Strategy In-Depth

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Citigroup India Investor Conference 2007

Day One Highlights

- About the event — The Citigroup India Investor Conference 2007 (13-14 March Mumbai, 15-16 March New Delhi) got under way in Mumbai with more than 100 companies and nearly 300 registered institutional investors at the event. In addition to guest speaker speeches and company presentations, there are five sector side tours running concurrently through the week. The large turnout reflects continued interest in the Indian market.
- Guest speaker takeaways — The RBI Deputy Governor Usha Thorat spoke on banking and financial inclusion in India's economic growth. Deepak Parekh (Chairman- HDFC Group and Member - Investment Commission) talked about India's key growth drivers, risk factors, successes and laggards in the infrastructure sector, financial sector reforms and regulation.
- Company takeaways — In this note, we highlight takeaways from some of the companies present during the day (Asian Paints, Bharat Forge, Sun Pharma, United Spirits, etc).

Ratnesh Kumar[1]
+91-22-6631-9888
ratnesh.kumar@citigroup.com

Tirthankar Patnaik[1]
tirthankar.patnaik@citigroup.com

See Appendix A-1 for Analyst Certification and important disclosures.

[1]Citigroup Global Market India Private Limited

Guest Speaker Takeaways

Deepak Parekh, Chairman- HDFC Group, Member- Investment Commission

- On Growth: Noted that growth has been fuelled by industry and services, while agriculture has been a laggard. However, expects growth to sustain despite this, at 8.5-9% levels due to: (1) Strong Demographics, with a significant working population (60% of the population is below the age of 30, as compared with 47% in China, 40% in US, 32% in Japan), which in turn is fuelling a consumption-led boom; (2) An Investment Cycle Upturn, as reflected in the strong order books of companies; (3) a continued outsourcing advantage with 65% of global offshore IT functions off-shored to India. Finally, he noted that the growing confidence of the Indian entrepreneur has been a final ingredient in India's growth recipe.

- Concerns Ahead. Include sustaining the low-cost labor advantage; improving the quality of the talent pool, efforts toward agricultural reforms, politics, and inclusive growth across states.

- Infrastructure Development: Noted that growth across sectors has been varied. Telecom is making remarkable progress on the back of liberalization, as reflected in low tariffs, even while tele-density remains low, indicating scope for further growth. However, on the flipside, the power sector continues to remain a laggard, with the lack of privatization resulting in a high power deficit and growing T&D losses. However, he views the gradual privatization of the sector, coupled with recent bids for ultra-mega-power plants as positive developments. This has attracted investor interest since policy uncertainties have been the major hurdle in the power sector.

- Using FX Reserves to finance infrastructure development: Explained that the India Infrastructure Finance Company (IIFCL)- a government-owned SPV, will facilitate the process; so that the IIFCL will use FX reserves as a security to provide a guarantee to Indian companies, to raise money overseas. This would be non-inflationary, thus quelling concerns about the impact on money supply.

- Financial Sector Developments: Noted that the financial sector has been growing rapidly in recent years, but the sector's regulatory framework still needs to evolve as there are multiple regulators in different segments of the financial sector. Mentioned that while the equity investing has been deregulated, debt market remains relatively closed and underdeveloped. Also pointed out that the mortgage insurance market remains in an underdeveloped stage, since there is a lack of clarity on regulation.

- Impact of higher interest rates on mortgages: Pointed out that housing finance companies are taking steps to ensure a minimal impact by either increasing EMIs, raising the loan tenure, or allowing balloon payments.

Usha Thorat, Deputy Governor, Reserve Bank of India

- Developments on the Monetary Front: Strong capital inflows, coupled with FX reserves increasing by over US$43bn in FY07 (more than double the growth in FY06), has resulted in a surge in liquidity and made monetary management difficult. In response to this, the RBI has hiked the cash reserve ratio (CRR) and also made adjustments in the liquidity adjustment facility (i.e., imposed caps on the repo). Controlling inflation has also become a policy priority, and stressed that any anti-inflationary measure is in fact also an anti-poverty measure.

