Catalysts

Product approvals in the US, licensing deals and alliances with global pharma majors.

Anchor themes

The Indian healthcare sector is a play on four themes: 1) US patent expiries; 2) secular domestic market growth, 3) participation in other emerging markets opportunities, including collaboration/alliances; and 4) R&D and manufacturing outsourcing.

Stocks for action

DRRD remains our top Buy in the sector. We expect significant earnings upgrades going forward for DRRD. Our FY13F numbers are ~18% higher than consensus.

Stock	Rating	Price (INR)	Price target (INR)
Dr. Reddy's (DRRD IN)	BUY	1,828	2,084
Glaxo (GLXO IN)	NEUTRAL	2,131	2,132
Ranbaxy (RBXY IN)	REDUCE	574	389
Cipla (CIPLA IN)	REDUCE	370	264

Pricing as of 8 Dec 2010

Earnings upgrades to continue in FY13

① US opportunity looms large

We believe that US patent expiries over the next two years will be a significant growth driver going forward. There are ~2,000 ANDAs pending with the USFDA, of which ~600 ANDAs are filed by Indian companies. We expect annual product sales worth ~US$64bn to go generic in FY12 and FY13.

② Domestic market is a secular growth story

The Indian domestic pharmaceuticals market is a secular growth story, with an expected growth rate of ~16% as per IMS. We expect the larger players such as Sun Pharma, Ranbaxy, Lupin, Cipla and Dr Reddy's to outperform the market. We note these companies have considerably expanded their field force and are addressing portfolio gaps. Such initiatives should drive growth, in our view.

③ Focus on emerging markets offers strong growth opportunity

We believe Indian pharmaceutical majors are now increasingly focusing on other emerging generic pharmaceutical markets, such as Russia, Brazil and Japan. Apart from own sales and marketing infrastructure, the emerging markets opportunity is being addressed through collaboration/alliance with large pharmaceutical companies. We believe this presents a low-risk strategy for Indian pharmaceutical companies to scale up their presence in emerging markets.

④ Outsourcing opportunity – down but not out

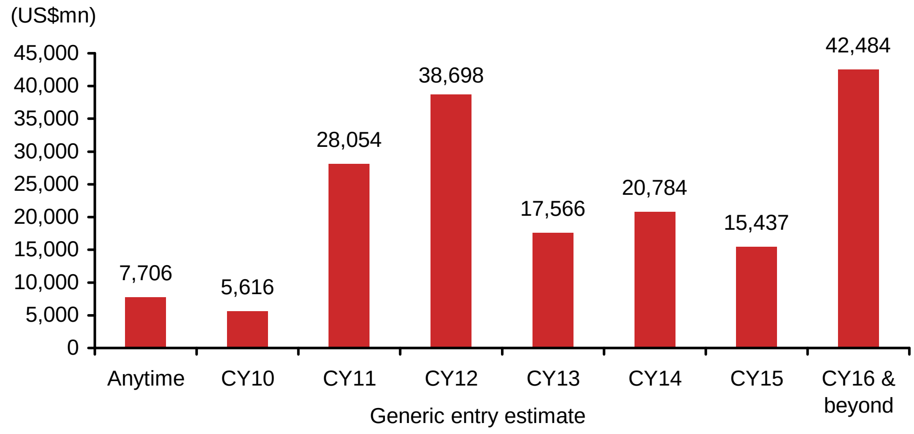
Indian pharmaceutical companies account for 2% of global pharmaceutical R&D and manufacturing outsourcing as per our estimates. We believe considerable investments have been made in setting up facilities and developing relationships with major global pharmaceutical companies. However, given the economic crisis and mega M&As, the ramp-up in outsourcing fell short of street expectations. However, we believe the ingredients are in place for growth to revive in FY12F.

Analysts

Saion Mukherjee
+91 22 4037 4184
saion.mukherjee@nomura.com

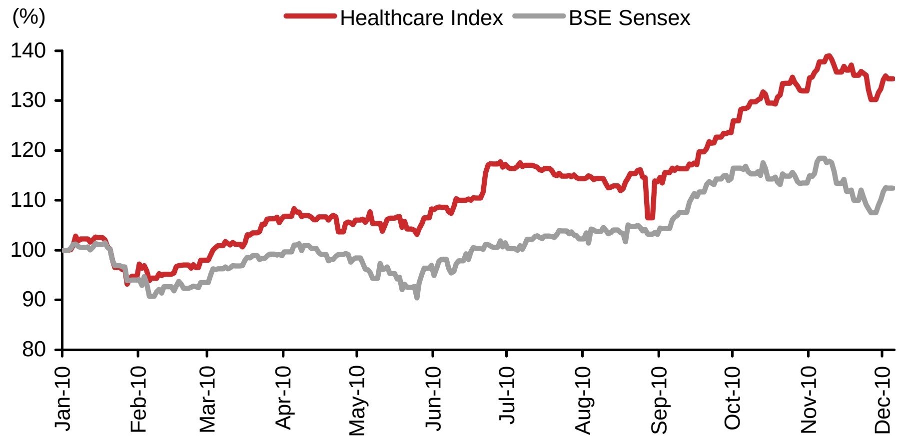
Aditya Khemka
+91 22 4037 4197
aditya.khemka@nomura.com

Exhibit 115. US patent expiry schedule



Source: Company data, Nomura estimates, www.fda.gov

Exhibit 116. Healthcare Index YTD price performance vs. the SENSEX



Source: Nomura estimates, Bloomberg

Property

NEUTRAL

Action

The recovery in the residential segment is over and now it is essential to ensure growth in volumes and execution, to lower dependence on external funding. Improvement in the office segment should help developers monetise some of their leased assets. The current pessimism for the sector is unwarranted, in our view, and we continue to prefer HDIL Ltd, Unitech Ltd and Puravankara.

Catalysts

A sharp upward move in volumes, led by strong economic growth, would make us more bullish. Rapid and large increases in interest rates would make us bearish.

Anchor themes

CY11-12 will be a crucial period for developers, as they need to sell and execute higher volumes, not only to deleverage themselves, but also to justify the large land banks they hold. If volumes are not substantially higher from here by CY12, then developers may not be able to get full value for their large land holdings.

Stocks for action

We prefer volume-oriented plays such as Unitech, Puravankara Projects and companies that are able to generate land in Mumbai in an inexpensive manner like HDIL.

Stock	Rating	Price (INR)	Price target (INR)
HDIL Ltd. (HDIL IN)	BUY	196	366
Unitech Ltd. (UT IN)	BUY	65	100
Puravankara Projects (PVKP IN)	BUY	110	168

Prices as of 8 December, 2010.

Pessimism unwarranted

① Regional divergence to increase in the residential segment

The recovery phase in the residential segment in India is now over, in our view. After the homogeneous pick-up in volumes seen across the country over the past 18 months, we think that in CY11F macro factors such as policy shocks, increasing interest rates and lower funding availability for developers could temper the overall demand scenario and affordability will play a larger role in deciding volume growth in each region. We maintain our view that the South Indian cities of Bangalore and Chennai are likely to show greater increases in volumes than Mumbai and the National Capital Region (NCR) owing to far better affordability metrics. We expect prices in Mumbai and NCR to hold steady in 1HCY11F, while there could be a 10-15% correction (or discounts being offered) in 2HCY11. For the rest of India, we expect prices to remain flat or display slow upward movement.

② Commercial segment to show an uptick in leasing and rents

Leasing demand should reach pre-recession 2008 levels by 1QCY11F, in our view. Over the past eight quarters, supply has, on average, been around 11mn sqft which is much lower than the pre-crisis levels. We expect supply to increase over the next two quarters and we see supply moderating only in CY12F, resulting in rents starting to increase, at the earliest, from 2HCY11F. We expect the larger, organised developers to see the benefits of improving leasing demand and stable rents before unorganised smaller players as there is a flight to quality assisted by competitive rents. CY11F may also see the long-awaited REIT listing of DLF Assets Ltd.

③ Execution to gain increased focus

Apart from ensuring that sales pick up through appropriate pricing, we believe, developers will have to make certain that execution does not falter. This will be especially crucial, given that cashflows are now linked to construction. In CY11F, a large chunk of developers' debt comes up for repayment and, we believe, it is necessary for developers to speed up execution from the current levels to ensure robust cash flows. Developers who are unable to show evidence of execution are likely to face funding issues – both debt and equity.

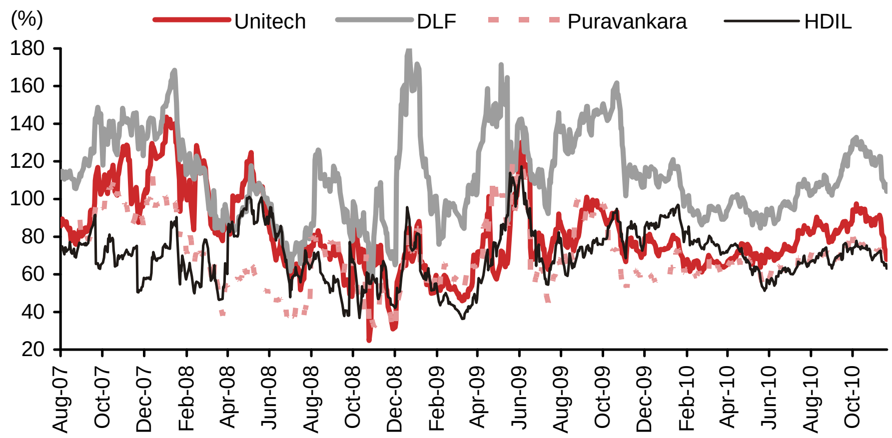
Analyst

Aatash Shah
+91 22 4037 4194
aatash.shah@nomura.com

④ Too much pessimism in stock prices

Following the recent 2G telecom issues and the property loan scandal in India, property stocks have corrected further by 15-30% over the past one month vs a 2% fall in the BSE Sensex. Investors are concerned that banks are likely to restrict funding to the sector following these concerns and may even recall loans. However, we think, this is highly unlikely; banks may tighten their processes and lengthen the timeline to sanction loans, but are unlikely to either restrict lending or recall their loans. Stepping back from the negative news flow surrounding the sector, one would realise that the issues are company-specific and not endemic to the sector. Property stocks are now trading at a 30-45% discount to their net asset values (NAV) which we think is building in too much pessimism. We would prefer to be invested in volume-oriented plays such as Unitech Ltd, Puravankara Projects Ltd and in companies which are able to generate land in Mumbai in an inexpensive manner like HDIL Ltd. We would expect the discount to NAV for these stocks to narrow in CY11F, as the companies deliver on sales volumes and execution.

Exhibit 117. Premium/discount to NAV



Source: Company data, Nomura research

Exhibit 118. Peer comparison

Ticker	Co Name	Rating	Current price (Rs)	NAV/share (Rs)	Disc. to NAV (%)	Mcap (Rsbn)	P/E (x)		P/BV (x)	
							FY11F	FY12F	FY11F	FY12F
DLFU IN	DLF	NEUTRAL	290	296	(2)	492.4	19.7	14.4	1.6	1.4
UT IN	Unitech	BUY	65	100	(35)	163.6	13.7	8.8	1.3	1.2
PVKP IN	Puravankara Projects	BUY	110	168	(34)	23.5	15.3	8.6	1.4	1.2
HDIL IN	HDIL	BUY	196	366	(47)	81.2	10.3	6.0	0.8	0.7
GPL IN	Godrej Properties	NEUTRAL	639	523	22	44.6	33.2	17.6	4.8	4.0
DBRL IN	DB Realty	Not rated	219	-	-	53.3	12.7	5.2	1.5	1.2
IBREL IN	Indiabulls Real Estate	Not rated	136	-	-	54.6	31.3	17.4	0.6	0.6
SOBHA IN	Sobha	Not rated	319	-	-	31.3	24.1	11.5	1.7	1.5
ARCP IN	Anant Raj	Not rated	106	-	-	31.3	15.5	8.7	0.8	0.8
MLIFE IN	Mahindra Lifespace	Not rated	399	-	-	16.3	13.3	9.3	1.6	1.3
PHNX IN	Phoenix Mills	Not rated	230	-	-	33.3	35.5	20.7	1.9	1.8
PEPL IN	Prestige Estates	Not rated	177	-	-	58.1	34.9	19.8	6.1	2.6
OBER IN	Oberoi Realty	Not rated	272	-	-	89.4	15.3	12.2	2.6	2.3

Prices as of 08 Dec 2010. Source: Nomura estimates for rated stocks, Bloomberg consensus for not rated stocks

Valuation methodologies and risks

Unitech: We value the company in two parts: 1) net asset value of the current land bank at INR78 per share and 2) Unitech Infra valued at INR22 per share. Our cost of capital assumption is 13.75%.

Downside risks include: 1) a reduction in liquidity and capital availability for developers, 2) stalled economic growth recovery, 3) an inability to successfully sell projects or construct them and 4) rising interest rates.

HDIL: We value HDIL using our net asset value estimate of its current saleable area at INR366 per share, without any discount/premium to NAV, and with cost of equity at 15%.

Downside risks include 1) a delay in shifting of slum dwellers in Phase 1 of the airport slum rehab project; 2) an increase in FSI in Mumbai, which would affect demand and pricing of TDR; and 3) an increase in interest rates, which would affect demand for property and sentiment for property stocks

Puravankara Projects Ltd: We value the stock using our net asset value estimate of its current land bank at INR168 per share, without any discount to NAV, and with cost of capital at 13.5%. We think the biggest risk is the potential failure to sell and execute projects on time, resulting in cash flow problems.

Downside risks: 1) a reduction in liquidity and capital availability for developers, 2) stalled economic growth. 3) Rising interest rates along with policy action to restrict lending to property developers which could lead to refinancing risks for Puravankara.

Telecoms

NEUTRAL

Action

After a disappointing 2010 (two out of three India telcos have underperformed the broader market YTD), we don't expect too many fireworks in 2011 either. Competition should be more benign, but regulations and political intervention will remain. 3G could surprise positively, and contrary to expectations that 3G will be largely used to address decongestion, we think strong data demand bodes well for the ARPU outlook. Rising proliferation of affordable smart-phones and applications will be key. We see M&A as an ongoing theme. Bharti is our relative pick in India.

Catalysts

Price stability in wireless segment, data growth and M&A.

Anchor themes

Data could be the biggest surprise this year as 3G is rolled out, but the core wireless segment could remain under pressure. The regulatory environment is uncertain.

Stocks for action

Bharti is our relative pick in India. We are NEUTRAL on Bharti, and have REDUCE ratings for IDEA and RCOM.

Stock	Rating	Price	Price target
Bharti (BHARTI IN)	NEUTRAL	348	332
IDEA Cellular (IDEA IN)	REDUCE	71	65
RCOM (RCOM IN)	REDUCE	130	140

Prices as of 8 December, 2010

Stability in adversity

① 2010 was another year of disappointment

2010 has been another disappointing year for Indian telecoms, with the sector up 2% on average, underperforming the local market by 10%. Positive operational surprises have been rare, and incremental traffic has been highly sought after. 3G auctions have stretched balance sheets, limiting capacity to cut prices further, as did the Chinese equipment ban issues earlier in the year, which hampered rollout plans of many carriers. Regulations were a key nemesis and the new telecoms minister is now heavily focused on the legitimacy of 2G licence allocations – putting the overall sector under more scrutiny.

② 2011 – not expecting fireworks, but more rationality

For 2011F, we expect: 1) competition to be more rational in the wireless segment, but overall prices to remain under pressure; 2) data to surprise on the upside, which could provide resilience to ARPU; 3) more competition in the enterprise segment; 4) upside capex risks as 3G/backhaul is extended; 5) no real M&A, but potential exits by some newcomers; and 6) far more regulatory scrutiny in the sector.

③ Bharti is our relative pick

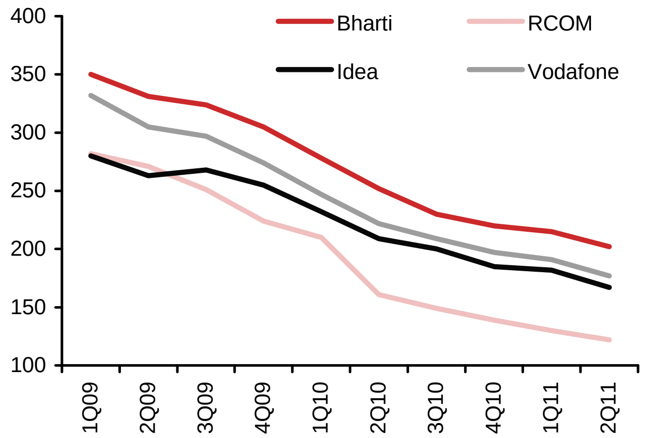
We have a NEUTRAL rating on Bharti, but see scope for upside surprises domestically, which could be offset by delays in operational turnaround in Africa. We believe operating trends from quarter to quarter will remain volatile in the coming year, which could see share price volatility, but on a fundamental basis any significant upside in the stock will likely be dependent on the African turnaround. We think Africa is a significant opportunity, but not without challenges, and it could take more than a year to realise the upside/downside potential. We have REDUCE ratings on IDEA and RCOM, due to expensive valuations and execution challenges. IDEA is well positioned to participate in potential M&A, in our view, but this needs regulatory amendments first, which could be a while away. In the meantime, we see its earnings upside limited to warrant a FY12F P/E of 25x.

Analysts

Sachin Gupta, CFA
+65 6433 6968
sachin.gupta@nomura.com

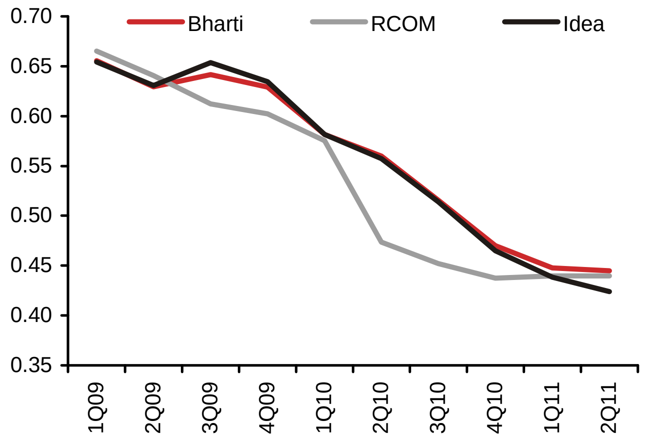
Neeraja Natarajan
+91 22 6723 5231
neeraja.natarajan@nomura.com

Exhibit 119. Quarterly ARPU trends



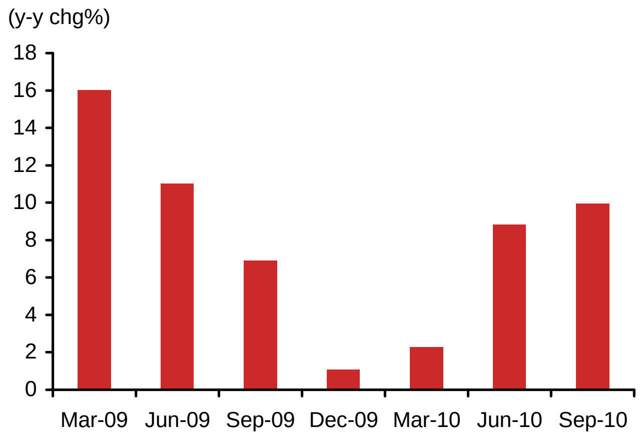
Source: Company data

Exhibit 120. Quarterly price trends



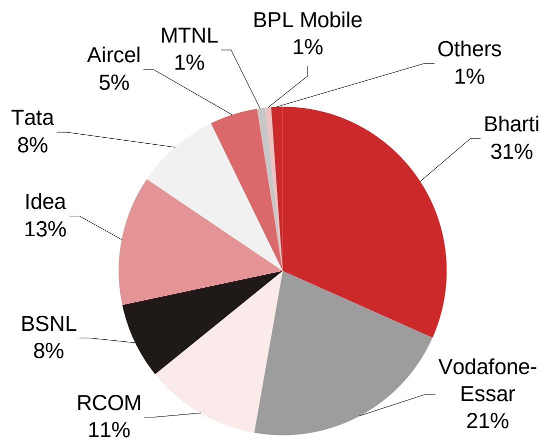
Source: Company data

Exhibit 121. Wireless industry growth trends



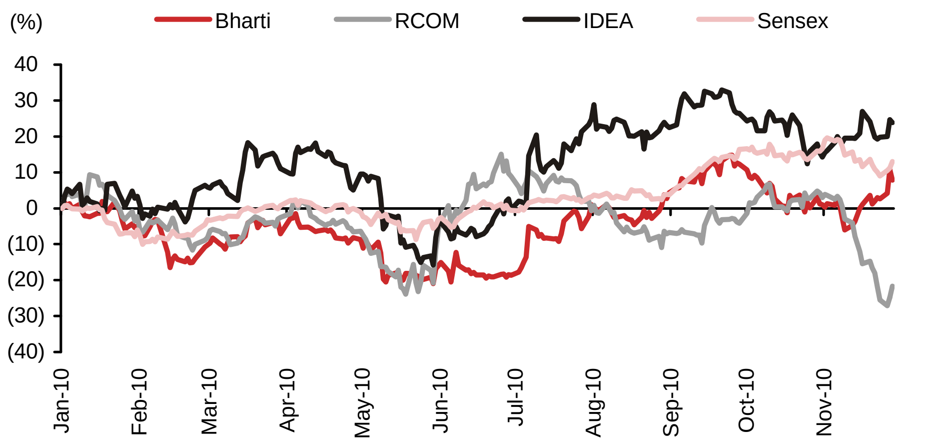
Source: TRAI

Exhibit 122. Revenue market share (Sep 2010)



Source: TRAI

Exhibit 123. Price performance of 3 telcos vs SENSEX



Source: Bloomberg

Transport infrastructure

BULLISH

Action

Domestic ports and logistics companies have underperformed over the past year on the back of a sluggish global economy. However, we expect the base effect and a modest pick-up in the global economy to help deliver mid-teen growth, and prefer CCRI and MSEZ on the theme. Airports are likely to benefit from rising air traffic, while return of risk-taking and clarity on regulatory issues along with land monetisation should drive up GVK, which is our preferred pick to GMR.

