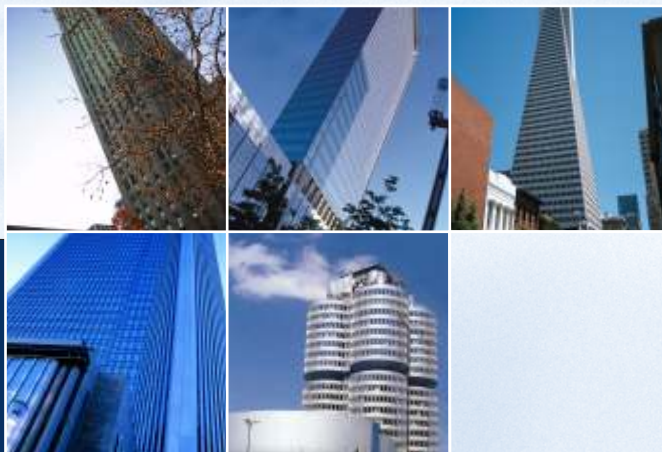


India Economic Outlook 2010



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India Economic Outlook

India's domestic consumption is highest among major Asian economies

Overview

The Indian economy has emerged out of the global economic crisis much faster than most other economies. Although India's growth rate declined from about 9% to 6.7% in 2008-09, we believe it has been a strong performance when compared with that of other emerging and developed economies. Driven by proactive fiscal and monetary stimuli, and backed by robust consumption, India, along with China, is likely to be the growth engine that helps other economies come out of recession. With the Prime Minister's Economic Advisory Council (PMEAC) estimating growth at 7.75% for 2009-10, 8% for 2010-11, and 9% thereafter, it would be prudent to assume the Indian economy is back in expansion mode.

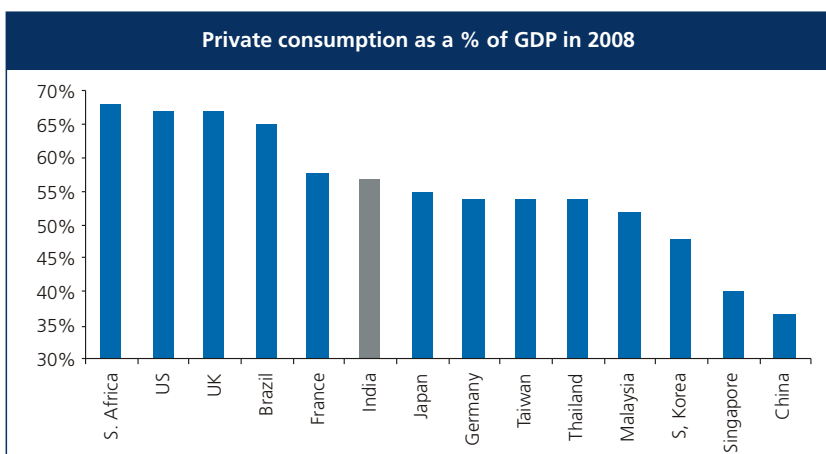
Adding to our optimism is India's continued standing as an attractive investment destination. The country's huge labour base, diversified natural resources and strong macroeconomic fundamentals meant that it moved up a spot to 49 in the World Economic Forum's Business Competitiveness Index 2009-2010. Furthermore, India retained the most preferred outsourcing destination according to A.T. Kearney Global Services Location Index 2009. These factors, coupled with stable annual growth, a booming capital market and a favourable environment for investment (resulting in a rapid growth in FDI) have made India the second fastest growing economy in the world.

While applauding the Indian economy's ability to withstand the global slowdown, one cannot ignore the significant impact of the crisis on the country. Growth rates decelerated from their highs and the massive fiscal stimuli are likely to widen the already huge fiscal deficit. Furthermore, lax monetary policy has led to renewed fears of spiralling inflation.

Key underlying factors sustaining the growth momentum are:

- **Domestic consumption coming to the fore:**

Even as exports declined during the global slowdown, India's robust domestic consumption helped offset the impact. According to data released by McKinsey Global Institute, India's private domestic consumption stood at 57% of the GDP in 2008, the highest among major Asian economies.



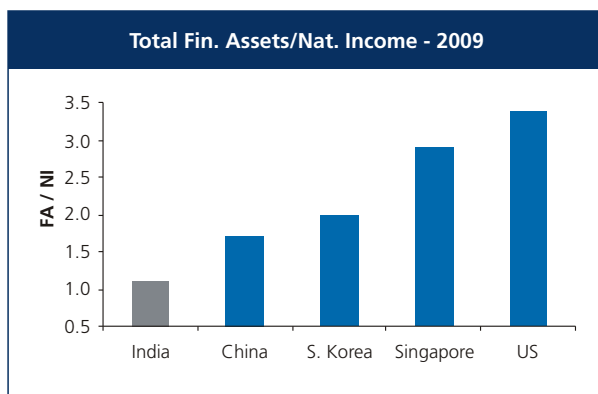
Source: McKinsey Global Institute

Furthermore, India's abysmally low share in global trade of 1.7% and Asia-Pacific trade of 6.1% in 2008 worked in the country's favour.

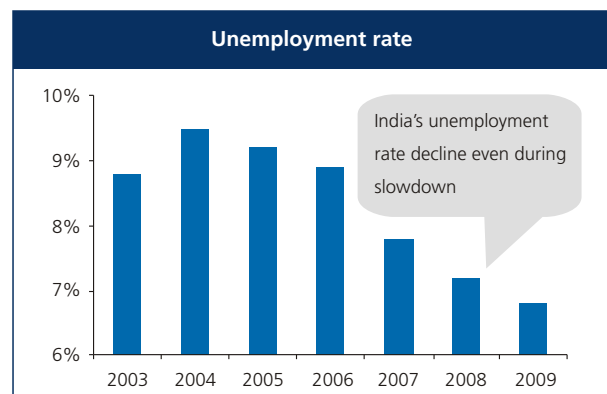
Government focus on employment generation reduced unemployment rate even during crisis

- **Economic fundamentals, FDI continue to be strong:**

India's highly regulated financial sector also kept it from being dealt a body blow by the crisis. India's total financial assets to national income ratio stood at 1.1 in 2009 compared to 1.7 for China and 3.4 for the US. Additionally, strong domestic demand and the government's employment creation initiatives kept the jobless rate relatively stable during the crisis compared to other countries.



Source: Global Insight, Cushman Wakefield, MCX, McKinsey



Source: CIA World Factbook

With 700 mn population, India's rural markets is expected to become a major consumption driver

Separately, FDI remained buoyant, backed by India's liberal investment policies, reforms and strong economic fundamentals. To increase fund flows to micro and small enterprises, the government has relaxed FDI norms, including the removal of the 24% ceiling on foreign holdings with sectoral caps.

- **Focus on infrastructure to support growth:**

The government plans to increase infrastructure spending as a percentage of GDP to 9% under the 11th Five Year Plan from about 5% now. The Plan also aims to envisage investment of over USD500 bn during 2007-12.

- **Growing rural market holds huge untapped potential:**

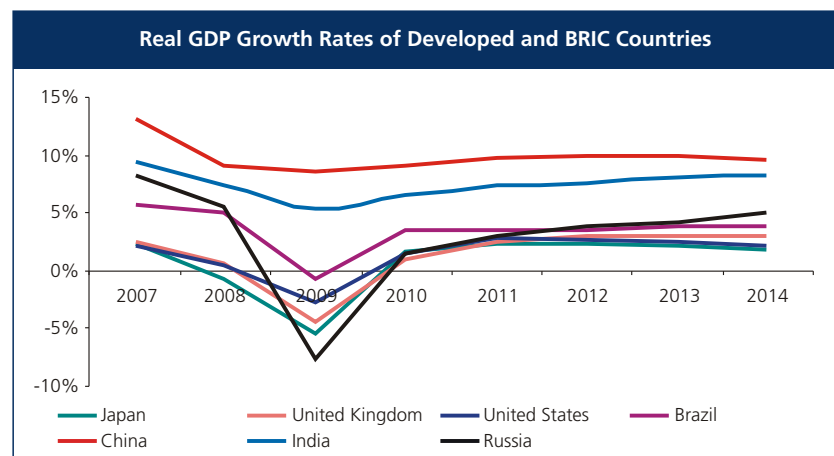
India's rural market—home to around 700mn people—could become a significant consumption driver in the coming years. Government focus on rural markets through special schemes, such as National Rural Employment Guarantee Scheme (NREGS), has pushed income levels higher. The Confederation of Indian Industries (CII) estimates the rural consumer market to top USD425 bn in 2010-11 compared to USD220 bn in 2004-05.

- **Focus on education ensures sustainability of growth:**

Highlighting the role of education in the development of a nation, the Indian government plans to increase its expenditure on education to 6% of the GDP in the 11th Five Year Plan from 3.6% in 2006-07. In addition, India's vast pool of scientific, technical and managerial workforce (available at relatively lower costs) provides a strong competitive edge. It also has the second-largest English-speaking population in the world. In addition, the country is expected to be the largest contributor to the world's working age population over the next six years.

With the advent of crisis, the policymakers' focus shifted from growth stimulation to growth sustainability

While the economic challenge in the past two decades had been to stimulate growth, the current economic crisis has caused the focus to shift from growth to sustenance of growth. The global downturn leading to a decline in manufacturing activity and a poor monsoon season saw India's economic growth decelerate. Furthermore, power shortage, poor transportation facilities and a huge unskilled labour force continued to affect India's growth. However, pre-emptive measures by way of stimulus partially shielded the Indian economy. Consequently, although India's real GDP grew at a much slower 6.7% in 2008-09 as compared with the 9.0% in 2007-08 and 9.7% in 2006-07, this growth was significantly higher than those recorded by other developing and emerging economies.



Source: IMF

In order to revive growth and infuse liquidity into the system, Reserve Bank of India (RBI) has slashed the cash reserve ratio (CRR) by 400 basis points since October 2008. RBI also lowered repo and reverse repo rates by 425 basis points and 275 basis points, respectively, during the same period. These measures infused about INR5,580 bn in the economy.

Change in Key Policy Rates (September 2008 - January 2010)			
	Early October 2008	January 2010	Quantum of reduction (basis points)
Repo Rate	9.00%	4.75%	425
Reverse repo Rate	6.00%	3.25%	275
Cash Reserve Ratio	9.00%	5.00%	400

Source: RBI

A world economy on the mend, coupled with stimulus gains, India's GDP is expected to return to its high growth ways. On the flip side, the loose monetary policy and supply side constraints have driven up inflation levels in India.

Inflation turned negative in June-August 2009 primarily due to the base effect; a spike in commodity and oil prices had stoked inflation in June-August 2008. However, inflation started to increase post August 2009. A poor monsoon season (South-West monsoon rainfall was the weakest since 1972 and 23% below the long-term average) hit crop production in India, leading to a surge in food commodity prices. As a result, food inflation jumped to 18.2% for the week ended

Rising food prices are stoking inflation in India. India's foreign exchange reserves declined in 2008-09 primarily due to valuation change.

26 December 2009. The annual WPI stood at 4.8% in November 2009 and is estimated to increase to 8% by March 2010 – significantly higher than the RBI's threshold limit of 5%. Although supply-side factors are blamed for the sharp spike in inflation, RBI in its third quarter monetary policy review on 29 January 2010 is likely to take pre-emptive measures, such as hiking CRR, to suck excess liquidity out of the system.

Even though India escaped the ravages of sub-prime crisis, bank failures and credit crunch, an emergency dose of fiscal and monetary medicine was nevertheless administered during October 2008 to January 2009. Indeed, interest rates were cut drastically and swiftly, and so was the cash reserve ratio, which freed up the mandatory cash that banks keep. This injection of liquidity prevented systemic crises and bankruptcies.

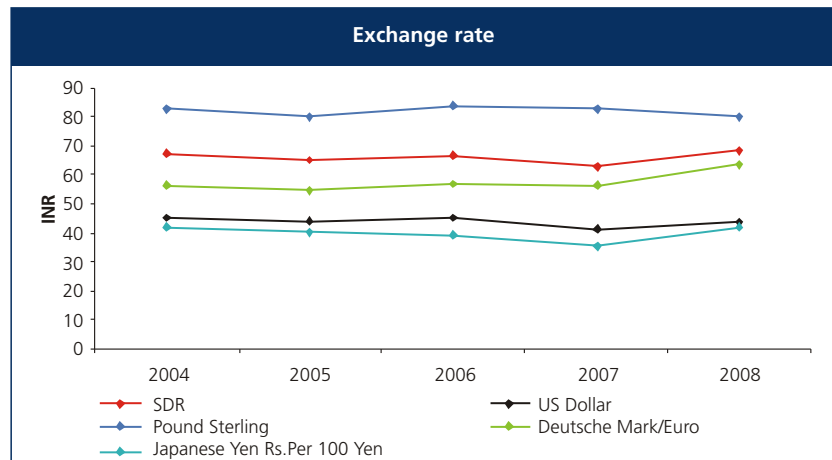
Interest rate								
Year	Call Money rate	Deposit Rates			Lending Rates	Yield of Government of India Securities		
		1 to 3 yrs.	Over 3-5 yrs.	Above 5 yrs.		Short-Term (1-5yrs.)	Medium Term (5-15yrs.)	Long-Term (15 yrs. & Above)
2004-05	4.65	5.25-5.50	5.75-6.25	5.75-6.25	10.25-10.75	4.32-8.14	4.71-7.73	5.43-7.83
2005-06	5.60	6.00-6.50	6.25-7.00	6.25-7.00	10.25-10.75	2.84-8.57	6.49-7.92	7.08-7.85
2006-07	7.22	7.50-9.00	7.75-9.00	7.75-9.00	12.25-12.50	6.23-11.37	6.61-8.67	7.47-10.00
2007-08	6.07	8.25-8.75	7.50-9.00	7.50-9.00	12.25-12.75	6.95-9.93	6.87-10.55	6.17-8.88
2008-09	7.06	8.00-8.75	7.75-8.50	7.75-8.50	11.50-12.50	4.61-11.09	5.50-10.69	6.27-8.26
2009-10	3.22	6.50-7.25	6.75-8.00	6.75-8.00	11.00-12.00	–	–	–

Source: RBI

Increased volatility between the US dollar and the Indian rupee has once again brought the focus back on exchange rates. The Indian rupee traded in the range of INR52.94 to INR46.06 to a US dollar in 2009 and strengthened 6.0% vis-à-vis the dollar in 2009. YTD (up to 11 January 2010), the Indian rupee has gained 2.8% over the US dollar. The global slowdown and rupee appreciation have adversely affected some high growth export-oriented sectors like IT, Retail, Auto Components, and Gems & Jewellery. These sectors now face increased competition from other low-cost countries such as China, Bangladesh and Pakistan. Nearly 65% of India's exports come from the low-margin Small and Medium Enterprises (SME) segment. With the rupee appreciating, their margins have narrowed further.

Strong rupee made imports cheap for India

UNCTAD estimates FDI inflows declined to USD1.2 tr in 2009 from 1.8 tr in 2008



Source: RBI

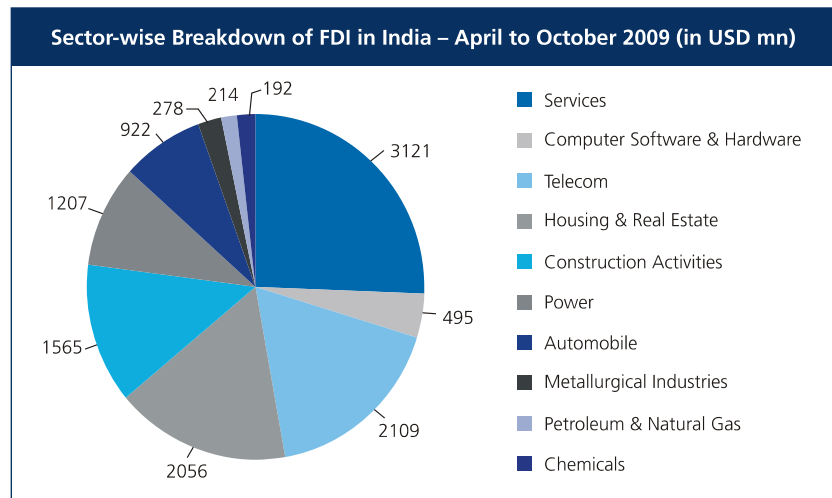
On a positive note, the stronger rupee made imports cheaper. India mainly imports crude, gems and jewellery, and capital goods. The country imports 75% of its crude oil requirement. The appreciating rupee lowered the effect of higher crude prices as well as helped Indian companies acquire assets abroad. Other beneficiaries of a stronger rupee include outbound Indian students and tourists.