- Focus on the 'need for inclusive growth'. Pointed out that in order to ensure inclusive growth there are a number of issues that need to be addressed. These include: (1) Agricultural reforms to facilitate food security for the poor and also achieve the government's 11th Plan target of 4% growth in agriculture. This would encourage employment growth and an improvement in social sector indicators. (2) Infrastructure Development both through public and private sector investment; and (3) Correcting the current skewed growth path across states.

- On the issue of financial sector inclusion. Is of the view that currently, the penetration of the financial sector remains low; since despite strong growth in urban areas, farmers continue to depend on informal lending in rural areas. In order to ensure that agriculture comprises 18% of the credit portfolio, RBI is focused on improving credit delivery and the encouragement of Microfinance initiatives through self-help groups.

Company Highlights

Asian Paints (ASPN.BO - Rs695.65; 1L)

- Paints market growth to remain strong - According to the management, the paints market in India is highly resilient to downturns and growth has historically never fallen below double digits. Growth outlook remains robust, expected at 1.5x-2x GDP growth. Asian Paints as a market leader is best positioned to leverage off this growth.

- Market leadership position allows pricing power - Asian Paints' market leadership, strong brand and large distribution allow it to price its products at a premium. The company has taken price hikes every quarter over the last 4 quarters. According to the management, Asian Paints is among the highest-margin paints companies in the world.

- International Business - Asian Paints targets to be within the top 3 players in the Middle East and South Asian markets. In other international markets like the South Pacific and Caribbean, Asian Paints is looking to increase its market share by 1% per annum. Management expects international business to grow at 15% per annum.

- Industrial Paints - Management has guided at growth in excess of 20% for its industrial paints business. Its associate JV Asian Paints-PPG has recently acquired ICY India's auto refinish business, which is likely to make Asian PPG the leader in the auto-refinish segment.

Bharat Forge (BFRG.BO - Rs315.45; 1L)

- Outsourcing opportunity remains strong - driven by increasing cost pressures of OEMs in developed markets and also an escalating shift to forged parts from cast parts.

- Revenue outlook - Management forecasts 25% CAGR in revenues over the next 3-4 years. Margins are forecast to remain stable at current levels.

- Outlook on Chinese venture - has experienced teething problems over the past 18 months, which are temporal in nature. Expected to grow at an exponential pace for the next 3-4 years.

- Investments in non-auto businesses - management to invest USD75m to develop capacities for non auto businesses - targets revenues of USD250m in 3-4 years from this venture (targeting industries like oil and gas, aerospace). Substantially higher EBITDA margins (~30%) in this business than current businesses that have 24-26% margins.

Gammon (GAMM.BO - Rs316.25; 1L)

- Gammon is targeting revenues of Rs20bn in FY07E and expects to grow the top line in FY08E and FY09E by 35% annually. Management's internal targets are, however, higher with expectations of 50% annual growth and sales of Rs45bn by FY09E.

- Gammon's management expects EBITDA margins to stabilize at the 9-9.5% levels.

- Gammon does not expect to raise equity capital in the parent company till FY10E. The parent had a D:E of 0.2x at the end of FY06 and expects to incrementally fund growth through debt. Given the low current leverage, the company does not expect a negative view about the credit profile of the company on account of full tax accounting. Further, GIPL currently has no debt and can also leverage if needed.

- Gammon expects roads, ports, power transmission and urban infrastructure projects to be key growth drivers for the company.

Glenmark (GLEN.BO - Rs598.10; 1M)

- Glenmark reiterated its focus on building drug discovery R&D as the primary driver of growth, by leveraging the cash flows generated from the branded and generics business.

- The management threw more light on its biologics strategy – investment phase (in biosimilars and new biologics) over 2006-09 and first lead to come through by 2009.

- Recent deal with Dyax adds to its drug discovery effort in areas of oncology and inflammation – in licensing deal, under which Glenmark would provide 3 targets against which Dyax's wide library of MABs would be screened. The management expects to file IND for the first molecule by 2009 and look at further licensing out options in Phase I/II.