Catalysts

Continued strength in port traffic is the key to MSEZ and CCRI, while non-aero revenue and real-estate monetisation will drive growth at GVKP, in our view.

Anchor themes

Pick-up in industrial activity will likely lead to a turnaround in EXIM traffic, benefiting port entities and container logistics companies. Similarly, an improving macroeconomy will benefit air traffic and related revenue streams at airports.

Stocks for action

GVK Power & Infrastructure offers diversified exposure on increasing air traffic, real-estate and rising power capacity. Container Corp of India is our preferred play on rising freight traffic.

Stock	Rating	Price	Price target
GVK Power & Infrastructure (GVKP IN)	BUY	40.1	53.1
Container Corp of India (CCRI IN)	BUY	1,285	1,575

Pricing as of 8 December, 2010

Global recovery to lead modest growth

① Recovery in the economy to pave way for EXIM traffic growth

After initial signs of a recovery in the domestic manufacturing and construction sectors in early 2010, IIP numbers reflect a slowdown in 2H2010. Historically, EXIM traffic growth numbers have mirrored IIP growth trends, which is a clear measure of economic activity levels. The logistics sector has also been affected, in line with the IIP slowdown in 2010.

② 2011 to be aided by a global recovery, albeit modest

Coupled with a lower base effect and a modest pick up in the global economy, we expect traffic growth of above 15% in 2011F, which should drive earnings growth for the transport sector. We believe companies operating in the ports space and those directly involved in container cargo will benefit from the expected surge in traffic in 2011. Our top picks in the space are Container Corp of India and Mundra Port & SEZ.

③ Recovery to benefit traffic at airports as well

Traffic at privatised metro airports grew 15-30% p.a. until CY08 before the recession. Following two years of negative growth, the sector has again witnessed a sharp revival in 2010, with air traffic soaring to new highs. However, more than air traffic itself, the lone airport developers (GMR and GVK) are also exposed to regulatory risks in the airport business, delays in real-estate monetisation and revival in their power pipeline. We prefer GVK Power & Infrastructure to GMR Infrastructure given the former's relatively undervalued power portfolio and Mumbai real-estate holdings.

④ Return of risk-taking is the key for infrastructure conglomerates

Even as air traffic numbers have surprised positively for most of 2010, we believe it is just one of the several things that need to fall into place for the airport sector in India; the others being regulatory approvals for a shift to the RoCE model for aero-revenues, monetisation of real estate and commercialisation of several potentially lucrative non-aero revenue contracts such as advertisement, retail shops, etc. We believe the market is now adjusting to these realities; we had highlighted this in our earlier notes in 2009 (*Crash landing*, 25 March, 2009).

Analyst

Amar Kedia
+91 22 4037 4182
amar.kedia@nomura.com

Recommendation summary

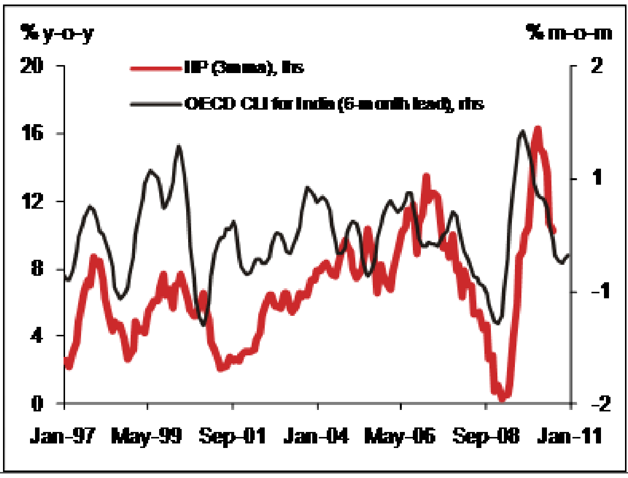
Stock	Price (INR)	PT (INR)	Rating
Container Corp of India (CCRI IN)	1,285	1,575	BUY
GVK Power & Infrastructure (GVKP IN)	40.1	53.1	BUY
Mundra Port & SEZ (MSEZ IN)	141	142	NEUTRAL
GMR Infrastructure (GMRI IN)	47	47	REDUCE

Pricing as of 8 December, 2010

Source: Nomura research

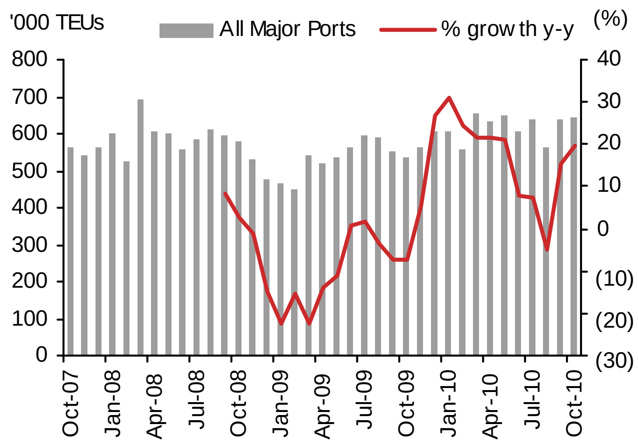
Simultaneously, the infrastructure developers as an asset class appear to have lost their appeal due to risk aversion. In our view, the progress on GVKP's power portfolio is exciting, even though its Mumbai land bank value remains undiscovered, as yet. We believe the return of risk-taking will be an important driver of stock prices in this asset class.

Exhibit 124. Industrial activity has dipped post the early 2010 pick-up



Source: OECD, CEIC and Nomura Global Economics

Exhibit 125. Container port traffic has remained subdued YTD FY11



Source: IPA, Nomura research

Mahindra and Mahindra MM IN

INDUSTRIALS/AUTOS & AUTO PARTS | INDIA

Kapil Singh +91 22 4037 4199 kapil.singh@nomura.com

NOMURA
NOMURA FINANCIAL ADVISORY AND SECURITIES (INDIA) PRIVATE LIMITED

Maintained

BUY

Action

Mahindra & Mahindra (MM) remains our top pick in the Indian auto sector. The company has a strong brand and distribution network in rural India and faces low competition. It is also well positioned to benefit from various government policies on rural growth and development. The standalone auto business trades at 11.7x FY12F EPS, at a 22% discount to Indian OEMs. Given the 43% volume growth in tractors in November 2010, we will review our tractor growth estimates and price target. We reaffirm our BUY rating.

Catalysts

Improved UV volumes led by de-bottlenecking, sustained tractor growth and successful new launches could be key catalysts.

Anchor themes

Nomura's economics team estimates 4.8% agricultural GDP growth for 2011F, vs 0.2% in 2010F. Strong agricultural GDP growth should drive rural incomes.

Closing price on 8 Dec	Rs789
Price target*	Rs892
	(set on 1 Nov 10)
Upside/downside	13.0%
Difference from consensus	19.3%
FY12F net profit (Rsmn)	27,751
Difference from consensus	3.7%

*PT under review

Source: Nomura

Nomura vs consensus

Our FY12F estimates are ahead of consensus by 4% due to higher margin estimates. In our view, the stock should trade at higher multiples as volume growth comes through.

Leveraging rural growth

① Key beneficiary of rural development

Rural India has been on the development agenda of India's government for the past few years. The rural development budget has doubled from Rs288bn in FY08 to Rs661bn in FY11F. In addition, minimum support prices for crops have consistently been increased, leading to strong income growth for farmers. We believe MM is likely to benefit from improved rural incomes, as it derives nearly 80% of its revenue from rural India.

② Volume growth likely to improve

MM's volume growth in the utility vehicles (UV) segment had lagged the industry, as the company was facing production constraints. We estimate volume growth will pick up in 2H FY11F as component supply issues are resolved.

③ Several new launches in pipeline

Over the next 18 months, MM will be launching several variants of the Xylo and Maaximo, a new SUV, a new pick-up truck in the US, refreshed Bolero and Scorpio models, and an entire range of heavy trucks. We, therefore, believe that the company has the potential to surprise on volume growth.

④ The stock remains undervalued relative to the sector

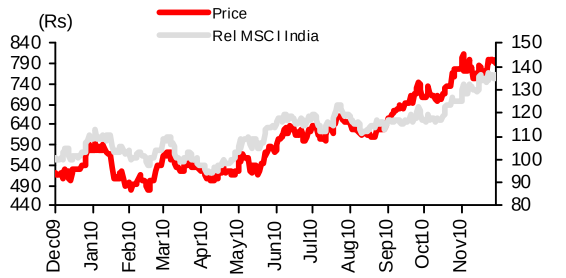
MM's standalone auto business trades at 11.7x FY12F EPS, below the sector average of 15x. We think the discount reflects: 1) market uncertainty over tractor growth, given historical cyclicality, although we think as growth comes through, valuations could improve; and 2) weakness in MM's recent UV volumes, growing by only 10% due to production constraints. As the company tides over these constraints, volume growth should improve, in our view. We value MM at Rs892. We value the standalone business at 13x one-year forward rolling EPS of Rs51.2 and investments at Rs226/share.

Key financials & valuations

31 Mar (Rsmn)	FY10	FY11F	FY12F	FY13F
Revenue	186,021	220,317	253,155	288,854
Reported net profit	20,416	25,163	27,751	31,251
Normalised net profit	19,882	25,163	27,751	31,251
Normalised EPS (Rs)	36.5	46.2	50.9	57.4
Norm. EPS growth (%)	140.6	26.6	10.3	12.6
Norm. P/E (x)	21.6	17.1	15.5	13.8
EV/EBITDA (x)	14.9	12.9	11.4	9.9
Price/book (x)	5.5	4.6	3.6	3.1
Dividend yield (%)	1.8	2.2	2.4	2.7
ROE (%)	31.2	29.2	25.9	24.1
Net debt/equity (%)	14.5	10.5	net cash	net cash
Earnings revisions				
Previous norm. net profit		25,163	27,751	31,251
Change from previous (%)		-	-	-
Previous norm. EPS (Rs)		46.2	50.9	57.4

Source: Company, Nomura estimates

Share price relative to MSCI India



	1m	3m	6m
Absolute (Rs)	1.6	24.3	38.3
Absolute (US$)	0.1	28.6	44.0
Relative to Index	6.8	19.3	21.9
Market cap (US$mn)			9,543
Estimated free float (%)			73.5
52-week range (Rs)			814/478.6
3-mth avg daily turnover (US$mn)			34.76
Stock borrowability			Hard
Major shareholders (%)			
LIC			17.5
M&M Trust			9.2

Source: Company, Nomura estimates

Exhibit 126. Volume growth estimates

Volumes (numbers)	FY11F	FY12F	FY13F
UVs+LCVs	255,805	291,618	332,444
Exports to the US	-	-	-
Maximo	24,000	36,000	39,600
Tractors+Skids	199,345	219,279	241,207
3W	54,432	59,875	65,863
Gio	10,800	12,960	15,552
Total	544,382	619,732	694,666
Volumes (% y-y)	**FY11F**	**FY12F**	**FY13F**
Uvs+LCVs	15.0	14.0	14.0
Exports to the US	0.0	0.0	0.0
Maximo	375.7	50.0	10.0
Tractors+Skids	14.0	10.0	10.0
3W	20.0	10.0	10.0
Gio	16.6	20.0	20.0
Total	19.1	13.8	12.1

Source: Nomura estimates

Exhibit 127. New product launch plans in the UV space

	Product code	Type	Comment	Timing
1	W201	SUV	New flagship model based on monocoque design, may be exported	Jun-11
2	S101	Compact SUV	Less than 4m, will qualify for excise duty benefits and may have a price tag of INR0.3m	Mid 2012
3	S102	Compact SUV	Up-market version of above	Late 2012
4	U202	SUV	Single/double-cab Xylo for export market	2012
5	U203	MPV	Face-lifted design of the above	Mar-11
6	U205	SUV	Xylo with m Hawk engine	2011
7	U206	SUV	Refreshed Xylo with improved design	NA
8	Bolero	UV	New version with improved styling	2011
9	Scorpio	SUV	US version of Scorpio	
9	W408	Pick up	Double-cab pick-up for US	2011
10	Logan	Car	Shortened version to meet lower excise duty norms	2011
11	Korando	SUV	From Ssangyong stable, 170Bhp turbo-diesel	2012

Source: *Autocar* magazine, November 2010

Valuation methodology

We value MM at Rs892, based on a sum-of-the-parts methodology. We value the standalone auto business at 13x average standalone EPS for FY12F and FY13F (ex subsidiary dividends) - Rs51.2 at Rs665.8/share. We value investments at Rs226/share after a 20% holding discount. We note that the stock still trades at a 22% discount to our coverage universe and that there is scope for multiples to re-rate, if tractor growth is higher than our estimate of 14% for FY11F. The SAAR for December 2010 implies 20% growth for tractors in FY11F.

Key risks

Acquisition of Ssangyong Motors: MM is planning to acquire Ssangyong Motors, Korea (announced in August 2010) - the fact that it is not a free cash flow positive company will pose a risk to MM's cash flows.

Below-normal rainfall in 2011: We have assumed a scenario of normal rainfall in 2011. However, if the rainfall is significantly below normal, it could have a material impact on our volume estimates.

Excise duty increases: We have assumed that the excise duty will not be increased from the current 10%. However, if the duty is raised further, it could have a materially negative impact on our margin estimates, as the company may not be able to pass through the increases in excise duty on tractor components.

Financial statements

Income statement (Rsmn)					
Year-end 31 Mar	**FY09**	**FY10**	**FY11F**	**FY12F**	**FY13F**
Revenue	130,937	186,021	220,317	253,155	288,854
Cost of goods sold	(95,657)	(127,041)	(153,120)	(179,087)	(205,604)
Gross profit	**35,279**	**58,980**	**67,197**	**74,067**	**83,249**
SG&A	(17,022)	(21,155)	(23,387)	(25,457)	(28,502)
Employee share expense	(10,246)	(11,985)	(13,902)	(16,127)	(18,707)
Operating profit	**8,011**	**25,840**	**29,908**	**32,484**	**36,040**
EBITDA	**10,926**	**29,552**	**34,168**	**37,682**	**42,553**
Depreciation	(2,915)	(3,712)	(4,260)	(5,198)	(6,513)
Amortisation					
EBIT	**8,011**	**25,840**	**29,908**	**32,484**	**36,040**
Net interest expense	(453)	(278)	(323)	72	641
Associates & JCEs					
Other income	2,703	1,994	2,676	3,023	3,384
Earnings before tax	**10,262**	**27,556**	**32,260**	**35,578**	**40,066**
Income tax	(1,997)	(7,674)	(7,097)	(7,827)	(8,814)
Net profit after tax	**8,265**	**19,882**	**25,163**	**27,751**	**31,251**
Minority interests					
Other items					
Preferred dividends					
Normalised NPAT	**8,265**	**19,882**	**25,163**	**27,751**	**31,251**
Extraordinary items	(396)	534	-	-	-
Reported NPAT	**7,869**	**20,416**	**25,163**	**27,751**	**31,251**
Dividends	(3,121)	(7,645)	(9,384)	(10,349)	(11,655)
Transfer to reserves	**4,749**	**12,771**	**15,779**	**17,402**	**19,597**
Valuation and ratio analysis					
FD normalised P/E (x)	52.0	21.6	17.1	15.5	13.8
FD normalised P/E at price target (x)	58.8	24.4	19.3	17.5	15.6
Reported P/E (x)	54.6	21.1	17.1	15.5	13.8
Dividend yield (%)	0.7	1.8	2.2	2.4	2.7
Price/cashflow (x)	23.0	21.4	12.6	12.0	10.4
Price/book (x)	8.2	5.5	4.6	3.6	3.1
EV/EBITDA (x)	41.6	14.9	12.9	11.4	9.9
EV/EBIT (x)	56.8	17.1	14.7	13.2	11.7
Gross margin (%)	26.9	31.7	30.5	29.3	28.8
EBITDA margin (%)	8.3	15.9	15.5	14.9	14.7
EBIT margin (%)	6.1	13.9	13.6	12.8	12.5
Net margin (%)	6.0	11.0	11.4	11.0	10.8
Effective tax rate (%)	19.5	27.8	22.0	22.0	22.0
Dividend payout (%)	39.7	37.4	37.3	37.3	37.3
Capex to sales (%)	10.2	3.8	6.8	5.9	5.2
Capex to depreciation (x)	4.6	1.9	3.5	2.9	2.3
ROE (%)	16.4	31.2	29.2	25.9	24.1
ROA (pretax %)	7.3	19.2	18.7	17.2	16.9
Growth (%)					
Revenue	13.0	42.1	18.4	14.9	14.1
EBITDA	(23.3)	170.5	15.6	10.3	12.9
EBIT	(32.5)	222.6	15.7	8.6	11.0
Normalised EPS	(60.7)	140.6	26.6	10.3	12.6
Normalised FDEPS	(60.7)	140.6	26.6	10.3	12.6
Per share					
Reported EPS (Rs)	14.4	37.5	46.2	50.9	57.4
Norm EPS (Rs)	15.2	36.5	46.2	50.9	57.4
Fully diluted norm EPS (Rs)	15.2	36.5	46.2	50.9	57.4
Book value per share (Rs)	96.6	143.7	172.6	220.0	256.0
DPS (Rs)	5.7	14.0	17.2	19.0	21.4

Source: Nomura estimates

16% CAGR in top line over the next two years will likely drive earnings

Cashflow (Rsmn)					
Year-end 31 Mar	**FY09**	**FY10**	**FY11F**	**FY12F**	**FY13F**
EBITDA	10,926	29,552	34,168	37,682	42,553
Change in working capital	8,524	(4,119)	4,777	2,787	3,532
Other operating cashflow	(752)	(5,341)	(4,745)	(4,733)	(4,789)
Cashflow from operations	**18,698**	**20,093**	**34,199**	**35,736**	**41,296**
Capital expenditure	(13,380)	(6,999)	(15,000)	(15,000)	(15,000)
Free cashflow	**5,318**	**13,094**	**19,199**	**20,736**	**26,296**
Reduction in investments	(15,714)	(6,116)	(8,333)	(8,333)	(8,333)
Net acquisitions					
Reduction in other LT assets	-	-	-	-	-
Addition in other LT liabilities	-		-	-	-
Adjustments	(174)	448			
Cashflow after investing acts	**(10,570)**	**7,426**	**10,866**	**12,403**	**17,962**
Cash dividends	(3,121)	(7,645)	(9,384)	(10,349)	(11,655)
Equity issue	361	7,024	-	8,418	-
Debt issue	20,461	(5,117)	(1,703)	(7,886)	(3,498)
Convertible debt issue					
Others			-	-	-
Cashflow from financial acts	**17,701**	**(5,738)**	**(11,087)**	**(9,818)**	**(15,152)**
Net cashflow	**7,132**	**1,688**	**(221)**	**2,585**	**2,810**
Beginning cash	8,612	15,744	17,432	17,211	19,796
Ending cash	15,744	17,432	17,211	19,796	22,606
Ending net debt	24,783	11,369	9,887	(584)	(6,892)

Source: Nomura estimates

Balance sheet (Rsmn)					
As at 31 Mar	**FY09**	**FY10**	**FY11F**	**FY12F**	**FY13F**
Cash & equivalents	15,744	17,432	17,211	19,796	22,606
Marketable securities					
Accounts receivable	10,437	12,581	17,659	20,311	23,194
Inventories	10,607	11,888	19,850	22,977	26,264
Other current assets	13,842	18,523	18,058	19,851	21,799
Total current assets	**50,629**	**60,424**	**72,778**	**82,935**	**93,864**
LT investments	57,864	63,980	72,314	80,647	88,980
Fixed assets	32,143	37,027	47,767	57,569	66,056
Goodwill					
Other intangible assets	489	41	41	41	41
Other LT assets					
Total assets	**141,126**	**161,472**	**192,901**	**221,192**	**248,942**
Short-term debt					
Accounts payable	34,431	33,673	45,954	53,542	61,927
Other current liabilities	13,547	18,292	23,364	26,134	29,400
Total current liabilities	**47,978**	**51,965**	**69,318**	**79,676**	**91,327**
Long-term debt	40,528	28,802	27,098	19,212	15,714
Convertible debt					
Other LT liabilities		2,438	2,438	2,438	2,438
Total liabilities	**88,505**	**83,205**	**98,854**	**101,326**	**109,479**
Minority interest					
Preferred stock					
Common stock	2,792	2,910	2,910	3,001	3,001
Retained earnings	49,829	75,358	91,137	116,865	136,462
Proposed dividends					
Other equity and reserves					
Total shareholders' equity	**52,621**	**78,268**	**94,047**	**119,866**	**139,463**
Total equity & liabilities	**141,126**	**161,473**	**192,901**	**221,192**	**248,942**
Liquidity (x)					
Current ratio	1.06	1.16	1.05	1.04	1.03
Interest cover	17.7	92.9	92.5	na	na
Leverage					
Net debt/EBITDA (x)	2.27	0.38	0.29	net cash	net cash
Net debt/equity (%)	47.1	14.5	10.5	net cash	net cash
Activity (days)					
Days receivable	28.6	22.6	25.0	27.4	27.5
Days inventory	40.9	32.3	37.8	43.8	43.7
Days payable	109.3	97.8	94.9	101.7	102.5
Cash cycle	(39.9)	(42.9)	(32.0)	(30.5)	(31.3)

Source: Nomura estimates

Net debt/equity is likely to decrease substantially

TATA Steel TATA IN

STEEL | INDIA

Alok Kumar Nemani +91 22 4037 4193 alokkumar.nemani@nomura.com
Prabhat Awasthi +91 22 4037 4180 prabhat.awasthi@nomura.com

Maintained

BUY

Action

TATA Steel is our top pick in the Indian metal space on: 1) stronger y-y earnings growth in FY13F resulting from a 2.9mn-tonne capacity expansion, scheduled to be completed by December 2011; 2) the sustainable turnaround of its European operations; and 3) Rio Tinto's offer to acquire Riversdale Mining, which should lead to value discovery for TATA Steel's Riversdale stake. Maintain BUY.

