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Event

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RESEARCH

Day one - Highlights

Jyotivardhan Jaipuria >> +91 22 6632 8658
Research Analyst
DSP Merrill Lynch (India)
jyoti_jaipuria@ml.com

India Research Team
DSP Merrill Lynch (India)

Key presentation highlights

Bharti exuded confidence that its revenue leadership faces no threat from new competition and subscriber quality for Bharti continues to be strong.

HDFC is fairly bullish on FY10. The company expects loan growth to be +20%, although it highlighted that the growth may be back ended (second-half). Additionally, it expects margins to be flattish and asset quality manageable.

Reliance Industries: KG D6 gas ramp up to peak production rate of 80mmscmd would take a minimum of 2 quarters and a maximum of 6 quarters. Guidance at Jan 22 analyst meet was production will peak by March 2010.

TCS: Indian IT vendors facing stiff bill rate pressure, as clients' prune IT budgets. While pipeline strong, deal closures still taking time and visibility poor. Management focusing on managing margins including hiring freeze, likely no wage hike next year, stringent performance management, offshoring and fixed price contracts.

Reliance Infra (RELI) highlighted the exponential growth in its EPC business as the key driver of parent earnings. RELI expects CAGR of 45-50% in EPC earnings for the next four years led by Rs210bn order book. Pipeline for Reliance Infra is robust considering that RPWR has ordered only two projects (Rs140bn for 4.3GW) and is schedule to order 12-15GW over the next two years. Reiterate Buy.

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Key takeaways from presentations

Bharti Airtel (BHTIF, Rs616, C-1-9)

Reena Verma Bhasin, CFA >>
Research Analyst
DSP Merrill Lynch (India)
91 22 - 6632 8667
reena_verma@ml.com

Summary & key highlight

- Bharti exuded confidence that its revenue leadership faces no threat from new competition and subscriber quality for Bharti continues to be strong.

Other highlights

- The Co does not foresee any sustainable impact of RCom's promotional GSM offer. The Co believes that RCom will find it difficult to resurrect itself from the current "discount" brand status. Bharti does not see any need for other GSM operators to react to RCom's offer.

- Bharti believes that already low tariffs, and large scale of existing operators are key barriers to viability of new players. Also, new players do not seem to have the money to rollout nation-wide operations despite the option of tower-sharing.

- Bharti acknowledged that rural customers constitute nearly 55% of its net additions. The Co said it is a myth to assume that the rural customer is only price-driven. Overall, minutes of use (MoU/sub) are expected to remain range-bound around current levels.

- Bharti does not foresee any material slowdown in wireless revenue growth despite the macro-slowdown. The Co also expects to maintain overall margins despite competitive and other pressures. The slowdown may have some impact on Bharti's enterprise-corporates segment but impact on overall company will likely be muted as this segment contributes ~4% of Co revenues.

- On the regulatory front, Bharti highlighted media reports that the cabinet is working towards an auction timeline of mid-Feb. The Co hopes that 3G auctions will be rational given recent concerns over macro-slowdown and liquidity.

Stock outlook

We re-iterate Bharti as our top pick; it is our only Buy-rated stock in the Indian telecom sector. We expect ~20% earnings growth for the Co despite recent worries over increased competition. Stock valuations appear attractive to us on a 12-month horizon. Buy.

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Rajeev Varma >>
Research Analyst
DSP Merrill Lynch (India)
+91 22 - 6632 8666
rajeev_varma@ml.com

Veekesh Gandhi
Research Analyst
DSP Merrill Lynch (India)
+91 22 - 6632 8677
veekesh_gandhi@ml.com

HDFC Ltd. (HGDFF, Rs1422, C-1-7)

Key Takeaway - Bullish on growth in FY10

- **HDFC is fairly bullish on FY10.** The company expects loan growth to be +20%, although it highlighted that the growth may be back ended (second-half). Additionally, it expects margins to be flattish and asset quality manageable.

Other Highlights

- **Outlook positive on mortgage space in FY10:** HDFC highlighted that the contraction (4-5%) in approvals in 3QFY09 was owing to lack of lending to developers and corporate (32% of the book is to non-individuals). But, as per HDFC, there has been a spurt in enquiries in Jan'09 and should translate into +20% growth, though back-ended (2nd half). Further, 20-25% fall in property prices is key to growth.

