Highlights: Day 1 India Conference

Investment Strategy | India
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Merrill Lynch

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Day 1 of the Merrill Lynch India Conference: Highlights

ICICI Bank - Moderation in growth becoming more visible. The bank expects moderation in loan growth to be around the 25% (from +30-35%) levels, going forward owing to rising rates but remains confident of improving margins owing to the change in the loan mix.

Gujarat Ambuja Cement Key takeaway – Good times to continue: Mr Anil Singhvi, Managing Director of Gujarat Ambuja emphasized to investors that CY07 & CY08 would be very good years for the Indian cement industry as tightness in supply-demand will likely continue. The company expects ~10% rise in cement prices over the next 18-24 months; earlier this week, prices in Gujarat, Maharashtra and Rajasthan increased by ~Rs3-5/bag (up 2-3%).

Bharti Airtel: Focus on revenue leadership: Mr Akhil Gupta, Joint Managing Director of Bharti highlighted to investors that the company was focused on revenue market share (RMS) in addition to customer market share (CMS) and would ideally aim for a RMS/CMS ratio of more than 1x. The latest quarterly results for 3Q FY07 reflect a widening gap in wireless revenues for Bharti versus Reliance Communication (RCom). In 3Q FY07, Bharti's wireless revenues rose by ~Rs4.55bn QoQ while RCom's revenues increased by ~Rs1.77bn QoQ. However, the gap in subscriber net additions was relatively lower; Bharti added 4.9mn wireless subs while RCom added 4mn subs in 3Q FY07.

Reliance Ind.: FY10E is likely to be a year of very strong earnings growth for Reliance. FY10E is likely to be first full year of oil and gas production from the D6 block in the KG basin and operation of Reliance Petroleum's refinery expansion.

Ranbaxy Laboratories: Ranbaxy management maintained their 2007 guidance of 15%+ revenue growth (likely US$1.6bn revenues) and maintenance of EBITDA margin at 16% levels (like CY06). This will likely be driven by strong product flow across all markets, strong growth in emerging and branded generic markets and continuing cost optimization.

Bajaj Auto: Volume growth to be strong but margin pressure over next two quarter. Process of demerger of the investment and manufacturing businesses expected to gather pace over the next 12-18 months.

Zee Enter: Zee TV has hiked ad rates by 15% last week, which is the third rate hike in FY07. This should have 9.4% increase in FY08E earnings for ZEEL.

GMR Infrastructure: GMR likely to announce the winner for the Advertisement contracts for its Delhi International Airport JV.

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Refer to important disclosures on page 12 to 15. Analyst Certification on page 10. Price Objective Basis/Risk on page 9.

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ICICI Bank (ICIJF, Rs947, C-1-7)

Key Takeaway – Moderation in growth becoming more visible

- The bank expects moderation in loan growth to around the 25% (from +30-35%) levels, going forward owing to rising rates but remains confident of improving margins owing to the change in the loan mix.

Other Highlights

- **International operations gaining traction.** ICICI Bank's (IBank) international operations appear to be gaining much more traction than expected led by a rise in both its international remittance market fees (market share has risen to almost 25% of the US$25bn NRI remittance market) and also from its overseas operations in London (which according to IBank is giving a ROE of 20%; adjusted for the upfront costs) and Canada which has broken even.

- **Provisioning function of conscious strategy + regulations.** ICICI Bank, once again, stressed in its presentation (at our India conference in Goa) how the sharp rise in NPL provisions was largely a function of the change in loan mix towards higher yielding personal loans (conscious strategy of the bank) and owing to higher general provisions (owing to regulations). It was not, according to IBank, an unforeseen event (barring the rural default) and not symptomatic of an uptick in the NPL cycle.

- **Focus on CASA, rural markets. No equity for 12-18 months**. The bank remains focused on expanding distribution to help improve CASA and also capitalize on the rural opportunity (apart from international). Additionally, it would actively use securitization and other means of financing (including unlocking value, if necessary in its subsidiaries) for funding its asset growth. Has ruled out a fresh equity issuance for the next 12-18 months.