Catalysts

Improving steel prices, positive news flow on capacity expansion and development on Riversdale Mining are likely to be key triggers.

Anchor themes

TATA Steel has shown a remarkable turnaround at Corus and a significant improvement in the profitability of its domestic business. With investment in mining projects, raw material integration for the company ought to improve significantly. At the same time, with strong cashflow, leverage should come down as well.

Closing price on 8 Dec	Rs624
Price target	**Rs846**
	(set on 5 Oct 10)
Upside/downside	35.5%
Difference from consensus	22.3%
FY12F net profit (Rsbn)	72.9
Difference from consensus	2.8%

Source: Nomura

Nomura vs consensus

TATA's European operations have exceeded street expectations time and again, but consensus remains negative. Also, its 2.9mn-tonne expansion, scheduled for 2H FY12F, has yet to be valued, which we think is unfair.

Fundamentals in place

① European operations: sustainable turnaround

TATA Steel's European operations – with their robust performance driven by focus on core strengths and fixed-cost savings – have continued to surprise the street. We expect Corus's EBITDA per tonne to stabilise in the range of US$60-70/t and that utilisation will be close to 90%.

With total EBITDA of close to US$1bn, we believe TATA Steel's European operations will be able to meet its debt obligations. TATA Steel has also started reinvesting in the projects to improve efficiency and augment capacity in Europe. These major points should help to maintain profitability despite raw-material cost pressures.

② Visibility improving on overseas raw material projects

TATA Steel has invested in raw-material projects through stakes in Riversdale (RIV AU, Not rated) and New Millennium Capital (NML CN, Not rated). Rio Tinto recently launched a takeover bid for Riversdale valued at US$3.47bn. We estimate TATA Steel's stakes in Riversdale at the offer price will be worth more than US$1.7bn (INR85/share). However, TATA Steel shares have yet to build any value from the above, in our view.

With Rio Tinto's interest in Riversdale, visibility on Riversdale's operations should improve, in our view, and the acquisition could offer potential upside for TATA Steel in terms of project progress.

③ Raw material integration drives India business

TATA Steel's India business has continued its robust performance, driven primarily by captive raw materials. Indian operations have 100% captive iron ore and close to 50% captive coking coal. Since we expect raw material prices to remain high, we think that the Indian operations will continue to post strong earnings.

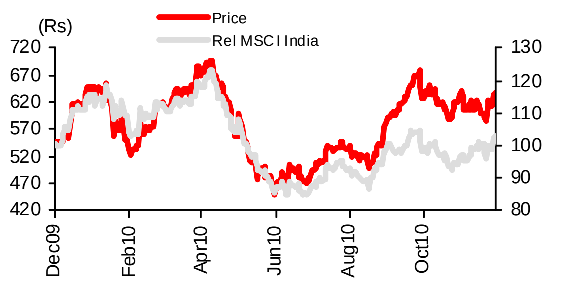
At the same time, with its 2.9mn-tonne expansion scheduled to be completed by December 2011, TATA Steel should see 33% y-y earnings growth in FY13F. We see TATA Steel as the only large Indian name with prospects of strong volume expansion in FY13F.

Key financials & valuations

31 Mar (Rsbn)	FY10	FY11F	FY12F	FY13F
Revenue	1,024	1,085	1,148	1,265
Reported net profit	(20.1)	64.1	72.9	96.6
Normalised net profit	(3.3)	64.1	72.9	96.6
Normalised EPS (Rs)	(3.7)	71.0	79.8	105.7
Norm. EPS growth (%)	(103.0)	na	12.4	32.5
Norm. P/E (x)	na	8.8	7.8	5.9
EV/EBITDA (x)	12.6	6.4	5.4	4.0
Price/book (x)	2.4	2.0	1.6	1.3
Dividend yield (%)	1.6	2.4	2.4	2.4
ROE (%)	(8.0)	24.9	22.8	24.5
Net debt/equity (%)	203.0	142.6	99.2	58.2
Earnings revisions				
Previous norm. net profit		64.1	72.9	96.6
Change from previous (%)		(0.1)	(0.0)	0.0
Previous norm. EPS (Rs)		71.0	79.8	105.7

Source: Company, Nomura estimates

Share price relative to MSCI India



	1m	3m	6m
Absolute (Rs)	(1.4)	7.5	38.3
Absolute (US$)	(2.9)	11.3	44.0
Relative to Index	5.1	3.5	23.6
Market cap (US$mn)			12,498
Estimated free float (%)			68.5
52-week range (Rs)			696/451.4
3-mth avg daily turnover (US$mn)			112.4
Stock borrowability			Hard
Major shareholders (%)			
Promoters			31.5

Source: Company, Nomura estimates

Drilling down

Significant cashflow after new capacity should reduce debt concerns

With TATA Steel's 2.9mn-tonne capacity expansion scheduled to be on line by December 2011, we believe the operating cashflow from its Indian operations will increase from INR83bn in FY11F to INR114bn in FY13F. At the same time, capital expenditure should come down from close to INR55bn in FY11F to INR10bn in FY13F (largely maintenance capex). Accordingly, we expect total free cashflow to increase from INR28bn in FY11F to INR105bn in FY13F. As a result, our forecasts show consolidated cashflow rising to US$2.6bn in FY13F, from US$1.1bn in FY11F. This should ease TATA Steel's debt concerns, given that it will help the company to improve its debt-equity and prepay a significant chunk of debt to reduce leverage.

Fundamentals in place – valuation attractive

TATA Steel's 2Q FY11 results have reaffirmed our belief in the turnaround of TATA Steel's European operations and the sustainability of its Indian operations' robust performance. TATA Steel Europe reported EBITDA per tonne of US$56/t in what was a tough quarter, as it faced: 1) high raw material prices (iron ore prices of US$145-150/t and coking coal prices at US$225/t); and 2) seasonal weakness on account of the summer holidays in Europe.

TATA Steel is trading at 8.1x FY12F EPS and 5.1x FY12F cash EPS. We believe this is at a significant discount to its peers and provides an attractive opportunity. With TATA Steel's European operations going strong and its 2.9mn-tonne expansion at Jamshedpur scheduled to start production in 12 months, we believe it has all the fundamentals in place for strong performance from hereon. Steel prices have also started to rise after recent weakness, and capacity utilisation at the European operations improved to 90% in 3Q FY11, from 87% in 2Q FY11.

We value the stock at INR846

Our sum-of-the-parts based price target of INR846 includes its domestic business at INR753/share, Corus at INR34/share, its interest in Riversdale Mining at INR44/share and its South East Asia business at INR15/share.

We value the domestic business at 10x FY12F standalone EPS of INR75.3 and Corus at 5x FY12F EV/EBITDA. We value TATA Steel's 24.2% stake in Riversdale Mining and 35% stake in Riversdale Mining's Benga project based on the company's current market cap of US$2.35bn.

Key risks to our call: 1) weak steel prices; 2) further deterioration in European economies; and 3) raw material prices rising significantly.

Exhibit 128. TATA Steel: strong cashflow to reduce debt concerns

(US$mn)	**FY11F**	**FY13F**
EBITDA/t (US$)	355	368
India business operating cashflow	1,848	2,544
Capital expenditure	(1,222)	(222)
Net operating cashflow	**626**	**2,322**
European business operating cashflow	702	637
Capital expenditure	(230)	(311)
Net operating cashflow	472	326
EBITDA/t (US$)	59	66
Consolidated cashflow	**1,098**	**2,648**
Gross debt (US$mn)	11,253	
Net debt (US$mn)	9,111	
Consolidated Interest cost (US$mn)	561	590
Net debt/cashflow	10.3	4.2

Source: Company data, Nomura estimates

Financial statements

Income statement (Rsbn)					
Year-end 31 Mar	FY09	FY10	FY11F	FY12F	FY13F
Revenue	1,473	1,024	1,085	1,148	1,265
Cost of goods sold	(1,335)	(988)	(979)	(1,021)	(1,107)
Gross profit	**139**	**36**	**106**	**127**	**158**
SG&A					
Employee share expense					
Operating profit	**139**	**36**	**106**	**127**	**158**
EBITDA	**181**	**80**	**151**	**169**	**204**
Depreciation	(43)	(45)	(44)	(43)	(46)
Amortisation					
EBIT	**139**	**36**	**106**	**127**	**158**
Net interest expense	(33)	(30)	(25)	(28)	(27)
Associates & JCEs	1	1	1	1	1
Other income	3	12	10	5	5
Earnings before tax	**109**	**18**	**91**	**104**	**137**
Income tax	(19)	(22)	(27)	(31)	(41)
Net profit after tax	**90**	**(3)**	**64**	**73**	**97**
Minority interests	0	(0)	(0)	(0)	(0)
Other items					
Preferred dividends					
Normalised NPAT	**90**	**(3)**	**64**	**73**	**97**
Extraordinary items	(41)	(17)	-	-	-
Reported NPAT	**50**	**(20)**	**64**	**73**	**97**
Dividends	(15)	(9)	(14)	(14)	(14)
Transfer to reserves	**35**	**(29)**	**50**	**59**	**83**
Valuation and ratio analysis					
FD normalised P/E (x)	5.0	na	8.8	7.8	5.9
FD normalised P/E at price target (x)	6.8	na	11.9	10.6	8.0
Reported P/E (x)	9.2	na	8.8	7.8	5.9
Dividend yield (%)	3.3	1.6	2.4	2.4	2.4
Price/cashflow (x)	2.9	4.3	5.3	5.1	4.2
Price/book (x)	1.6	2.4	2.0	1.6	1.3
EV/EBITDA (x)	6.1	12.6	6.4	5.4	4.0
EV/EBIT (x)	7.9	27.9	9.1	7.2	5.1
Gross margin (%)	9.4	3.5	9.8	11.0	12.5
EBITDA margin (%)	12.3	7.9	13.9	14.7	16.2
EBIT margin (%)	9.4	3.5	9.8	11.0	12.5
Net margin (%)	3.4	(2.0)	5.9	6.4	7.6
Effective tax rate (%)	17.4	116.8	29.6	29.5	29.6
Dividend payout (%)	30.1	na	21.4	19.1	14.4
Capex to sales (%)	7.3	6.8	4.2	4.0	1.9
Capex to depreciation (x)	2.5	1.5	1.0	1.1	0.5
ROE (%)	16.0	(8.0)	24.9	22.8	24.5
ROA (pretax %)	11.8	3.4	10.3	12.0	14.8
Growth (%)					
Revenue	12.0	(30.5)	5.9	5.8	10.2
EBITDA	1.9	(55.6)	87.3	12.4	20.7
EBIT	1.6	(74.4)	199.3	19.2	25.0
Normalised EPS	50.4	(103.0)	na	12.4	32.5
Normalised FDEPS	50.4	(103.0)	na	12.4	32.5
Per share					
Reported EPS (Rs)	67.8	(22.6)	71.0	79.8	105.7
Norm EPS (Rs)	123.8	(3.7)	71.0	79.8	105.7
Fully diluted norm EPS (Rs)	123.8	(3.7)	71.0	79.8	105.7
Book value per share (Rs)	379.3	257.1	318.5	386.8	477.3
DPS (Rs)	20.4	9.9	15.2	15.2	15.2

Source: Nomura estimates

TATA Steel should see strong EBITDA growth driven by 2.9mn-tonne expansion

Cashflow (Rsbn)					
Year-end 31 Mar	**FY09**	**FY10**	**FY11F**	**FY12F**	**FY13F**
EBITDA	181	80	151	169	204
Change in working capital	69	106	(4)	(4)	(8)
Other operating cashflow	(95)	(57)	(41)	(54)	(62)
Cashflow from operations	**156**	**129**	**105**	**111**	**135**
Capital expenditure	(107)	(69)	(46)	(46)	(24)
Free cashflow	**49**	**60**	**59**	**66**	**111**
Reduction in investments	(30)	10	-	-	-
Net acquisitions	(11)	5	0	0	0
Reduction in other LT assets	(5)	5	-	-	-
Addition in other LT liabilities	(7)	(1)	-	-	-
Adjustments	(24)	(22)	(1)	-	-
Cashflow after investing acts	**(29)**	**57**	**59**	**66**	**111**
Cash dividends	(15)	(9)	(14)	(14)	(14)
Equity issue	0	81	9	7	-
Debt issue	63	(123)	(25)	(44)	(21)
Convertible debt issue					
Others					
Cashflow from financial acts	**48**	**(51)**	**(29)**	**(51)**	**(35)**
Net cashflow	**19**	**6**	**29**	**16**	**76**
Beginning cash	42	61	68	97	112
Ending cash	61	68	97	112	188
Ending net debt	538	463	410	351	254

Source: Nomura estimates

Concerns on account of high leverage should come down with improved cash flows

Balance sheet (Rsbn)					
As at 31 Mar	**FY09**	**FY10**	**FY11F**	**FY12F**	**FY13F**
Cash & equivalents	61	68	97	112	187
Marketable securities					
Accounts receivable	130	116	123	130	144
Inventories	217	187	198	210	231
Other current assets	130	68	68	68	68
Total current assets	**539**	**439**	**485**	**519**	**629**
LT investments	64	54	54	54	54
Fixed assets	453	458	460	462	440
Goodwill	154	145	145	145	145
Other intangible assets					
Other LT assets	7	1	1	1	1
Total assets	**1,216**	**1,097**	**1,146**	**1,182**	**1,271**
Short-term debt					
Accounts payable	231	234	248	262	289
Other current liabilities	72	68	68	68	68
Total current liabilities	**303**	**302**	**316**	**330**	**357**
Long-term debt	544	510	485	441	441
Convertible debt	55	21	21	21	-
Other LT liabilities	28	27	27	27	27
Total liabilities	**930**	**860**	**850**	**820**	**826**
Minority interest	9	9	9	9	8
Preferred stock					
Common stock	7	9	9	9	9
Retained earnings					
Proposed dividends					
Other equity and reserves	270	219	278	344	427
Total shareholders' equity	**277**	**228**	**287**	**354**	**436**
Total equity & liabilities	**1,216**	**1,097**	**1,146**	**1,182**	**1,270**
Liquidity (x)					
Current ratio	1.78	1.45	1.54	1.57	1.76
Interest cover	4.2	1.2	4.2	4.5	6.0
Leverage					
Net debt/EBITDA (x)	2.97	5.76	2.72	2.07	1.24
Net debt/equity (%)	194.0	203.0	142.6	99.2	58.2
Activity (days)					
Days receivable	39.3	43.9	40.3	40.4	39.5
Days inventory	61.2	74.5	71.8	73.0	72.6
Days payable	67.6	85.8	89.8	91.4	90.9
Cash cycle	32.8	32.6	22.2	22.0	21.2

Source: Nomura estimates

Pantaloon Retail India PF IN

CONSUMER RELATED/RETAIL | INDIA

Manish Jain +91 22 4037 4186 manish.jain@nomura.com
Anup Sudhendranath +91 22 4037 5406 anup.sudhendranath@nomura.com

Maintained

BUY

NOMURA
NOMURA FINANCIAL ADVISORY AND SECURITIES (INDIA) PRIVATE LIMITED

Action

With organised retail set to take off in India over the next few years, we believe PRIL is best placed to benefit from the attractive opportunity in the Indian retail sector. Through its market leadership across various retail formats, unmatched scale and strong brand recognition, we believe PRIL is the most attractive way to invest in the Indian retail story over the medium term. Maintain BUY.

Catalysts

We think PRIL's ongoing restructuring of its business segments could be a key near-term catalyst. Reducing its stake in an insurance JV and the opening up of FDI in the multi-brand retail sector could also boost share-price performance.

Anchor themes

Penetration of organised retail remains low in India, nudging 10%, by our estimates, and should continue to grow in the medium term. PRIL, in our view, is very well placed to benefit from such growth.

Closing price on 8 Dec	Rs389.5
Price target	Rs553
	(set on 19 Apr 10)
Upside/downside	42.0%
Difference from consensus	4.3%
FY11F net profit (Rsmn)	3,552
Difference from consensus	8.6%

Source: Nomura

Nomura vs consensus

We are ahead of consensus on earnings for FY11, where revenue growth performance could surprise the street on the upside.

Well placed to deliver

① Strong business momentum

Pantaloon Retail India (PRIL) has consistently delivered a strong operational performance over the past couple of quarters and we think that over the medium term it is likely to benefit from the growth of modern retail. With the food business likely to be PRIL's focus over the next few years, we believe that its quarterly performance will become less volatile.

② Food to be focus area

PRIL has identified the food segment as being the group's focus area. We expect the food business to contribute some 50% of revenue over the next couple of years, from 35% now. This should mean significantly reduced investment in inventory and receivables, which would be positive from a balance-sheet and cash-flow perspective over the next few years.

③ FDI rule changes to be a catalyst

While there has been a lot of market interest in government policy on opening up FDI in the multi-brand retail sector, no concrete measures have yet been taken. However, we believe this will change over the next couple of years as the government recently signalled its intention to open up FDI in multi-brand retail. This will, we believe, be a key catalyst for the retail sector in India, which could see operational expertise as well as financial support come to India.

④ Valuation attractive

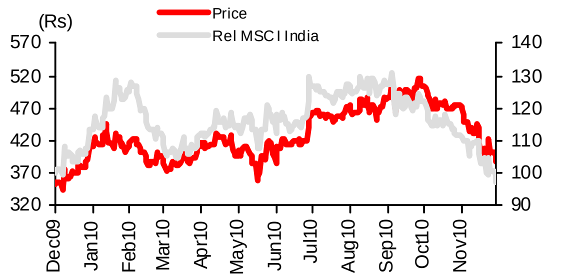
We value the core retail business at 10x EV/EBITDA, on our FY12F assumptions. This is in line with where PRIL has traded over the past two years. It has underperformed the Sensex over the past three month on unrelated negative news flow around corporate debt. We see this as an opportunity for long-term investors to BUY.

Key financials & valuations

30 Sep (Rsmn)	FY09	FY10F	FY11F	FY12F
Revenue	63,417	78,013	96,925	118,906
Reported net profit	1,406	2,239	3,552	4,853
Normalised net profit	1,406	2,239	3,552	4,853
Normalised EPS (Rs)	7.39	10.61	16.83	22.99
Norm. EPS growth (%)	2.7	43.6	58.6	36.6
Norm. P/E (x)	52.7	36.7	23.1	16.9
EV/EBITDA (x)	16.4	13.0	10.2	8.3
Price/book (x)	3.1	2.6	2.4	2.1
Dividend yield (%)	0.2	0.4	0.4	0.5
ROE (%)	6.5	8.1	10.7	13.2
Net debt/equity (%)	114.8	79.9	71.7	62.8
Earnings revisions				
Previous norm. net profit		2,239	3,552	4,853
Change from previous (%)		-	-	-
Previous norm. EPS (Rs)		10.61	16.83	22.99

Source: Company, Nomura estimates

Share price relative to MSCI India



	1m	3m	6m
Absolute (Rs)	(17.8)	(19.3)	(1.4)
Absolute (US$)	(19.1)	(16.5)	2.7
Relative to Index	(12.3)	(25.8)	(19.4)
Market cap (US$mn)			1,824
Estimated free float (%)			55.3
52-week range (Rs)			518/345.0
3-mth avg daily turnover (US$mn)			3.76
Stock borrowability			Hard
Major shareholders (%)			
Promoter group			44.7
Capital World			4.8

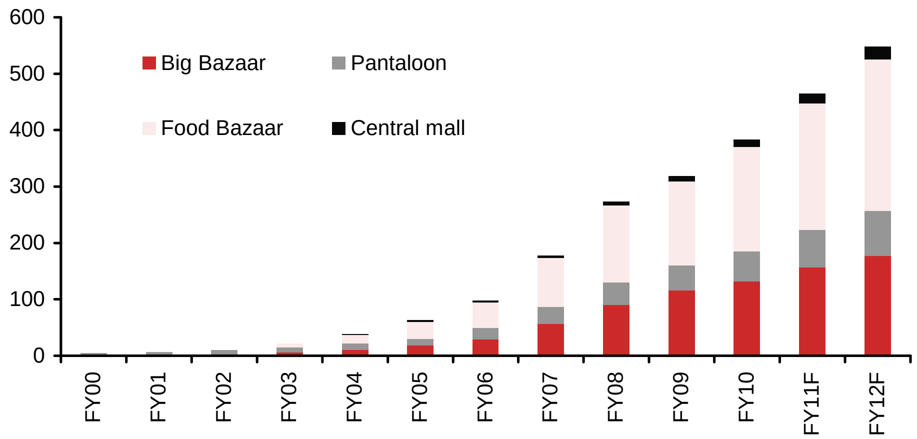
Source: Company, Nomura estimates

Drilling down

Continuing growth in retail space

PRIL remains committed to increasing its retail space by 2.5-3mn sq ft per year over the next few years. Since it intends to focus on food, its store sizes may become smaller and we think there could be significant additional store space under the Food Bazaar and KB fair-price formats. This should drive sales growth much faster than over the past few years, we believe.