The strength of the Indian economy, the global recovery and a resurgent rupee are helping the country attract significant amounts of foreign capital. After touching a low of USD63.1 bn in March 2009, outstanding FII equity investments grew 34.9% to USD85.1 bn in September 2009. On a y-o-y basis, outstanding FII equity investments grew 8.8% in September 2009. According to Securities and Exchange Board of India (SEBI) data, FIIs invested USD15.54 bn in equity markets until 16 November 2009, the highest ever in a single year. Furthermore, FDI flows remained robust in spite of the global crisis. While United Nations Conference on Trade and Development (UNCTAD) estimates global FDI inflows to decline to USD1.2 tr in 2009 from USD1.8 tr in 2008, FDI equity flows into India during April-October 2009 grew 6.1% y-o-y to INR852.73 bn. However, FDI equity inflows (in US dollar terms) declined 5.7% y-o-y to USD17.64 bn during the same period primarily due to rupee appreciation. With a 17.7% share of total FDI equity inflows, the Services sector led the pack, followed by Telecommunications (12.0%) and Housing and Real Estate (11.7%) during April-October 2009. Mauritius was the highest contributor to FDI equity inflows in India during the same period followed by Singapore and the US.

UNCTAD estimates global FDI inflows to increase to USD1.4 tr in 2010 and USD1.8tr in 2011. It expects India to continue to receive significant amounts of FDI in the coming years and, in its World Investment Prospects Survey 2009–2011, ranked the country as the third most preferred destination for FDI. India plans to increase FDI inflow to USD50 bn a year by 2012, and to achieve that goal, it plans to simplify procedures.

World Investment Prospects Survey 2009–2011 ranked India as third most preferred destination for FDI

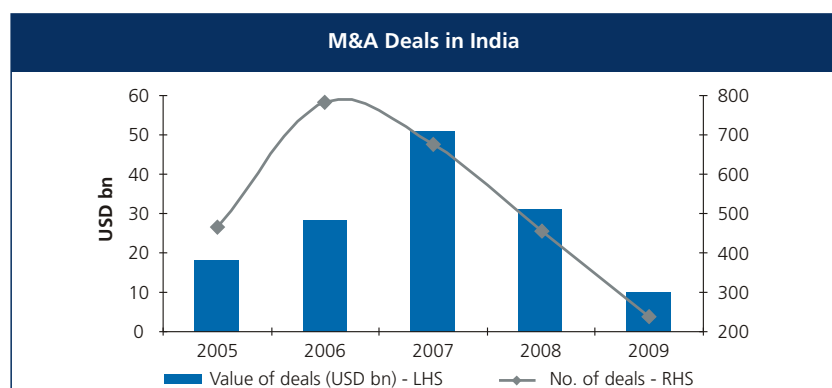
Rising food prices are stoking inflation in India
India's foreign exchange reserves declined in 2008-09 primarily due to valuation change



Source: Department of Industrial Policy & Promotion

The global financial meltdown dampened sentiments of private equity (PE) and venture capital (VC) companies and they adopted a cautious approach in 2009. As a result, private equity and merger & acquisition (M&A) deals in CY2009 declined for the second consecutive year to USD3.8 bn from USD10.5 bn in 2008 and USD13.6 bn in 2007, according to Venture Intelligence data. Additionally, the total number of deals nearly halved to 232 in CY2009 from 443 deals in CY2008; in average PE deal size terms, this translated to 30.2% y-o-y decline to USD16.5 mn in CY2009. The positive aspect, though, is the Indian Private Equity Confidence survey, conducted by Deloitte in February 2009, saying that the long-term outlook of private equity investors for India remained positive. Venture Capital investments also declined during 2009. Total VC investments during 9M CY2009 stood at USD201 mn (46 deals) compared to USD709 mn (124 deals) in the same period of CY2008.

The merger and acquisition (M&A) environment was no different in CY2009. According to Grant Thornton, while the total number of announced M&A deals declined to 267 in CY2009 from 454 in CY2008, total value of deals declined to USD10.03 bn in CY2009 from USD30.95 bn in CY2008. Additionally, there were only eight deals worth over USD250 mn in CY2009 compared to 24 deals in CY2008. As a result, the average deal size plummeted to USD37.57 mn in CY2009 from USD68.17 mn in CY2008.



Source: Grant Thornton

Real private consumption grew 5.6% in 2Q FY2009-10 compared to 1.6% in 1Q FY2009-10

Overall, India has been largely successful in countering the global economic meltdown, but like its global counterparts, the country is faced with the dilemma of when to end bailouts. Although recovery has set in, as exhibited by 7.9% GDP growth in the second quarter (August-September 2009), it remains fragile, with government expenditure still the key demand driver for consumption. Private consumption has started to revive, but at a slower pace. Real private consumption grew 5.6% in the second quarter compared to 1.6% in the first quarter of the financial year 2009-2010. Although it is difficult to ascertain the exact time of withdrawal of stimulus, two things are certain: a) withdrawal is likely to take place only when the recovery gains traction; and b) it will be happen in a phased manner. The subsequent sections of this report provide an overview of India's economy, a commentary on the key aspects of high-interest sectors, with an elucidation of chief growth drivers, trends and outlook.

Datamonitor expects BPO services to expand at a CAGR of 12% during 2008-2013

CII survey and HSBC Markit Business Activity Index shows that service sector is witnessing strong revival

IIP decline for the first time in 15 years in December 2008

Economy Overview

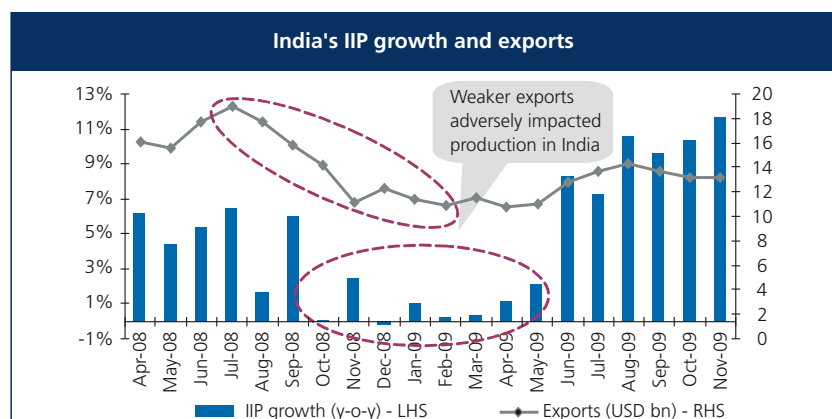
Services sector – growth engine of the Indian economy

The Indian services sector, which contributed approximately 56% to the GDP in 2008–09, continues to capitalise on factors such as steady rise in outsourcing, strong technical capabilities in information technology and IT-enabled services (ITES), and growing hospitality sector. India's cost-competitiveness, skilled manpower and strategic advantage (in terms of language skills) have helped it emerge as a strong contender to leverage these opportunities. The significant inflow of business process outsourcing (BPO) services has benefited the country. As per Datamonitor, BPO services are estimated to expand at a CAGR of 12% during 2008–13 and reach USD5.7bn in 2013.

India's services sector showed resilience to the economic crisis; on a year-on-year basis, community services grew 13% in 2008–09, while the transport and communication sector and financial & other services sector expanded 9.0% and 7.8%, respectively, during the same period. A survey conducted by the Confederation of Indian Industry (CII) indicated that the services sector gained momentum during April–October 2009. While 12% of the surveyed companies grew 20% relative to the 12.5% rise during the same period last year, over 30% of the sub-sectors reported growth in the range of 10–20% in the first seven months of 2009–10 compared to 24% in the comparable period last year. HSBC Markit Business Activity Index, an index based on the survey of 400 Indian services companies, rose to 57.41 in December 2009—the highest since September 2008—and exhibited that business activity was at its fastest pace in December 2009 during September 2008 to December 2009 period.

Manufacturing sector back on growth trajectory

India is establishing itself as a global manufacturing centre on the back of cheap and skilled manpower. The government's policy initiatives, such as abolition of license raj, liberalisation of the manufacturing sector and removal of cap on foreign ownership, and 100% FDI through the automatic route, fuelled the sector's growth. However, the manufacturing sector, which recorded a growth of 9.0% during 2007–08, was adversely impacted by the global economic slowdown. The sector grew 2.75% in 2008–09. Although the rise in domestic consumption supported production, India's Index of Industrial Production (IIP) turned negative for the first time in 15 years in December 2008, primarily due to a decline in exports.



Source: Bloomberg, Aranca Research

Backed by government stimulus, manufacturing sector is gaining momentum

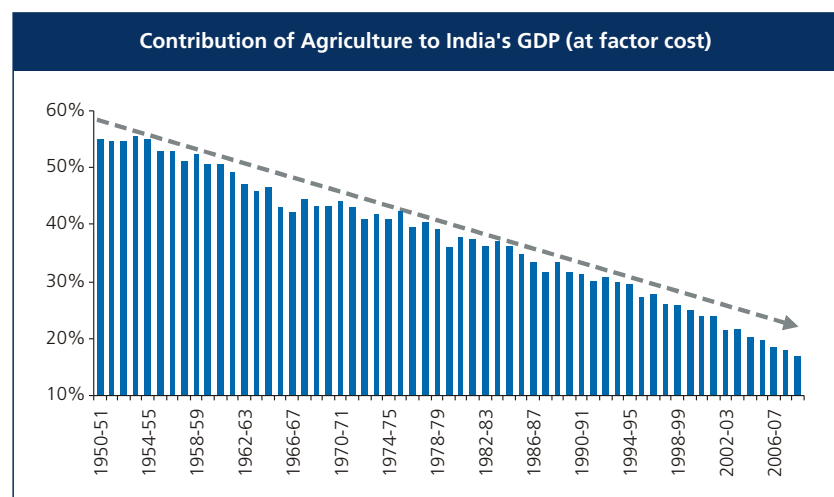
Almost 60% of India's workforce either directly or indirectly depends on agriculture for livelihood

Agriculture sector incurs an estimated annual loss of USD16 bn due to poor infrastructure

Nonetheless, the manufacturing sector, backed by the government stimulus, is showing signs of revival. In order to provide a fillip to the sector, the government lowered the excise duty and service tax by 6% and 2%, respectively, along with a reduction in key interest rates. Furthermore, an increase in exports in November 2009 (for the first time in 14 months) lifted the IIP. India's exports moved up 18.2% to USD13.2bn during the same month. The Markit Economics Purchasing Managers' Index (PMI) climbed to 55.6 in December 2009 from 53 in November 2009, indicating an increase in factory production. Furthermore, the Indian government is expected to introduce a national manufacturing policy by the end of June 2010, which is expected to augment investment in the sector.

Agricultural sector – a long way to go

The Indian economy has transformed from an agriculture-based to a services- and manufacturing-based economy. As a result, the contribution of agriculture to total GDP has decreased from 55.1% in 1950–51 to 17.0% in 2008–09. However, agriculture continues to be a prominent sector as almost 60% of the country's workforce either directly or indirectly depend upon the same for their livelihood.



Source: RBI Handbook of Statistics, Aranca Research

Even after years of technological advancements, the agriculture sector continues to be affected by factors such as lack of infrastructure facilities (like irrigation, food processing and storage) as well as technological hindrances. The sector is estimated to incur an annual loss of over USD16bn (INR76.5 bn) per year due to poor infrastructure facilities. Furthermore, the sector primarily depends on the monsoon rains on account of the lack of adequate irrigational facilities. Scarcity of monsoon rains in 2009 had an adverse impact on the sector's performance. The Department of Agriculture and Cooperation estimates the total area under major Kharif crops to decrease 5.4% year-on-year to 104.2 million hectares in 2009–10, while the Economic Advisory Council estimates the sector to decline 2% during the same period.

In order to enhance the income of rural India and improve food security in the country—along side containing the food price inflation, which has spiralled to double-digits—the government intends to improve the sector's performance. The

11th Five Year Plan aims to boost the agriculture growth to 4%

11th Five Year Plan aims to boost the agriculture growth to 4%

The government aims to award road contracts worth USD20 bn by June 2010

Indian ports are likely to miss their 2012 target of 1.02 tonnes of cargo handling by a huge margin

11th Five Year Plan (2007–2012) aims to accelerate the agricultural growth to 4%. The government's policy initiatives include: (i) a one-time bank loan waiver for over 40 million farmers translating to almost USD14.6bn; (ii) approval of 60 agricultural export zones; and (iii) approval of a 2% interest subsidy on farm loans to fuel the sector's growth. Though the government is focusing on the revival of the agricultural sector, a number of challenges and fundamental constraints need to be addressed before it can witness robust growth relative to the services or manufacturing sectors.

Infrastructure sector – plethora of investment opportunities

Inadequate infrastructure, rapid economic growth and government's increasing focus on infrastructure development has led to several investment opportunities for private and public enterprises. The government has planned an investment of USD500bn over the period 2007–12 for infrastructure development.

India, with the fifth-largest power generation capacity in the world, has one of the lowest per capita consumption worldwide (and half of that in China). Power demand in India continues to outstrip supply. In order to bridge the demand-supply gap, additional 78,000 MW of power capacity is required by 2012. To facilitate the same, the government has permitted 100% FDI in generation, transmission and distribution, income-tax holidays, as well as exempted import duty on capital goods (for mega projects).

Surface transport is another area poised for rapid growth. Despite having the second-largest road network in the world (3.3 million km), India is facing the acute problem of inadequate road network and poor road quality. Although road development faces challenges, such as acquisition of private land, it has not deterred the government from making and implementing ambitious investment plans. From November 2009 until January 2010, the government has awarded contracts worth USD12bn. It has a target of building roads of 7,000 km per year (20 km per day), and plans to award additional contracts worth USD20bn by June 2010. While 100% FDI in road development projects and income-tax benefits are considered to be the key features of these contracts, the National Highway Authority of India (NHAI) provides viability gap funding.

India's aviation sector is poised for a take off. Additional passengers are opting for air transport, driven by rising income, and lower tariffs due to rising competition and changing travel requirements. In 2009, domestic passenger traffic grew 7.9% to 44.5 million. As the year drew to a close, airlines clocked a passenger load factor of 75%. The aviation sector is estimated to require an investment of USD120bn by 2020. To cater to the burgeoning air traffic, India would need: (i) about 1,000 aircraft by 2020; (ii) modernisation and upgrade of airports (USD10bn per annum investment opportunity); (iii) greenfield airport projects (nearly 11); and (iv) investments in maintenance, repair and overhaul capacity.

The infrastructure investment story has its share of hiccups. Due to the credit crisis and dwindling demand for commodities owing to the global recession and sluggish global trade, India is expected to achieve up to 743 million tonnes of cargo handling at major ports by 2012 as against its target of 1.02 billion tonnes. However, as economic recovery is underway throughout the world, investment prospects in ports for a country with 7,517 km of coast line are getting brighter. The

India possesses only 0.5% of the global proved oil reserves

India's power consumption is expected to double from current level of 600 TWh by 2020

National Maritime Development Programme (NMDP) for modernising the port sector includes 276 ports, and 111 shipping and inland projects at a total investment of approximately USD22bn (INR1.0tr) by 2012. These include construction and upgrade of berths, procurement of equipment, and dredging and deepening of approach channels and berth areas.

The Indian rail sector is also changing over to the fast track. It is the second-largest rail network in the world under a single management as well as the second-largest profit making public sector unit. Encouraged by this factor, investments were stepped up as witnessed by the three-fold increase in planned expenditure to USD50bn over the period 2007–12. Investment opportunities primarily exist for laying new tracks, gauge conversion, new rail bogies, safety and signalling systems, IT, and setting up infrastructure facilities at and near railways stations. The rail sector is also pursuing an ambitious plan of a dedicated freight corridor (worth USD90bn) to streamline freight movements across eastern and western corridors, by carrying heavier cargo loads at faster speeds.