Our main conclusion

- It is after many years that IBank is actively talking about a moderation in growth. Ironically, in our view, a moderation in growth (assuming growth is still in the 25% levels) could potentially improve the profitability (ROE) of the bank if margins improve and fee revenues grow at +40% (driven by international business). Key challenge would be to ensure the uptick in NPL's is manageable.

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Gujarat Ambuja Cements (XBRIF/GUJTF, Rs143.15/US3.24, C-1-7/C-1-7)

- **Key takeaway – Good times to continue:** Mr Anil Singhvi, Managing Director of Gujarat Ambuja emphasized to investors that CY07 & CY08 should be very good years for the Indian cement industry as tightness in supply-demand will likely continue. The company expects ~10% rise in cement prices over the next 18-24 months; earlier this week, prices in Gujarat, Maharashtra and Rajasthan increased by ~Rs3-5/bag (up 2-3%).

- **Room for price increases despite import duty cut:** Gujarat Ambuja estimates the landed cost of imports at ~Rs229-255/bag versus local cement prices in India at ~Rs190-200/bag. The company sees headroom for local cement prices to rise despite the government's recent announcement of a cut in cement import duty to 0%.

- **Demand unlikely to slowdown anytime soon:** The company expects cement demand to grow at ~10% p.a. over the next 2-3 years and believes this growth estimate may be conservative given the historical correlation between cement demand and GDP growth in India at ~1.3x.

- **Capacity additions likely to be lagged:** While the industry's announced capacity pipeline totals ~75mn tpa, Gujarat Ambuja believes that all of the announced capacities may not fructify in the next 2-3 years. Hence, supply tightness may continue.

- **Gujarat Ambuja ranks ahead of peers on profitability:** The company highlighted that its EBITDA margin at ~39% ranks among the highest in the Indian cement industry and places it in a coveted league globally. The company pointed to its strong captive infrastructure viz its own bulk-handling terminals, ships and its large, low-cost captive power capacities as key drivers of sustainable competitive advantage.

- **We maintain Buy rating with PO of Rs160/sh:** We expect Gujarat Ambuja to deliver strong earnings growth through CY07 and believe it is still too early for investors to exit the Indian cement sector with an eye on likely ballooning of supply by end-CY08/early-CY09.

Bharti Airtel Ltd (BHTIF, Rs782, C-1-9)

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- **Key takeaway: Focus on revenue leadership**: Mr Akhil Gupta, Joint Managing Director of Bharti highlighted to investors that the company was focused on revenue market share (RMS) in addition to customer market share (CMS) and would ideally aim for a RMS/CMS ratio of more than 1x. The latest quarterly results for 3Q FY07 reflect a widening gap in wireless revenues for Bharti versus Reliance Communication (RCom). In 3Q FY07, Bharti's wireless revenues rose by ~Rs4.55bn QoQ while RCom's revenues increased by ~Rs1.77bn QoQ. However, the gap in subscriber net additions was relatively lower; Bharti added 4.9mn wireless subs while RCom added 4mn subs in 3Q FY07.

- **Industry subscriber additions could accelerate further:** Bharti opined that industry net adds could accelerate further from current levels of ~7mn subs per month, given that network coverage of leading operators like Bharti currently spans only ~54% of total population. Bharti will focus on achieving ~75-80% population coverage over the next 2-3 years so long as its key performance filters (the 3-line graph) remain supportive of such growth.

- **Roaming cuts unlikely to have dramatic earnings impact**: Bharti estimates the net profit impact of cuts in roaming tariffs (negative impact) versus cut in port charges (positive impact) at ~US$25-30mn on a full year basis i.e. ~2% of our FY08E profit forecast.

- **Outcome of Hutch deal still uncertain:** Bharti said it remains to be seen whether the imminent sale of Hutch-Essar will lead to ownership change or yield industry consolidation. If Vodafone acquires Hutch, Vodafone will cease to be a strategic partner of Bharti and will relinquish board representation. However, regulations do not restrict Vodafone from staying on as a financial investor in Bharti.

- **Keen on the broadcasting/DTH business**: Bharti has applied for a DTH licence and believes that broadcasting could offer growth opportunities that may be very similar to its wireless telephony business. DTH also uses over-the-air technology and allows for modular capex. Also, the cost of DTH equipment should drop as economies of scale kick-in. While DTH could become a mass-market product, IPTV will remain a niche offering in the absence of unbundling of the last mile. At this stage, Bharti intends to focus on content-delivery and does not plan to develop/own any content.