Exhibit 129. PRIL: store growth (number of stores)



Source: Company data, Nomura research

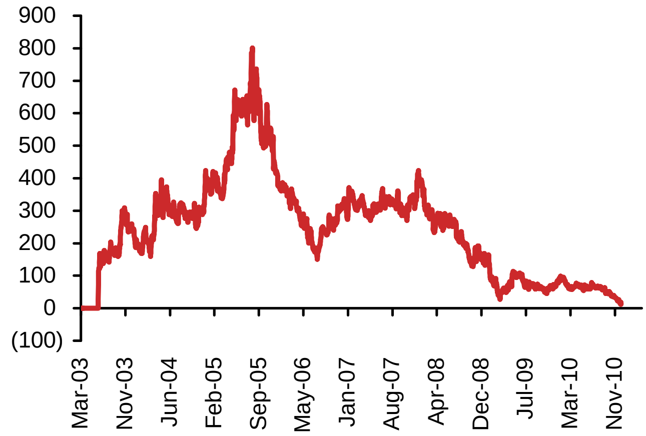
Trading at a steep discount

We find that PRIL is trading at 16.9x FY12F EPS, which is among the lowest multiples in the sector. Even the premium/discount to Sensex has come down significantly over the past few months, and we believe that this is a good opportunity to BUY what we consider to be the most attractive retail story in India.

Exhibit 130. PRIL: one-year forward P/E (x)

Source: Bloomberg, Nomura research

Exhibit 131. PRIL: premium/discount to Sensex



Source: Bloomberg, Nomura research

Exhibit 132. FMCG and retail universe valuation comparison

Company	Ticker	Nomura rating	Price (INR)	P/E (x) FY11F	P/E (x) FY12F	FY12F PEG (x)
Asian Paints	APNT IN	BUY	2,658	28.1	24.0	1.3
Colgate Palmolive	CLGT IN	REDUCE	850	25.8	23.5	3.4
Dabur	DABUR IN	BUY	97	27.7	21.8	1.0
Godrej Consumer	GCPL IN	NEUTRAL	409	27.7	21.5	0.6
Hindustan Unilever	HUVR IN	REDUCE	296	30.4	26.4	3.2
ITC	ITC IN	BUY	167	26.1	22.4	1.3
Marico	MRCO IN	REDUCE	125	27.0	22.8	1.3
United Spirits	UNSP IN	BUY	1,431	33.6	23.4	0.4
Tata Global Beverages	TGBL IN	NEUTRAL	115	15.3	13.9	1.0
Titan Industries	TTAN IN	REDUCE	3,573	47.3	37.6	1.3
Nestle *	NEST IN	REDUCE	3,742	43.8	34.6	1.6
Pantaloon Retail	PF IN	BUY	389	23.1	16.9	0.4
Average				**30.0**	**24.9**	**1.3**

* Nestle valuations are for CY10F and CY11F

Source: Bloomberg, Nomura research

Valuation methodology

We value the core business at INR610/share. We value all the subsidiaries and support businesses at 1x capital employed. The combined value for all the other businesses stands at INR74/share. After deducting net debt of INR131/share, our price target comes to INR553.

Risks to our investment view

The retail sector is a leveraged play on the macro fundamentals in the country. Any downward trend on the macro front presents downside risk to our numbers for PRIL.

Financial statements

Income statement (Rsmn)					
Year-end 30 Sep	**FY08**	**FY09**	**FY10F**	**FY11F**	**FY12F**
Revenue	50,489	63,417	78,013	96,925	118,906
Cost of goods sold	(35,122)	(44,300)	(54,765)	(68,042)	(83,472)
Gross profit	**15,367**	**19,118**	**23,248**	**28,884**	**35,434**
SG&A	(8,855)	(11,091)	(13,339)	(16,185)	(19,624)
Employee share expense	(2,741)	(2,743)	(3,355)	(4,168)	(5,232)
Operating profit	**3,771**	**5,284**	**6,554**	**8,531**	**10,579**
EBITDA	**4,605**	**6,684**	**8,271**	**10,511**	**12,900**
Depreciation	(834)	(1,401)	(1,716)	(1,979)	(2,321)
Amortisation	-	-	-	-	-
EBIT	**3,771**	**5,284**	**6,554**	**8,531**	**10,579**
Net interest expense	(1,853)	(3,182)	(3,242)	(3,229)	(3,305)
Associates & JCEs					
Other income	38	61	80	80	80
Earnings before tax	**1,956**	**2,162**	**3,393**	**5,382**	**7,353**
Income tax	(697)	(757)	(1,154)	(1,830)	(2,500)
Net profit after tax	**1,260**	**1,406**	**2,239**	**3,552**	**4,853**
Minority interests	-	-	-	-	-
Other items	-	-	-	-	-
Preferred dividends	-	-	-	-	-
Normalised NPAT	**1,260**	**1,406**	**2,239**	**3,552**	**4,853**
Extraordinary items	-	-	-	-	-
Reported NPAT	**1,260**	**1,406**	**2,239**	**3,552**	**4,853**
Dividends	(107)	(116)	(317)	(317)	(401)
Transfer to reserves	**1,153**	**1,290**	**1,922**	**3,235**	**4,452**

Robust revenue growth driven by focus on food category

Valuation and ratio analysis					
FD normalised P/E (x)	54.2	52.7	36.7	23.1	16.9
FD normalised P/E at price target (x)	76.9	74.9	52.1	32.9	24.1
Reported P/E (x)	54.2	52.7	36.7	23.1	16.9
Dividend yield (%)	0.2	0.2	0.4	0.4	0.5
Price/cashflow (x)	na	na	168.3	25.7	20.6
Price/book (x)	3.6	3.1	2.6	2.4	2.1
EV/EBITDA (x)	22.4	16.4	13.0	10.2	8.3
EV/EBIT (x)	27.3	20.7	16.4	12.5	10.1
Gross margin (%)	30.4	30.1	29.8	29.8	29.8
EBITDA margin (%)	9.1	10.5	10.6	10.8	10.8
EBIT margin (%)	7.5	8.3	8.4	8.8	8.9
Net margin (%)	2.5	2.2	2.9	3.7	4.1
Effective tax rate (%)	35.6	35.0	34.0	34.0	34.0
Dividend payout (%)	8.5	8.2	14.2	8.9	8.3
Capex to sales (%)	15.9	7.2	4.2	4.1	3.5
Capex to depreciation (x)	9.6	3.3	1.9	2.0	1.8
ROE (%)	8.2	6.5	8.1	10.7	13.2
ROA (pretax %)	10.4	9.9	10.2	12.0	13.5
Growth (%)					
Revenue	56.0	25.6	23.0	24.2	22.7
EBITDA	113.6	45.1	23.7	27.1	22.7
EBIT	111.0	40.1	24.0	30.2	24.0
Normalised EPS	(17.4)	2.7	43.6	58.6	36.6
Normalised FDEPS	(17.4)	2.7	43.6	58.6	36.6
Per share					
Reported EPS (Rs)	7.2	7.4	10.6	16.8	23.0
Norm EPS (Rs)	7.2	7.4	10.6	16.8	23.0
Fully diluted norm EPS (Rs)	7.2	7.4	10.6	16.8	23.0
Book value per share (Rs)	109.3	125.5	149.1	164.2	184.9
DPS (Rs)	0.6	0.6	1.5	1.5	1.9

Source: Nomura estimates

Cashflow (Rsmn)					
Year-end 30 Sep	FY08	FY09	FY10F	FY11F	FY12F
EBITDA	4,605	6,684	8,271	10,511	12,900
Change in working capital	(7,237)	(3,438)	(3,467)	(3,873)	(3,728)
Other operating cashflow	(2,936)	(3,425)	(4,315)	(3,444)	(5,183)
Cashflow from operations	**(5,568)**	**(178)**	**489**	**3,193**	**3,988**
Capital expenditure	(8,012)	(4,590)	(3,249)	(4,006)	(4,212)
Free cashflow	**(13,580)**	**(4,768)**	**(2,760)**	**(813)**	**(224)**
Reduction in investments	(3,345)	(3,675)	(500)	1,500	1,000
Net acquisitions	-	-	-	-	-
Reduction in other LT assets	-	-	-	-	-
Addition in other LT liabilities	808	(480)	154		
Adjustments					
Cashflow after investing acts	**(16,116)**	**(8,923)**	**(3,106)**	**687**	**776**
Cash dividends	(125)	(135)	(371)	(371)	(470)
Equity issue	6,901	2,355	5,727	-	-
Debt issue	8,922	6,586	(1,500)	(500)	-
Convertible debt issue					
Others					
Cashflow from financial acts	**15,698**	**8,806**	**3,856**	**(871)**	**(470)**
Net cashflow	**(419)**	**(117)**	**750**	**(184)**	**306**
Beginning cash	1,629	1,211	1,093	1,843	1,660
Ending cash	1,211	1,094	1,843	1,660	1,966
Ending net debt	20,707	27,411	25,160	24,844	24,538

Source: Nomura estimates

Balance sheet (Rsmn)					
As at 30 Sep	FY08	FY09	FY10F	FY11F	FY12F
Cash & equivalents	1,211	1,093	1,843	1,660	1,966
Marketable securities					
Accounts receivable	1,132	1,773	2,137	2,655	3,258
Inventories	14,298	17,878	20,732	23,368	25,410
Other current assets	9,645	12,083	13,950	17,318	21,233
Total current assets	**26,286**	**32,827**	**38,663**	**45,002**	**51,866**
LT investments	5,865	9,540	10,040	8,540	7,540
Fixed assets	15,288	19,140	20,672	22,699	24,590
Goodwill	-	-	-	-	-
Other intangible assets	-	-	-	-	-
Other LT assets	-	-	-	-	-
Total assets	**47,439**	**61,507**	**69,376**	**76,241**	**83,997**
Short-term debt	2,000	3,249	3,249	3,249	3,249
Accounts payable	4,991	8,213	9,832	12,481	15,311
Other current liabilities					
Total current liabilities	**6,991**	**11,462**	**13,080**	**15,729**	**18,560**
Long-term debt	19,918	25,255	23,755	23,255	23,255
Convertible debt	-	-	-	-	-
Other LT liabilities	1,385	906	1,060	2,595	3,137
Total liabilities	**28,294**	**37,622**	**37,895**	**41,579**	**44,952**
Minority interest	-	-	-	-	-
Preferred stock	-	-	-	-	-
Common stock	319	381	423	423	423
Retained earnings	18,148	22,344	29,897	33,078	37,462
Proposed dividends					
Other equity and reserves	678	1,161	1,161	1,161	1,161
Total shareholders' equity	**19,145**	**23,885**	**31,481**	**34,662**	**39,045**
Total equity & liabilities	**47,439**	**61,507**	**69,376**	**76,241**	**83,997**
Liquidity (x)					
Current ratio	3.76	2.86	2.96	2.86	2.79
Interest cover	2.0	1.7	2.0	2.6	3.2
Leverage					
Net debt/EBITDA (x)	4.50	4.10	3.04	2.36	1.90
Net debt/equity (%)	108.2	114.8	79.9	71.7	62.8
Activity (days)					
Days receivable	6.5	8.4	9.1	9.0	9.1
Days inventory	120.7	132.6	128.7	118.3	106.9
Days payable	41.7	54.4	60.1	59.8	60.9
Cash cycle	85.4	86.5	77.7	67.5	55.1

Source: Nomura estimates

Balance sheet deleveraging to continue

Cairn India CAIR IN

OIL & GAS/CHEMICALS | INDIA

Anil Sharma +91 22 4037 4338 anil.sharma.1@nomura.com
Ravikumar Adukia +91 22 4037 4232 ravikumar.adukia@nomura.com

Maintained

BUY

Action

Cairn India has underperformed the Sensex by ~15% since the mid-August announcement of a proposed change in its ownership (and resulting uncertainties on government approvals). We believe the stock could remain range-bound until clarity emerges on the deal. But after that, irrespective of the outcome, we think it could do some catching up as its Rajasthan story remains promising. BUY.

Catalysts

Early clarity on the government's decision on the Cairn Energy-Vedanta deal, continued strength in oil prices, and fast ramp-up in Cairn's MBA production.

Anchor themes

We believe oil prices could strengthen further in 2011, driven by QE-2 and improving fundamentals. We like Cairn India as a pure oil play and continue to see significant upside from the Rajasthan block, with nearly 4bn boe of discovered resources and 2.5bn boe of prospective exploration resources.

Closing price on 8 Dec	Rs327.0
Price target*	**Rs370.0**
	(set on 5 May 10)
Upside/downside	13.1%
Difference from consensus	16.1%
FY11F net profit (Rsbn)	53.3
Difference from consensus	13.0%

*PT under review

Source: Nomura

Nomura vs consensus

Our medium-term oil forecasts are ahead of the Street. We continue to see exploration upside in Rajasthan and are more optimistic than consensus.

Story to continue after a break

① Cairn has been an under-performer recently

Cairn India has been an under-performer since the mid-August announcement of a proposed change in ownership (through the sale of a 51% stake in Cairn India by Cairn Energy to Vedanta). Over this period, Cairn India stock is down ~8%, whereas the Sensex is up ~8.4% and spot oil prices have also rallied by nearly 22%. Prior to this, Cairn India's stock was positively correlated to oil prices. We would attribute most of its recent under-performance to uncertainties around the deal.

② Deal or no deal – no impact on Cairn India's operations

We think the issues around the Cairn PLC-Vedanta deal (government approvals, pre-emption rights of ONGC, royalties, etc) are procedural and could get sorted out over the next two to three months. Also, we do not see ownership issues affecting Cairn India's operations.

③ Rajasthan story remains intact

Cairn India's production ramp-up at Rajasthan has been much sharper than expected; Mangala reached its peak in 3Q10 ahead of our expectation of end 2010. Operating costs and crude discounts remain well within management guidance. Cairn management remains confident that Mangala can reach 150kbpd (subject to government approvals) and that the Rajasthan block could produce 240kbpd (vs its current approved peak of 175kbpd).

④ Twin advantages — defensive and potential upside

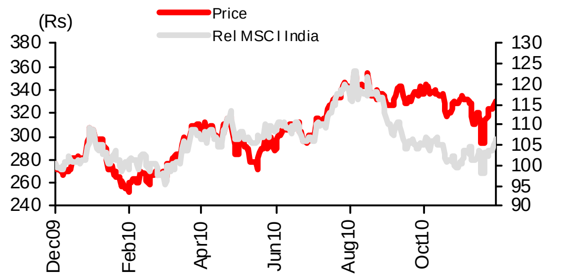
We continue to like Cairn as a Rajasthan resource upside story. In near term, however, uncertainties on ownership issues and open offer price mean the stock could remain range-bound. Nonetheless, we see it as a good defensive play and, given its recent under-performance and the firming of oil prices, we think Cairn could catch up once clarity on the matter of ownership emerges.

Key financials & valuations

31 Mar (Rsbn)	FY09	FY10	FY11F	FY12F
Revenue	14.3	16.2	94.3	175.3
Reported net profit	8.0	10.5	53.3	113.7
Normalised net profit	8.1	10.6	53.3	113.7
Normalised EPS (Rs)	4.3	5.6	28.1	59.9
Norm. EPS growth (%)	na	30.9	403.7	113.3
Norm. P/E (x)	76.7	58.6	11.6	5.5
EV/EBITDA (x)	64.5	65.4	8.1	3.3
Price/book (x)	1.9	1.8	1.6	1.3
Dividend yield (%)	0.0	0.0	0.9	1.8
ROE (%)	2.6	3.2	14.7	26.1
Net debt/equity (%)	net cash	7.3	net cash	net cash
Earnings revisions				
Previous norm. net profit		11.3	53.3	113.7
Change from previous (%)		(6.7)	-	0.0
Previous norm. EPS (Rs)		6.0	28.1	59.9

Source: Company, Nomura estimates

Share price relative to MSCI India



	1m	3m	6m
Absolute (Rs)	(1.5)	(0.6)	13.4
Absolute (US$)	(3.0)	2.9	18.1
Relative to Index	5.0	(4.9)	(2.3)
Market cap (US$mn)			13,786
Estimated free float (%)			22.7
52-week range (Rs)			355.5/252.8
3-mth avg daily turnover (US$mn)			18.84
Stock borrowability			Hard
Major shareholders (%)			
Cairn Plc			62.4
Petronas			14.9

Source: Company, Nomura estimates

Exhibit 133. Cairn India – SOTP valuation

	US$mn	INRbn	INR/ share	2P reserves / resources mmboe	2P reserves / resources Implied US$/boe	Remarks
Rajasthan block						
Conventional Recovery	9,556	453	239	494	19.3	DCF Based
Enhanced Recovery	1,471	70	37	216	6.8	DCF Based
Other producing blocks						
Ravva	268.5	12.7	7	16	16.8	DCF Based
Cambay	106.5	4.3	2	8	13.3	DCF Based
Future upsides in Rajasthan block						
20 small fields - Contingent 2P Resources	588	26	14	98	6.0	2P reserves @ US$6/boe
20 small fields - prospective resources	1,232	54	29		1.0	GHIP of 1.9bboe @ US$1/boe
Future exploration upside – prospective resources	1,050	46	24	175	6.0	Gross 250mmboe @US$ 6/boe
KG-DWN-98/2	210	9	5	35	6.0	2P reserves @ US$6/boe
Enterprise value	**14,483**	**676**	**356**	**1,042**	**13.9**	
Net cash	1,050	24	13			FY11 end
Equity value	**15,532**	**699**	**369**	**1,042**	**14.9**	
Target price			**370**			

Source: Nomura estimates

Exhibit 134. Sensitivity of NAV to key variables

		LT Brent prices (US$/bbl)				
		60	**70**	**75**	**80**	**90**
INR/US$	**41.0**	319	340	350	360	381
	42.0	325	346	357	367	388
	43.7	336	358	**369**	380	402
	45.0	344	367	378	389	412
	47.0	349	372	384	396	419

		Discount to Rajasthan crude				
		6%	**8%**	**10%**	**12%**	**15%**
LT Brent price (US$/bbl)	**60.0**	341	342	336	330	320
	70.0	364	365	358	351	341
	75.0	375	376	**369**	362	351
	80.0	387	387	380	372	362
	90.0	409	409	402	394	382

		WACC (%)				
		10.0%	**11.0%**	**11.6%**	**12.0%**	**13.0%**
LT Brent price (US$/bbl)	**60.0**	350	341	336	333	325
	70.0	374	364	358	354	345
	75.0	386	375	**369**	365	355
	80.0	398	386	380	375	365
	90.0	423	409	402	397	385

Source: Nomura estimates

Valuation methodology and risks

We value Cairn India on a sum of the parts basis. We calculate the NAV of its key fields Mangala, Bhagyam and Aishwariya (under development) and Rageshwari & Saraswati (FDP approved) using a discounted cash flow (DCF) methodology. Our NAV of MBA and R&S field is INR276/share. The Ravva and Cambay blocks are valued at INR7/share and INR2/share, respectively. We value Cairn's 10% share in the 2P reserves in KG-DWN-98/2 block at a conservative US$6/boe. We value recoverable resources (140mmboe now) in other 20 fields at US$6/boe and prospective resources of 1.76bn boe (net of recoverable resources) at US$1/boe. We also assign a value of US$6/boe to exploration upsides (prospective recoverable resources of 250mmboe – Cairn's share of 175mmboe). Our SOTP value of Cairn is INR369/share, and we round this up to reach our price target of Rs370. Risks include delays in ramp-up of production, lower oil prices, higher-than-expected discounts and higher-than-assumed cess.