- **High collateral against developer loans:** HDFC highlighted that the value of collateral it has against its developer loans (10-12% of loans) was fairly high. It outlined that typically the project itself and additional assets are mortgaged. Further, it also takes pledge of shares and corporate guarantees, if required. The value of collateral is estimated at 2-3x the loans, in most instances. Moreover, as per HDFC, all developer loans are performing at this juncture.

- **Margin pressure may be benign:** HDFC believes that margin pressure may be relatively benign as HDFC should be able to a) re-deploy the liquid funds available with it to fund loan assets; b) benefit from the very sharp fall in wholesale borrowing rates; and c) has got reset clauses in many of its corporate borrowings done in Oct-Nov'08, enabling it to re-price those in 3-6 months. However, this is post the 13bps correction in spreads seen in FY09 v/s FY08.

Conclusion

We are less bullish on the growth prospects as we think growth might be a challenge-property prices remain a wild card. We estimate 15% disbursement growth, 18% loan growth and 16-17% earnings growth in FY10. However, in the challenging environment of CY09, this would also be amongst the best defensive and could show earnings growth better than the most financials.

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Reliance Industries Ltd.(XRELF, Rs1280, B-1-7)

Key takeaways

Vidyadhar Ginde >>
Research Analyst
DSP Merrill Lynch (India)
91 22 - 6632 8673
vidyadhar_ginde@ml.com

- KG D6 gas ramp up to peak production rate of 80mmscmd would take a minimum of 2 quarters and a maximum of 6 quarters. Guidance at Jan 22 analyst meet was production will peak by March 2010.
- Finding, development and production cost of KG D6 would be USD8-10/bbl
- USD8bn has been spent on E&P till date including on KG D6 development and exploration
- The Mumbai High Court order on Jan 30 lifting ban on KG D6 gas sales by RIL as an interim measure allows it to sign 5-year contracts. Any such contracts will be subject to court decision on litigation with RNRL and NTPC for 40mmscmd of gas
- For the first 5 years sale of gas at over USD4.2/mmbtu is highly unlikely
- RIL expects its refineries to achieve over USD6/bbl premium to Singapore refining margins. It has achieved USD6-8/bbl premium to Singapore margins in the last few quarters
- 30% of RPL sales (mainly diesel) are likely to be to Europe, 40% to Asia and Middle East and balance 30% to other markets like US and Africa. Gasoline exports will be mainly to Asia, Middle East and US. Diesel exports will be mainly to Europe and Asia
- In terms of complexity RIL and RPL's refineries are two of the top three in the world among refineries with over 300k bpd capacity. This gives them ability to produce stringent quality spec products and to process different types of "difficult" crude. RIL processed 24 different crude in 2008 as against 6-8 crude, which most other complex refiners process. RPL's ability to produce 10ppm sulfur diesel, which became applicable in Europe from Jan 2009, will help it place products in a big way in Europe. Not all Russian refiners, which export to Europe, comply with these specs
- Term contracts for 2009 product sale are tied up
- In response to question on whether treasury shares could be cancelled response was that any decision in this regard may be taken in 2H FY10E. Original thought was to use treasury shares as currency for acquisition.

Reliance Infra (RCTDF, Rs521, C-1-7)

Key Takeaway – EPC key driver of earnings

Bharat Parekh >>
Research Analyst
DSP Merrill Lynch (India)
91 22 - 6632 8656
bharat_parekh@ml.com

Reliance Infra (RELI) highlighted the robust growth in its EPC business as the key driver of parent earnings. RELI expects CAGR of 45-50% in EPC earnings for the next four years led by Rs210bn order book. Pipeline for Reliance Infra is huge considering that RPWR has ordered only two projects (Rs140bn for 4.3GW) and is schedule to order 12-15GW over the next two years. Reiterate Buy.