- **Tower subsidiary to increase focus on sharing**: Bharti emphasized that the formation of a separate subsidiary for its tower business would sharpen focus on infrastructure sharing. The company has not yet decided on any equity partnership or separate listing for its tower business.

- **Execution is the key business challenge**: In its discussions with investors Bharti emphasized that scaling up its business for the huge potential of the under-penetrated Indian market remains the key challenge. Additionally, competitive intensity of the market will continue to be high.

- **Re-iterate Buy, Bharti remains our top pick**: We remain Buyers of Bharti and believe it will maintain significant leadership in terms of network coverage for at least the next 18-24 months. This coupled with our expectation of continued strong subscriber growth in the Indian market drives our Buy rating on the stock. Bharti remains our top pick in the Indian telecom sector.

Bajaj Auto (BJJAF, Rs2,825, C-2-7)

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Presentation focused on few distinct areas – core business, mainly two wheelers, exports and insurance and finance subsidiaries.

- Management highlighted that the domestic two wheeler market will continue to be dominated by motorcycles, and expected to touch 10mn units by Year 2010 (up from ~7mn units in FY07). Bajaj Auto expects to increase its share from ~35% presently to >40%.

- Margin pressure to continue through the next few quarters, with leading players expected to hold on to market share, rather than profitability. Bajaj Auto expects to partially mitigate this by moving to high-end, super premium bikes (recently launched the 180cc Pulsar which is adding to volumes and is also more profitable), as well the new upgraded platform which is readying for a Q2 FY08 launch.

- Exports now account for 17% of sales. Management elaborated on entry into newer markets – Indonesia, Iran and Nigeria. They indicated that both Nigeria and Iran will be voluminous and profitable but relatively low margin businesses, competing with aggressively priced Chinese bikes. On the other hand, Indonesia is expected to register initial losses (mainly related to start up costs, brand building expenses etc), but generate strong profits over the longer term.

- Expansion plans are on track with the Uttarchal plant expected to come up by April 2007. Initial capacity of 300,000 units will be ramped up to 1mn units over the next year. Aggregate two/three wheeler capacity expected to increase to 5.5mn by FY09 (up from 3.2mn units currently) for a cumulative capex of Rs 15bn.

- Process of demerger of the investment and manufacturing businesses expected to gather pace over the next 12-18 months. Commenting on the insurance subsidiaries and the eventual listing, the management highlighted that the regulations will decide the same, but likely only in 3-4 years.

Reliance Industries (XRELF, Rs1,388, B-1-7)

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Main takeaways:

- FY10E is likely to be a year of very strong earnings growth for Reliance. FY10E is likely to be first full year of oil and gas production from the D6 block in the KG basin and operation of Reliance Petroleum's refinery expansion.

Other highlights:

- Oil production from D6 discoveries could begin in 2009.
  RIL may invest directly in city gas distribution. Selling treasury shares is an option RIL may exercise to fund capex. RIL is implementing three mega projects currently - development of gas discoveries in D6 at USD5.2bn, RPL refinery project at USD6bn, Retailing involving capex of USD5.6bn and equity investment of USD2bn. More capex would be required to develop D6 oil discovery, on exploration and investment in gas distribution and marketing.

- RIL's investment in the East coast-West coast pipeline is in the form of a Rs20-25bn deposit. RIL is not in favor of equity investment due to likely low regulated return. However RIL may invest directly in city gas distribution, which could offer much higher than regulated returns. RIL's interest in city gas distribution is driven by the fact that CNG and PNG price realisation is much higher than price power, fertilizer or even other industrial consumers may be ready to pay.

- RIL expects to fund capex from internal accruals, debt (net gearing at just 26%) and if required from sale of 173m treasury shares worth almost USD5bn. Equity funding for refinery has been completed but more debt will be raised. In case of retailing 56 stores are operational now and consumer response to date has exceeded management expectation. Our view: We also expect strong earnings growth for RIL in FY10E. Our earnings forecast however does not factor in profit from oil production in D6. Strong earnings growth in FY09E also cannot be ruled out especially if D6 oil and gas production starts in 1H FY09 as indicated by RIL's partner in D6 Niko Resources in its press releases. E&P will be a significant driver of earnings growth with D6 oil and gas production and coal bed methane starting in FY09E, gas production from NEC-25 block in FY10E and oil production from KG III 6 in FY11E.