- Reiterated guidance that one more R&D licensing deal and one European acquisition would be concluded before end-FY07.

Gokaldas Exports (GOKL.BO - Rs246.50; 1M)

- Growth triggers — 1) Growing order books in exports and focus on diversifying customer base; 2) Expansions going on-stream; and 3) Exploring opportunities as a supplier to large branded retailers looking to scale up in the domestic market, management believes this will be margin accretive.

- Enriching product mix, further — Entered the structured suits market for men and women, which fetch higher prices (~$40/pc) and superior margins –

recently set up a new facility in Bangalore. This apart, exploring export opportunity in new products like 1) industrial work-wear 2) innerwear and sleepwear products, looking to tie up with international lingerie brand and 3) Garments made from technical textiles.

- Good progress on expansions — Started production at Chennai SEZ plant and three new units in 3Q, production to ramp-up by 4Q – employs 54,000 people today. Plans to add more plants in Mysore (Apr'07), Tumkur (Apr'07) and Hyderabad (Sept'07) – this will increase present capacity of 26m pieces by ~35% to 36mn pieces by FY08.

- Margin expansion to continue— EBITDA margins likely to expand to 12% in FY07E. Focus on value addition, new customer additions, strong order flows drive volume growth with relatively stable pricing environment are key reasons for this – this trend is expected to continue.

Grasim (GRAS.BO - Rs2,053.90; 1L)

- In cement (58% of sales), the ratio of blended cement should increase from 1.29 to around 1.35 by 4QFY08 partly due to the 1.3m tpa grinding unit in north India. This should help increase volumes and cut costs. Power costs will also fall by Rs2/unit as captive thermal power capacity increases by 50% to 90%, replacing diesel generating sets and grid power.

- In VSF (28% of sales), Grasim plans to enter the speciality and non woven segment in the medium to long term for market enlargement. Demand in this segment is growing in Western countries and is currently being met by producers such as Lenzing of Austria. The planned capacity growth in VSF by 49,000 tpa (18%) will meet domestic and international demand.

- Sponge iron (8% of sales) margins continue to be low (6-10%) due to inadequate availability of natural gas. Capacity utilization should increase to about 80-90% from about 50% currently once it starts getting regular supplies of natural gas (likely by Dec 2007), and help to increase margins.

- Dividend policy: As far as possible, Grasim plans to maintain a payout ratio of 20-25% keeping in mind that interest rates are rising and their own strong capex plans of Rs47bn over the next two years particularly in case of cement for which it is expanding effective capacity by 10m tpa to 23m tpa by 1Q FY09.

GSPL (GSPT.BO - Rs48.60; 1M)

- Rollout of network on schedule: GSPL's pipeline network is on track, with the commissioning of the key Hazira-Vapi section of the network. Management is confident of doubling transmission volumes by CY09.

- GSPL to benefit from infrastructure status for pipelines: Future pipeline segments of GSPL will benefit from the new government policy on granting infrastructure status to cross-country pipelines.

- Jamnagar pipeline to cater to future demand growth: Besides demand from Reliance's refinery, GSPL's pipeline to Jamnagar will also be able to cater to demand from the proposed SEZ and Essar's refinery.

HDFC Bank (HDBK.BO - Rs959.65; 2L)

- Asset quality remains stable - no real changes over the recent past, including the unsecured portfolio, where there has been a level of concern that has been expressed in the market space.

- Margins should also remain stable in the 3.8%-4% range - HDBK has maintained its margins in both falling and rising rate environments, and that should not change. As far as CASA (Current and Savings Accounts) proportions are concerned, while the levels could go down and there could be a slight shift to term deposits, the low-share is offset by the higher returns on the existing CASA deposits.

- Growth slowdown on account of higher rates - HDBK has not seen any meaningful change yet, and it believes while industry growth levels should come down, at current GDP growth levels, it does not expect industry growth to fall below 22-23%. It believes it should be able to sustain its own asset growth rates of 25-30%, as in the past.