Financial statements

Income statement (Rsbn)					
Year-end 31 Mar	**FY08**	**FY09**	**FY10**	**FY11F**	**FY12F**
Revenue	10	14	16	94	175
Cost of goods sold	(6)	(7)	(7)	(26)	(34)
Gross profit	**4**	**8**	**9**	**68**	**142**
SG&A	(2)	(3)	(2)	(3)	(3)
Employee share expense	-	-	-	-	-
Operating profit	**2**	**5**	**6**	**65**	**139**
EBITDA	**7**	**9**	**10**	**73**	**153**
Depreciation	(5)	(4)	(4)	(8)	(14)
Amortisation	-	-	-	-	-
EBIT	**2**	**5**	**6**	**65**	**139**
Net interest expense	(0)	(0)	(0)	(1)	(1)
Associates & JCEs	-	-	-	-	-
Other income	1	5	4	4	8
Earnings before tax	**3**	**10**	**10**	**68**	**146**
Income tax	(2)	(2)	0	(15)	(32)
Net profit after tax	**2**	**8**	**11**	**53**	**114**
Minority interests	-	-	-	-	-
Other items	(2)	0	-	-	-
Preferred dividends	-	-	-	-	-
Normalised NPAT	**(0)**	**8**	**11**	**53**	**114**
Extraordinary items	-	(0)	(0)	-	-
Reported NPAT	**(0)**	**8**	**11**	**53**	**114**
Dividends	-	-	-	(6)	(13)
Transfer to reserves	**(0)**	**8**	**11**	**47**	**101**
Valuation and ratio analysis					
FD normalised P/E (x)	na	76.7	58.6	11.6	5.5
FD normalised P/E at price target (x)	na	86.8	66.3	13.2	6.2
Reported P/E (x)	na	77.2	59.0	11.6	5.5
Dividend yield (%)	-	-	-	0.9	1.8
Price/cashflow (x)	105.6	59.9	565.4	11.1	5.2
Price/book (x)	2.0	1.9	1.8	1.6	1.3
EV/EBITDA (x)	91.6	64.5	65.4	8.1	3.3
EV/EBIT (x)	293.5	121.9	102.5	9.2	3.7
Gross margin (%)	36.5	53.0	54.1	72.2	80.8
EBITDA margin (%)	65.9	64.9	60.8	77.9	87.3
EBIT margin (%)	20.6	34.3	38.8	69.2	79.1
Net margin (%)	(2.4)	56.1	64.8	56.5	64.8
Effective tax rate (%)	44.5	18.9	(3.4)	22.0	22.0
Dividend payout (%)	na	-	-	11.4	11.4
Capex to sales (%)	116.0	220.7	207.4	28.1	15.1
Capex to depreciation (x)	2.6	7.2	9.4	3.2	1.8
ROE (%)	(0.1)	2.6	3.2	14.7	26.1
ROA (pretax %)	0.7	1.6	1.8	17.0	34.9
Growth (%)					
Revenue	2,512.9	41.5	13.3	480.7	86.0
EBITDA	na	39.4	6.2	643.2	108.5
EBIT	na	136.3	28.1	934.8	112.5
Normalised EPS	na	na	30.9	403.7	113.3
Normalised FDEPS	na	na	30.9	403.7	113.3
Per share					
Reported EPS (Rs)	(0.1)	4.2	5.5	28.1	59.9
Norm EPS (Rs)	(0.1)	4.3	5.6	28.1	59.9
Fully diluted norm EPS (Rs)	(0.1)	4.3	5.6	28.1	59.9
Book value per share (Rs)	165.4	172.9	178.5	203.5	256.6
DPS (Rs)	-	-	-	2.8	6.0

Source: Nomura estimates

Large growth in earnings with the expected ramp-up of production at Rajasthan block

Cashflow (Rsbn)					
Year-end 31 Mar	**FY08**	**FY09**	**FY10**	**FY11F**	**FY12F**
EBITDA	7	9	10	73	153
Change in working capital	(32)	8	(8)	3	(1)
Other operating cashflow	31	(7)	(0)	(21)	(32)
Cashflow from operations	**6**	**10**	**1**	**56**	**120**
Capital expenditure	(12)	(32)	(34)	(26)	(26)
Free cashflow	**(6)**	**(21)**	**(33)**	**30**	**94**
Reduction in investments	(7)	5	(15)	15	-
Net acquisitions	(33)	-	-	-	-
Reduction in other LT assets	(9)	(36)	(32)	(12)	(15)
Addition in other LT liabilities	1	1	(1)	1	3
Adjustments	(5)	6	76	(1)	20
Cashflow after investing acts	**(59)**	**(45)**	**(5)**	**34**	**102**
Cash dividends	-	-	-	(6)	(13)
Equity issue	1	25	0	-	-
Debt issue	(2)	38	(9)	(11)	(4)
Convertible debt issue	-	-	-	-	-
Others	12	34	(42)	23	(0)
Cashflow from financial acts	**11**	**97**	**(51)**	**6**	**(17)**
Net cashflow	**(48)**	**52**	**(56)**	**40**	**85**
Beginning cash	61	13	65	9	49
Ending cash	13	65	9	49	134
Ending net debt	(10)	(22)	25	(24)	(113)

Source: Nomura estimates

Balance sheet (Rsbn)					
As at 31 Mar	**FY08**	**FY09**	**FY10**	**FY11F**	**FY12F**
Cash & equivalents	13	65	9	49	134
Marketable securities	-	-	-	-	-
Accounts receivable	1	2	3	6	12
Inventories	1	2	3	4	7
Other current assets	5	4	8	4	4
Total current assets	**21**	**73**	**24**	**64**	**158**
LT investments	7	2	17	2	2
Fixed assets	0	1	1	8	8
Goodwill	253	253	253	253	253
Other intangible assets	-	-	-	-	-
Other LT assets	29	65	97	108	123
Total assets	**310**	**393**	**392**	**435**	**544**
Short-term debt	-	-	-	-	-
Accounts payable	4	9	9	9	17
Other current liabilities	4	7	6	9	10
Total current liabilities	**8**	**16**	**15**	**18**	**27**
Long-term debt	3	44	34	26	22
Convertible debt	-	-	-	-	-
Other LT liabilities	5	6	4	6	9
Total liabilities	**16**	**65**	**53**	**50**	**57**
Minority interest	-	-	-	-	-
Preferred stock	-	-	-	-	-
Common stock	18	19	19	19	19
Retained earnings	(1)	8	18	65	166
Proposed dividends	-	-	-	-	-
Other equity and reserves	277	301	301	302	301
Total shareholders' equity	**294**	**328**	**339**	**386**	**487**
Total equity & liabilities	**310**	**393**	**392**	**436**	**544**
Liquidity (x)					
Current ratio	2.45	4.51	1.60	3.48	5.94
Interest cover	77.0	76.8	42.6	66.2	122.0
Leverage					
Net debt/EBITDA (x)	net cash	net cash	2.50	net cash	net cash
Net debt/equity (%)	net cash	net cash	7.3	net cash	net cash
Activity (days)					
Days receivable	59.0	36.5	51.5	18.4	19.3
Days inventory	70.3	78.6	112.5	47.2	60.3
Days payable	203.2	340.6	423.7	123.1	140.7
Cash cycle	(73.9)	(225.6)	(259.7)	(57.5)	(61.1)

Source: Nomura estimates

Ambuja Cements ACEM IN

BASIC MATERIALS/CONSTRUCTION MATERIALS | INDIA

Maintained

REDUCE

NOMURA

NOMURA FINANCIAL ADVISORY AND SECURITIES (INDIA) PRIVATE LIMITED

Jamil Ansari +91 22 4037 4192 jamil.ansari@nomura.com

Action

We maintain our REDUCE rating and price target of INR113, based on an EV/IC multiple-based methodology. The stock's recent outperformance puts it at trading premiums of 23% and 22% over peers ACC and Ultratech, respectively. We believe such gaps are unjustified and expect a correction, as most of the earnings upside appears to be priced in.

Catalysts

Pressure on earnings from a correction in realisations in the company's core markets could dampen share price performance.

Anchor themes

Profitability of the Indian cement sector looks set to decline considerably over the next two to three years and valuations are yet to reflect the lower profitability levels. We expect Ambuja Cement to deliver an average ROCE of 26% during FY10-12F, compared with the 33% that the company delivered during FY06-09.

Closing price on 8 Dec	Rs137.9
Price target	**Rs113.0**
	(set on 6 Oct 10)
Upside/downside	-18.0%
Difference from consensus	**0.2%**
FY11 net profit (Rsmn)	14,382
Difference from consensus	**7.0%**

Source: Nomura

Nomura vs consensus

Our FY11F earnings forecasts for Ambuja Cement are broadly in line with consensus.

Premium valuations look unjustified

① Earnings outperformance to end

We believe Ambuja Cements' earnings have been the most resilient in the sector in the recent past, as the company benefitted from its lack of exposure to Southern markets and because it replaced clinker purchases with its own clinker capacity. However, we believe that earnings catalysts for the company are now near an end, and issues such as higher fuel costs will result in the company mirroring the overall earnings performance of the sector.

② Too much premium for quality

Ambuja Cements has been successful in generating best-in-sector ROCEs over a cycle, resulting in the stock being awarded a valuation premium over its peers. However, we believe the recent outperformance of the stock has made the premium too high, with the stock now trading at premiums of 23% and 22% to peers ACC and Ultratech on an EV/tonne basis, on our estimates.

③ Consolidation with ACC/Holcim may take time

We believe there have been expectations in the market that Holcim might consolidate its two cement companies in India (ACC and Ambuja Cements) into one entity. But our interaction with management suggests this will be a long-drawn process, and that parent Holcim is in no hurry to undertake this consolidation.

④ Valuation

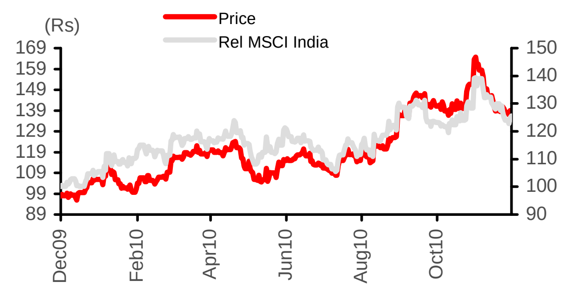
We value Ambuja Cements on an EV/IC-based methodology, in which the multiple is derived using an average ROCE of 26% for the FY10-12F period and a WACC of 12.7%. We retain our REDUCE rating and price target of INR113, which implies 18% potential downside and implies an EV/EBITDA of 6.7x and an EV/tonne of US$137 on Ambuja Cements' FY11F financials.

Key financials & valuations

31 Dec (Rsmn)	FY09	FY10F	FY11F	FY12F
Revenue	71,194	75,787	82,165	91,800
Reported net profit	12,184	13,733	14,382	16,784
Normalised net profit	12,184	13,733	14,382	16,784
Normalised EPS (Rs)	7.41	9.01	9.44	11.02
Norm. EPS growth (%)	4.6	21.6	4.7	16.7
Norm. P/E (x)	18.6	15.3	14.6	12.5
EV/EBITDA (x)	10.6	8.8	8.5	7.2
Price/book (x)	3.2	3.1	3.0	2.8
Dividend yield (%)	1.7	1.8	2.2	2.5
ROE (%)	20.1	20.7	20.7	22.9
Net debt/equity (%)	net cash	net cash	net cash	net cash
Earnings revisions				
Previous norm. net profit		13,733	14,382	16,784
Change from previous (%)		-	-	-
Previous norm. EPS (Rs)		9.01	9.44	11.02

Source: Company, Nomura estimates

Share price relative to MSCI India



	1m	3m	6m
Absolute (Rs)	(15.7)	0.5	19.7
Absolute (US$)	(17.0)	4.0	24.7
Relative to Index	(9.0)	(3.8)	4.2
Market cap (US$mn)			4,661
Estimated free float (%)			53.6
52-week range (Rs)			164.7/96.0
3-mth avg daily turnover (US$mn)			7.78
Stock borrowability			Hard
Major shareholders (%)			
Holcim			46.4
LIC			11.4

Source: Company, Nomura estimates

Drilling down

Returns to deteriorate going forward

We expect Ambuja Cements to deliver an average ROCE of 26% during FY10-12F, compared with the 33% average ROCE generated by the company during FY06-09. However, we think valuations do not reflect this decline in profitability, and imply an average ROCE of 32% for the company during this period.

Valuation methodology

We value Ambuja Cements using an EV/IC (Enterprise Value/Invested Capital) multiple method. The EV/IC multiple is derived as follows:

EV / IC = (ROCE – g) / (WACC – g)

(EV = Enterprise Value, IC = Invested Capital, ROCE = Average ROCE for the current and following 2 years and g = long-term growth)

Exhibit 135. Valuation

Cost of debt (%)	8	
Cost of equity (%)	13.0	
Debt / Equity ratio (%)	6	
WACC (%) [A]	12.7	
Average ROACE (FY11-FY12) (%) [B]	26.0	
Terminal growth (%) [C]	4	
Target EV / IC multiple [D]	2.53	(B-C)/(A-C)
Invested capital [E]	62,623	FY12F
Target EV	158,266	D * E
Net debt	(13,254)	FY12
Equity value	171,520	Equity value
Price target	113	

Source: Nomura research

Our price target values Ambuja Cements at an EV/EBITDA multiple of 6.6x on FY11F estimated EBITDA. We find the stock is currently trading at an FY11F EV/ EBITDA multiple of 8.5x.

On an EV/tonne basis, our price target implies a valuation of US$137 for Ambuja Cements' end-FY11F capacity, while the stock is currently trading at an EV/ tonne valuation of US$170.

Key risks

- Better-than-expected volume growth in CY11F on the back of an overall pick-up in demand in the sector would put our earnings estimates at risk.
- Stronger-than-expected realisations in the company's core markets (North India) would result in better profitability for Ambuja Cements.

Financial statements

Income statement (Rsmn)					
Year-end 31 Dec	**FY08**	**FY09**	**FY10F**	**FY11F**	**FY12F**
Revenue	62,347	71,194	75,787	82,165	91,800
Cost of goods sold	(32,121)	(38,026)	(37,831)	(41,524)	(45,836)
Gross profit	**30,226**	**33,168**	**37,955**	**40,641**	**45,965**
SG&A	(12,595)	(14,316)	(15,786)	(17,526)	(19,149)
Employee share expense	(2,661)	(2,728)	(3,276)	(3,492)	(3,777)
Operating profit	**14,970**	**16,124**	**18,894**	**19,622**	**23,039**
EBITDA	**17,568**	**19,094**	**22,590**	**23,956**	**27,728**
Depreciation	(2,598)	(2,970)	(3,696)	(4,334)	(4,689)
Amortisation					
EBIT	**14,970**	**16,124**	**18,894**	**19,622**	**23,039**
Net interest expense	(321)	(224)	(249)	(405)	(482)
Associates & JCEs					
Other income	1,966	2,133	1,258	1,329	1,421
Earnings before tax	**16,615**	**18,033**	**19,902**	**20,546**	**23,977**
Income tax	(5,676)	(5,849)	(6,170)	(6,164)	(7,193)
Net profit after tax	**10,939**	**12,184**	**13,733**	**14,382**	**16,784**
Minority interests					
Other items					
Preferred dividends					
Normalised NPAT	**10,939**	**12,184**	**13,733**	**14,382**	**16,784**
Extraordinary items	3,083	-	-	-	-
Reported NPAT	**14,023**	**12,184**	**13,733**	**14,382**	**16,784**
Dividends	(3,919)	(4,277)	(4,457)	(5,348)	(6,239)
Transfer to reserves	**10,104**	**7,907**	**9,276**	**9,034**	**10,545**
Valuation and ratio analysis					
FD normalised P/E (x)	19.5	18.6	15.3	14.6	12.5
FD normalised P/E at price target (x)	16.0	15.2	12.5	12.0	10.3
Reported P/E (x)	15.2	18.6	15.3	14.6	12.5
Dividend yield (%)	1.6	1.7	1.8	2.2	2.5
Price/cashflow (x)	14.1	8.8	11.8	10.1	7.2
Price/book (x)	3.7	3.2	3.1	3.0	2.8
EV/EBITDA (x)	11.6	10.6	8.8	8.5	7.2
EV/EBIT (x)	13.7	12.6	10.5	10.4	8.7
Gross margin (%)	48.5	46.6	50.1	49.5	50.1
EBITDA margin (%)	28.2	26.8	29.8	29.2	30.2
EBIT margin (%)	24.0	22.6	24.9	23.9	25.1
Net margin (%)	22.5	17.1	18.1	17.5	18.3
Effective tax rate (%)	34.2	32.4	31.0	30.0	30.0
Dividend payout (%)	27.9	35.1	32.5	37.2	37.2
Capex to sales (%)	-	-	-	-	-
Capex to depreciation (x)	-	-	-	-	-
ROE (%)	27.2	20.1	20.7	20.7	22.9
ROA (pretax %)	23.3	21.6	24.0	24.3	26.9
Growth (%)					
Revenue	10.7	14.2	6.5	8.4	11.7
EBITDA	(14.1)	8.7	18.3	6.0	15.7
EBIT	(17.2)	7.7	17.2	3.9	17.4
Normalised EPS	1,374.5	4.6	21.6	4.7	16.7
Normalised FDEPS	1,374.5	4.6	21.6	4.7	16.7
Per share					
Reported EPS (Rs)	9.08	7.41	9.01	9.44	11.02
Norm EPS (Rs)	7.08	7.41	9.01	9.44	11.02
Fully diluted norm EPS (Rs)	7.08	7.41	9.01	9.44	11.02
Book value per share (Rs)	37.23	42.45	44.60	46.59	49.57
DPS (Rs)	2.20	2.40	2.50	3.00	3.50

Source: Nomura estimates

Most expensive cement stock under our coverage, in our view

Cashflow (Rsmn)					
Year-end 31 Dec	FY08	FY09	FY10F	FY11F	FY12F
EBITDA	17,568	19,094	22,590	23,956	27,728
Change in working capital	(2,464)	6,562	(4,757)	(3,085)	1,328
Other operating cashflow					
Cashflow from operations	**15,104**	**25,656**	**17,833**	**20,871**	**29,056**
Capital expenditure					
Free cashflow	**15,104**	**25,656**	**17,833**	**20,871**	**29,056**
Reduction in investments	9,566	(3,946)	-	-	-
Net acquisitions					
Reduction in other LT assets	(1,997)	2,369	-	-	-
Addition in other LT liabilities	24	1,051	-	-	-
Adjustments					
Cashflow after investing acts	**22,696**	**25,130**	**17,833**	**20,871**	**29,056**
Cash dividends	3,350	3,656	3,809	4,571	5,333
Equity issue	(0)	1	0	0	0
Debt issue	(418)	(1,230)	1,500	1,500	-
Convertible debt issue					
Others					
Cashflow from financial acts	**2,932**	**2,427**	**5,309**	**6,071**	**5,333**
Net cashflow	**25,628**	**27,557**	**23,142**	**26,942**	**34,389**
Beginning cash	6,508	8,518	8,807	14,196	10,641
Ending cash	32,136	36,075	31,949	41,138	45,030
Ending net debt	(5,632)	(7,150)	(11,039)	(5,984)	(9,491)

Source: Nomura estimates

Balance sheet (Rsmn)					
As at 31 Dec	FY08	FY09	FY10F	FY11F	FY12F
Cash & equivalents	8,518	8,807	14,196	10,641	14,148
Marketable securities	3,324	7,270	7,270	7,270	7,270
Accounts receivable	2,246	1,522	1,860	1,998	2,148
Inventories	9,387	6,832	8,402	9,896	9,929
Other current assets	3,243	2,632	3,661	3,891	4,210
Total current assets	**26,718**	**27,064**	**35,389**	**33,696**	**37,705**
LT investments					
Fixed assets	47,535	60,049	54,679	59,683	62,049
Goodwill					
Other intangible assets					
Other LT assets	3,865	1,496	1,496	1,496	1,496
Total assets	**78,118**	**88,608**	**91,564**	**94,874**	**101,249**
Short-term debt					
Accounts payable	10,032	10,671	10,130	8,731	10,252
Other current liabilities	4,706	6,740	5,461	5,636	5,945
Total current liabilities	**14,738**	**17,411**	**15,591**	**14,367**	**16,197**
Long-term debt	2,887	1,657	3,157	4,657	4,657
Convertible debt					
Other LT liabilities	3,808	4,858	4,858	4,858	4,858
Total liabilities	**21,432**	**23,926**	**23,606**	**23,882**	**25,712**
Minority interest					
Preferred stock					
Common stock	3,045	3,047	3,047	3,047	3,047
Retained earnings	53,684	61,662	64,938	67,972	72,516
Proposed dividends					
Other equity and reserves	(43)	(27)	(27)	(27)	(27)
Total shareholders' equity	**56,686**	**64,682**	**67,958**	**70,992**	**75,537**
Total equity & liabilities	**78,118**	**88,608**	**91,564**	**94,874**	**101,249**
Liquidity (x)					
Current ratio	1.81	1.55	2.27	2.35	2.33
Interest cover	46.7	71.9	75.8	48.5	47.8
Leverage					
Net debt/EBITDA (x)	net cash	net cash	net cash	net cash	net cash
Net debt/equity (%)	net cash	net cash	net cash	net cash	net cash
Activity (days)					
Days receivable	10.9	9.7	8.1	8.6	8.3
Days inventory	86.6	77.8	73.5	80.4	79.1
Days payable	95.6	99.4	100.3	82.9	75.8
Cash cycle	1.8	(11.9)	(18.7)	6.1	11.6

Source: Nomura estimates

Hindustan Petroleum Corporation

HPCL IN

OIL & GAS/CHEMICALS | INDIA

Maintained

REDUCE

NOMURA FINANCIAL ADVISORY AND SECURITIES (INDIA) PRIVATE LIMITED

Anil Sharma +91 22 4037 4338 anil.sharma.1@nomura.com

Ravikumar Adukia, CFA +91 22 4037 4232 ravikumar.adukia@nomura.com

Action

Since its recent peak in mid-September, HPCL has underperformed the Sensex by 25%. Hopes of reforms have taken a backseat again, with plans for diesel now on the backburner. Given inflation worries, a near-term price hike looks unlikely. The entire subsidy-sharing mechanism remains ad hoc. Firming up oil prices are likely to derail any plan for reforms, in our view. REDUCE reiterated.

Catalysts

Tightening fundamentals, weakening US dollar, potentially higher inflation expectations and abundant money supply will likely all lead to higher oil prices.

Anchor themes

We believe the oil price will strengthen further, driven by QE2 and improving fundamentals, thus further dashing hopes of de-regulation/reforms. We continue to believe that for OMCs to emerge as a long-term investment idea, concrete and transparent policies on the subsidy-sharing mechanism are a must.

Closing price on 8 Dec	Rs410.2
Price target	**Rs270.0**
	(set on 5 May 10)
Upside/downside	-34.2%
Difference from consensus	-43.9%
FY11F net profit (Rsbn)	3.37
Difference from consensus	-76.3%

Source: Nomura

Nomura vs consensus

Predicting earnings for OMCs is a mathematical exercise, as subsidy amounts are large and the sharing mechanism ad-hoc and opaque. Also, we are more bullish on oil prices.

Deflating hopes

① Markets getting sceptical on deregulation/reforms

Since reaching its recent peak in mid-September, HPCL has underperformed the Sensex by some 25%. Hopes of deregulation/ reforms have been dashed in recent months, as the government decided to put the diesel de-regulation issue on the backburner, and has yet to provide clarity on the sharing mechanism for the current fiscal year and going forward. The stock's underperformance suggests to us that the market is starting to doubt the deregulation/ reform story. Even with its recent underperformance, we believe the stock is factoring in too much hope of deregulation and reforms.

② Higher oil prices could play spoilsport

We maintain our bullish view on oil prices and believe that oil prices could reach US$100/bbl in the coming year. Higher oil prices mean higher under-recoveries (unless the retail price increases, which we think is unlikely) and more pain for the oil marketing companies. We estimate that at our oil price assumption of US$100/bbl, under-recovery size increases to US$20bn in FY12, far higher than the actual US$10bn in FY10 and our estimate of US$15bn for FY11.