Other Highlights

- **Projects on target:** Reliance infra has pre-poned execution of Sasan project by three years starting Dec 2011. RELI commissioned two of its five toll road projects in Jan/Feb 2009 costing Rs7.5bn and is likely to commission the remaining three projects in July,2010.
- **Rs99bn cash in hand, reduced exposure to ICD; Buyback ahead:** RELI has reduced exposure to ICD from Rs50bn in FY2008 to Rs29bn as at Dec2008. Further it has utilized Rs7.96bn in its recent buyback and (average price Rs900). RELI expects to launch 2nd tranch of buyback worth Rs12bn in the next two weeks, which will get completed in April,2009.
- **Targeting a 40-50% CAGR in EPC:** The Company has an order book of Rs210bn in EPC, 60% of which comes from RPWR. In FY09E, EPC business is expected to grow at 90%. The management expects a 40-50% CAGR growth in sales over next four years, with an EBIDTA margin of 10%. It further expects to get orders from RPWR for 12-14GW over the next two years, which would grow the order book.
- **Conclusion:** We reiterate our Buy on RELI trading at 0.9x P/BV.

Mitali B Ghosh >>
Research Analyst
DSP Merrill Lynch (India)
+91 22 - 6632 8661
mitali_b_ghosh@ml.com

Pratish Krishnan >>
Research Analyst
DSP Merrill Lynch (India)
+91 22 - 6632 8679
pratish_krishnan@ml.com

Kunal Tayal >>
Research Analyst
DSP Merrill Lynch (India)
+91 22 - 6632 8663
kunal_tayal@ml.com

Tata Consultancy Services (TACSF,Rs491,C-1-7)

Key Takeaway

TCS indicated stiff bill rate pressure as clients' prune IT budgets. While pipeline appears strong, deal closures still taking time and visibility is poor. Management is focusing on managing margins. Steps include hiring freeze, likely no wage hike next year, stringent performance management, offshoring and fixed price contracts.

Other Highlights

- Pricing key challenge, as clients look to prune IT budgets. Company trying to manage clients IT budgets pressures by more offshoring and fixed price contracts.
- Deal pipeline healthy. Hopes the worst behind in project cancellations in verticals like Banking/Financial Services and telecom, but early to conclude definitively yet. Overall deal closures taking time and visibility poor. Good traction in pharma, media and retail. Getting enquiries from Satyam clients
- Key focus is on managing margins: No more hiring, stringent performance management and will consider defering joining dates for campus offers made last year for FY10 (24,500), particularly given attrition could fall.
- Likely no wage increase next year and variable compensation proportion may also be increased. Further tightening of selling, general and administration costs likely.
- Citi Global - Commitment on take or pay deal signed last quarter at Citi holdings level. This quarter as CGSL consolidated, will have hit from intangibles amortisation too.
- Dividend payout increase would be evaluated from an effective usage of cash perspective.

Conclusion

Though, near term we see few catalysts and next couple of quarters likely challenging, we maintain Buy on favorable risk-reward ie beaten down valuation for a secular offshoring story, strong business model and quality management.

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Price objective basis & risk

Bharti (BHTIF)

We have a price objective of Rs800/sh for Bharti. Our PO is based on an EV/EBITDA of 8x FY10E and PE of 14x FY10E, and is supported by DCF using 11.5% WACC and 5% terminal growth. Our target PE & EV/EBITDA multiples reflect the lower end of Bharti's long-term valuation bands. Bharti has traded in the range of 14-24x on a PE basis and 8-15x on EV/EBITDA. We believe valuations will remain at a premium to regional peers due to relatively strong (+20%) underlying earnings potential. However, we think multiples are unlikely to revert to peak levels due to YoY slowdown in market growth and uncertain policy environment. Our PO does not factor any separate value for Bharti's tower business and stronger-than-anticipated tower-sharing would present upside. Possible dramatic regulatory changes and irrational 3G bidding would pose risks.

HDFC (HGDFF)

Our PO of Rs1980 captures the lower value of subs and factors in some moderation in growth. While the overall business is likely to see some macro headwinds, we do think HDFC can still generate recurring earnings growth of +15% in FY10 in a year in which we expect most banks to see a collapse in earnings growth (due to rising credit costs as NPLs spike in SME segment). Moreover, on its core biz., we estimate HDFC has been generating an ROE of +30% for the past many years. While the ROE is likely to fall to +25% in FY09E (owing to the capital raising through FCCB conversion), we estimate the ROE to rebound to +28% by FY11. Hence, we believe the stock could still trade at 2.5-3.0x, FY10E book (core book, it could arguably trade at +3.5x-4.0, one year forward) given comfort on asset quality, estimated earnings growth of 16-17% through FY10-11 and ROE of +29% on its core biz. (19.4% on reported book). Adding Rs602/shr for subs, we get our PO. A sharp rise in NPLs and inability to maintain growth are risks to our Price Objective.