- Agriculture lending - unlikely to become a large proportion of the asset book; While it does see commercially viable lending opportunities in this segment, it is likely to remain selective in this space.

- Overall, it continues to believe the market should continue to expand and its own shares should continue to expand.

I-flex (IFLX.BO - Rs1,855.65; 3M)

- More and more banks opting for core banking solutions to continue driving good growth for I-flex's product business.

- Oracle has indicated in the past that it will keep I-flex listed for 5 years - when queried on the possibility of a delisting.

Jet Airways (JET.BO - Rs574.10; 3H)

- Domestic operations - Jet expects its domestic revenues to grow at a steady 16-17% CAGR next few years. Overall market forecast to grow at a faster pace - we expect ~22-25% CAGR for the next 3 years - driven by supply-side pressures. Domestic market yet to see signs of rationalization. Fleet expansion of LCCs (low-cost carriers) continues at an unabated pace.

- Domestic margins - short term, Jet expects its domestic yields to remain steady (despite onset of lean season), albeit we think this will be to some extent buffered by surcharges. Longer term, Jet forecasts its EBITDAR margins will stabilize at around 20% (vs. 13% currently).

- International operations - US operations hold the key to long-term profitability. Jet will initially target 3 cities in North America - New York, San Francisco and Toronto - with flights commencing in FY08E. Management expects the routes will turnaround in 12 - 18 months. Currently, all routes (including London) are profitable, though S. E. Asian routes (to Singapore and Kuala Lumpur) might again become unprofitable as wide-bodies replace 737s on these routes.

- Fund raising - equity issuance is on the anvil, quantum as yet remains uncertain. With current debt equity of around 2.4x (as at end Dec06), and a capex plan of over USD2bn (most of which will be debt-funded), we believe that an equity infusion is inevitable.

L&T (LART.BO - Rs1,529.75; 2L)

- L&T targets to double revenues by FY10.

- L&T wanted to get into shipbuilding a long time back but were prevented from doing the same. This could be a big growth driver. In India for defense the Government shipyards take 5 years to build a ship whereas L&T could perhaps do the job in less than 2 years. Shipbuilding revenues will have a large defense component of ~ 20-30% in the future. In the long term, L&T wants to build a high technology shipyard so that it can do value-added work in India just as is done in Korea and Singapore and not just build large hulls as in China.

- Despite working on Delhi, Hyderabad and Bangalore airports, L&T has the capacity for more airport orders as capacity is not a constraint. Larger orders do not mean more manpower; it only means that a better project manager needs to be in charge. So if ticket sizes increase it helps L&T. Chennai, Calcutta and 35 non metro airports are likely to come up for bidding, and this could be a big growth area.

- On nuclear orders only L&T, HCC and Gammon are prequalified to do civil works. However, this area would be a growth opportunity only after a year or so. Whenever the opportunity comes up L&T is ready to capitalize.

- As volumes go up the defense orders will have a larger impact. Offset contracts should kick-in in the near future for orders given to Boeing, Airbus, EADs and the sale of F-16/F-18s and Hornets as the case might be.

- Investments in shipbuilding and power equipment manufacturing would not be of the big bang nature and will happen over a period of time. So the quantum is too small to bother with if the L&T balance sheet can absorb the same or not. L&T might issue FCCBs to fund the same.

Raymond (RYMD.BO - Rs341.30; 1L)

- Thrust on branded retailing — Plans to expand its premium brand portfolio and existing network of ~400 retail outlets to 480 stores in FY07E and 605 stores in FY08E, with retail space growing from 1.1m sq.ft by 30% over the next two years. Focus is primarily on Tier II and Tier III cities - management expects branded apparel revenues to grow at 20% over FY07-09E and higher EBITDA margins of 14-15% (vs. 6-7% of peers) given its premium positioning.

- New ventures have started paying off - With expansions at most of its joint ventures complete – the company is starting to witness good order flows for the high value shirting; production has stabilized at the woolen jacketing plant; rapid growth in export garment operations of suits, trousers, and shirts (all 100% subs) after initial hiccups.