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Ranbaxy Laboratories (XANDF, Rs414, C-2-7)

Key Take-away from management presentation

Ranbaxy management maintained their 2007 guidance of 15%+ revenue growth (likely US$1.6bn revenues) and maintenance of EBITDA margin at 16% levels (like CY06). This will likely be driven by strong product flow across all markets, strong growth in emerging and branded generic markets and continuing cost optimization.

Update on key issues

- The Poanta Saheb facility was inspected by the FDA last week and management expects the warning letter issue to be resolved latest by mid-07 (earliest by March'07)

- **R&D & SG&A outlook.** Likely 25% increase in R&D spend in CY07E (similar to 2005 levels) while SG&A spend for CY07E likely to remain at similar level to CY06

Product update

- **Lipitor in Canada (about US$1bn).** Ranbaxy expects generic Lipitor in Canada to be an opportunity post the May'07 patent expiry; however launch is dependent on Pfizer's appeals ruling. Likely 2008 opportunity for Ranbaxy,

- **Generic Pravastatin.** Likely resolution of the FDA issue at Poanta Sahib could result in FDA approval for generic Pravastatin which is now about US$200mn opportunity. Despite 6-month exclusivity, Ranbaxy believes the economic value of this opportunity is far lower now (noting complete genericisation of other dosages).

- **Generic Valtrex (US$1.08bn).** Ranbaxy is FTF on the product and having received FDA approval, this could be an at-risk launch. Trial date not yet set; possible 2008 opportunity.

Region-wise growth and margin outlook

- **North America.** Despite pricing erosion of 15% likely to continue in the base US business, management expects overall growth in US to be driven by the 76 ANDAs pending approval of which about 20 are FTF Para IV opportunities.

- **Western Europe**. Growth outlook for Western Europe markets (Germany, France, and UK) in the near-term remains uncertain in the light of pricing pressure (UK) and healthcare reforms. Longer term, the market opportunity in EU is expected to double to US$34bn by 2010 with high growth expected in Italy, France and Spain (generic penetration is 7-10%)

- **Eastern Europe (largely Romania).** Driven by full year impact of the Terapia acquisition, Ranbaxy expects its Romania geography to scale up to US$120-130mn in CY07 vs. US$70mn in CY06.

- **India.** Having achieved the No. 1 rank in India (5.1% market share), Ranbaxy expects to maintain about 13-15% growth trend in India driven by high chronic share (21%).

- **Other markets.** Ranbaxy expects continuing expanding share of the BRICS markets (36% share in 2006 vs. 32% in 2005) which have a strong and consistent contribution to overall profitability.

- **EBITDA margin outlook.** Although management have guided to maintaining 16% EBITDA margin for 2007, over the long term (about 3 years) EBITDA margin likely in 20% range.

Investment Thesis

Maintain Neutral on valuations and low visibility yet on growth up tick in US/EU and big ticket product opportunities**.**

Zee Entertainment Enterprises (XZETF; Rs334.65, C-1-7)

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Key Takeaways

Zee TV has hiked ad rates by 15% last week, which is the third rate hike in FY07. This should have 9.4% increase in FY08E earnings for ZEEL.

Other highlights

- Company remains comfortable with opening ratings of Star Plus's KBC and believes that events don't last long, which the daily soaps would bounce back due to habits.
- Company expects ad revenues to grow at 25%YoY in FY08E led mainly by price hikes on Zee TV.
- Increased disclosure levels from pay market has had a +ve impact on P&L from 3QFY07. In 3Q FY07, ZEEL had Rs150mn from Dish TV.

ML View

- We maintain our Buy rating on the stock as it being the core beneficiary of ratings increase & distribution reforms in content distribution led by Digitalization either through DTH or Digital Cable.

WWIL

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Key Takeaways

- WWIL to launch its HITS platform from March 2007. This should accentuate the last-mile subscriber acquisition plan of WWIL.