Energy security gaining prominence

Ensuring the availability of energy at competitive prices continues to be a key challenge for policymakers in India. As per the BP Statistical Review of the World Energy June 2009, India possesses only 0.5% of the global proved oil reserves, but is the fourth-largest consumer of oil with a 3.4% share in oil consumption worldwide. Oil imports at USD93.2bn alone comprised about 32.4% of total imports in 2008–09. Considering the consumption pattern and availability of energy resources, energy security has emerged as a priority for the government.

India continues to face power shortages as demand for power continuously outpaces growth in power generation capacity. India's per capita electricity consumption increased at a CAGR of 4.4% to 704.2 kilo watt hour (kWh) over the period 2002–03 to 2007–08. As per KPMG estimates, India's power consumption would double from the current level of 600 terawatt hour (TWh) per annum by 2020 primarily due to growing economic activity, and increase in wealth and population as well as infrastructure developments. KPMG also estimates that India would need to increase its generation capacity to 241 giga watt (GW) from the current 156 GW. Furthermore, fuel shortages and other factors, such as lower rainfall adversely impacting hydro power generation, continue to affect India's power generation. As a result, the country's peak power deficit is expected to increase to 12.6% in 2009–10 from 11.9% in 2008–09.

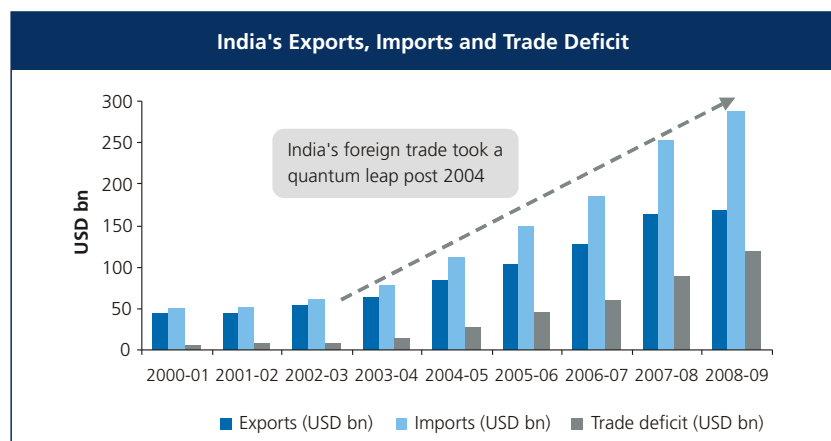
In order to attain energy security, the government undertook several policy initiatives including diversification of the oil and gas supply base, intensification of upstream activities to increase domestic supply of oil, acquisition of a stake in overseas oil fields, focus on renewable sources of energy and adoption of an integrated energy policy in December 2008. India entered into a nuclear deal with the US in October 2008 that enabled it to access high-grade uranium ore, a major roadblock to the development of its indigenous nuclear programme. Moreover, Jawaharlal Nehru National Solar Mission, launched in November 2009, aims to deploy 20,000 MW of solar power by 2022. The National Mission for Enhanced Energy Efficiency aims to reduce India's annual energy usage by 5% by 2015.

India's foreign trade policy (2004-09) boosted trade activity and generated over 14 mn jobs

India's export grew 3.4% in 2008-09 compared to 25% in earlier years due to decline in global trade

Foreign Trade – a special policy focus to boost trade

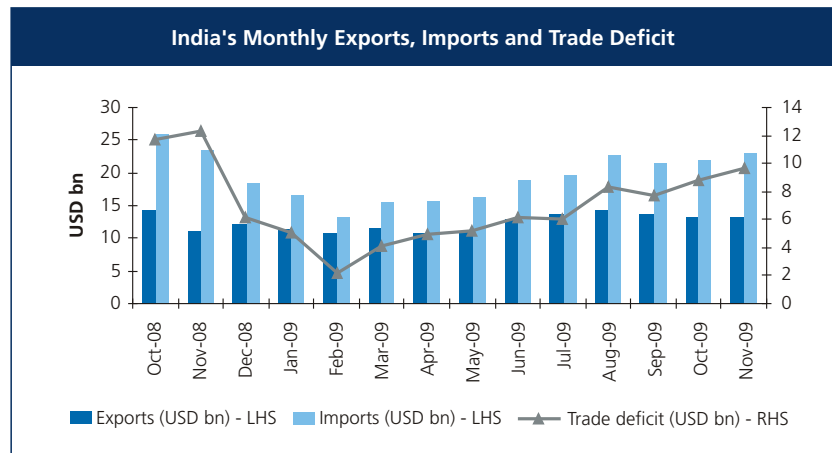
Foreign trade in India was plagued by strict bureaucratic controls in the pre-liberalisation era. The Government of India's Statement on Trade Policy in Parliament in August 1991 marked the beginning of a new era in the country's foreign trade policy; thus, the focus shifted to promotion and development of foreign trade from controls and regulations. The Indian Foreign Trade Policy (2004–09) led to a surge in trade activity and generated over 14 million jobs during 2004–09. India's exports increased to USD168.7bn in 2008–09 from USD63.8bn in 2003–04 led by policy initiatives. As per World Trade Organisation (WTO) data, the country's share in the global merchandise trade expanded to 1.45% in 2008 from 0.83% in 2003. Growth in imports outpaced that in exports and further widened the trade deficit. India's imports increased to USD287.8bn in 2008–09 from USD78.1bn in 2003–04. Consequently, the country's trade deficit rose to USD119.1bn from USD14.3bn during the same period.



However, the economic crisis had an adverse impact on foreign trade in 2009. While the WTO estimates global foreign trade volumes to have declined 9%, IMF estimated a fall of 11% during the same period. In line with the decline in global trade, the growth rate in exports slowed down to 3.4% in 2008–09 from an average growth rate of 24.6% over the period 2002–03 to 2007–08. India's monthly exports continued to fall on a year-on-year basis (during October 2008 to October 2009) due to weakness in global economies. Nonetheless, with the global recovery setting in and major developed nations emerging out of the recession coupled with stimulus to boost exports, India's exports reversed 13 months of decline and grew 18.2% year-on-year to USD13.2bn in November 2009. Furthermore, India's exports rose to USD14.6bn, a 15-month high, in December 2009 due to growing demand from developed nations, primarily due to festivities. Additionally, lower oil prices kept India's imports flat compared to 2008 levels. Consequently, the trade deficit lowered to USD9.7 bn in November 2009 compared to USD12.3 bn in November 2008.

FTP 2009-14 aims to increase India's exports to USD200 bn by March-2011

Stimulus package likely to widen India's fiscal deficit to 6.8% in 2009-10



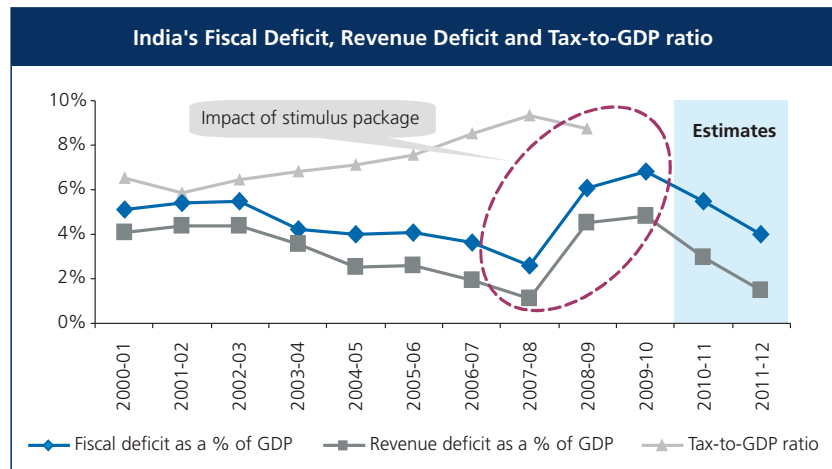
Source: Bloomberg, Aranca Research

In order to further strengthen its foreign trade, India in its Foreign Trade Policy 2009-14 (FTP 2009-14) has taken several policy initiatives. The FTP 2009-14 aims to improve the infrastructure related to exports, reduce transaction costs and refund indirect taxes and levies. The policy targets an annual growth of 15% in total exports and expects to increase them to USD200 bn by March-2011. Further, the plan targets a growth rate of 25% in the country's exports during March-11 to March-14 and aims to double the country's export of goods and services. In line with its targets under the plan, the government has agreed to extended Duty Entitlement Pass Book (DEPB) scheme till December 2010, income tax benefits under Section 10(A) for IT industry and under Section 10(B) for 100% export oriented units by one more year till March 2011 among others. Additionally, India plans to reduce its dependence on the US and Europe, which account for over 40% of its exports, and inked trade agreements with South Korea and Association of Southeast Asian Nations (ASEAN) in August 2009. These agreements are likely to facilitate trade between India and member countries.

Fiscal Deficit – stimulus package to widen deficit in 2009–10

India has successfully reduced its fiscal deficit by introducing the Fiscal Responsibility & Budget Management Act (FRBM) in 2004. While fiscal deficit declined to 2.6% of GDP in 2007–08, revenue deficit stood at 1.1% during the same period. The tax-to-GDP ratio, which increased to 9.3% in 2007–08 from 5.9% in 2001–02, led to the fall in fiscal deficit. The FRBM, which entailed elimination of revenue deficit and reduction of fiscal deficit to 3% of GDP by 2009, appeared to be on course, until derailed by the economic crisis. In order to stimulate growth, the government announced tax incentives; as a result, the tax-to-GDP ratio declined to 8.8% in 2008–09, while the revenue deficit surged to 4.5%. Furthermore, the government increased its spending during 2008–09 to augment demand. Consequently, the country's fiscal deficit moved up to 6.1% of GDP in 2008–09. Higher government spending coupled with the stimulus package could raise the fiscal deficit to 6.8% in 2009–10.

With improvement in global economic condition, India's fiscal deficit is expected to reduce drastically

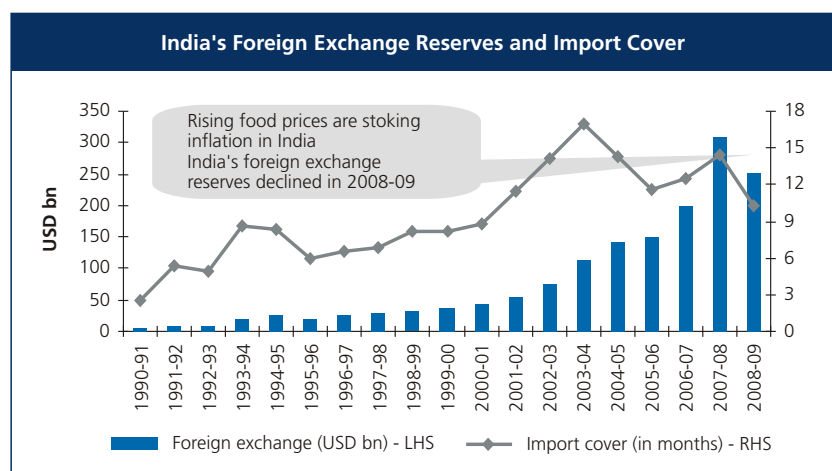


Source: RBI Handbook of Statistics 2008-09, News Articles, Aranca Research

With the sustenance of economic recovery, the government is expected to withdraw the stimulus package and the FRBM is expected to be on track. The government aims to reduce the fiscal deficit to 5.5% and 4.0% of GDP in 2010–11 and 2011–12, respectively. Furthermore, the revenue deficit is estimated to be 3.0% and 1.5%, respectively, during the same period.

Forex reserves continue to rise

India has come a long way in the last two decades—from the verge of a default in 1991 (the country was forced to utilise its gold holdings to secure a loan in order to pay its international debt) to a global financial powerhouse in 2010. The open door policy marked the beginning of growth in the Indian economy. The country's foreign exchange reserves increased from USD5.8bn in 1990–91 to USD252.0bn in 2008–09. Furthermore, the import cover moved up from 2.5 months in 1990–91 to 10.3 months in 2008–09.

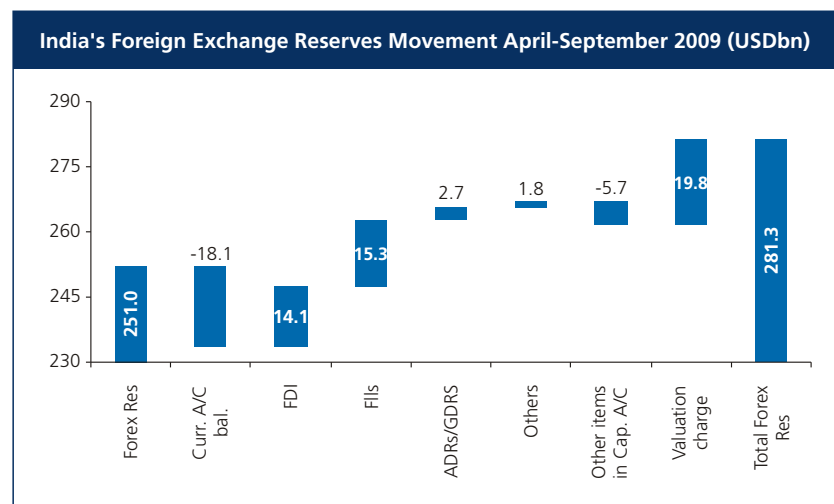


Source: RBI Handbook of Statistics 2008-09

Higher foreign investments and valuation gains boosted India's foreign exchange reserves by USD29.3 bn

India bought 200 tonnes of gold from IMF to diversify its reserves away from weakening US dollar

India continues to record impressive growth in foreign exchange. Foreign exchange reserves rose by USD29.3bn during April to September 2009 due to higher foreign investments and valuation gains. The country has attracted significant foreign investments on account of its spectacular performance, especially during the global economic slowdown. During April to September 2009, foreign investment in India stood at USD32.1bn, of which FDI and portfolio investments comprised USD14.1bn and USD17.9bn, respectively. Valuation gains due to depreciation of the US dollar vis-à-vis other currencies added USD19.8bn to the country's reserves during the same period. Furthermore, IMF's additional allocation of Special Drawing Rights (SDRs) in two tranches increased the total foreign exchange reserves by USD5.2bn.



Source: RBI Handbook of Statistics 2008-09, RBI Bulletin January 2010, Aranca Research

Further, foreign exchange reserves increased to USD283.5 bn in January 2010. India's impressive growth coupled with policy initiatives are leading to a surge in capital inflows. However, huge capital inflows coupled with low interest rate scenario in the US are resulting in strengthening of the rupee against the US dollar. India rupee appreciated 6.0% against the US dollar in 2009. Appreciation of rupee against the US dollar erodes the value of India's reserves as majority of India's reserves are held in dollar denominated assets. In order to diversify its reserves from the weakening US dollar, India in November 2009 purchased 200 metric tonnes of gold from the IMF for USD6.7 bn, which is estimated to have boosted the proportion of gold to its total reserves to almost 6% from 4% earlier.