③ Difficult to be positive — REDUCE reaffirmed

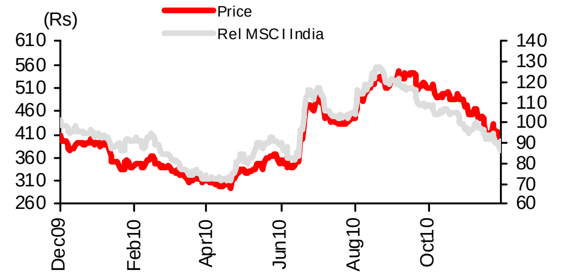
We believe that both price-setting and the subsidy-sharing mechanism remain ad-hoc and non-transparent. Post the June price hike, subsidy amounts are lower but remain very large, and forecasting earnings (or losses) is still difficult, in our opinion. Although hopes remain in some quarters that there will be some sort of reform before the planned FPOs of ONGC and IOC, we remain circumspect. We continue to believe that for OMCs to re-emerge as long-term investment ideas, further clarity is needed on future steps towards de-regulation, as well as the sharing mechanism. REDUCE maintained.

Key financials & valuations

31 Mar (Rsbn)	FY09	FY10	FY11F	FY12F
Revenue	1,248	1,076	1,337	1,489
Reported net profit	5.75	12.98	3.37	2.69
Normalised net profit	5.75	12.98	3.34	2.69
Normalised EPS (Rs)	16.96	38.29	9.84	7.93
Norm. EPS growth (%)	(49.3)	125.7	(74.3)	(19.5)
Norm. P/E (x)	24.2	10.7	41.7	51.8
EV/EBITDA (x)	12.4	13.7	22.3	22.6
Price/book (x)	1.3	1.2	1.3	1.2
Dividend yield (%)	1.3	1.2	1.2	0.5
ROE (%)	5.4	11.6	3.0	2.4
Net debt/equity (%)	206.4	182.2	223.3	232.9
Earnings revisions				
Previous norm. net profit		3.45	3.34	2.69
Change from previous (%)		275.7	-	-
Previous norm. EPS (Rs)		10.19	9.84	7.93

Source: Company, Nomura estimates

Share price relative to MSCI India



	1m	3m	6m
Absolute (Rs)	(12.4)	(22.3)	17.6
Absolute (US$)	(13.7)	(19.6)	22.5
Relative to Index	(5.7)	(27.3)	2.0
Market cap (US$mn)			3,082
Estimated free float (%)			49.0
52-week range (Rs)			546/294.9
3-mth avg daily turnover (US$mn)			17.08
Stock borrowability			Hard
Major shareholders (%)			
Government of India			51.1
LIC			12.3

Source: Company, Nomura estimates

Exhibit 136. Likely under-recoveries at different oil prices – woes continue

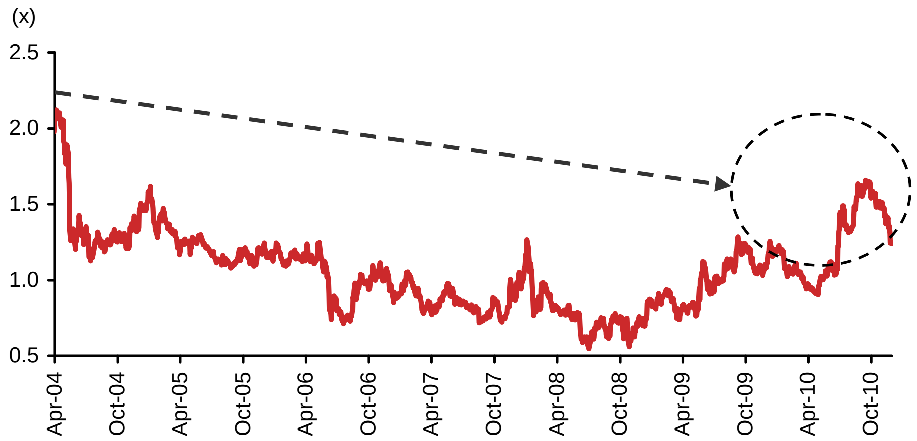
Under-recoveries (INRbn)	FY09	FY10	FY11F	FY12F		
Brent (US$/bbl)	85	70	83	**85**	**90**	**100**
Petrol	52	61	22	0	0	0
Diesel	523	83	248	87	197	416
PDS Kerosene	282	175	193	156	172	204
Domestic LPG	176	141	196	163	194	256
Total (INRbn)	**1033**	**461**	**659**	**406**	**563**	**877**
	22	**10**	**15**	**9**	**13**	**20**

Source: Petroleum Planning & Analysis Cell (PPAC), Nomura estimates

We assume further price hikes of INR2/lit in diesel, INR3/lit in PDS kerosene and INR35/cyl in domestic LPG in FY12F)

Yet, we expect the size of the problem to increase to US$20bn in FY12F at our oil price forecast of US$100/bbl for FY12F

Exhibit 137. HPCL: 1-year fwd P/BV ratio



Source: Bloomberg, Nomura research

HPCL's one-year forward P/BV multiple has come off from recent highs but remains higher than the historical average

Valuation methodology

Our 12-month price target of INR270 is based on a 0.8x P/BV multiple applied to our estimate of FY12F book value per share.

Risks

The key upside valuation risk is a significant change in government policy on fixing retail prices. We believe complete deregulation would be a big positive in the long term and could lead to a rerating of the stock. Even partial deregulation, but with a clear policy on sharing of any under-recoveries, would be positive for HPCL, in our view. A significant and sustained decline in global oil prices would also be positive, as losses on retail fuels decline sharply at low oil prices. Also, refining margins that are higher than our estimates would be a positive for HPCL.

Financial statements

Income statement (Rsbn)					
Year-end 31 Mar	**FY08**	**FY09**	**FY10**	**FY11F**	**FY12F**
Revenue	1,047	1,248	1,076	1,337	1,489
Cost of goods sold	(1,008)	(1,194)	(1,010)	(1,287)	(1,434)
Gross profit	**39**	**53**	**67**	**50**	**54**
SG&A	(31)	(34)	(53)	(45)	(51)
Employee share expense	-	-	-	-	-
Operating profit	**7**	**19**	**14**	**5**	**4**
EBITDA	**16**	**29**	**25**	**17**	**18**
Depreciation	(9)	(10)	(12)	(12)	(14)
Amortisation	-	-	-	-	-
EBIT	**7**	**19**	**14**	**5**	**4**
Net interest expense	(8)	(21)	(9)	(12)	(13)
Associates & JCEs	-	-	-	-	-
Other income	12	9	16	12	14
Earnings before tax	**11**	**7**	**21**	**5**	**4**
Income tax	0	(1)	(8)	(2)	(1)
Net profit after tax	**12**	**6**	**13**	**3**	**3**
Minority interests	-	-	-	-	-
Other items	(0)	-	-	-	-
Preferred dividends	-	-	-	-	-
Normalised NPAT	**11**	**6**	**13**	**3**	**3**
Extraordinary items	-	-	0	0	-
Reported NPAT	**11**	**6**	**13**	**3**	**3**
Dividends	(1)	(2)	(5)	(2)	(1)
Transfer to reserves	**10**	**4**	**8**	**1**	**2**
Valuation and ratio analysis					
FD normalised P/E (x)	12.2	24.2	10.7	41.7	51.8
FD normalised P/E at price target (x)	8.1	15.9	7.1	27.4	34.1
Reported P/E (x)	12.2	24.2	10.7	41.2	51.8
Dividend yield (%)	0.7	1.3	1.2	1.2	0.5
Price/cashflow (x)	na	2.4	4.2	9.8	6.0
Price/book (x)	1.3	1.3	1.2	1.3	1.2
EV/EBITDA (x)	19.3	12.4	13.7	22.3	22.6
EV/EBIT (x)	41.9	18.8	25.3	78.7	114.5
Gross margin (%)	3.7	4.3	6.2	3.7	3.7
EBITDA margin (%)	1.5	2.3	2.4	1.3	1.2
EBIT margin (%)	0.7	1.5	1.3	0.4	0.2
Net margin (%)	1.1	0.5	1.2	0.3	0.2
Effective tax rate (%)	(2.3)	19.3	38.8	33.0	33.0
Dividend payout (%)	10.5	36.2	36.5	58.7	29.5
Capex to sales (%)	3.0	1.5	3.4	2.1	2.2
Capex to depreciation (x)	3.7	2.0	3.1	2.3	2.3
ROE (%)	11.3	5.4	11.6	3.0	2.4
ROA (pretax %)	2.0	4.4	2.8	0.9	0.6
Growth (%)					
Revenue	17.6	19.1	(13.7)	24.2	11.4
EBITDA	(34.6)	83.7	(12.2)	(31.8)	2.1
EBIT	(57.5)	164.0	(28.0)	(64.4)	(28.6)
Normalised EPS	(27.8)	(49.3)	125.7	(74.3)	(19.5)
Normalised FDEPS	(27.8)	(49.3)	125.7	(74.3)	(19.5)
Per share					
Reported EPS (Rs)	33.5	17.0	38.3	10.0	7.9
Norm EPS (Rs)	33.5	17.0	38.3	9.8	7.9
Fully diluted norm EPS (Rs)	33.5	17.0	38.3	9.8	7.9
Book value per share (Rs)	311.9	316.9	341.3	326.8	332.4
DPS (Rs)	3.0	5.3	5.0	5.0	2.0

Source: Nomura estimates

Deteriorating financials

Cashflow (Rsbn)					
Year-end 31 Mar	**FY08**	**FY09**	**FY10**	**FY11F**	**FY12F**
EBITDA	16	29	25	17	18
Change in working capital	(53)	29	(2)	(0)	(4)
Other operating cashflow	20	0	10	(3)	9
Cashflow from operations	**(17)**	**58**	**33**	**14**	**23**
Capital expenditure	(32)	(19)	(36)	(28)	(32)
Free cashflow	**(49)**	**39**	**(3)**	**(14)**	**(9)**
Reduction in investments	3	(74)	28	(29)	5
Net acquisitions	-	-	-	-	-
Reduction in other LT assets	-	-	-	-	-
Addition in other LT liabilities	2	0	2	(1)	-
Adjustments	(2)	7	(6)	29	3
Cashflow after investing acts	**(46)**	**(28)**	**21**	**(15)**	**(1)**
Cash dividends	(5)	(1)	(2)	(2)	(1)
Equity issue	0	-	-	-	-
Debt issue	61	54	(12)	25	18
Convertible debt issue	-	-	-	-	-
Others	(8)	(22)	(11)	(7)	(13)
Cashflow from financial acts	**48**	**31**	**(25)**	**16**	**4**
Net cashflow	**2**	**3**	**(4)**	**1**	**3**
Beginning cash	1	3	6	2	4
Ending cash	3	6	2	4	7
Ending net debt	165	221	211	247	262

Source: Nomura estimates

Balance sheet (Rsbn)					
As at 31 Mar	**FY08**	**FY09**	**FY10**	**FY11F**	**FY12F**
Cash & equivalents	3	6	2	4	7
Marketable securities	-	-	-	-	-
Accounts receivable	17	22	24	22	24
Inventories	120	88	126	155	171
Other current assets	53	44	54	12	9
Total current assets	**193**	**160**	**206**	**192**	**212**
LT investments	68	142	114	143	138
Fixed assets	152	167	192	194	212
Goodwill	-	-	-	-	-
Other intangible assets	-	-	-	-	-
Other LT assets	-	-	-	-	-
Total assets	**414**	**468**	**512**	**528**	**561**
Short-term debt	-	-	-	-	-
Accounts payable	69	56	74	82	92
Other current liabilities	55	61	92	67	71
Total current liabilities	**124**	**118**	**166**	**150**	**162**
Long-term debt	168	228	213	251	269
Convertible debt	-	-	-	-	-
Other LT liabilities	16	16	18	17	17
Total liabilities	**308**	**361**	**397**	**418**	**448**
Minority interest	-	-	-	-	-
Preferred stock	-	-	-	-	-
Common stock	3	3	3	3	3
Retained earnings	91	92	100	96	98
Proposed dividends	-	-	-	-	-
Other equity and reserves	12	12	12	12	12
Total shareholders' equity	**106**	**107**	**116**	**111**	**113**
Total equity & liabilities	**414**	**468**	**512**	**528**	**561**
Liquidity (x)					
Current ratio	1.55	1.36	1.25	1.28	1.30
Interest cover	0.9	0.9	1.5	0.4	0.3
Leverage					
Net debt/EBITDA (x)	10.47	7.65	8.28	14.25	14.80
Net debt/equity (%)	156.1	206.4	182.2	223.3	232.9
Activity (days)					
Days receivable	5.7	5.8	7.9	6.3	5.7
Days inventory	36.5	31.8	38.6	39.8	41.6
Days payable	20.5	19.2	23.6	22.2	22.3
Cash cycle	21.8	18.4	23.0	23.9	25.0

Source: Nomura estimates

Higher debt is creating balance-sheet pressure

Valuation and risks

Valuation and risks

Sections			Valuation methodology	Risks
Economics			--	--
Autos	Mahindra and Mahindra	MM IN	We value MM, based on SOTP, at Rs892/share. We value the auto business at 13x average EPS of FY12F, FY13F EPS(Rs51.2), or Rs666/share. We value investments at Rs226/share after a 20% holding discount. We value the listed subsidiaries at their market cap and unlisted investments at their book value. Some new ventures such as the truck JV with Navistar International are in early stages with products yet to be launched. Hence, we have valued them conservatively at the book value of their investments.	Slower-than-estimated volume growth in utility vehicles. In case volume growth in UVs is lower than our estimates, MM could see its earnings fall as the company is in high capex mode. Below normal rainfall — Indian agricultural growth is highly dependent on rainfall. In case rainfall is below normal, or if there is a drought, Mahindra's tractor volumes could be much lower than our estimates. In case Mahindra Forging's European subsidiaries make very high losses, it could impact cash flows for MM. Losses in investments. In case some of the new ventures make significant losses, it could destroy value for MM.
	Bajaj Auto	BJAUT IN	We value Bajaj Auto based on DCF at Rs1,810. This includes Rs209/share as book value of investments. The implied target multiple on the average one-year forward earnings (average of FY12-FY13F EPS) has increased from 15x to 15.9x.	Slower-than-expected volume growth; possibility of price wars breaking out that could result in downside to our margin estimates; and a global slowdown in domestic and/or export markets could present downside risks to our volume estimates.
Banks	ICICI Bank	ICICIBC IN	We value the core ICICI bank at 2.6x FY12F P/BV.	Downside risks include slower-than-expected economic growth, a rapid increase in bond yields owing to rising fiscal deficit and increasing global stress could hurt ICICI's international book.
	State Bank of India	SBIN IN	We value the parent SBI bank at 2x FY12F P/BV.	Faster-than-expected increases in rates or slower-than-expected loan growth are key risks to our rating and price target for the bank.
	HDFC Bank	HDFCB IN	We apply a target P/E multiple of 4.3x, which is higher than the stock's average trading multiple of 3.4x, but lower than its peak multiple of 5x. The trough multiple was 1.9x over the past five years.	Higher-than-expected delinquencies and the bank's ability to deliver loan growth are key risks to our rating and price target.
Construction materials (Cement)	Ambuja Cements	ACEM IN	We value Ambuja Cement on an EV/IC multiple based valuation technique using the average ROCE for the next three years.	1) Better-than-expected volume growth in CY11F on the back of an overall pick-up in demand in the sector will put our earnings estimates at risk. 2) Stronger-than-expected realisations in the company's core markets (north India) will result in better profitability for Ambuja Cement putting our Reduce rating on the stock at risk.
	India Cements	ICEM IN	We value India Cements on a sum-of-the-parts basis. We value its cement business using the EV/IC multiple-based method using the average ROCE that the company is expected to generate in the next 3 years, while we value the company's ownership of the Indian Premier League franchise "Chennai Super Kings" at Rs26/share.	Risks: 1) A sharp recovery in cement prices in south India would put our earnings estimates at risk. 2) We are not building in any upside from the possibility of the company getting coal from its Indonesian mines. 3) Unlocking the value of the Indian Premier League asset at a price higher than our current estimate.
	Ultratech Cement	UTCM IM	We value Ultratech on an EV/IC-multiple-based methodology using average ROCE of 19% expected from the company during the next three years, WACC of 12.2% and long-term growth of 4%.	1) higher-than-expected price realisations in the company's core markets of South and West; and 2) better-than-estimated volume offtake.
	ACC	ACC IN	We value ACC on an EV/IC multiple based valuation technique using the average ROCE for the next three years.	1) Any significant ramp-up in cement dispatch volumes higher than our current estimates will put our earnings estimates at risk. 2) A higher-than-anticipated improvement in price realizations in the company's core markets in south and west India.
Consumer	Pantaloon Retail India	PF IN	We value the core business at Rs610/share. We value all the subsidiaries and support businesses at 1x capital employed. The combined value for all the other businesses stands at Rs74/share. After deducting net debt of Rs131/share, our price target comes to Rs553.	The retail sector is a leveraged play on the macro fundamentals in the country. Any downward trend on the macro front presents downside risk to our numbers.
	ITC	ITC IN	We value the company using a sum-of-the-parts valuation methodology. We value the core cigarette business at Rs149 per share based on a P/E multiple of 22x FY11F earnings. The other core businesses are valued at around Rs44 per share. We have valued the net cash (after deducting corporate expenses) at book value.	Policy directives from the union government form the biggest risk to our investment view.
	Asian Paints	APNT IN	We value Asian Paints at 25x FY12F, which is a 4% premium to the other consumer companies.	A sharp increase in input prices could mean a potential risk to our earnings estimates. However, we consider the company to be well prepared to deal with an increase in input prices by way of price hikes in the near term.
	United Spirits	UNSP IN	We value the domestic business at an EV/EBITDA multiple of 14x and Whyte & Mackey at an EV/EBITDA multiple of 7x on average FY12 and FY13 earnings.	Worsening of profitability in the domestic business owing to higher raw material costs is a key downside risk to our BUY call.
	Hindustan Unilever	HUVR IN	We value HUVR at 20x our FY12 earnings estimate of Rs11.2.	Significant easing of competitive pressures which could lead to lower A&P spend which is the key risk to our call. However, we see this situation as unlikely given the aggressive intent of P&G as well as other domestic players to compete with HUVR.

Sections			Valuation methodology	Risks
	Marico Industries	MRCO IN	Our sum-of-the-parts valuation is Rs118, of which the core business accounts for Rs109 (20x FY12F EPS) and Kaya Rs9 (2x FY12F sales).	A sharp drop in price of key input Copra is a key risk to our earnings and target price.
	Dabur India	DABUR IN	We value Dabur at 24x average FY12F and FY13F EPS. The P/E multiple we assign is in line with the multiple we assign to other consumer companies under our coverage.	The key downside risk to our estimates is lower-than-expected margin performance on the back of higher input costs.
Electrical equipment	Crompton Greaves	CRG IN	We value the core business at 20x Sep 12F EPS and the stake in Avantha Power at 4x book value to arrive at our PT of Rs380.	1) Slowdown in power sector investments; 2) rising competition in projects business; and 3) substantial rise in commodity prices could hit margins.
	ABB India	ABB IN	We value ABB India at 25x Sep-12F EPS, in line with the historical average (adjusted for the difference between expected and actual earnings).	A sharper-than-expected recovery in the industrial and power products segment; substantial decline in commodity prices, thus benefitting margins.
	Bharat Heavy Electricals	BHEL IN	We value BHEL using a discounted cashflow (DCF) methodology, assuming a cost of equity of 11.5% and a terminal growth rate of 4% (explicit forecast period until FY17F, second-stage growth forecast until FY20).	Higher-than-expected share of private orders under the 12th and 13th Five-year Plans, material upward revision in capacity additions during the 12th or 13th Five- Year Plans, delays or cancellation in capacity by new domestic manufacturers.
	Thermax	TMX IN	Our PT of Rs725 is based on 18x FY12F EPS. As the company fully recovers from cyclical lows by FY12, we believe the stock would trade at mid-cycle multiples factoring growth potential beyond FY12. Accordingly, we apply 18x FY12F EPS which is in-line with historical average cycle multiple for the company.	1) Depreciation of the rupee could benefit exports, 2) power shortages may continue if capacity addition plans are delayed, 3) the company's move towards utility boiler business could reduce earnings volatility, 4) easing coal prices would help boost demand for captive power plants and 5) we currently do not build in any significant contribution from the Babcock JV – however, material order booking over the next 12m or so could significantly alter visibility and lead to a positive change in our stance.
	Cummins India	KKC IN	Our price target of Rs820 is based on 18x Sep 12F EPS (from 16x).	Downside risks: 1) Appreciation of the rupee could dampen the growth outlook as the competitive advantage of cheap Indian products will be reduced to an extent. 2) Diesel prices pose a risk to the demand for back-up power. 3) Competition from Chinese players — apart from some domestic competition, Cummins India also competes with Chinese manufacturers. However, the nature of the industry prohibits a large market share for vendors without a solid service support network in the country. As such, we believe KKC will remain the dominant player in its category. Upside risks: 1) Raw material costs could pose negative or positive upsides depending on commodity price movements. 2) Export recovery could continue to surprise in the near term.
IT Services & Software	HCL Technologies	HCLT IN	Our PT of Rs510 is based on 16x one-year rolling forward earnings, which is at a 20% discount to our Infosys target multiple.	Key downside risks to our call: 1) a lower-than-expected revenue ramp-up in the core software and infrastructure services divisions; 2) continued pressure on margins even post 2Q FY11; and 3) rupee appreciation against the US dollar.
	Mphasis	MPHL IN	Our PT of Rs770is based on 14x one-year forward earnings which is a 30% discount to our target multiple for Infosys.	1) Continued pricing pressure and slower-than-anticipated offshoring from HP and 2) Rupee appreciation beyond assumed levels.
	Infosys Technologies	INFO IN	Our PT of Rs3,200 is based on 20x one-year rolling forward earnings, which is in line with the stock's five-year average.	Key risks to our call on the downside are 1) a sharp appreciation of the rupee against the US dollar; and, 2) a double-dip recession in the US while upside risks include an increase in discretionary spending by clients, fuelled by higher-than-expected economic growth in the US and Europe.
	Tata Consultancy Services	TCS IN	Our PT of Rs1,000 is based on 20x one-year forward earnings – which is at par with our target multiple for Infosys.	Risks to our call on the downside are 1) a sharp appreciation of the rupee against the US dollar, and; 2) moderation in utilisation from current levels could provide downside to our margin expectations.
	Wipro	WPRO IN	Our price target of Rs450 is based on 18x 1-yr forward earnings which implies a 10% discount to our target multiple for Infosys.	Risks to our call on the upside are 1) ability to keep wage inflation in check and maintain elevated levels of operational efficiency could provide an upside bias to our estimates and 2) sharper-than-anticipated revival in TMT (Telecom, Media & Telecom) and manufacturing could aid Wipro's growth, while on the downside the risk is rupee appreciation beyond assumed levels.
	Tech Mahindra	TECHM IN	Our price target of Rs690 is based on 12x one-yr rolling forward consolidated earnings - which is a 40% discount to our Infosys target valuation.	Upside risks include higher-than-anticipated revenue ramp-up in Mahindra Satyam and early announcement of a merger with Satyam. On the downside, risks include an extension of sluggishness in BT to AT&T and the emerging market telco rollout business.
	Patni Computer Systems	PATNI IN	Our PT of Rs460 is based on 12x one-year rolling forward earnings. The 12x multiple that we use to value Patni is a discount of 40% to the multiple we use to value Infosys and in line with the historical average at which Patni has traded. Upside risks include potential stake sale by promoters and large deal wins.	Downside risks include 1) attrition rates climbing up and affecting volume growth and 2) delay in large deal ramp-ups.
	Cognizant	CTSH US	Our PT of US$68 is based on 22x one-year forward earnings – which is a 10% premium to Infosys.	Risks on the upside include an increase in discretionary spending by clients, fuelled by higher-than-expected economic growth in the US and Europe. Downside risks include: 1) a sharp appreciation of the rupee against the US dollar; and, 2) a double-dip recession in the US.