Other highlights

- Subscriber acquisition. WWIL to looking to acquire 2-3 significant regional MSOs, first of which in Gujarat has been acquired recently.
- MSO are in consultation with TRAI on getting 30-40% of FTA revenues of last-mile cable operators (Rs77/sub). This could materially improve the viability of WWIL business model.
- WWIL is looking to do a QIP in the near term US$100mn. Promoters are already taking 5% equity at Rs.122/share to reinforce the confidence.

Dish TV

Key Takeaways

Dish TV's subscriber addition run rate still continues to be strong at 25K/week, which is 2x its main competitor.

Other highlights

- Dish TV reiterated its target of 8mn subs by FY11E v/s 1.7mn currently & 2mn by FY07E.
- Company said that currently the subs. Acquisition cost (SAC) is ~1200/sub., which could go up following increase in competition from likely new entrants such as Sun Direct, Reliance & Bharti.
- Company expects its de-merged stock to list from 25-26th February, 2007. ZEEL would go ex-Dish TV on Feb 12
- It expects a significant scale-up in revenues during FY08E as many subs. Who took the connection in FY06, would end their one year 'free' period in FY08E. Expects to achieve break-even in FY08E with 4.5mn subs.

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GMR Infrastructure (XFIMF, Rs392.7, NR)

Key Takeaway

GMR likely to announce the winner for the Advertisement contracts for its Delhi International Airport JV.

Other highlights

- The company will keenly evaluate the opportunities in the three airports – Navi Mumbai, Kolkatta and Chennai that are expected to be opened up for privatization in the next 2-3 quarters. Besides, it will also focus on the opportunities from the planned privatization of 35 non-metros airports.
- In the power sector, the company will focus on coal and hydro plants going forward and will aggressively pursue the opportunities from the transmission sector. It recently won 140 MW Talong Hydro project on competitive bidding.
- Currently, the company has a Debt : Equity ratio of 1:1. The company can leverage its books for debt:equity of 4:1. Therefore, going forward the projects will be financed through additional debt and internal accruals. GMR doesn't plan any equity dilution on a 2-3 year horizon.
- Company expects revenue to grow to US$1bn. The contribution from Airports is likely to increase from current 30% to 50% by FY10E.

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Price Objective Basis & Risk

ICICI Bank

ICICI Bank is trading at 2.6x FY08E adj. book and 16.3x PE (FY08E). This is a +25-30% discount to its private sector peer banks. We maintain our view that IBank could continue to trade at 2.6x adj. book, one year forward (FY09E) owing to:

- Earnings growth to sustain at 28% CAGR through FY09 with improving visibility on the bank's ability to improve its C-I ratio and fee revenues that should positively impact its ROE. More importantly, pre-provision profits are forecast to rise at even a more rapid pace of 39% CAGR.
- ICICI Bank's dominant retail franchise and expanding distribution network which provides higher visibility on the bank's ability to sustain the expected earnings growth.
- ROE forecast to rise to 18% by FY09.
- Asset quality (in terms of net NPL's) should be manageable despite the forecast rise in NPL's owing to the bank's ability to provide aggressively in coming years.
- Rapidly rising value of subsidiaries which effectively provides upside to the valuation range.

Hence, at 2.6x FY09E adj. book the stock could trade at Rs870. Adding Rs334 for the subsidiary value, we get our PO of Rs1,200.

Sharp rise in rates impacting growth or inability to manage the uptick in the NPL cycle are risks to our PO.

Bharti Airtel

Our price target of Rs850/sh places pegs Bharti at a PE of 21x Mar '09E and EV/EBITDA of 11x Mar '09E versus its historical 1-yr forward trading range of 18-22x on a PE basis and 10-12x on an EV/EBITDA basis. Our price target is also supported by DCF.

Risks are 1) unexpected growth slowdown in the Indian market, 2) unforeseen financial burden from likely 3G auctions, and 3) sustained pressure on RoE due to overseas expansion plans.

Reliance Industries

RIL's price objective on sum of parts basis works out to Rs1,474/share. The value of the core refining and petrochemical business has been calculated on DCF. Value of its investment in Reliance Petroleum is calculated on DCF value of RPL and applying it to RIL's holding in RPL. Its oil and gas reserves and resources are also valued on DCF basis. RIL's investment in IPCL is valued at current market price.