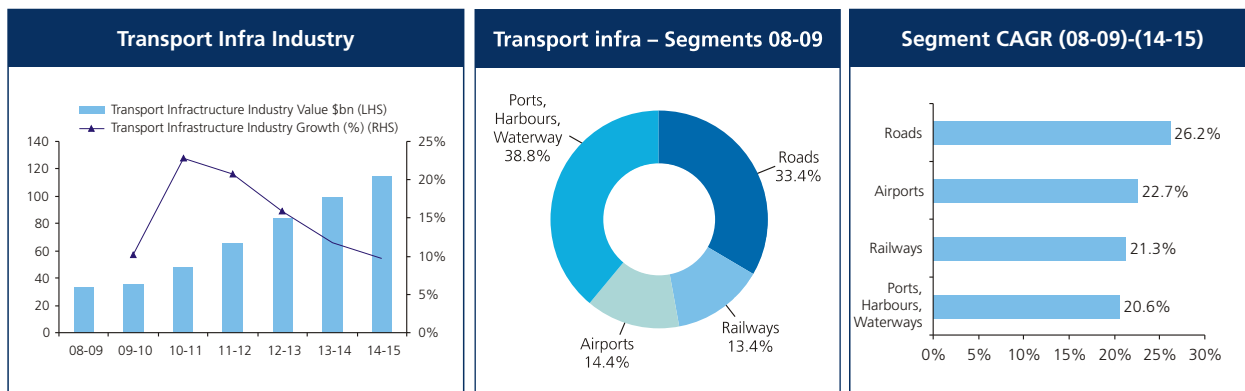
The US dollar is expected to slump further in 2010 against major currencies due to grim US economic outlook and loose monetary policy. JP Morgan Chase expects US dollar to fall to a record low in 2010 as the US Fed is likely to keep the interest rates to near zero until 2011. Further, it expects that countries will try to diversify their reserve holdings away from dollar, which will aggravate the situation. With the US dollar expected to weaken further, policymakers in India are likely to diversify their reserve holdings away from the US dollar in 2010.

Infrastructure Sector

BMI estimates India's transport infrastructure industry at USD 33.2bn in 2008-09

Business Monitor International (BMI) broadly classifies the India Infrastructure sector into two: a) transport and b) Energy and Utilities. Since we are discussing the power and energy sectors in separate sections, this section will focus on the transport infrastructure segment. We will also discuss a related segment, 'telecom infrastructure', given the high investor interest in that space as India's telecom market booms.

The Indian Transport Infrastructure industry was pegged at USD 33.2bn in 2008-09 by BMI. The major Industry segments are Roads, Railways, Airports and Ports & Waterways. With all segments expected to grow at a CAGR of over 20% between 2008-09 and 2014-15, we estimate the overall transport infrastructure industry to expand at a CAGR of 23% to USD 114.9 bn.



Source: BMI India Infrastructure Report Q1 2010

Indian government plans to award contracts worth USD 20bn by June 2010

Roads: Despite having the second-largest road network in the world (3.3 million km), India is faced with the acute problem of inadequate road network and poor road quality. From November 2009 until January 2010, the government has awarded contracts worth USD 12bn. It has a target of building 7,000 km per year (20 km per day) of roads, and plans to award additional contracts worth USD 20bn by June 2010. According to IBEF and industry sources, the country's road sector would require an investment of USD 80bn in the next 3-4 years, of which USD 45bn is anticipated from the private sector.

Railways: The Indian Government stepped up its investments in the sector as reflected in the three-fold increase in planned expenditure to USD 50bn over 2007–12. Investment opportunities primarily exist for laying new tracks, gauge conversion, new rail bogies, safety and signalling systems, IT, and setting up infrastructure facilities at and near railways stations.

Airports: In 2009, domestic passenger traffic grew 7.9% to 44.5 million. Domestic and international passenger volumes are estimated to expand at a CAGR of 18% and 14%, respectively, between 2008–2009 and 2016–17. To cater to the burgeoning air traffic, India would need to modernise and upgrade airports, presenting an estimated USD 10bn a year investment opportunity. Investment plans also include setting up Greenfield airports (nearly 11), and maintenance, repair and capacity overhaul projects.

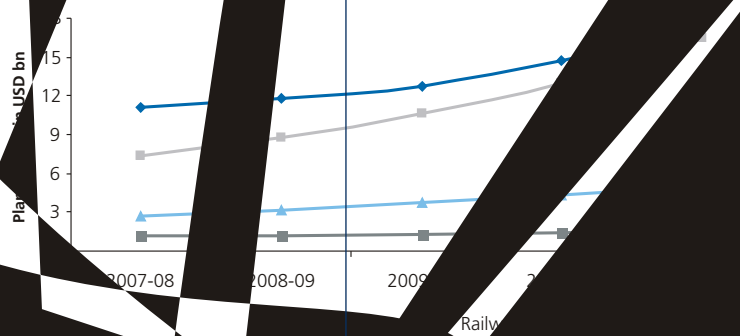
Ports: In 2008-09, cargo traffic at major ports increased to 530.4 million tonnes (MT) from 519.24 (MT) of cargo in 2007-08¹. The ongoing global economic recovery also brightens the prospect of greater investment in ports. The National

Domestic & international passenger volumes estimated to grow at a CAGR of 18% and 14%, respectively, between 2008–2009 and 2016–17

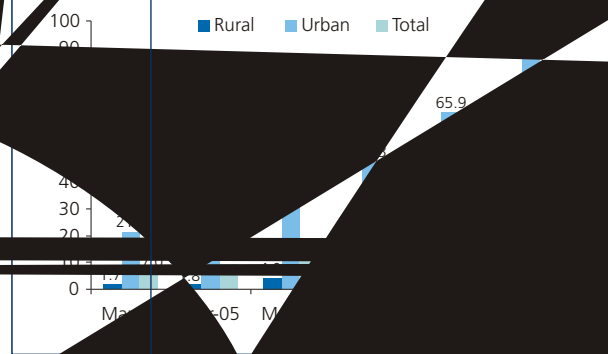
Infrastructure

Maritime Investment Programme (NMDP) for modernising the port infrastructure, including 117 shipping and inland projects at a total investment of approximately USD 22bn by 2012. These include construction and upgrade of berths, replacement of equipment, and dredging and deepening of channels and berth areas.

Projected 11th Five Year Plan expenditure on Transport



India Teledensity – Urban and Rural



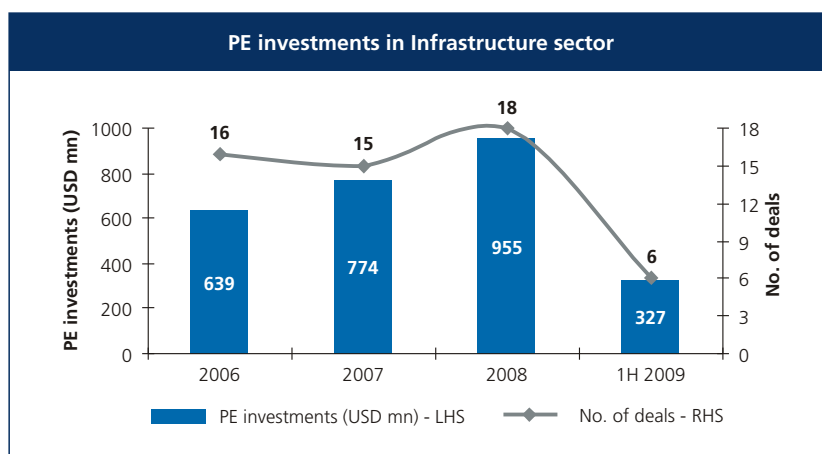
in urban and rural tele-density, we

among PE...
 compared to USD 955 mn (18 deals) in...
 2007³. Nevertheless, we expect PE investments

PE investments in the infrastructure sector likely to revive

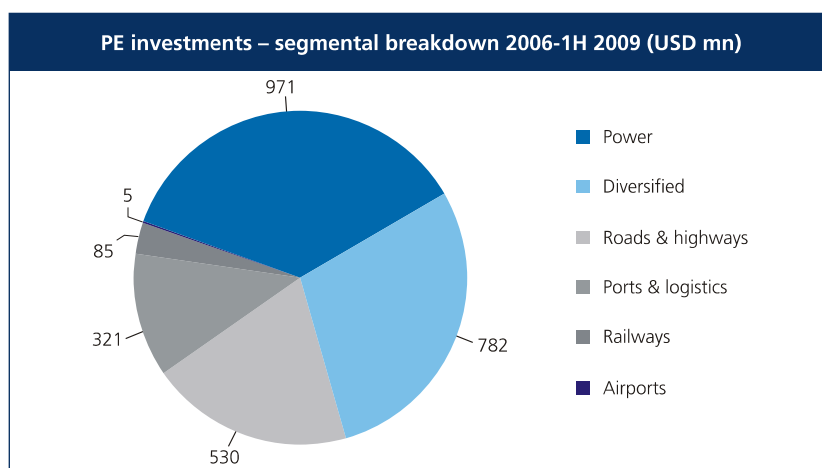
Power sector attracted 36% of the total PE investments in the infrastructure sector

in the sector to increase in the near-to-medium term, led by the renewed buoyancy in the global macro economic environment and revival of investor sentiment. In April 2009, State Bank of India (SBI) and Macquarie Capital launched an USD 1bn infrastructure fund – Macquarie-SBI Infrastructure Fund – with plans to increase the fund's corpus to over USD 2-3bn. Furthermore, according to the data released by Perqin, a UK based PE research firm, of the total USD 1.8bn funds in the process of being raised as on 30 September 2009, USD 1.5bn was by India dedicated infrastructure funds.



Source: Ernst & Young

According to Ernst & Young data, based on total amount raised, the Power sector attracted a majority of the PE funds in the infrastructure space from 2006 to the first half of the calendar year 2009, followed by diversified infrastructure projects. Of the total number of deals recorded during the period, diversified infrastructure projects accounted for 18, roads and highways, and power 15 and 14, respectively.



Source: Ernst & Young

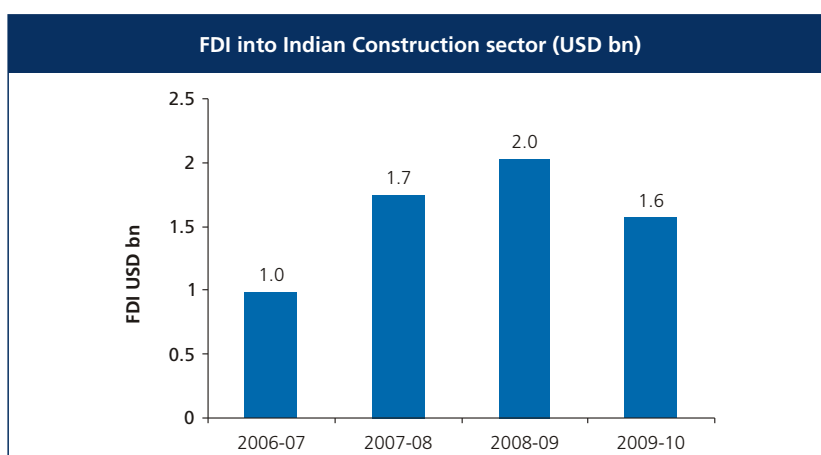
Growth drivers:

- Strong economic growth** – Clearly, the most important factor influencing growth of the infrastructure sector is India's economic ascendancy. Across both services and manufacturing, robust domestic and export demand implies a need for upgrading infrastructure across the country.

Cumulative FDI in the construction sector between April 2000 and October 2009 totalled USD 6.7 bn

Outstanding lending to infrastructure increased from USD 30.7bn in 2007 (March ending) to USD 57.8bn by 2009

- Govt initiatives including FDI** – The Indian government has launched initiatives to mobilise resources for infrastructure development and overcome fund deficit. It opened most infrastructure sectors to FDI and granted tax holidays to companies. The government is also encouraging PPPs in development projects. These government initiatives are likely to boost growth in the infrastructure sector. According to DIPP data, cumulative FDI in the construction sector between April 2000 and October 2009 totalled USD 6.7bn.



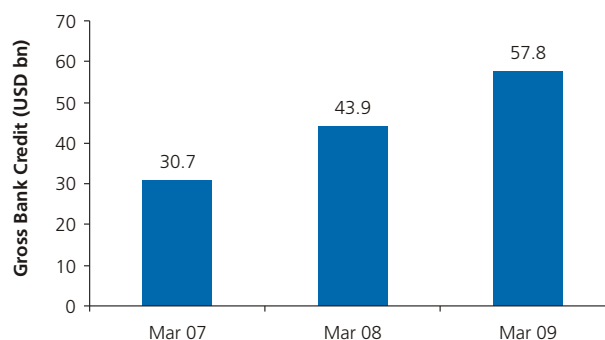
Source: FIPB Note: 2009-10 is April to Oct 2009

The government also announced that state-owned Indian Infrastructure Finance Co. (IIFC) will increase its lending to the commercial banking sector, which, in turn, is expected to pass on the extra liquidity to the private sector. In addition, IIFC will guarantee to refinance 60% of total commercial bank loans for PPP projects over the next 15 to 18 months.

- Increased lending to sector by banks** – To increase credit to infrastructure lending, Reserve Bank of India (RBI) has initiated a number of measures, such as allowing banks to enter take-out financing arrangements, issue long-term bonds for funding infrastructure projects, relax single and group borrower limits for additional credit exposure in the infrastructure sector, and invest in unrated infrastructure bonds within the ceiling of 10% for unlisted non-Statutory Liquidity Ratio securities. These measures have helped in increasing infrastructure lending in India. According to RBI data, banks' outstanding lending to infrastructure increased from USD 30.7bn in 2007 (March ending) to USD 57.8bn by 2009.

By 2012, the Indian government is targeting total investments of USD 150bn by private sector

Gross Bank Credit - Infrastructure sector outstanding (USD bn)

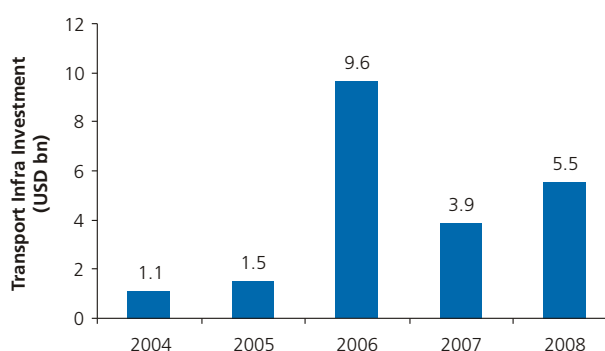


Source: RBI

To help infrastructure firms meet their massive fund requirements, RBI, in October 2009, also created a new non-banking finance company category. The new category would help NBFCs raise more money from overseas markets, as the Government has raised the cap to USD 500mn from USD 100mn under the approval route. This could lower the lending rate for the sector.

- Increased private sector participation** – To tap the growth opportunities, major companies have increased their infrastructure investments in India. World Bank data estimated cumulative private sector investment in India's transport sector at USD 21.7bn. According to the report by PricewaterhouseCoopers (PWC), by 2012, the Indian government is targeting total investments of USD 150bn by private sector. This is likely to be a key growth driver for the sector in the medium-to-long term.

Private sector investment in India Transport infra sector (USD)



Source: Worldbank

Key challenges:

- Long gestation period and high value of investment** – Projects in the infrastructure sector are characterised by a long gestation period and high value of investments. Hence, systemic or other delays could adversely affect return on investments.

- **Underdeveloped bond market** – Although the government has announced its intention to harness investments through insurance and pension funds, the performance of the bond market would have a direct impact on its efforts. In India, the bond market is not as established as the equity market and would need to be significantly revamped to support the government's long-term plans.
- **User charges** – Improper and ineffective levy of user charges due to political pressure results in longer recovery periods. This deters investors from investing in infrastructure projects.
- **Improper implementation** – Although the government has allowed private companies to participate in containerised goods transport, the Department of Industrial Policy and Promotion states that railways is a public sector entity and amendments are required to facilitate private sector participation. Concerns related to inefficiency might act as deterrents to growth.

Major companies

An overview of the Indian Transport Infrastructure sector with the major companies is detailed in the chart below. Government's open policies on FDI, state funding, and RBI's favourable guidelines on infrastructure lending have resulted in domestic infrastructure players aggressively venturing into the Roads, Airports and Ports segments. PE investors have shown interest in infrastructure players with diversified project portfolio. The segment attracted about 29% (USD 782mn) during 2006-H1 2009.