- Denim business still under pressure — Outlook on denim business remains sluggish, while Indian operations are operating at 90% capacity utilizations with relatively stable prices (Rs.109/mtr) in India; JV's EU & US operations are experiencing a slowdown (70% utilization), expecting some recovery in 2HFY08.

- New developments - 1) Focus on inorganic initiatives for growth, particularly in women's wear; 2) exploring opportunities to unlock value for its real estate assets (140acres) in Thane, but expects a beginning on this in the next 2-3 years; 3) consolidate opportunities in engineering files and tools business, also open to spinning it off at a later date.

Reliance Communications (RLCM.BO - Rs416.70; 1M)

- Wireless sub adds dip a temporary phenomenon: While not ascribing any particular reason for the fall in sub adds in Feb-07, the company expects a recovery in the next 3-6 months with significant capacity addition in the existing 7 GSM circles (additional 6 mn lines) by April and re-instatement of CDMA capex (at least till the time there is clarity on GSM spectrum for the additional circles).

- Release of GSM spectrum holding back RCOM: Acknowledging this as a challenge for the industry, and especially for the potential new entrants, the company indicated that the timing of the GSM launch will be dependent on the release of GSM spectrum. However, the scale of investment will be significantly higher than the annual run-rate of the GSM peers as they will have to catch up on the network coverage.

- Passive infrastructure sharing could create meaningful value: RCOM confirmed the strong tailwinds on which the tower-sharing industry will be built. It believes that an average tenancy of 2-3 operators is easily possible and does not think their advantage will be diluted by offering their network to new entrants on a selective basis.

- DTH/IPTV launch in 3Q07: While there are still loose ends to be tied-up, RCOM is likely to advance its complementary services of DTH & IPTV in the next 6 months.

Sasken (SKCT.BO - Rs503.95; 1M)

- "E-Series" target on track – management had indicated that it would sign its first client in Q4FY07.

- Looking for acquisition in the telecom service provider space to add a new sub vertical in its core telecom vertical.

Satyam (SATY.BO - Rs452.15; 1M)

- Demand environment remains strong – It does not see any impact of the much talked about global slowdown as of now.

- Pricing stable with an upward bias – new clients coming in at 3-5% higher rates but the company is still assessing the weighted average impact for the next year.

- On budget-related issues – Satyam indicated that there will be no impact of MAT on reported earnings and the impact of ESOP is still not very clear; however, it is likely to pass it on to employees.

State Bank of India (SBI.BO - Rs980.70; 1L)

- Growth: Currently growing at 26%, and while higher interest rates could have an impact, it has not seen any impact as yet. It expects retail assets to grow at about 22%-24%.

- Margins: Recent increases in lending rates could actually push up margins in the near term, and 1Q08. Over the medium term, it believes margins could come down a little, to the 315-320bp levels.

- Funding: Continue to be comfortable on the funding front, and have been lenders in the call market for the last one year. It has not been participating meaningfully in bulk deposits that are being offered, unlike its associate banks.

- Capital: Is comfortable at over 12%, given the tier 2 bonds and hybrid capital that it has raised.

Sun Pharma (SUN.BO - Rs1,023.10; 3L)

- R&D pipeline - Sun Pharma has indicated that there are about 3 known targets for the NCE research. The most advanced molecule is an anti allergy molecule for which an IND has been filed in the US and phase II studies are ongoing. Sun Pharma is hosting a conference on March 15 to discuss the R&D pipeline in detail.

- Product launches in the domestic market will slow from the current levels over the next 3 years due to the onset of the patent regime.

- No immediate target for Acquisitions - The company indicated that there were no major targets for acquisition that could come through in the near term.

- Budget Impact - The current budget has no impact on the company's tax rate over the next 3 years.

Tata Chemicals (TTCH.BO - Rs189.00; 2M)

- Soda Ash price outlook stable: Tata Chem sees that strong Soda Ash prices are likely to sustain in the medium term. Tata Chem's Magadi (Kenya) expansion will be functioning from April-07 and will be a key driver for FY08 earnings growth.