Significant weakening in refining and petrochemical margins even below our expectation is a risk to our price objective. Such a decline in margins is more likely to be triggered by negative surprises on demand rather than supply. As discussed our refining margin forecasts assume almost all possible refinery projects coming up. Large disappointments on E&P front could be another risk to our price objective. We have valued even resources and exploration upside.

Zee Entertainment

Our PO of Rs328 is based on sum-of-the-parts & signifies an improving outlook. **Risks**: Competition from Star & New channels from NDTV, Cricket World Cup '07 on competing channel, lack of penetration of CAS system, cap of cable tariffs by TRAI and slowdown in penetration of Zee Turner/Dish TV.

Analyst Certification

We, Rajeev Varma, Reena Verma Bhasin, CFA, Bharat Parekh, S. Arun, Visalakshi Chandramouli and Vidyadhar Ginde, hereby certify that the views each of us has expressed in this research report accurately reflect each of our respective personal views about the subject securities and issuers. We also certify that no part of our respective compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

Special Disclosures

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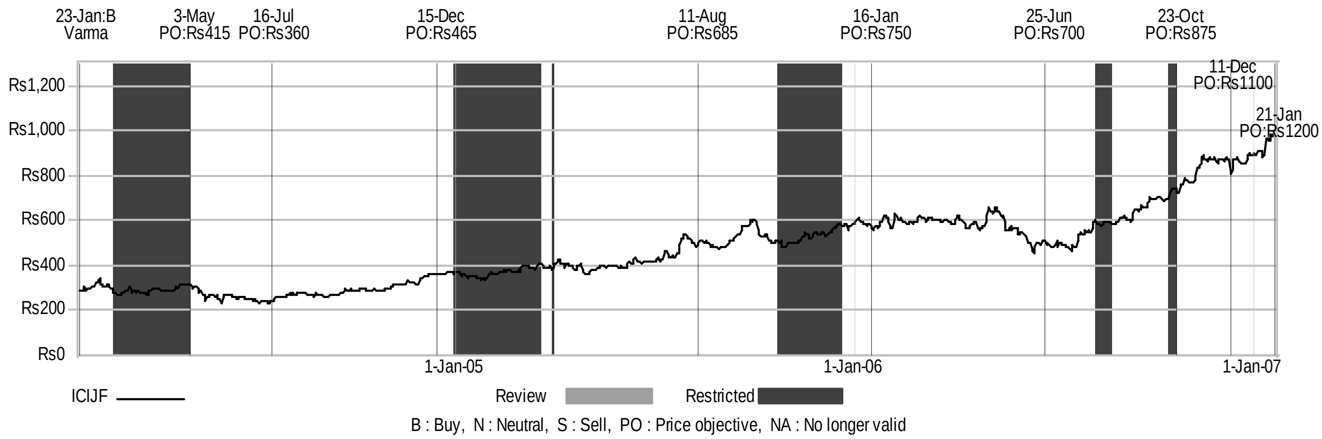
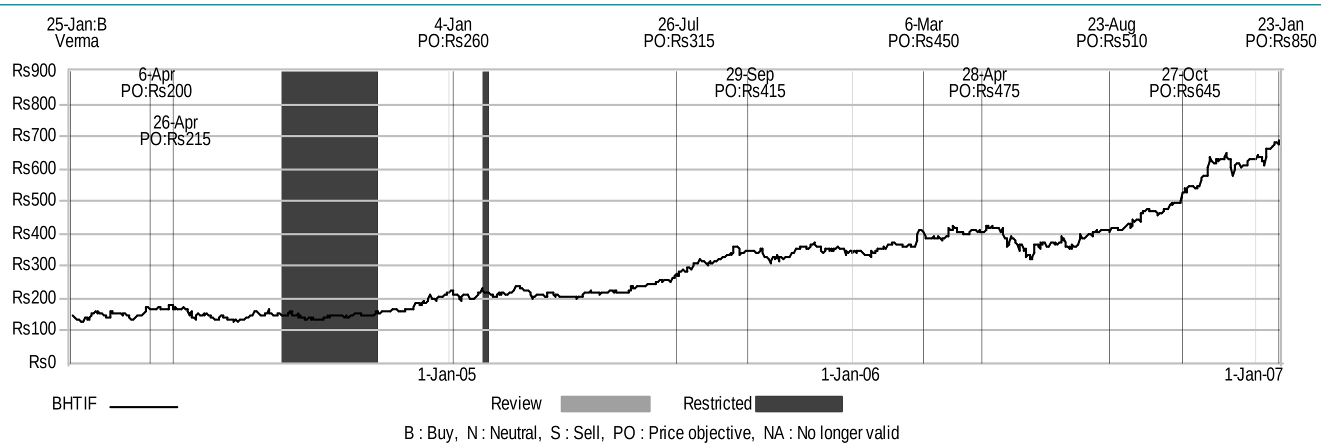
Important Disclosures