Recent Deals in the Infrastructure sector			
Company	Key Segment	Investor	Deal Value
Ashoka BuildCon	Infrastructure	IDFC PE	USD 50mn
GKC Projects	Infrastructure	Franklin Templeton PE	USD 13mn
IRB Infrastructure Developers	Infrastructure (Roads)	IPO	USD 240mn
Gammon Infrastructure Projects	Infrastructure	IPO	USD 68.52
Futura Infraprojects	Infrastructure	Frontline Ventures	USD 40 mn
Totem Infrasturcture	Infrastructure	Aquarius Investment	USD 7.5 mn
IL&FS Transportation Networks	Infrastructure	Goldman Sachs	5.13% stake
Ramky Infrastructure	Infrastructure	IL&FS Investment	USD 40 mn

Source: Vccircle, News articles

India Transport Infrastructure – Opportunity and Major players				
Market Segment	Roads	Railways	Airports	Ports & Waterways
Segment share	33% share	13% share	14% share	39% share
Market opportunity	USD11.1bn sector in 2008-09E. Expected 26% CAGR to USD44.8bn by 2014-15	USD4.5bn sector in 2008-09E. Expected 21% CAGR to USD14.2bn by 2014-15	USD4.8n sector in 2008-09E. Expected 23% CAGR to USD16.2bn by 2014-15	USD12.9n sector in 2008-09E. Expected 21% CAGR to USD39.7bn by 2014-15
Key Drivers	<p>Freight: 65% of total cargo carried by road in 2008</p> <p>Increasing car ownership: Est 6.7% of population owns car in 2009. This to reach 11.1% by 2014</p> <p>USD 80 bn investment expected in road network over next 3-4 years</p>	<p>Railway passengers estimated to grow from 6524 bn in 2009 to 15180 by 2020E at a CAGR of 8%</p> <p>Freight Tonnage expected to grow from 833 mm in 2009 to 1850 mm by 2020 at a CAGR of 7.5%</p>	<p>Domestic and international passenger volumes are estimated to expand at a CAGR of 18% and 14%, respectively, between 2008-2009 and 2016-17E</p> <p>Modernization Programs of AAI</p>	<p>As foreign trade expands, India's ports are likely to increase cargo handling capacity to 1,855 MT by 2012 from the present 758 MT, with an investment of about US\$ 20.61 bn</p> <p>India emerging as a major destination for container operations</p>
Major players	GMR Group, Gammon Infrastructure, IJM (India), PBA Infrastructure, Sadbhav Engineering, Hindustan Construction, Soma Enterprise etc	Indian Railways, DMRC, Reliance Infrastructure, SNC-Lavalin, SMB construction companies such as Era Infra and J Kumar etc	GMR Group, GVK Group, Punj Lloyd, IRB Infrastructure Developers, Consolidated Construction Consortium etc	Tata Steel, Larsen & Toubro, Essar Shipping Ports and Logistics, Mundra Port, Total Group, Lanco Infratech, FS Maritime Infra Co, Navayunga Group etc

Source: Aranca Research, Cushman & Wakefield

Outlook:

Infrastructure investment in India is set to grow significantly. The country has become a major outbound investor and Indians are being lured by other countries to seek investment opportunities there. Investment banking company Goldman Sachs estimates the Indian infrastructure sector's investment requirement over the next 10 years at USD 1.7tn. It adds that more investments would come from the domestic market than overseas. Recognising the need of a well developed infrastructure for achieving robust economic growth, the government has unveiled a USD 320bn investment plan for upgrading ports, railroads, highways and airports over the next 15 years. Liberalised FDI norms and tax holidays, coupled with banks' increasing willingness to lend to the infrastructure sector, have accelerated private participation in the sector. While an undeveloped bond market and improper levy of user charges are impediments to growth in the sector, progressive action can be expected in light of increasing investor interest in the sector. Consequently, it is estimated that India's transport infrastructure industry to expand at a CAGR of 23% to USD 114.9bn by 2014-15.

¹ Indian brand equity foundation report on Ports. Jan 2010

² Telecom Regulatory Authority of India (TRAI) Annual report 2009.

³ VC Circle, Business news article

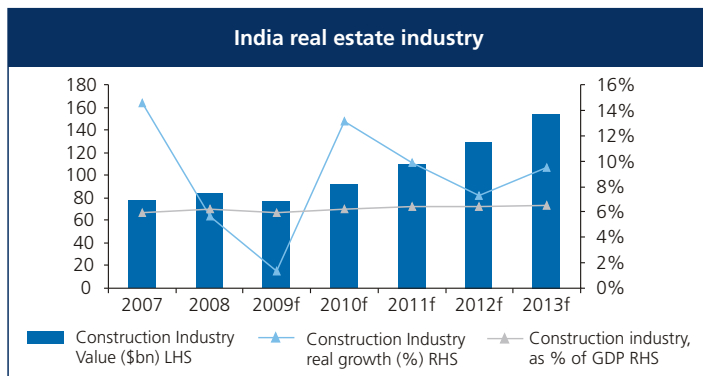
Real Estate Industry

Strong economic growth to lead real estate sector on the path to recovery

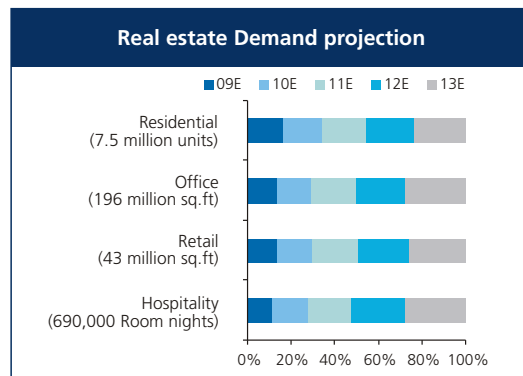
Private estimates put the value of the real estate industry at \$57bn in 2007, rising to \$105bn by 2012 at a CAGR of 13%

The Indian real estate sector experienced a slowdown in 2008-09 as consumer and business confidence fell due to the global economic downturn. Lack of bank liquidity severely impacted ongoing projects. However, strong economic fundamentals and GDP growth of over 7% in the future is expected to lead the sector on the path to recovery.

Real estate demand can be broadly divided into a) residential b) office premises c) retail demand and d) hotels & hospitality demand. As per the BMI India Real Estate Report Q1 2010, the construction industry in India, which was estimated at \$76.5bn in 2009, is expected to increase to \$154.2bn by 2013 at a CAGR of 19%. While BMI's construction industry statistics include estimates for industrial construction, we have used these statistics as a proxy for the real estate sector. An estimate by Singularity Advisors has put the size of the Indian real estate market at \$57bn in 2007 and projected growth to \$105bn by 2012. While the precise composition of the industry value among the four segments are unavailable, industry experts point that approximately 74% share can be attributed to the residential segment.



Source: BMI India Real estate report Q1 2010

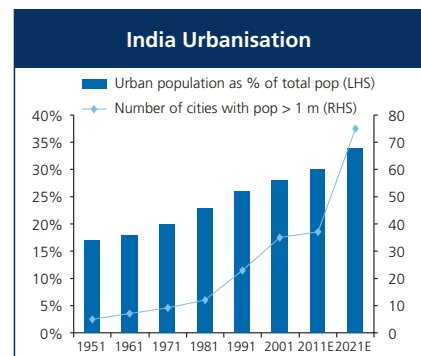
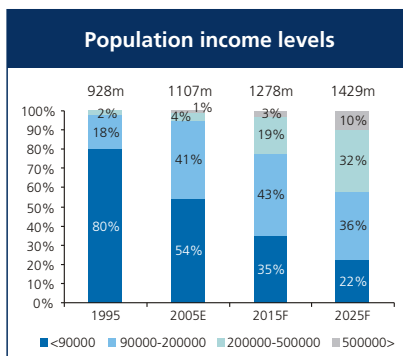
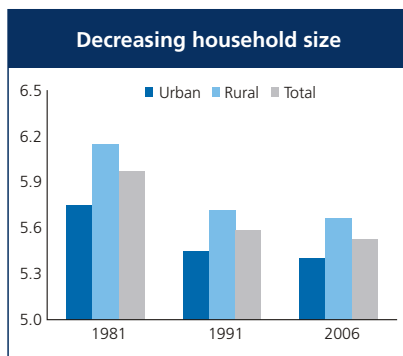


Source: Cushman & Wakefield

According to Cushman & Wakefield, the pan-India commercial office space demand during 2009–2013 stands at approximately 196 million sq.ft, while retail space demand for the same period is estimated at 43 million sq.ft. Demand for hospitality segment is expected to be more than 690,000 room nights, while that of the residential segment to be over 7.5 million units.

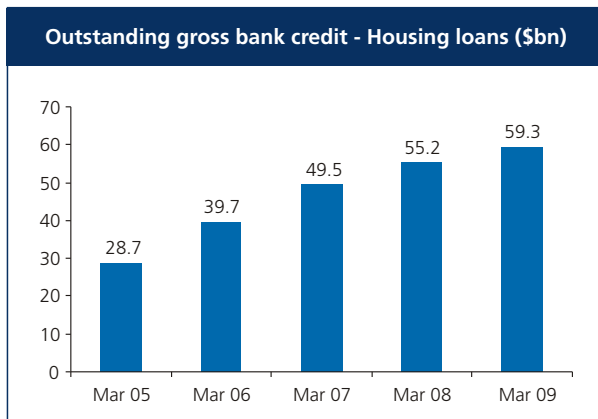
Growth drivers

- **Favourable demographic trends helping demand:** Smaller family sizes, rising income levels and trends witnessed in greater

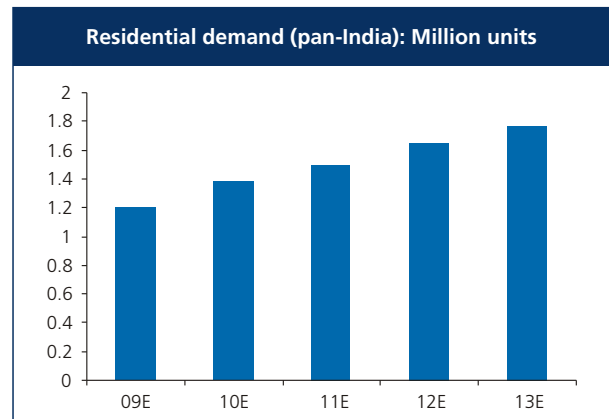


Source: Moody's and ICRA, Mckinsey, Statistical Outline of India

urbanisation has set the pace for residential housing demand. The increase in consumer credit is also expected to aid residential demand. As per RBI the outstanding gross bank credit for personal housing loans touched USD 59.3bn on March 09 growing at a CAGR of 20% between 2005 and 2009.



Source: RBI



Source: Cushman & Wakefield

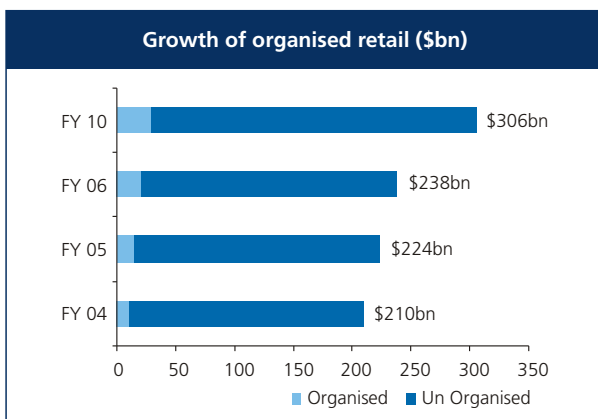
Decreasing household size, increasing income levels and growth in home finance to aid residential real estate growth

Shift towards organised retail and open FDI policies to generate demand for commercial retail space

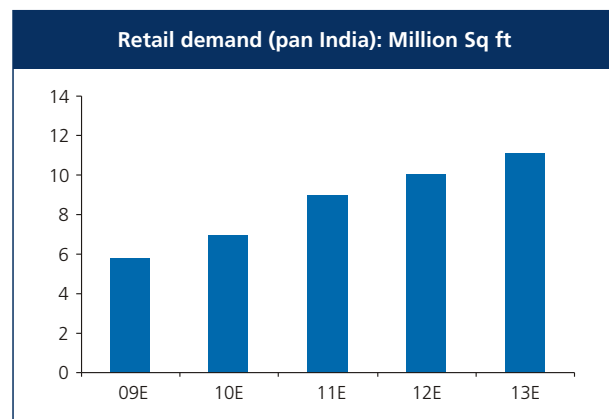
According to Cushman & Wakefield, pan-India residential demand is estimated at 7.5 million units between 09E and 13E, out of which about 60% is expected in the top seven cities (Bangalore, Chennai, Hyderabad, Kolkata, Mumbai, NCR and Pune). The tier 1 cities of Bangalore, Mumbai and NCR alone are expected to account for 43% of the total pan-India demand.

- Growth in organised retail:** The industry was estimated at about USD240bn in 2007-2008 growing at over 6–7% annually. Organised retailing accounts for a small but fast-growing share of the total industry; its share has more than doubled from 2% in FY2003 to 4.4% (USD10.5bn) in FY2006.

Market estimates put the growth of organised retail in the range of 25–30% annually. Moreover, several policy initiatives (51% FDI in single brand retailing and ongoing policy debate to allow 100%) hold a lot of promise for the Indian retail sector. Several national and international corporates have either forayed into the retail segment or firmed up plans to enter the retail segment.



Source: IBEF

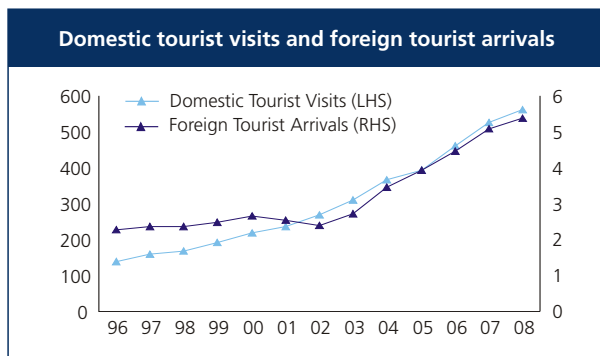


Source: Cushman & Wakefield

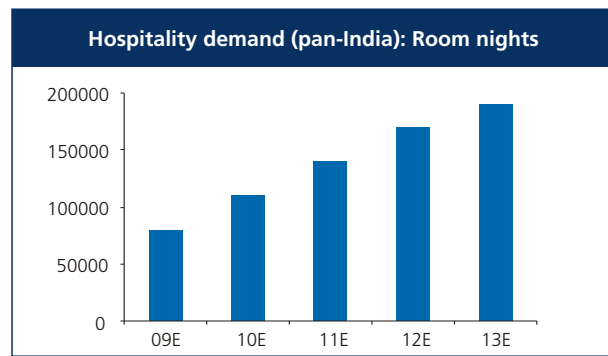
Growth in leisure and business travel expected to create demand for hotel rooms in the hospitality sector

Cumulative retail demand across India is estimated to be 43 million sq.ft. by 2013, out of which demand in the top seven cities is expected to be nearly 34.6 million sq.ft. Demand is expected to be concentrated in tier 1 cities, constituting nearly 46% of the total estimated pan-India demand during the period under consideration.

- Growth in leisure and business travel helps increase demand for hotel rooms:** As per the Ministry of Tourism statistic, domestic tourist visits increased at a CAGR of 12% to 563 million and foreign tourist arrivals rose at a CAGR of 9% to 5.4 million between 2000 and 2008. With India's GDP expected to increase over 7% in the next few years, business travel is likely to register strong growth. According to Cushman & Wakefield, buoyancy in the travel segment is expected to boost the pan-India accommodated demand for the hospitality sector to more than 690,000 room nights by 2013.