Sections			Valuation methodology	Risks
Infrastructure & Construction	Larsen & Toubro	LT IN	We value L&T using sum-of-the-parts methodology. In our view, L&T's fair value trading range is 20-25x one-year forward earnings. We value the core construction business at 22.5x FY12F earnings at Rs1,860/share. We value subsidiaries at Rs449/share.	Rising interest rates, lower-than-expected execution, a substantial increase in raw material prices, and a higher risk premium are the key risks to our price target.
	IVRCL Infra	IVRC IN	We value IVRCL using a sum-of-the-parts methodology. The core construction business is valued at 12x adjusted one-year forward earnings. We have valued IVR A&H and HDO at a 20% holding discount to their respective market caps. Our 12-month price target is Rs220.	The main risks to our call are: 1) a deterioration in the macro environment resulting in a rise in interest rates and risk premium, which would hurt the base business and subsidiary valuations; 2) a slowdown in order inflows and execution; and 3) AP orders constitute 17% of the orderbook and may not be executed in the near term owing to the unstable political situation there.
	Nagarjuna Constructions	NJCC IN	We value NJCC using a sum-of-the-parts methodology. The core construction business is valued at 12x adjusted one-year forward earnings to arrive at a value of Rs136/share. We value the construction business in line with other mid-tier construction companies and at a 45% discount to Larsen & Toubro. We value the BOT projects at 1.5x equity invested. We value NCC Urban at its current book value. We separately value the current order book of its international operations at 8x current profit. Our price target is Rs194.	The key risks to our call are deterioration in the macro environment; execution delays; and a fall in subsidiary valuations. Higher cash outflows for subsidiaries would reduce earnings. There are real estate-related risks also.
	HCC	HCC IN	We value HCC using a sum-of-the-parts methodology. We value its core construction business at 12x adjusted one-year forward earnings, a 45% discount to L&T's multiple, to arrive at a one-year forward value of Rs33/share. We have valued BOT projects as sum of 1.5x equity invested. We value Lavasa using DCF assuming a development area of 157mn sqft, year of completion of 2030F, price appreciation of 5% per year and WACC of 12.5%. We value 247 Corporate Park based on the valuation implied by the stake sale. Our price target is Rs80.	1) A substantial slowdown in order inflows; 2) execution delays and lower-than-estimated margins; 3) a rise in interest rates and risk premium; and 4) lower-than-expected value discovery from subsidiaries.
Metals	TATA Steel	TATA IN	We value TATA Steel on a sum-of-the-parts basis: We have valued its India business at 10x FY12F EPS at Rs753/share. We value Corus at EV of US$5bn (5x FY12F EV/EBITDA). It contributes Rs34 to our target price. We value Tata Steel's South-East Asia business at Rs15/share. We have valued stakes in Riversdale at Rs44/share.	Slowdown in Europe: European operations are very sensitive to capacity utilisation owing to high fixed costs. Therefore, a slowdown in Europe would be a concern Steel prices turn weak. Raw material prices increase more than our estimates
	Steel Authority of India	SAIL IN	We value SAIL at 10x FY12F core earnings and add total capex done through FY11 at face value to arrive at our price target of Rs264. While core business contributes Rs192/share, Rs89/share comes from capex done. We have subtracted Rs71bn of net debt from the above which is Rs17/share.	Coking coal prices remain high despite softening steel prices. Government divests its stake at significant discount to market price. Further delay in expansion plan.
	Sterlite Industries	STLT IN	We have valued the core business of Hindustan Zinc at 10x FY12F core earnings and add FY11F cash and investments of INR118.7bn to arrive at total valuation of INR486bn, contributing INR 94/share.We have valued Sterlite's copper business at 8x core earnings at INR17.7bn. It contributes INR5.3 to our price target. Sterlite's standalone has total cash and equivalent of INR174bn, contributing INR52 to our target price. We value Sterlite Energy on DCF at INR98bn. Sterlite Energy contributes INR29 to our target price. We have valued Balco at INR 74bn at 5x FY13E EV/EBITDA. We value Sterlite's stake of 51% in Balco at INR37.7bn, contributing INR11.2 to our price target. We have valued Vedanta Aluminium at 5x FY12E EV/EBITDA. We value VAL at INR102bn and it contributes INR7.5 to our price target.	1) Weak metal prices; 2) delay in expansion plans.

Sections			Valuation methodology	Risks
Oil & Gas / Chemicals	Reliance Industries	RIL IN	We use the SOTP method to value RIL's different businesses. For its core businesses, we use EV/EBITDA multiples. We use a 7x FY12F EV/EBITDA multiple for its refining and petrochemical business. We use DCF to value the company's new E&P business. Our PT is Rs1,200/share.	Deterioration in refining margins and sharper-than-expected decline in petrochemical margins; 2) delays in ramp-up of KG-D6 volume; 3) rupee appreciation against the US dollar.
	Cairn India	CAIR IN	We value Cairn India on a SOTP basis combining NAV and DCF. We calculate the NAV of its key fields Mangala, Bhagyam and Aishwariya (under development) and Rageshwari & Saraswati (FDP approved) using a discounted cash flow (DCF) methodology. Our NAV of MBA and R&S field is Rs276/share. The Ravva and Cambay blocks are valued at Rs7/share and Rs2/share, respectively. We value Cairn's 10% share in the 2P reserves in KG-DWN-98/2 block at a conservative US$6/boe. We value recoverable resources (140mmboe now) in other 20 fields at US$6/boe and prospective resources of 1.76bboe (net of recoverable resources) at US$1/boe. We also assign a value of US$6/boe to exploration upsides (prospective recoverable resources of 250mmboe — Cairn's share of 175mmboe). Our SOTP based NAV for Cairn is Rs369/share.	Delays in ramp-up of production; lower oil prices and higher discounts and higher cess than our assumptions.
	Petronet LNG	PLNG IN	We use DCF methodology to value Petronet LNG. Based on WACC of 9.6% and 1% terminal growth rate, DCF-based price target is Rs145.	Key downside risks to our valuation include: 1. Lower-than- expected spot volumes could significantly impair profitability and valuations. 2. The Dahej off-take agreement provides for 5% annual rises in the regasification charges. Although we believe we are conservative in our assumptions of re- gasification charges, any sharp cut could have a negative impact on profitability and valuations. 3 PLNG's Kochi terminal is under construction and execution delays and cost overruns could hurt our valuation of the Kochi terminal.
	Gujarat State Petronet	GUJS IN	We use DCF methodology to value GSPL. We use a WACC of 10.4% and terminal growth rate of 2.5%. Our DCF-based price target is Rs150.	Downside risks to our investment view include: Lower-than-expected growth in transmission volumes, A sharp cut in the transmission tariff by the PNGRB post application of new regulations. An eventually higher social contribution as per the directives of the Gujarat government. In our estimates, we do not factor any outgoing here.
	Indraprastha Gas	IGL IN	We use a DCF methodology to value IGL. We use a WACC of 10.8% and terminal growth rate of 2.5%. Our DCF-based price target is Rs440.	Under the new PNGRB regulations, the regulator can only control network tariff (based on 14% post tax ROCE principle) and not the end-product pricing. Therefore, we do not build in any tariff cut, especially during the three-year exclusivity period that ends in January 2012. Any sharp cut in the overall tariff would negatively impact our valuations. 2. Slowdown in CNG conversions and new PNG connections.
	Hindustan Petroleum Corporation	HPCL IN	Our 12-month price target of Rs270 is based on a 0.8x P/BV multiple applied to our estimate of FY12F book value per share.	The key upside valuation risk is a significant change in government policy on fixing retail prices. We believe complete deregulation would be a big positive in the long term and could lead to a rerating of the stock. Even partial deregulation, but with a clear policy on sharing of any under-recoveries, would be positive for HPCL, in our view. A significant and sustained decline in global oil prices would also be positive, as losses on retail fuels decline sharply at low oil prices. Also, refining margins that are higher than our estimates would be a positive for HPCL.
	GAIL India	GAIL IN	We have used sum-of-the-parts to value GAIL's diversified business. We have valued its gas transmission business (including gas trading) at 10x FY12F EBITDA, petrochemical business at 7x FY12F EBITDA, and LPG business at 6x FY12F EBITDA. We also value E&P upside at a conservative INR15/share.	Key downside risks: lower transmission volume growth, a sharp cut in overall tariffs by the regulator (we do not assume any cut), a sharper polymer price decline than our assumption and higher subsidy burden than our assumptions form key risks.
Power& Utilities	Lanco Infratech	LANCI IN	We use Sum-of-the-parts (SOTP) valuation methodology for Lanco. We value the EPC/construction business at 8x FY12 P/E, power business using Milestone-adjusted FCFE valuation at 14% cost of equity, power trading business at 9x FY12 P/E, real estate business at 30% discount to NAV calculated using 20% WACC and toll roads using DCF at 15% Cost of Equity. Thereafter, we apply 15% holding company discount to our SOTP value to arrive at our target price of Rs76/share.	1) Interlinked business lines entail 'cascading risk' to earnings; 2) Lower coal supplies under already signed FSAs/LoAs and 3) Potential equity dilution to fund 10.6GW under-development project pipeline.
	NTPC	NATP IN	We use the residual income model to value the company. Key assumptions of our model are 1) Cost of equity - 12%, Terminal RoE - 20% and Terminal growth rate - 2%.	1) Project execution delays; 2) Lower coal supplies under already signed FSAs/LoAs; 3) Reinvestment risk and 4) Adverse regulatory changes.

Sections			Valuation methodology	Risks
	Power Grid Corp of India	PWGR IN	We use the residual income model to value the company. Key assumptions of our model are 1) Cost of equity - 12%, Terminal RoE - 17% and Terminal growth rate - 3%.	1) Slippage in capex / capitalization rate; 2) Adverse regulatory changes; 3) Competitive bidding regime could push returns, growth outlook lower and 4) Payment security / cashflows risk.
	Reliance Power	RPWR IN	We deploy FCFE-based methodology to value operational / under construction /reasonable likelihood power generation projects of the company. In order to capture the risk of a power project from conception to commissioning, we adjust the FCFE value of the projects for 'milestone discounts' (risk weights assigned to the non-achievement of six key milestones we identify for various types of projects). Key assumption of our FCFE model is 15% cost of equity.	1) Milestone achievements especially related to financial closure; 2) Greater visibility on planned capacity addition of around 17GW could merit its inclusion in our earnings forecast and 3) Third-party sale of 'surplus' coal from company's domestic captive coal mines or from coal concessions in Indonesia.
	JSW Energy	JSW IN	We deploy FCFE-based methodology to value operational / under construction /reasonable likelihood power generation projects of the company. In order to capture the risk of a power project from conception to commissioning, we adjust the FCFE value of the projects for 'milestone discounts' (risk weights assigned to the non-achievement of six key milestones we identify for various types of projects). Key assumption of our FCFE model is 14% cost of equity.	Upside risks: 1) Manages to address near-term exposure to imported spot coal, 2) Fall in spot prices of imported coal; Downside risks: 1) Lower-than expected merchant tariff realization, 2) Further delays in capacity additions at the Ratnagiri-I and RWPL-I facilities, 3) Shortfall in anticipated fuel supply from Sungai Belati (Indonesia).
	Adani Power	ADANI IN	We deploy FCFE-based methodology to value operational / under construction /reasonable likelihood power generation projects of the company. In order to capture the risk of a power project from conception to commissioning, we adjust the FCFE value of the projects for 'milestone discounts' (risk weights assigned to the non-achievement of six key milestones we identify for various types of projects). Key assumption of our FCFE model is 13% cost of equity.	Upside risks: 1) Increase in tariff/delay in commencement date of 1000MW PPA with GUVNL, 2) milestone achievements especially related to fuel security and offtake arrangement; Downside risks: 1) Lower-than expected merchant tariff realization, 2) lower GCV/higher price of imported coal from Adani Enterprises Ltd (AEL)
Pharmaceuticals	Dr Reddy' s Laboratories	DRRD IN	We value DRRD at Rs2,084 per share. We use 23x P/E Multiple for blended FY12-13E base earnings to arrive at Rs1949/share. We further attribute Rs135/share for one-off opportunities.	Key risk to our call: a) delay in key product approvals; b) Price cuts and regulatory changes in Germany and Russia, c) INR appreciation and; d) increased investment in high risk opportunities.
	Lupin	LPC IN	We value LPC at 20x FY12F earnings, in line with other front-line generic companies, to arrive at our 12-month price target of Rs417.	1) A slowdown of growth in India; 2) a delay in product approvals; 3) slower-than-expected ramp up in brand business; and d) faster-than estimated generic competition in Suprax.
	Glenmark Pharmaceuticals	GNP IN	Over the past one year Glenmark has traded at a P/E range of 14 -19x with an average of 15.6x. We expect a premium to the one-year average P/E multiple given a better debt and receivable position than earlier. Based on this methodology, we arrive at a target price of Rs405. We value the core business at Rs372/share (based on 18x FY12 and rolled forward by six months at a cost of equity of 12.5% to arrive at one yr forward target); R&D at Rs21/share and Zetia opportunity at Rs13/share. Furthermore, the US can potentially present an upside. We are not valuing the R&D pipeline on a product-by-product basis.	(a) Further deterioration in working capital cycle of the company, (b) Negative development on the two key advanced molecules in innovation R&D pipeline (c) Lower than expected revival in emerging market revenues, and (d) Significant delay in approval of new products from the USFDA.
	Sun Pharmaceutical Industries Ltd	SUNP IN	Our price target of Rs1,694 is derived using a sum-of-the-parts (SOTP) valuation (methodology unchanged). We value its: 1) Base business at Rs1,614; we value Sun Pharma's base business at 20x FY12F EPS of Rs80.7; and 2) One-offs at Rs80 per share.	The key upside risks to our call include: 1) a quicker resolution of FDA issues and a stronger pickup in the base business; and 2) Higher realisations from Effexor XR or other product specific opportunities that are not sustainable would not change our view. The key downside risks include: 1) regulatory issues continuing beyond the expected timeline; 2) a delay in product approvals, and; 3) a slowdown in the domestic market.
	GlaxoSmithKline Pharmaceuticals	GLXO IN	We use a valuation multiple at 25x CY11F to arrive at our end-CY10 price target of Rs2,040. We roll-forward our end-CY10 price target at a 11% cost of equity to arrive at our 12-month price target of Rs2,132.	Key upside risks: 1) value-accretive acquisitions and 2) higher-than-expected revenue growth rates due to faster ramp-up of vaccine sales. Key downside risks: 1) landmark regulatory and legal announcements resulting in concerns about limited scope for patented drug opportunities in India could lead to a re-rating of the stock, in our view; 2) additional price controls imposed by the Indian government. Currently, around 29% of GLXO's domestic pharmaceutical sales are generated from drugs under price control; and 3) impact of adverse regulatory developments on key products like Cervarix.
	Ranbaxy Laboratories Ltd	RBXY IN	We value the base business using DCF. Based on base business valuation of Rs244 and one-off product valuation of 145, we arrive at a 12-month price target of Rs389.	1) Positive outcome of DoJ investigation that could significantly increase the one off product valuation; 2) greater-than-estimated increase in sales.
	Cipla	CIPLA IN	We value the stock at 15x FY12F earnings to arrive at a 12 month price target of Rs264.	a) Approval and significant ramp up in generic combination inhaler in Europe; b) partnerships that can substantially ramp up export volumes, and; c) acquisition/stake sale leading to value unlocking.

Sections			Valuation methodology	Risks
Real Estate	Housing Development & Infrastructure	HDIL IN	We value HDIL using our net asset value estimate of its current saleable area at Rs366 per share, without any discount/premium to NAV, and with cost of equity at 15%.	Downside risks include 1) a delay in shifting of slum dwellers in Phase 1 of the airport slum rehab project; 2) an increase in FSI in Mumbai, which would affect demand and pricing of TDR; and 3) an increase in interest rates, which would affect demand for property and sentiment for property stocks.
	Unitech Ltd	UT IN	We value the company in two parts: 1) net asset value of the current land bank at Rs78 per share and 2) Unitech Infra valued at Rs22 per share. Our cost of capital assumption is 13.75%.	Downside risks include: 1) a reduction in liquidity and capital availability for developers, 2) stalled economic growth recovery, 3) an inability to successfully sell projects or construct them and 4) rising interest rates.
	Puravankara Projects	PVKP IN	We value the stock using our net asset value estimate of its current land bank at Rs168 per share, without any discount to NAV, and with cost of capital at 13.5%. We think the biggest risk is the potential failure to sell and execute projects on time, resulting in cash flow problems.	Downside risks: 1) a reduction in liquidity and capital availability for developers, 2) stalled economic growth. 3) Rising interest rates along with policy action to restrict lending to property developers which could lead to refinancing risks for Puravankara.
Telecoms	Bharti Airtel	BHARTI IN	Our DCF-based price target is based on a WACC of 9% and a terminal growth rate of 3%.	Downside risks to our investment view include stronger-than-expected competition and unfavourable regulatory developments related to various fees and charges. Upside risks include benign competition and faster-than-anticipated stability in pricing.
	Idea Cellular	IDEA IN	Our DCF-based price target is based on a WACC of 9.8% and a terminal growth rate of 4%.	Upside risks to our view: 1) A favourable resolution of regulatory issues; and 2) faster-than-anticipated industry consolidation.
	Reliance Communications	RCOM IN	Our DCF- based price target is based on a WACC of 12.7% and a terminal growth rate of 4%.	Key upside risks to our investment view include lessening competitive activity and potential M&A transactions.
Transport infrastructure	Container Corporation of India	CCRI IN	We believe the new bulk cargo policy could raise the FCF CAGR over FY11-20F by >500bps, thus driving a re-rating for CCRI. Our PT of Rs1,575 values CCRI at 18x Sep 12F EPS, which is towards the higher end of the historical trading band (12-20x), but still lower than the peak (20x).	Delays in the approval for bulk cargo entry could dampen return ratios and negatively impact cash flows. Pricing and margin assumptions for the new bulk cargo business are still to be validated by actual performance and, thus, pose a risk to our view and valuation. CCRI is currently enjoying Section 80IA benefits, which should gradually start tapering off from FY14, as the incremental eligible asset base for these benefits will be lower, in our view. We estimate that this could push up tax rates 3-4pp by FY16-17F for the existing business.
	GVK Power & Infrastructure	GVKP IN	We value all GVKP projects individually to arrive at a fair value of Rs54.30/share.We net out the proposed investment into the oil & gas venture from the project NPV (since the venture is exploratory as it stands) to arrive at our revised 12-month price target of Rs53.10/share.	Regulatory risk on MIAL aero-revenues; 2) delays in MIAL real-estate; 3) entire MIAL land might not be vacated; and 4) regulatory risk on merchant sale of power at J2 and Gautami.
	Mundra Port & SEZ	MSEZ IN	Our price target of Rs142 is based on sum-of-the-parts analysis. We value the core port business at Rs85.8 per share, using a cost of equity of 11.50%, the Container Terminal 2 (CT2) at Rs16 per share using a cost of equity of 11.50%, its special economic zone (SEZ) at Rs23.6 per share (at a cost of equity of 18% less 15% discount), the Dahej Port at Rs2.6 per share (2x P/BV) and the Hazira port and Mormugao coal terminal project at Rs4.4 per share (2x P/BV net of equity investments required). Projected cash on books, as of Sep-11, adds another Rs9.4/share. We have yet to assign any value to the logistics businesses, as it is at a nascent in its infancy.	1) Success in getting anchor clients at its SEZ, and 2) extension of port concession beyond FY31. Downside risks include: 1) our assumed dividend payout ratio might not be maintained and 2) a substantial share of traffic is dependent on promoter group companies.
	GMR Infrastructure	GMRI IN	We have valued all GMR projects individually to arrive at a fair value of Rs44.4/share. We have assigned a 15% holding company discount to assets other than airports (and related real estate). Including the cash balance as of March '10 (net of investments into the valued projects), we arrive at our price target of Rs47.	An aero tariff regime that is more favourable than expected; upside from real estate development assets; non-aero revenue contracts at DIAL and GHIAL could be re-negotiated at better rates than assumed; new order wins and progress on projects not valued for lack of financial closure.