Reliance Inds (XRELF)

Our PO of Rs1,581 (GDR US$68.75) is based on a sum of parts valuation. The value of the refining and petrochemical business has been calculated on an EV/EBITDA basis using a multiple of 7-8x on FY10E EBITDA. The value of its investment in Reliance Petroleum (RPL) is calculated by applying the EV/EBITDA based value of RPL (multiple of 7x FY10E EBITDA) to RIL's holding in RPL. Oil and gas reserves and resources, as well as its retail business, are valued on a DCF basis using WACC of 11.8%. Refining and marketing, including investment in RPL, is 21pct of PO, E&P valuation (Rs900) 57pct, petrochemicals 16pct and organized retail 6pct. Risks are (1) Decline in refining and petrochemical margins being steeper than expected, (2) Lower than expected oil price. (3) huge disappointments on the E&P front as we have valued exploration upside of Rs154/share, (4) failure in the retail business, and (5) changes in government policies (eg, withdrawal of the tax holiday) which may have a direct impact on the business, cash flow and profit.

Reliance Infrastructure (RCTDF)

Our PO of Rs1100 / US$67 is based on 15pct discount to our SOTP valuation. The parent business is valued at Rs.246/share based on DCF. We value the stake of 33-45pct in power projects of Reliance Power at Rs.873/share on DCF basis, while we value the stake of 26pct in Power distribution business at Rs54/share. Its 74-100pct stake in Power Transmission business is valued at Rs24/share at 1.2x book value, and stakes of 69pct in the Metro project and

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51pct in road projects are valued based on DCF at Rs61/share. A stake of 66pct in real estate business is valued at Rs35/share on DCF basis. Other investments are valued at Re1/share on book value. Based on this, we arrive at an SOTP value of Rs1294/share. Our PO translates into 2x FY10E P/BV, which is below the utility sector leaders such NTPC 3.1x. Risks to our PO are: ability to source quality power, viable gas supply, discontinuity/delay of power sector reforms, delay in project execution, non-availability of fuel, currency and freight risks, potential matching of demand-supply of power in India leading fall in power rates.

Tata Consultancy (TACSF)

Our PO of Rs550 is set at an FY10E PE of 9.5x, which based on a 20% discount to Infosys target PE. This is higher than the range of 5 to 10%, to factor in higher exposure to the banking vertical and absence of track record as a listed company during the last trough. Risks are steeper and longer than anticipated global slowdown, greater competition from global and Indian vendors, and Rupee appreciation.

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Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	35	41.67%	Buy	5	16.67%
Neutral	19	22.62%	Neutral	2	14.29%
Sell	30	35.71%	Sell	3	11.11%

Investment Rating Distribution: Financial Services Group (as of 01 Jan 2009)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	134	43.23%	Buy	48	36.92%
Neutral	93	30.00%	Neutral	29	32.22%
Sell	83	26.77%	Sell	20	24.69%

Investment Rating Distribution: Technology Group (as of 01 Jan 2009)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	68	35.79%	Buy	4	6.35%
Neutral	49	25.79%	Neutral	9	23.68%
Sell	73	38.42%	Sell	12	18.18%

Investment Rating Distribution: Telecommunications Group (as of 01 Jan 2009)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	82	45.30%	Buy	12	18.18%
Neutral	51	28.18%	Neutral	12	30.77%
Sell	48	26.52%	Sell	7	17.50%

Investment Rating Distribution: Utilities Group (as of 01 Jan 2009)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	65	38.92%	Buy	23	39.66%
Neutral	42	25.15%	Neutral	16	42.11%
Sell	60	35.93%	Sell	16	29.09%

Investment Rating Distribution: Global Group (as of 01 Jan 2009)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1297	38.46%	Buy	314	26.81%
Neutral	859	25.47%	Neutral	210	28.23%
Sell	1216	36.06%	Sell	229	20.71%

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