Source: Ministry of Tourism

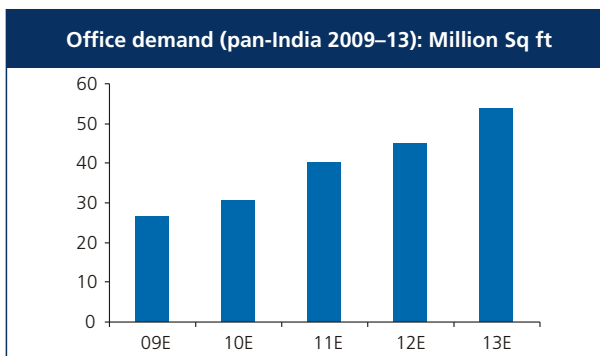


Source: Cushman & Wakefield

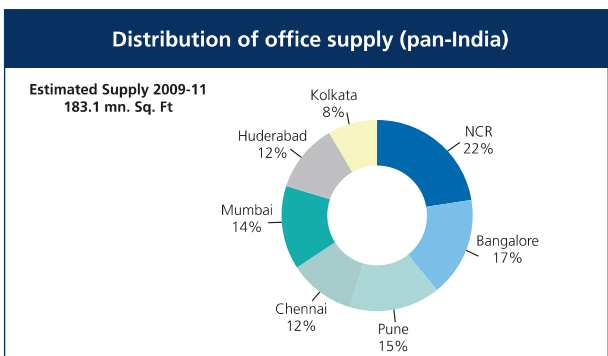
Strong domestic growth from IT/ITES, BFSI, Telecom and Pharma sectors to assist demand for commercial office space

Of the total demand, NCR is expected to constitute 15% of demand owing to Commonwealth Games. Tier 2 and 3 cities are also likely to generate demand for 242,000 room nights by 2013 due to various initiatives taken by the Indian government to promote commercial and tourism activity in these locations.

- Growth in core sectors like IT/ITES driving commercial real estate:** With the economy estimated to grow over 7% in the near future, robust demand for office space is expected from companies, particularly in the IT/ITeS, BFSI, Telecom and Pharma sectors. According to E&Y estimates, in the year 2006 total supply of commercial office space (grade A, non-captive) in National Capital Region (NCR), Mumbai, Hyderabad, Bengaluru, Pune and Chennai together was recorded in the range of 40–45 million sq. ft. The absorption was primarily driven by the IT/ITES industry, which accounted for almost 70–75% of total absorption.



Source: Cushman & Wakefield



Source: Knight Frank

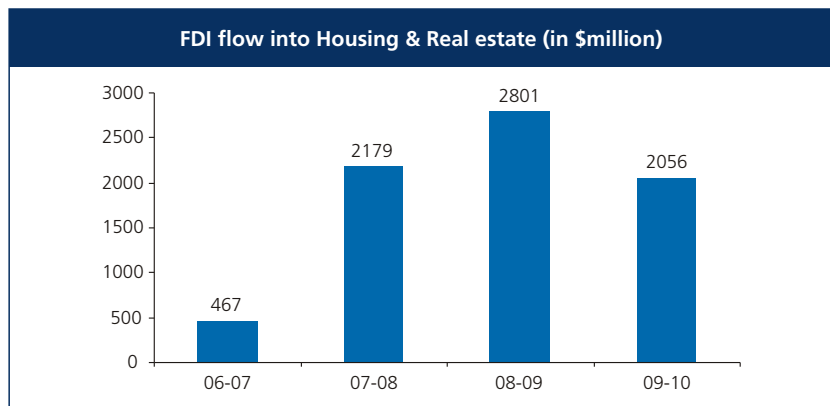
However, with supply expected to exceed demand by a wide margin, we expect instability in office rentals

Government's open FDI policy has led to inflows of USD7.6bn into the Indian real estate sector between April 2000 and October 2009

Archaic laws have spiked land costs

According to Cushman & Wakefield, cumulative office space demand between 2009 and 2011 is estimated at approximately 97 million sq.ft. However, Knight Frank expects cumulative supply of 183 million sq.ft. in the same period. We believe this will lead to instability in rentals during the period.

- FDI and other supportive government policies:** The government currently allows 100% FDI for townships, housing and construction development projects (including commercial premises, hotels, resorts, hospitals, educational institutions, etc.), subject to certain guidelines. This coupled with buoyant demand for residential and commercial real estate has facilitated strong FDI inflows into the real estate sector. Between April 2000 and October 2009, FDI of \$7.6bn flowed into the Indian real estate sector.



Source: Dept of Industrial Policy & Promotion. * 09-10 is April 09 to Oct 09

The stimulus package unveiled by the government in the latter half of 2008-2009 benefited the real estate sector as financing through ECBs in residential segment was allowed. This brought more liquidity into the hands of domestic real estate developers.

Key challenges

- Archaic laws on land and rent control:** The Urban Land Ceiling Act was enacted in 1976 primarily with the objective of preventing land hoarding by developers. This legislation fixed a ceiling on the vacant urban land that a person or an association in urban agglomerations can acquire and hold with the ceiling limit ranging between 500 to 2,000 sq.m. This limited the supply of land with private developers and led to a spike in land cost. While this Act has been repealed in many states, Andhra Pradesh, Assam, Bihar, Orissa and West Bengal have not adopted the repeal.

The Rent Control Act governs the payment of fair rent to landlords and protects tenants against eviction, but sometimes effectively allows tenants to retain rented property. Various states and Union Territories have formulated their own rent control legislation with regards to regulating chargeable rents, recovery and possession of property, and tenancy rights. These laws act as disincentives towards investment in housing infrastructure.

- High levies by the government:** Stamp duty needs to be paid on all documents that are registered and the rate varies from state to state. With stamp duty rates of 13% in Delhi, 14.5% in Uttar Pradesh and 12.5% in

India has one of the highest levels of stamp duty

Transparency regarding property titles hampering real estate development

Haryana, India has perhaps one of the highest levels of stamp duty. Some states even have double stamp incidence, first on land and then on its development. In contrast, the maximum rate levied in most developed markets is in the range of 1–2%. The taskforce appointed by the 13th Finance Commission has recommended that the real estate sector should be integrated into the GST framework by subsuming the stamp duty on immovable property levied by the states. While it is currently unclear as to how this will impact the real estate industry, it is widely expected to reduce the property levies.

- **Transparency regarding property titles:** Another important issue in real estate development is that of title to property. In India, the State does not certify a title to housing or land property. Revenue records do not represent documents of title, and ownership is established only by the sequence of earlier transfers. Thus, the fundamental question of title has often led to enormous litigation. The system, as it exists, imposes a responsibility on the part of the purchaser with regard to the inspection of the title. The result is tenuous titles to land and non-transparency in property transactions which hampers large-scale real estate development.

Major companies

An overview of the Indian real estate sector with the major companies is detailed in the chart below. Buoyed by the government's open policies on FDI and external borrowings, domestic developers have used bank credit, public markets (India and abroad) and private equity to fund new projects.

India real estate – Opportunity and Major players				
Market Segment	Residential	Office	Retail	Hospitality
Forecast demand between 2009 and 2013	7.5 million units between 2009 and 2013	196 million sq. ft. between 2009 and 2013	43 million sq. ft. between 2009 and 2013	690,000 room nights between 2009 and 2013
Drivers	Favourable demographic trend : decreasing household size and increasing income levels and urbanisation	Expected growth in IT/ITES, BFSI, Telecom and Pharma sectors to drive demand for office space	To benefit from growth of organized retail in the country	Growth in tourist and business travel to drive demand for hotel rooms
Domestic listed players	DLF, Unitech, HDIL, Indiabulls Real Estate, Omaxe, Sobha Developers, Puravankara, Parsvnath, Akruiti Nirman, Hiranandani Constructions (AIM), Ishaan Real Estate (AIM)			
Domestic un-listed players	Runwal, K Raheja, Mantri, Shapoorji Pallonji, Evershine, Kalpataru, Lokhandwala, Nitesh Estates etc			
Foreign players	Emaar Group (Dubai), Nakeel Group (Dubai), Keppel Land (Singapore), Salim Group (Indonesia), Lee Kim Tah Holdings, IJM Berhad (Malaysia) etc			
Real estate funds	Blackstone, Xander, Morgan Stanley, Sun-Apollo, Trikona Capital, Texas Pacific Group, DE Shaw, Mirae, KKR, Prudential, Fidelity, HSBC, Syphony Capital etc			

Source: Aranca Research, Cushman & Wakefield

The details of select PE deals that have happened in the sector between 2007 and 2009 are given in the table below

Private Equity participation in Real Estate sector		
Company	PE Fund	Details
2007		
B Seenaiah & Co.	L&T, IDFC, Amansa Capital	Picked up a 7% stake for USD 33mn
Sunteck Realty	Kotak Realty Fund	Approx USD 31mn for 11% stake
Nagarjuna Construction	Blackstone	Invested USD 150mn to pick a 12.5% stake
Soma Enterprise	3i India Infrastructure Fund	USD 101mn for a minority stake in the Hyderabad-based firm
K Raheja Corp	Ishaan Real Estate	40% stake each in 8 real estate projects promoted by K Raheja Corp for ₹133mn
Oberoi Constructions	Morgan Stanley Real Estate	Invested USD 152mn in Oberoi Constructions
2008		
Golden Gate Properties	RREEF (Deutsche Bank)	Purchase of an undisclosed for USD 70mn
HDIL	DE Shaw	Investing USD 250mn in Mack Star Marketing, an HDIL group company
Prozone Enterprises	Triangle Real Estate Fund	27% stake in Prozone subsidiary for a total consideration of approx USD 98mn
Lodha Group	Deutsche Bank'	25% in an SPV owned by Mumbai-based developer Lodha Group for USD 425mn
Anant Raj Projects	TAIB Bank (Bahrain)	Picked up a 26% stake for USD 46mn
Indu Projects	Credit Suisse	Invested USD 100mn for a minority stake
Phoenix Mills	MPC Synergy (Germany)	Picked up equity in various SPVs floated by Phoenix Mills for USD 200mn
Janapriya Engineers	Kotak Realty Fund	Picked up 50% holding in an affordable housing project of Janapriya Engineers
2009		
Keystone Realtors	SUN Apollo Ventures	15% stake in Mumbai-based for USD 64mn
Parsvnath Developers	Red Fort Capital	June 09: purchased 18% stake in subsidiary PLDPL for USD 19.3mn

Source: Press Note: Figures in INR converted at the USD-INR rate of 46.7INR

Strong demand in the residential and commercial segments along with progressive action by the government to assist the Real Estate sector

Outlook

Favourable demographic trends that include decreasing household size, and increasing income levels and urbanisation along with greater access to home finance is expected to aid the growth of residential real estate segment. With an estimated demand of 7.5 million units between 09E and 13E, 60% of which is expected to come from the top seven cities (Bangalore, Chennai, Hyderabad, Kolkata, Mumbai, NCR and Pune), this space is likely to see more action as both domestic and foreign players ramp up their operations helped by rising FDI inflows and interest from private equity funds.

The commercial real estate segment is expected to recover from the slump experienced in 2008-09, led by buoyant demand for space in key sectors such as retail, hospitality and IT/ITES. Industry research indicates that supply would exceed demand in the office space market which can lead to price volatility in the sub-segment. While the challenges of archaic laws and high levies remain, progressive action can be expected from the Union Government in terms of GST and repeal of regressive laws. In this overall context private estimate of industry growth from \$57bn (in 2007) to \$105bn (by 2012) at a CAGR of 13% is achievable.

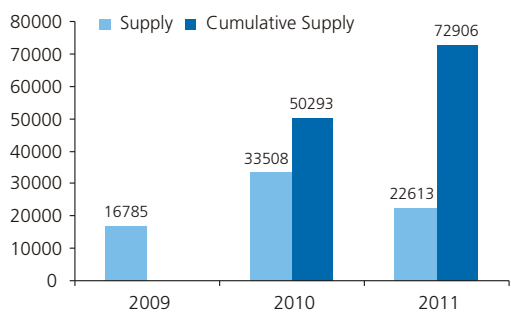
Mumbai residential market to witness infusion of 72906 units between 2009 and 2011

Real estate round-up - Mumbai

Residential

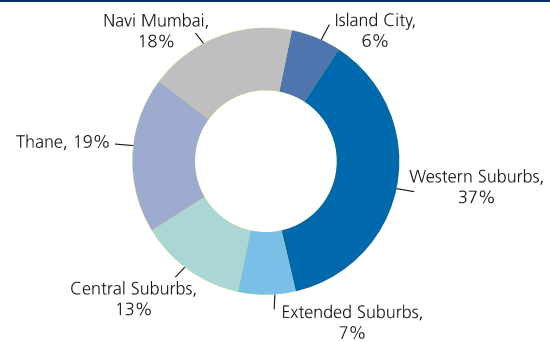
The Mumbai residential market can be divided into: the Island city, the Western Suburbs, the Central Suburbs, the Extended Suburbs, Thane and Navi Mumbai. According to Knight Frank forecasts, the city is expected to witness an infusion of around 72,906 units of new residential space by the end of 2011. Of this, the largest number of units is expected in the Western Suburbs (37%), Thane (19%) and Navi Mumbai (18%). Of the forecast supply, 2 BHK's and 3 BHK's are estimated to constitute 48% and 23%, respectively.

Mumbai – Estimated supply 2009–11 (No: of units)



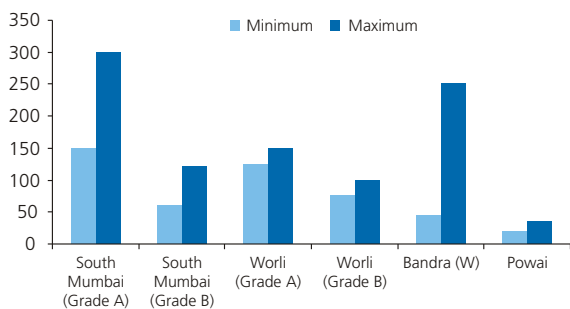
Source: Knight Frank Research

Mumbai – Distribution of supply 2009–11



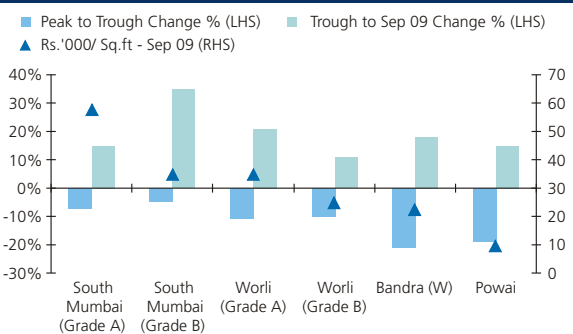
Due to acute shortage of apartments in South Mumbai, this area fetches astronomical rentals and capital values. Knight Frank estimated price stabilisation in most markets in Q2 2009 and price increases in Q3 09, with prime locations witnessing maximum recovery.

Mumbai – Residential rental values (2 BHK, Rs'000)



Source: Knight Frank Research

Average Residential Capital value trend



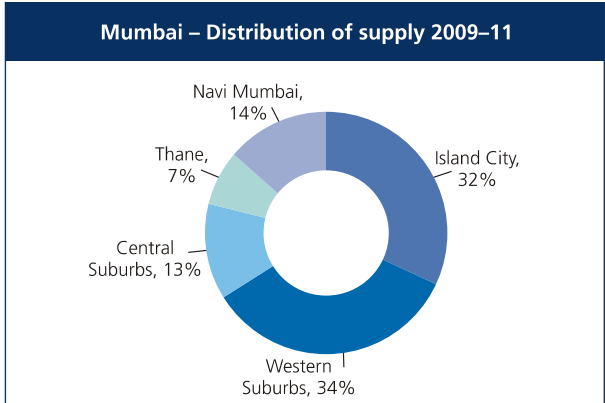
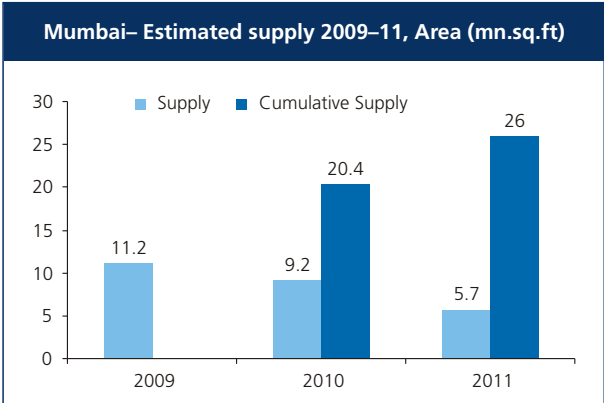
State Government initiatives to attract developers to the affordable homes segment

In 2009, the government in its efforts to increase supply of affordable housing; sold applications for affordable housing units through Maharashtra Housing and Area Development Authority (MHADA) under all income categories. The Mumbai Metropolitan Regional Development Authority (MMRDA) also announced a tie-up with a private developer to construct around 6,000 tenements in Karjat. The state government's stipulation of a Floor Space Index (FSI) of 2.5 for housing schemes for the Economically Weaker Sections (EWS), Low Income Groups (LIG) and Middle Income Groups (MIG) is also expected to encourage private developers to target these segments.