Source: Nomura research

NOMURA

NOMURA

Any Authors named on this report are Research Analysts unless otherwise indicated

Analyst Certification

We, Prabhat Awasthi, Nipun Prem and Sanjay Kadam, hereby certify (1) that the views expressed in this Research report accurately reflect our personal views about any or all of the subject securities or issuers referred to in this Research report, (2) no part of our compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this Research report and (3) no part of our compensation is tied to any specific investment banking transactions performed by Nomura Securities International, Inc., Nomura International plc or any other Nomura Group company.

Important Disclosures

Conflict-of-interest disclosures

Important disclosures may be accessed through the following website: http://www.nomura.com/research/pages/disclosures/disclosures.aspx . If you have difficulty with this site or you do not have a password, please contact your Nomura Securities International, Inc. salesperson (1-877-865-5752) or email grpsupport@nomura.com for assistance.

Online availability of research and additional conflict-of-interest disclosures

Nomura Japanese Equity Research is available electronically for clients in the US on NOMURA.COM, REUTERS, BLOOMBERG and THOMSON ONE ANALYTICS. For clients in Europe, Japan and elsewhere in Asia it is available on NOMURA.COM, REUTERS and BLOOMBERG.
Important disclosures may be accessed through the left hand side of the Nomura Disclosure web page http://www.nomura.com/research or requested from Nomura Securities International, Inc., on 1-877-865-5752. If you have any difficulties with the website, please email grpsupport-eu@nomura.com for technical assistance.

The analysts responsible for preparing this report have received compensation based upon various factors including the firm's total revenues, a portion of which is generated by Investment Banking activities.

Industry Specialists identified in some Nomura International plc research reports are employees within the Firm who are responsible for the sales and trading effort in the sector for which they have coverage. Industry Specialists do not contribute in any manner to the content of research report in which their names appear.

Distribution of ratings (Global)

Nomura Global Equity Research has 1878 companies under coverage.
48% have been assigned a Buy rating which, for purposes of mandatory disclosures, are classified as a Buy rating; 41% of companies with this rating are investment banking clients of the Nomura Group*.
37% have been assigned a Neutral rating which, for purposes of mandatory disclosures, is classified as a Hold rating; 54% of companies with this rating are investment banking clients of the Nomura Group*.
13% have been assigned a Reduce rating which, for purposes of mandatory disclosures, are classified as a Sell rating; 16% of companies with this rating are investment banking clients of the Nomura Group*.
As at 30 September 2010.
The Nomura Group as defined in the Disclaimer section at the end of this report.

Explanation of Nomura's equity research rating system in Europe, Middle East and Africa, US and Latin America for ratings published from 27 October 2008

The rating system is a relative system indicating expected performance against a specific benchmark identified for each individual stock. Analysts may also indicate absolute upside to price target defined as (fair value - current price)/current price, subject to limited management discretion. In most cases, the fair value will equal the analyst's assessment of the current intrinsic fair value of the stock using an appropriate valuation methodology such as discounted cash flow or multiple analysis, etc.

STOCKS

A rating of '**Buy**', indicates that the analyst expects the stock to outperform the Benchmark over the next 12 months.
A rating of '**Neutral**', indicates that the analyst expects the stock to perform in line with the Benchmark over the next 12 months.
A rating of '**Reduce**', indicates that the analyst expects the stock to underperform the Benchmark over the next 12 months.
A rating of '**RS-Rating Suspended**', indicates that the rating and target price have been suspended temporarily to comply with applicable regulations and/or firm policies in certain circumstances including when Nomura is acting in an advisory capacity in a merger or strategic transaction involving the company.
Benchmarks are as follows: **United States/Europe**: Please see valuation methodologies for explanations of relevant benchmarks for stocks (accessible through the left hand side of the Nomura Disclosure web page: http://www.nomura.com/research);**Global Emerging Markets (ex-Asia):** MSCI Emerging Markets ex-Asia, unless otherwise stated in the valuation methodology.

SECTORS

A '**Bullish'** stance, indicates that the analyst expects the sector to outperform the Benchmark during the next 12 months.
A '**Neutral'** stance, indicates that the analyst expects the sector to perform in line with the Benchmark during the next 12 months.
A '**Bearish'** stance, indicates that the analyst expects the sector to underperform the Benchmark during the next 12 months.
Benchmarks are as follows: **United States**: S&P 500; **Europe**: Dow Jones STOXX 600; **Global Emerging Markets (ex-Asia)**: MSCI Emerging Markets ex-Asia.

Explanation of Nomura's equity research rating system for Asian companies under coverage ex Japan published from 30 October 2008 and in Japan from 6 January 2009

STOCKS

Stock recommendations are based on absolute valuation upside (downside), which is defined as (Price Target - Current Price) / Current Price, subject to limited management discretion. In most cases, the Price Target will equal the analyst's 12-month intrinsic valuation of the stock, based on an appropriate valuation methodology such as discounted cash flow, multiple analysis, etc.
A '**Buy'** recommendation indicates that potential upside is 15% or more.
A '**Neutral'** recommendation indicates that potential upside is less than 15% or downside is less than 5%.
A '**Reduce'** recommendation indicates that potential downside is 5% or more.
A rating of '**RS'** or '**Rating Suspended'** indicates that the rating and target price have been suspended temporarily to comply with applicable regulations and/or firm policies in certain circumstances including when Nomura is acting in an advisory capacity in a merger or strategic transaction involving the subject company.
Securities and/or companies that are labelled as '**Not rated'** or shown as '**No rating'** are not in regular research coverage of the Nomura entity identified in the top banner. Investors should not expect continuing or additional information from Nomura relating to such securities and/or companies.

SECTORS

A '**Bullish'** rating means most stocks in the sector have (or the weighted average recommendation of the stocks under coverage is) a positive absolute recommendation.
A '**Neutral'** rating means most stocks in the sector have (or the weighted average recommendation of the stocks under coverage is) a neutral absolute recommendation.
A '**Bearish'** rating means most stocks in the sector have (or the weighted average recommendation of the stocks under coverage is) a negative absolute recommendation.

Explanation of Nomura's equity research rating system in Japan published prior to 6 January 2009 (and ratings in Europe, Middle East and Africa, US and Latin America published prior to 27 October 2008)

STOCKS

A rating of '1' or '**Strong buy'**, indicates that the analyst expects the stock to outperform the Benchmark by 15% or more over the next six months.
A rating of '2' or '**Buy'**, indicates that the analyst expects the stock to outperform the Benchmark by 5% or more but less than 15% over the next six months.
A rating of '3' or '**Neutral'**, indicates that the analyst expects the stock to either outperform or underperform the Benchmark by less than 5% over the next six months.
A rating of '4' or '**Reduce'**, indicates that the analyst expects the stock to underperform the Benchmark by 5% or more but less than 15% over the next six months.
A rating of '5' or '**Sell'**, indicates that the analyst expects the stock to underperform the Benchmark by 15% or more over the next six months.
Stocks labeled '**Not rated'** or shown as '**No rating'** are not in Nomura's regular research coverage. Nomura might not publish additional research reports concerning this company, and it undertakes no obligation to update the analysis, estimates, projections, conclusions or other information contained herein.

SECTORS

A '**Bullish'** stance, indicates that the analyst expects the sector to outperform the Benchmark during the next six months.
A '**Neutral'** stance, indicates that the analyst expects the sector to perform in line with the Benchmark during the next six months.
A '**Bearish'** stance, indicates that the analyst expects the sector to underperform the Benchmark during the next six months.
Benchmarks are as follows: **Japan**: TOPIX; **United States**: S&P 500, MSCI World Technology Hardware & Equipment; **Europe**, by sector - *Hardware/Semiconductors*: FTSE W Europe IT Hardware; *Telecoms*: FTSE W Europe Business Services; *Business Services*: FTSE W Europe; *Auto & Components*: FTSE W Europe Auto & Parts; *Communications equipment*: FTSE W Europe IT Hardware; **Ecology Focus**: Bloomberg World Energy Alternate Sources; **Global Emerging Markets**: MSCI Emerging Markets ex-Asia.

Explanation of Nomura's equity research rating system for Asian companies under coverage ex Japan published prior to 30 October 2008

STOCKS

Stock recommendations are based on absolute valuation upside (downside), which is defined as (Fair Value - Current Price)/Current Price, subject to limited management discretion. In most cases, the Fair Value will equal the analyst's assessment of the current intrinsic fair value of the stock using an appropriate valuation methodology such as Discounted Cash Flow or Multiple analysis etc. However, if the analyst doesn't think the market will revalue the stock over the specified time horizon due to a lack of events or catalysts, then the fair value may differ from the intrinsic fair value. In most cases, therefore, our recommendation is an assessment of the difference between current market price and our estimate of current intrinsic fair value. Recommendations are set with a 6-12 month horizon unless specified otherwise. Accordingly, within this horizon, price volatility may cause the actual upside or downside based on the prevailing market price to differ from the upside or downside implied by the recommendation.
A '**Strong buy'** recommendation indicates that upside is more than 20%.
A '**Buy'** recommendation indicates that upside is between 10% and 20%.
A '**Neutral'** recommendation indicates that upside or downside is less than 10%.
A '**Reduce'** recommendation indicates that downside is between 10% and 20%.
A '**Sell'** recommendation indicates that downside is more than 20%.

SECTORS

A '**Bullish'** rating means most stocks in the sector have (or the weighted average recommendation of the stocks under coverage is) a positive absolute recommendation.
A '**Neutral'** rating means most stocks in the sector have (or the weighted average recommendation of the stocks under coverage is) a neutral absolute recommendation.
A '**Bearish'** rating means most stocks in the sector have (or the weighted average recommendation of the stocks under coverage is) a negative absolute recommendation.

Price targets

Price targets, if discussed, reflect in part the analyst's estimates for the company's earnings. The achievement of any price target may be impeded by general market and macroeconomic trends, and by other risks related to the company or the market, and may not occur if the company's earnings differ from estimates.

Disclaimers

This publication contains material that has been prepared by the Nomura entity identified on the banner at the top or the bottom of page 1 herein and, if applicable, with the contributions of one or more Nomura entities whose employees and their respective affiliations are specified on page 1 herein or elsewhere identified in the publication. Affiliates and subsidiaries of Nomura Holdings, Inc. (collectively, the 'Nomura Group'), include: Nomura Securities Co., Ltd. ('NSC') Tokyo, Japan; Nomura International plc, United Kingdom; Nomura Securities International, Inc. ('NSI'), New York, NY; Nomura International (Hong Kong) Ltd., Hong Kong; Nomura Financial Investment (Korea) Co., Ltd., Korea (Information on Nomura analysts registered with the Korea Financial Investment Association ('KOFIA') can be found on the KOFIA Intranet at http://dis.kofia.or.kr); Nomura Singapore Ltd., Singapore (Registration number 197201440E, regulated by the Monetary Authority of Singapore); Nomura Securities Singapore Pte Ltd., Singapore (Registration number 198702521E, regulated by the Monetary Authority of Singapore); Capital Nomura Securities Public Company Limited; Nomura Australia Ltd., Australia (ABN 48 003 032 513), regulated by the Australian Securities and Investment Commission and holder of an Australian financial services licence number 246412; P.T. Nomura Indonesia, Indonesia; Nomura Securities Malaysia Sdn. Bhd., Malaysia; Nomura International (Hong Kong) Ltd., Taipei Branch, Taiwan; Nomura Financial Advisory and Securities (India) Private Limited, Mumbai, India (Registered Address: Ceejay House, Level 11, Plot F, Shivsagar Estate, Dr. Annie Besant Road, Worli, Mumbai- 400 018, India; SEBI Registration No: BSE INB011299030, NSE INB231299034, INF231299034, INE 231299034).

THIS MATERIAL IS: (I) FOR YOUR PRIVATE INFORMATION, AND WE ARE NOT SOLICITING ANY ACTION BASED UPON IT; (II) NOT TO BE CONSTRUED AS AN OFFER TO SELL OR A SOLICITATION OF AN OFFER TO BUY ANY SECURITY IN ANY JURISDICTION WHERE SUCH OFFER OR SOLICITATION WOULD BE ILLEGAL; AND (III) BASED UPON INFORMATION THAT WE CONSIDER RELIABLE.

NOMURA GROUP DOES NOT WARRANT OR REPRESENT THAT THE PUBLICATION IS ACCURATE, COMPLETE, RELIABLE, FIT FOR ANY PARTICULAR PURPOSE OR MERCHANTABLE AND DOES NOT ACCEPT LIABILITY FOR ANY ACT (OR DECISION NOT TO ACT) RESULTING FROM USE OF THIS PUBLICATION AND RELATED DATA. TO THE MAXIMUM EXTENT PERMISSIBLE ALL WARRANTIES AND OTHER ASSURANCES BY NOMURA GROUP ARE HEREBY EXCLUDED AND NOMURA GROUP SHALL HAVE NO LIABILITY FOR THE USE, MISUSE, OR DISTRIBUTION OF THIS INFORMATION.

Opinions expressed are current opinions as of the original publication date appearing on this material only and the information, including the opinions contained herein, are subject to change without notice. Nomura is under no duty to update this publication. If and as applicable, NSI's investment banking relationships, investment banking and non-investment banking compensation and securities ownership (identified in this report as 'Disclosures Required in the United States'), if any, are specified in disclaimers and related disclosures in this report. In addition, other members of the Nomura Group may from time to time perform investment banking or other services (including acting as advisor, manager or lender) for, or solicit investment banking or other business from, companies mentioned herein. Further, the Nomura Group, and/or its officers, directors and employees, including persons, without limitation, involved in the preparation or issuance of this material may, to the extent permitted by applicable law and/or regulation, have long or short positions in, and buy or sell, the securities (including ownership by NSI, referenced above), or derivatives (including options) thereof, of companies mentioned herein, or related securities or derivatives. In addition, the Nomura Group, excluding NSI, may act as a market maker and principal, willing to buy and sell certain of the securities of companies mentioned herein. Further, the Nomura Group may buy and sell certain of the securities of companies mentioned herein, as agent for its clients.
Investors should consider this report as only a single factor in making their investment decision and, as such, the report should not be viewed as identifying or suggesting all risks, direct or indirect, that may be associated with any investment decision. Please see the further disclaimers in the disclosure information on companies covered by Nomura analysts available at www.nomura.com/research under the 'Disclosure' tab.
Nomura Group produces a number of different types of research product including, among others, fundamental analysis, quantitative analysis and short term trading ideas; recommendations contained in one type of research product may differ from recommendations contained in other types of research product, whether as a result of differing time horizons, methodologies or otherwise; it is possible that individual employees of Nomura may have different perspectives to this publication.

NSC and other non-US members of the Nomura Group (i.e. excluding NSI), their officers, directors and employees may, to the extent it relates to non-US issuers and is permitted by applicable law, have acted upon or used this material prior to, or immediately following, its publication. Foreign-currency-denominated securities are subject to fluctuations in exchange rates that could have an adverse effect on the value or price of, or income derived from, the investment. In addition, investors in securities such as ADRs, the values of which are influenced by foreign currencies, effectively assume currency risk.

The securities described herein may not have been registered under the US Securities Act of 1933, and, in such case, may not be offered or sold in the United States or to US persons unless they have been registered under such Act, or except in compliance with an exemption from the registration requirements of such Act. Unless governing law permits otherwise, you must contact a Nomura entity in your home jurisdiction if you want to use our services in effecting a transaction in the securities mentioned in this material.

This publication has been approved for distribution in the United Kingdom and European Union as investment research by Nomura International plc ('NIPlc'), which is authorized and regulated by the UK Financial Services Authority ('FSA') and is a member of the London Stock Exchange. It does not constitute a personal recommendation, as defined by the FSA, or take into account the particular investment objectives, financial situations, or needs of individual investors. It is intended only for investors who are 'eligible counterparties' or 'professional clients' as defined by the FSA, and may not, therefore, be redistributed to retail clients as defined by the FSA. This publication may be distributed in Germany via Nomura Bank (Deutschland) GmbH, which is authorized and regulated in Germany by the Federal Financial Supervisory Authority ('BaFin'). This publication has been approved by Nomura International (Hong Kong) Ltd. ('NIHK'), which is regulated by the Hong Kong Securities and Futures Commission, for distribution in Hong Kong by NIHK. This publication has been approved for distribution in Australia by Nomura Australia Ltd, which is authorized and regulated in Australia by the Australian Securities and Investment Commission ('ASIC'). This publication has also been approved for distribution in Malaysia by Nomura Securities Malaysia Sdn Bhd. In Singapore, this publication has been distributed by Nomura Singapore Limited ('NSL') and/or Nomura Securities Singapore Pte Ltd ('NSS'). NSL and NSS accepts legal responsibility for the content of this publication, where it concerns securities, futures and foreign exchange, issued by their foreign affiliates in respect of recipients who are not accredited, expert or institutional investors as defined by the Securities and Futures Act (Chapter 289). Recipients of this publication should contact NSL or NSS (as the case may be) in respect of matters arising from, or in connection with, this publication. Unless prohibited by the provisions of Regulation S of the U.S. Securities Act of 1933, this material is distributed in the United States, by Nomura Securities International, Inc., a US-registered broker-dealer, which accepts responsibility for its contents in accordance with the provisions of Rule 15a-6, under the US Securities Exchange Act of 1934.

This publication has not been approved for distribution in the Kingdom of Saudi Arabia or to clients other than 'professional clients' in the United Arab Emirates by Nomura Saudi Arabia, Nomura International plc or any other member of the Nomura Group, as the case may be. Neither this publication nor any copy thereof may be taken or transmitted or distributed, directly or indirectly, by any person other than those authorised to do so into the Kingdom of Saudi Arabia or in the United Arab Emirates or to any person located in the Kingdom of Saudi Arabia or to clients other than 'professional clients' in the United Arab Emirates. By accepting to receive this publication, you represent that you are not located in the Kingdom of Saudi Arabia or that you are a 'professional client' in the United Arab Emirates and agree to comply with these restrictions. Any failure to comply with these restrictions may constitute a violation of the laws of the Kingdom of Saudi Arabia or the United Arab Emirates.
No part of this material may be (i) copied, photocopied, or duplicated in any form, by any means; or (ii) redistributed without the prior written consent of the Nomura Group member identified in the banner on page 1 of this report. Further information on any of the securities mentioned herein may be obtained upon request. If this publication has been distributed by electronic transmission, such as e-mail, then such transmission cannot be guaranteed to be secure or error-free as information could be intercepted, corrupted, lost, destroyed, arrive late or incomplete, or contain viruses. The sender therefore does not accept liability for any errors or omissions in the contents of this publication, which may arise as a result of electronic transmission. If verification is required, please request a hard-copy version.

Additional information available upon request

NIPlc and other Nomura Group entities manage conflicts identified through the following: their Chinese Wall, confidentiality and independence policies, maintenance of a Restricted List and a Watch List, personal account dealing rules, policies and procedures for managing conflicts of interest arising from the allocation and pricing of securities and impartial investment research and disclosure to clients via client documentation.

Disclosure information is available at the Nomura Disclosure web page:

http://www.nomura.com/research/pages/disclosures/disclosures.aspx

IN80-90

NOMURA

Nomura Asian Equity Research Group

Hong Kong	Nomura International (Hong Kong) Limited 30/F Two International Finance Centre, 8 Finance Street, Central, Hong Kong Tel: +852 2536 1111 Fax: +852 2536 1820
Singapore	Nomura Singapore Limited 5 Temasek Boulevard #11-01, Suntec Tower Five, Singapore 038985, Singapore Tel: +65 6433 6288 Fax: +65 6433 6169
Taipei	Nomura International (Hong Kong) Limited, Taipei Branch 17th Floor, Walsin Lihwa Xinyi Building, No.1, Songzhi Road, Taipei 11047, Taiwan, R.O.C. Tel: +886 2 2176 9999 Fax: +886 2 2176 9900
Seoul	Nomura Financial Investment (Korea) Co., Ltd. 17th floor, Seoul Finance Center, 84 Taepyeongno 1-ga, Jung-gu, Seoul 100-768, Korea Tel: +82 2 3783 2000 Fax: +82 2 3783 2500
Kuala Lumpur	Nomura Securities Malaysia Sdn. Bhd. Suite No 16.5, Level 16, Menara IMC, 8 Jalan Sultan Ismail, 50250 Kuala Lumpur, Malaysia Tel: +60 3 2027 6811 Fax: +60 3 2027 6888
India	Nomura Financial Advisory and Securities (India) Private Limited Ceejay House, Level 11, Plot F, Shivsagar Estate, Dr. Annie Besant Road, Worli, Mumbai- 400 018, India Tel: +91 22 4037 4037 Fax: +91 22 4037 4111
Indonesia	PT Nomura Indonesia Suite 209A, 9th Floor, Sentral Senayan II Building Jl. Asia Afrika No. 8, Gelora Bung Karno, Jakarta 10270, Indonesia Tel: +62 21 2991 3300 Fax: +62 21 2991 3333
Sydney	Nomura Australia Ltd. Level 25, Governor Phillip Tower, 1 Farrer Place, Sydney NSW 2000 Tel: +61 2 8062 8000 Fax: +61 2 8062 8362
Tokyo	Equity Research Department Financial & Economic Research Center Nomura Securities Co., Ltd. 17/F Urbannet Building, 2-2, Otemachi 2-chome Chiyoda-ku, Tokyo 100-8130, Japan Tel: +81 3 5255 1658 Fax: +81 3 5255 1747, 3272 0869

Caring for the environment: to receive only the electronic versions of our research, please contact your sales representative.