ICIJF Price Chart



The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark Grey shading indicates the security is restricted with the opinion suspended. Light Grey shading indicates the security is under review with the opinion withdrawn. Chart current as of December 31, 2006 or such later date as indicated.

BHTIF Price Chart



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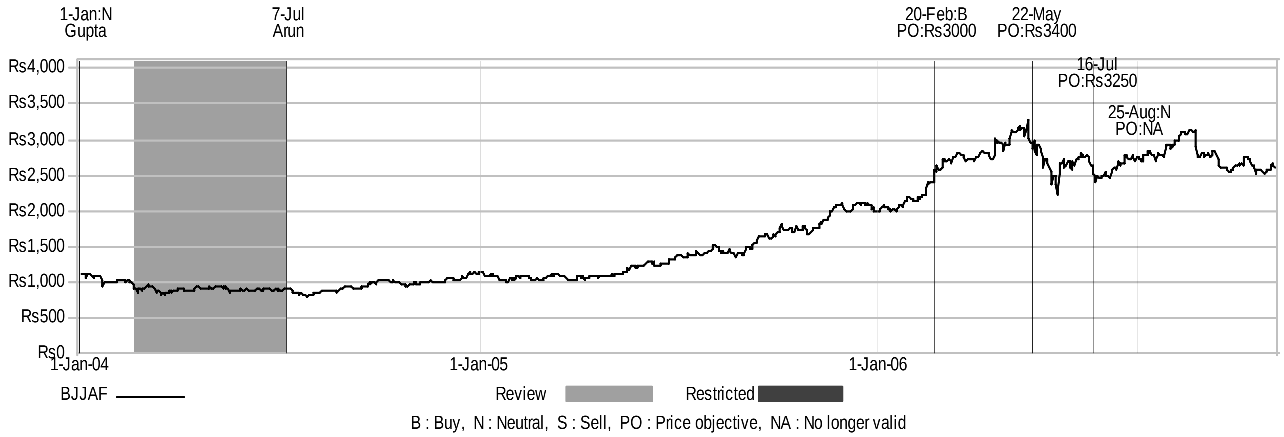
BJJAF Price Chart



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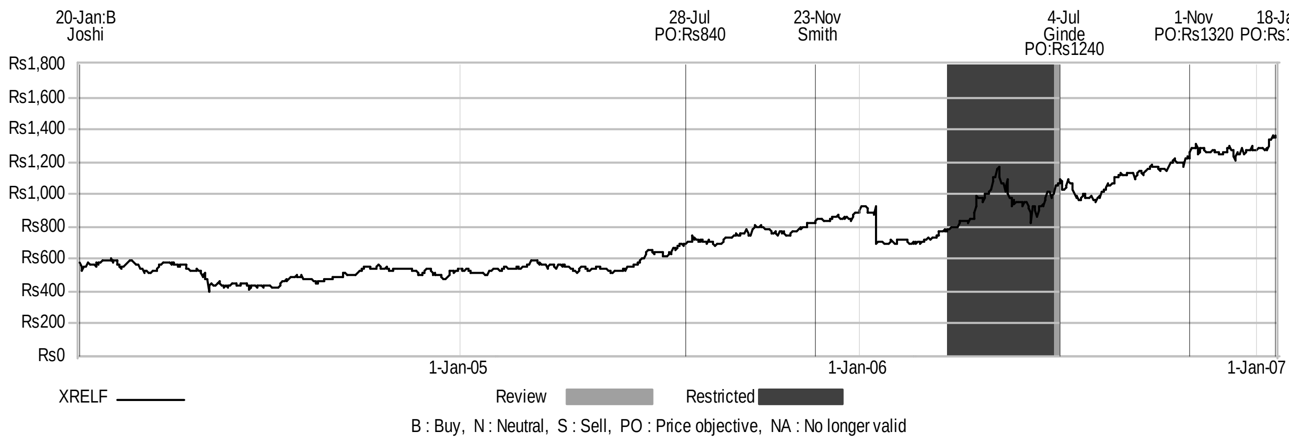
XRELF Price Chart