Supreme Court judgement clearing sale of mill land and repeal of ULCRA by Maharashtra government positively impacts construction activity

Mumbai Commercial Office

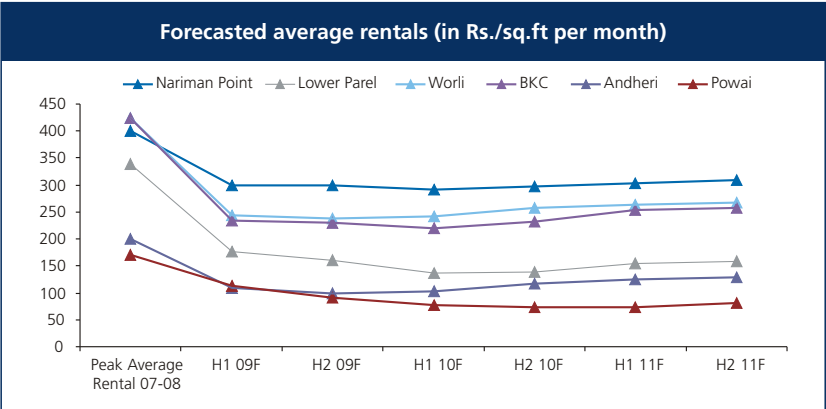
In 2005, the Supreme Court's decision to clear around 50 acres of mill land for sale in the heart of Mumbai and the repeal of the ULCRA have contributed positively to construction activity in locations such as Lower Parel and Worli. Of the cumulative office space supply of 26 million sq.ft estimated in Mumbai between 2009 and 2011, Island City and Western Suburbs are expected to contribute 32% and 34%, respectively.



Source: Knight Frank Research

Knight Frank estimates supply to exceed demand which may lead to price volatility during 2010-11

While average rentals had a significant fall in all micro-markets compared to the peak experienced in 2007-08, modest growth is expected by 2010. The detailed forecasts in rentals are given below.



Source: Knight Frank Research

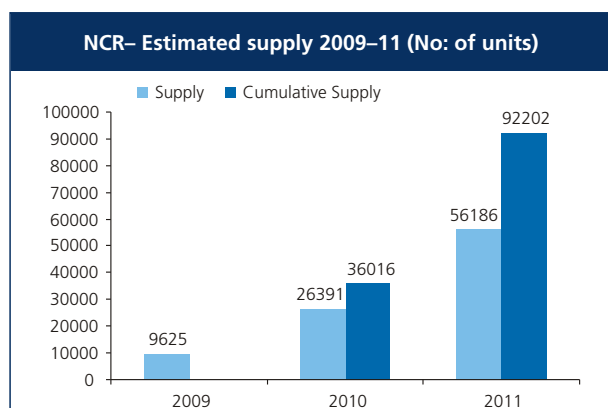
According to Knight Frank, over the next three years, around 26 million sq.ft. of Grade A office space is expected to be infused across Mumbai, with incremental demand for such space (assuming realistic GDP forecasts) forecasted to be only 18.4 million sq.ft, or 71% of anticipated supply. This may lead to price volatility during 2010-11.

Delhi's improved connectivity with Gurgaon and Noida helps real estate development in NCR

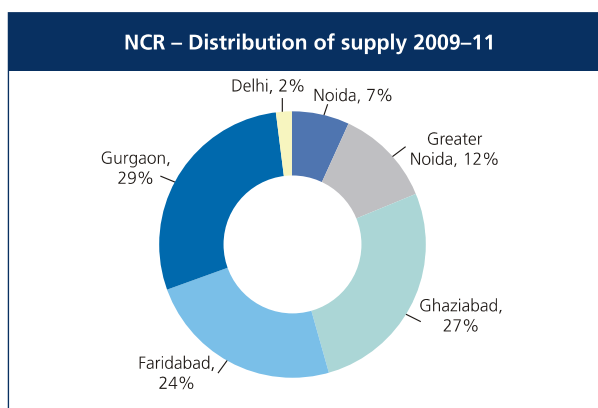
Real estate round-up – National Capital Region (NCR)

Residential

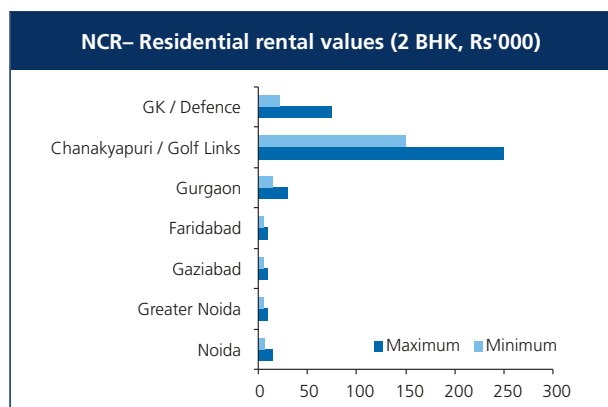
Construction of the eight-lane Delhi-Gurgaon expressway and the eight-lane Delhi-Noida direct flyover along with the widening reach of the Delhi Metro has vastly improved Delhi's connectivity with Gurgaon and Noida, aiding real estate development in both regions. Knight and Frank estimates the NCR market to see infusion of approximately 92,202 units, equating to 160.2 million sq.ft. of fresh supply of residential space between 2009 and 2011.



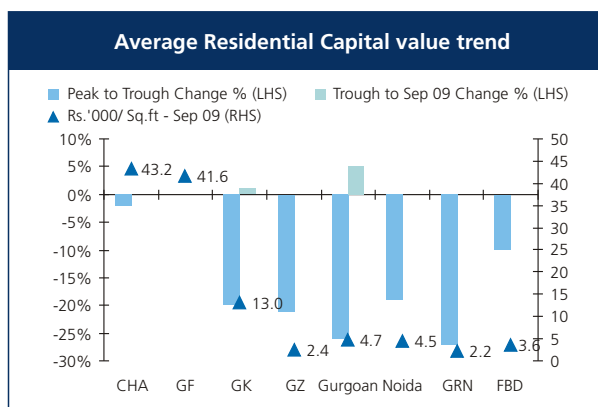
Source: Knight Frank Research



As per Knight Frank, most micro-markets across the NCR have exhibited price stability in Q2 09. Unlike Mumbai, the NCR residential capital values experienced minimum bounce-back from the troughs that were achieved in 2008-09



Source: Knight Frank Research



Note: CHA = Chanakyapuri, GF = Golf Links, GK = Greater Kailash, GZ = Ghaziabad, GRN = Greater Noida, FBD = Faridabad

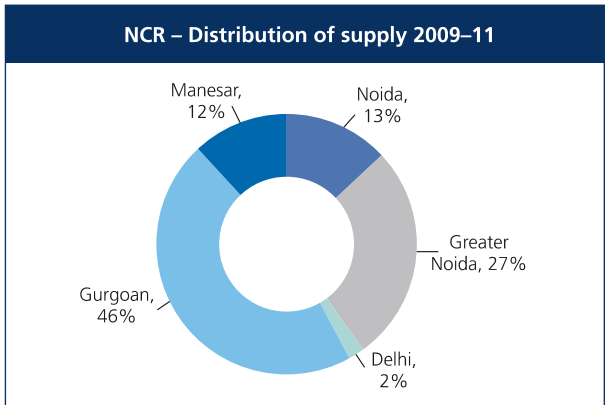
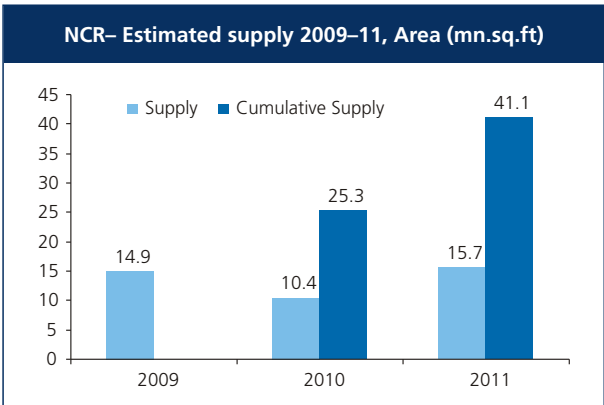
61% of supply between 2009 and 2011 to enter the market in 2011

Unlike Mumbai, about 61% of the supply during 2009-2011 is expected in 2011. This is expected to result in price volatility at the beginning of 2011.

New office supply of 41.1 mn.sq.ft to arrive in NCR between 2009 and 2011

NCR Commercial Office

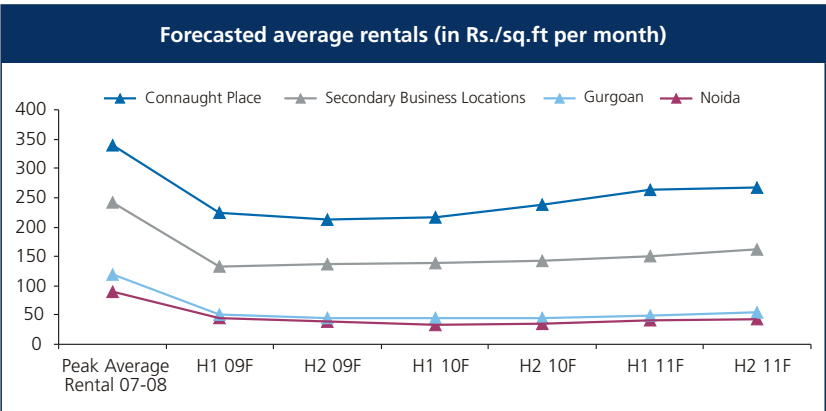
A strong manufacturing base, supported by the IT/ITES, Pharmaceutical, Banking and Automobile sectors, has made NCR one of the most important commercial hubs in the country. As noted, infrastructure developments such as the eight-lane expressway connecting Gurgaon and Delhi, and the Delhi Metro Rail project and the Noida-Delhi DND expressway have strengthened the connectivity within NCR. Knight Frank estimates the NCR market to be infused with new office space supply of around 41.1 million sq.ft between 2009 and 2011.



Source: Knight Frank Research

However, projected office space demand between 2009 and 2011 is only 59% of estimated supply

The region has experienced major supply infusion in the past two years which has adversely affected office space rentals. The poor performance of the IT/ITES industry, and the Automobile and Financial sectors, following the global slowdown, placed more pressure on the real estate sector as companies cancelled office expansion plans. With India expected to grow at a fast pace, office rentals are likely to return to growth by the latter half of 2010. Detailed market-by-market forecasts are provided in the table below.



Source: Knight Frank Research

According to Knight Frank, projected office space demand in NCR between 2009 and 2011 is 24.1 million sq.ft, which is only 59% of estimated supply of 41.1 million sq.ft. This may lead to price instability in 2010-11.

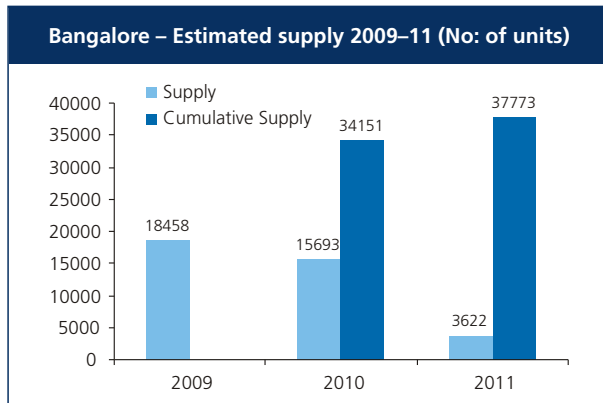
Growth in IT sector aided Bangalore's property development market

Real estate round-up - Bangalore

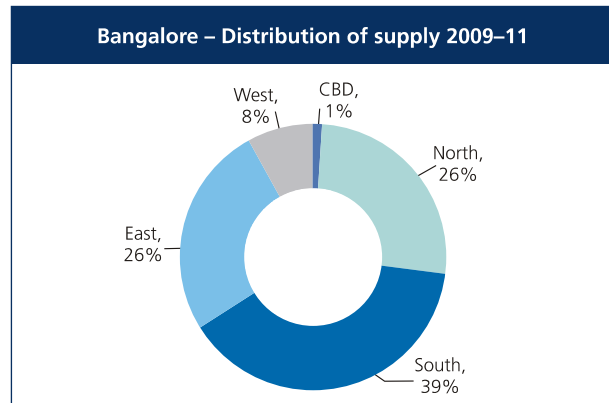
Residential

Increasing disposable income due to robust growth in IT sector and demand for premium homes led to steady growth in the Bangalore property market between 2007 and middle of 2008. However, the global economic crisis and its impact on the IT sector resulted in a slowdown in the residential market around middle of 2008.

Recovering from this slowdown, Knight Frank estimates that Bangalore would witness a residential supply of approximately 72 million sq.ft. from about 37773 units between 2009 and 2011. While 53% of this supply will be in the form of 3 BHK apartments, 2 BHK apartments would constitute 30% of the total supply. The southern zone with 39% share would be the largest contributor to the supply, whereas northern and eastern zones will contribute about 26% each to the supply

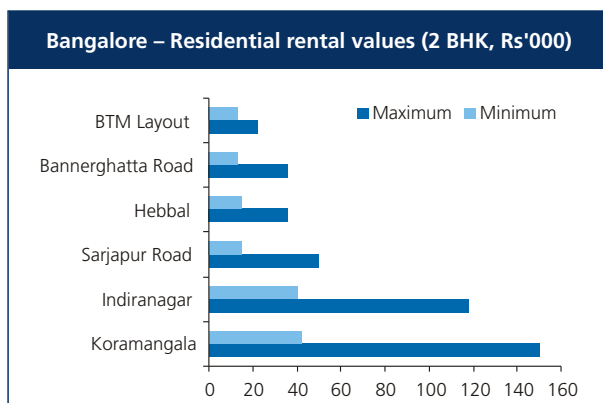


Source: Knight Frank Research

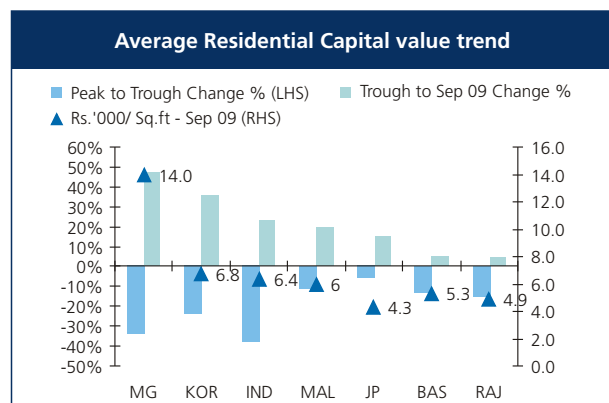


Prices in prime locations have rebounded after sharp correction in 2008

The economic slump led to a price correction of 25–35% even in prime locations such as M.G.Road, Koramangala and Indira Nagar. However, as the economy rebounded, these markets witnessed maximum increase in capital values (by 25–45% between March 2009 and September 2009). 2010 will be an important year as approximately 42% of the three-year supply would be entering the market.



Source: Knight Frank Research.