- Policy initiative on Fertilizers imminent: Tata Chem expects that there will be clarity on the new fertilizer policy soon. It believes that the policy will be supportive of de-bottlenecking of Urea plants and its Barbala plant will be a beneficiary.

- New initiatives could be future drivers: Tata Chem will be investing Rs500m over the next 2-3 years in R&D in bio and nano-technology including bio-fuels.

- The company is also investing in building a back-end (including farm advisory, cold chain, packaging and wholesaling) for fresh farm products using the Tata Kisan Sansar Network.

Tech Mahindra (TEML.BO, Rs1492 - Not Rated)

- Pricing stable with an upward bias—-However, the company believes that looking at T&M-based pricing will become less relevant ard as hybrid models in pricing emerge.

- Wage benchmarking currently ongoing (precursor to deciding on wage hikes for next year) – however, with the present supply-side situation offshore wages are expected to go up at least 15% and onsite wages by 2.5-3.5%, in management's view.

- Campus offers to 3,500 graduates made for next year.

- The large $1b BT contract will start being visible in revenues from Q1FY08 and will take 6-8 quarters to hit peak rate. Margins on the new business to be in-line with company averages – as per the company.

United Phosphorus (UNPO.BO - Rs312.60; 1L)

- Guidance of US$750-770m revenues and 18-19% EBIDTA margins in FY08—-We highlight that EBIDTA margin guidance is after a one-time restructuring charge of cEur25m likely to be taken on rationalization of manufacturing and manpower; net of this, EBIDTA margins would be in-line with our estimates.

- Cerexagri - management expects an upswing in profitability to be much more rapid that we currently estimate - up to 20% from the current sub 10% in 18-20 months (our estimates build in 16% in FY09). We believe the higher guidance is on the back of the more aggressive rationalization measures planned by the company.

- UPL would continue to look at acquisitions - strategic fit rather than size is the key benchmark for the company. Reiterated that with growing scale, ability to invest in future growth initiatives - organic and inorganic - has improved considerably.

United Spirits (UNSP.BO - Rs757.60; 1L)

- Growth, Margins to Remain Strong - United Spirits' top-line growth is likely to remain strong, driven by strong volumes and improving product mix. Improving product mix changes are likely to drive further margin expansion.

- Focus on top end increasing - United Spirits is increasing its focus on the top-end whiskey segment. The management believes that Scotch whiskey is likely to emerge as a very important segment and are gearing up to increase presence in the segment. Its current Scotch brand 'Black Dog' will be extended to 8-year and 18-year-old variants.

- Close to acquiring White & Mackay - Due diligence on White & Mackay is on. White & Mackay will provide much needed bulk Scotch for the Indian operations - the company currently imports 12m liters of scotch for its blending requirements, which will only increase. Additionally, the company also mentioned that a shortage of Scotch whiskey is building up, and Scotch prices are going up.

- White & Mackay will be value accretive - Management stated that White & Mackay will be EPS accretive from year one. According to the management, of the total cost of acquisition, 70% is composed of the value of the Scotch inventory of White & Mackay. The acquisition will be funded through debt, of which only 50% will be on United Spirits' books, while the remaining will be non-recourse debt on White & Mackay's books.

Wipro (WIPR.BO - Rs581.90; 1L)

- Confident on demand environment and pricing – lack of clarity on the two large telecom clients (going through M&A) the only negative.

- Confident on maintaining margins in a narrow band—-For the first 9mFY07 – margins have remained almost flat yoy despite ~120 bp negative impact of inorganic initiatives and wage hikes affected.

- "String of Pearls" strategy on acquisition to continue – Wipro plans to use a part of the cash on books to fill in gaps in service offerings.

Appendix A-1

Analyst Certification

I, Ratnesh Kumar, research analyst and the author of this report, hereby certify that all of the views expressed in this research report accurately reflect my personal views about any and all of the subject issuer(s) or securities. I also certify that no part of my compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report.

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A member of Ratnesh Kumar's household holds a long position in the shares of Grasim Industries, Reliance Communications and State Bank of India.

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