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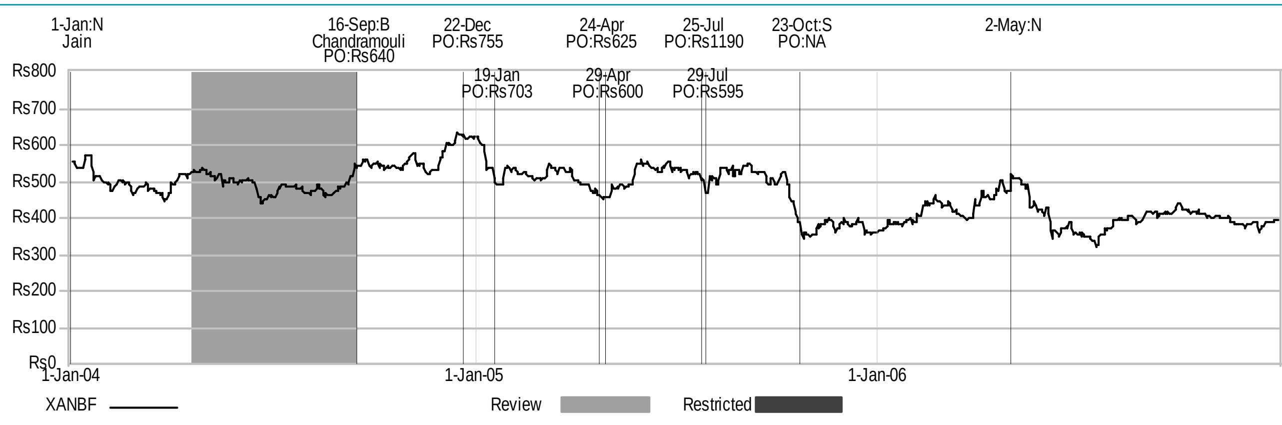
XANBF Price Chart



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Investment Rating Distribution: Autos Group (as of 31 Dec 2006)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	32	37.21%	Buy	7	21.88%
Neutral	38	44.19%	Neutral	7	18.42%
Sell	16	18.60%	Sell	3	18.75%

Investment Rating Distribution: Banks Group (as of 31 Dec 2006)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	92	40.35%	Buy	50	54.35%
Neutral	113	49.56%	Neutral	66	58.41%
Sell	23	10.09%	Sell	11	47.83%

Investment Rating Distribution: Chemicals Group (as of 31 Dec 2006)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	29	42.65%	Buy	5	17.24%
Neutral	31	45.59%	Neutral	9	29.03%
Sell	8	11.76%	Sell	3	37.50%

Investment Rating Distribution: Health Care Group (as of 31 Dec 2006)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	93	43.87%	Buy	26	27.96%
Neutral	108	50.94%	Neutral	33	30.56%
Sell	11	5.19%	Sell	3	27.27%

Investment Rating Distribution: Telecommunications Group (as of 31 Dec 2006)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	73	45.91%	Buy	23	31.51%
Neutral	69	43.40%	Neutral	14	20.29%
Sell	17	10.69%	Sell	6	35.29%

Investment Rating Distribution: Global Group (as of 31 Dec 2006)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1306	42.74%	Buy	406	31.09%
Neutral	1509	49.38%	Neutral	446	29.56%
Sell	241	7.89%	Sell	53	21.99%

* Companies in respect of which MLPF&S or an affiliate has received compensation for investment banking services within the past 12 months.

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