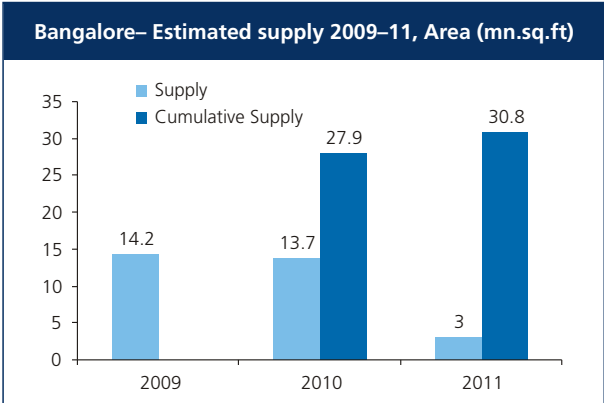


Note: MG= MGRoad, KOR=Koramangala, IND= Indiranagar, MAL=Malleswaram, JP= JP Nagar, BAS = Basavangudi, RAJ=Rajaji Nagar

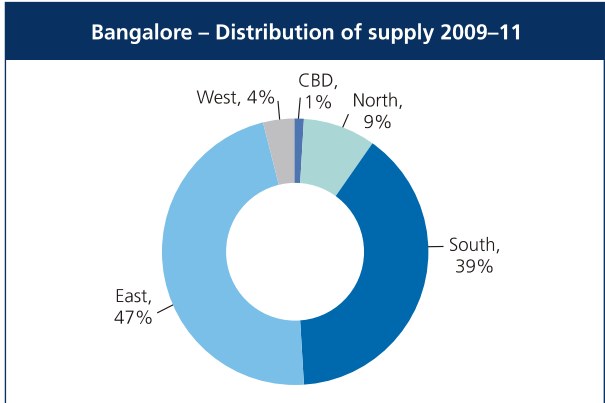
Host to over 2000 IT companies, Bangalore's commercial office space demand majorly driven by IT/ITES

Bangalore Commercial Office

Bangaluru's economy is primarily dependent on the IT/ITES sector, which has fuelled growth in the city's office, residential, retail and hospitality sectors. The city is host to over 2,000 IT companies and continues to be at the forefront of India's IT sector. Of the 30.8 million sq.ft. office supply estimated in Bangalore between 2009 and 2011, 47% is expected in the eastern part, while 39% is expected in the southern part.



Source: Knight Frank Research



Government support and in-principal approvals for 10 SEZ's in textiles, aerospace, etc. to aid non-IT office demand

Rental values across the city are likely to remain stagnant for the foreseeable future. Knight Frank estimates rentals in Whitefield to decrease further as this region has been witnessing oversupply. Led by the State Government's support and in-principal approvals for 10 SEZs in sectors such as textiles, aerospace, manufacturing and R&D, Bangalore is gradually witnessing a shift from being an IT/ITES destination to an investment destination for other sectors.

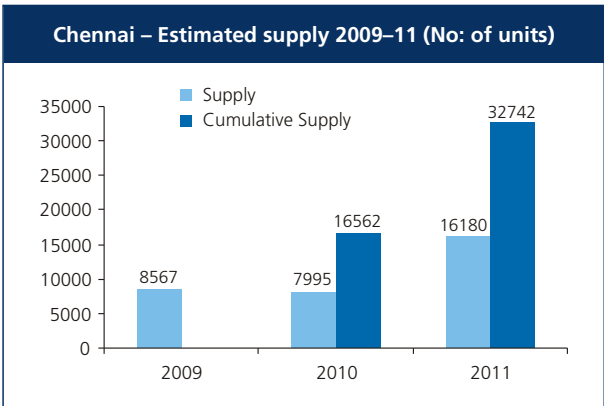
Chennai residential market to witness infusion of 32742 units between 2009 and 2011

Real estate round-up - Chennai

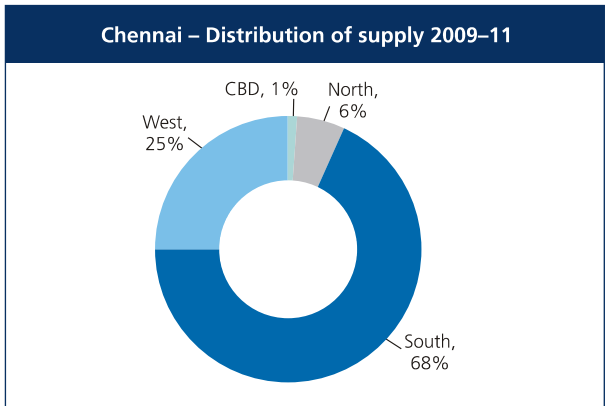
Residential

Like Bangalore, growth of the IT/ ITES sector and demand for premium housing significantly influenced Chennai's real estate. The Chennai Metropolitan Development Authority (CMDA) is promoting Rajiv Gandhi Salai as a prominent IT destination and Sriperumbudur as an electronic and manufacturing hub. This has resulted in further residential development in the southern and western parts of the city.

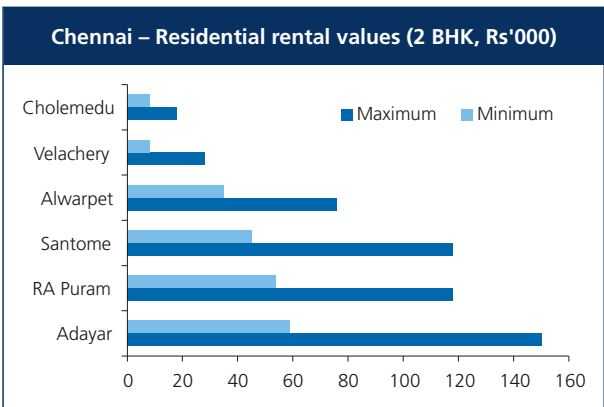
Knight Frank estimates Chennai to have a residential supply of about 32742 residential units totalling approximately 45 million sq.ft. between 2009 and 2011. About 68% of these units are expected to be developed in the southern zone.



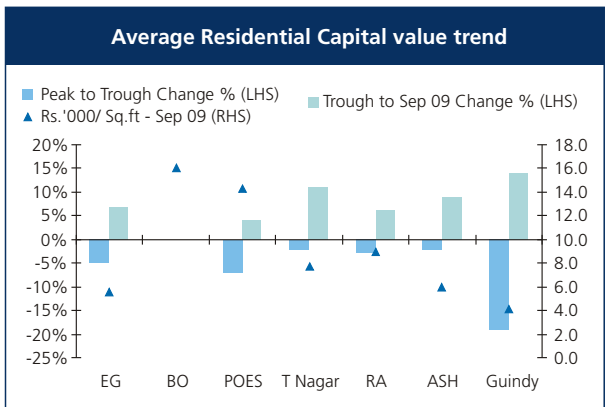
Source: Knight Frank Research



The residential capital values across Chennai which witnessed a correction in the range of 5–20% from its peak until September 2009 are currently stabilizing.



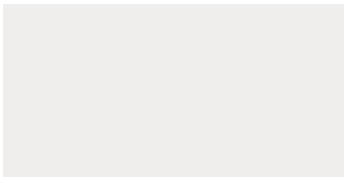
Source: Knight Frank Research.



Note: EG= Egmore, BO= Boat Club, POES= Poes Garden, RA = RA Puram, ASH= Ashok Nagar, VAD= Vadapalani

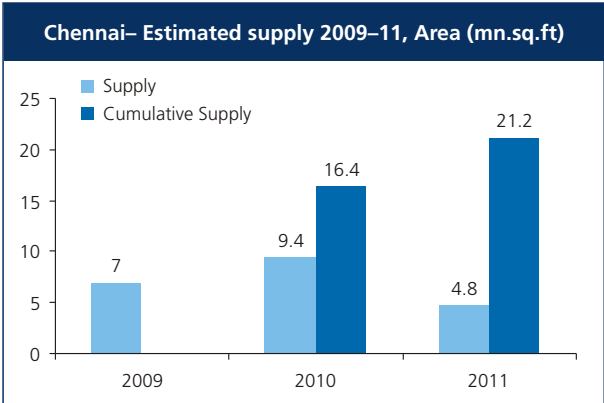
Relaxation of coastal regulation zone construction rules to encourage developers

Relaxation of coastal regulation zone construction rules is expected to renew interest from developers. However, Rajiv Gandhi Salai may experience pricing pressure due to large supply of residential units and lack of adequate social infrastructure.

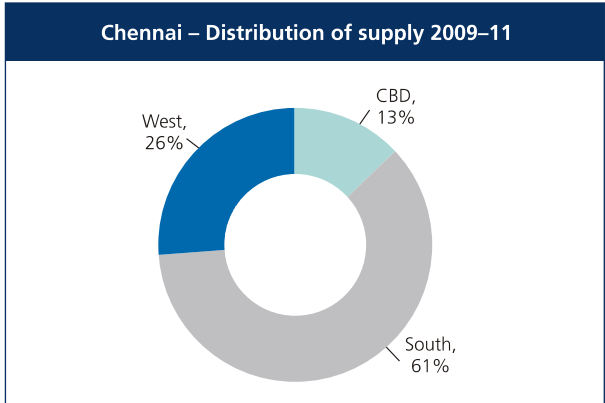


Chennai Commercial Office

While the rise of the IT/ITES industry increased the demand for office space until 2008, like Bangalore, the Chennai Commercial real estate market slumped following the economic downturn. A cumulative supply of 21.2 million sq.ft is expected in Chennai between 2009 and 2013.



Source: Knight Frank Research



Chennai's commercial office market to remain subdued in 2010

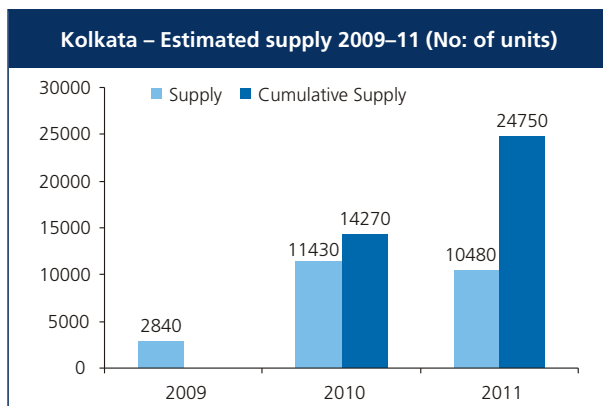
According to Knight Frank, Chennai witnessed a property bubble in 2007-08, and commercial land was purchased at irrationally high levels during the same period. However, faced with current levels of dropping demand, developers with high project costs are finding it difficult to sell or lease space. With no sign of price appreciation, it is reasonable to expect investment in Chennai's office market to remain subdued in 2010.

Kolkata residential market to experience infusion of 24750 units between 2009 and 2011

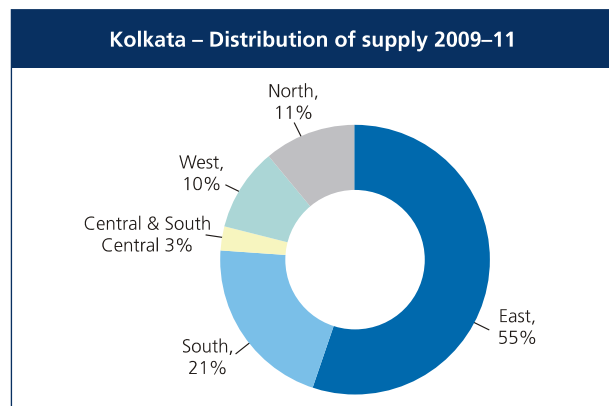
Real estate round-up - Kolkata

Residential

Kolkata, the capital city of West Bengal, is the commercial centre of Eastern India. This city has witnessed significant changes in its skyline over the past as many IT/ITES companies invested in campuses to accommodate their growing operations. Knight Frank estimates that the city would have a residential supply of about 24750 units between 2009 and 2011. About 55% of these upcoming housing units are expected in the East zone.

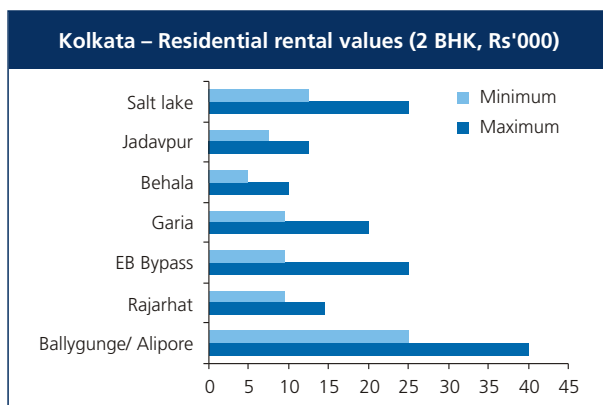


Source: Knight Frank Research

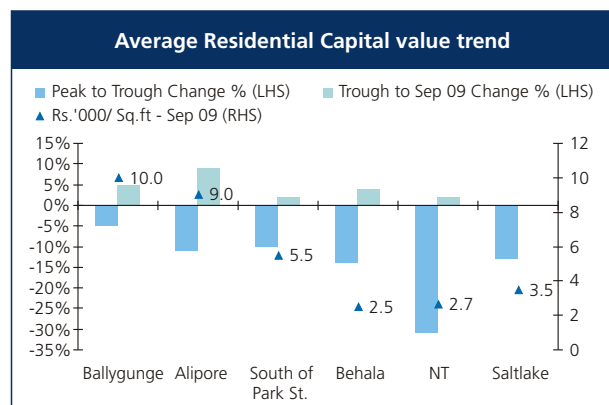


Slump in property prices was much below than that witnessed in Tier 1 cities

While Kolkata witnessed slump in property prices in 2008, it was much below than that witnessed in Tier I cities such as Mumbai. While Tier 1 cities registered declines in the 25–40% range, average decline in Kolkata was about 10–18%.



Source: Knight Frank Research



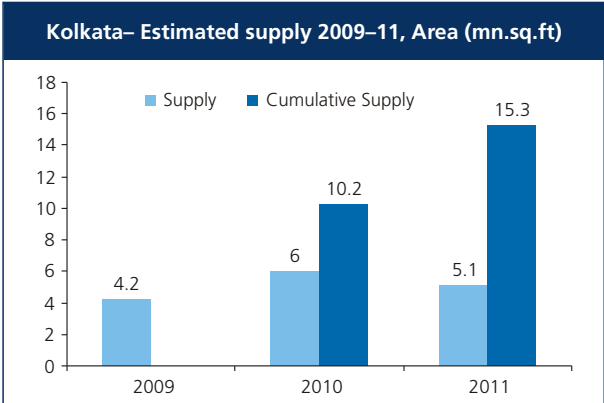
Note: NT=New Town Rajarhat

Despite increasing construction costs and lacklustre, the city did not experience a decline in demand for residential property. The Capital values of residential units witnessed moderate uptrend from the declines experienced in 2008; these values are expected to move upwards in 2010.

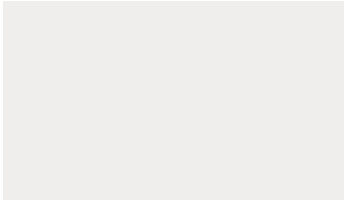
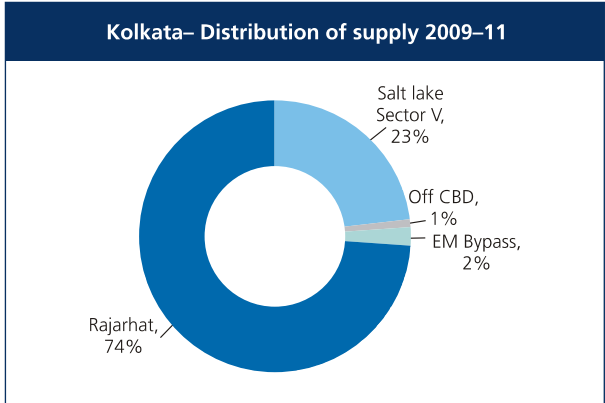
Many IT companies have invested in the commercial centre of Eastern India

Kolkata Commercial Office

Kolkata, the economic hub of Eastern India, is being acknowledged as one of the fastest growing IT destinations in the country, attracting companies such as Tata Consultancy Services, Cognizant Technologies, PWC, ITC Infotech, Computer Associates, Siemens, IBM and Wipro BPO. According to Knight Frank, the Kolkata office market experienced a paradigm shift with the opening of Salt Lake Sector V, which is a new business district in the suburbs dedicated to the development of the city's IT sector.



Source: Knight Frank Research



The slowdown in the IT sector adversely impacted the rental market in Kolkata, but wide disparity was observed here. As per Knight Frank estimates, other micro-markets in the city registered a decline in rentals ranging from 8-10% from the peak values in June 2008 to March 2009. However, Salt Lake Sector V witnessed a rental decline of 33% during the same period. The year 2010 is expected to provide important indications regarding how rentals will develop, going forward.

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