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Event

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RESEARCH

Day two - 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

Axis bank highlighted how its 'sales process' and risk management systems were designed to take care of rapid loan growth, while managing asset quality. The bank did highlight that growth may moderate in coming quarters.

HUL: Given the staple nature of HUL's products, demand cutbacks due to economic slowdown are unlikely to be significant.

HDFC Bank highlighted that the bank is targeting in-house customers for retail loan growth and thereby ensuring that delinquencies remain under check.

Idea said they are unperturbed by investor nervousness over their margins as the cost increases are temporary and largely reflect a planned effort to deepen presence.

L&T expects spill orders from existing order book and domains such as power to result in order book increase in FY10-11. Expect order book decline to be away by 2-3years, while margin pressure and working capital expansion are possible in FY10E.

Reliance Capital has shifted towards profitability v/s growth across all businesses incl. life insurance biz.

SBI remains confident of growing its loans by 20-25% over the next few years and also highlighted that it has the requisite capital to do so. SBI also highlighted that it is sitting on huge unrealized gains on its treasury book, which it may book over the next few quarters.

Sterlite: Downside risk is lowest in case of zinc with ~60% of global zinc capacity making cash losses at current zinc prices.

Suzlon expects new orders to pick-up in India and abroad led by improving regulation, new players and credit flows. We see new order of ~500MW in the next 3-4 months, while company guides for 1GW for the next six months.

Tata Steel: Domestic demand remains weak but has recovered slightly from Oct lows especially in long products due to better infra demand. However domestic pricing is likely to remain weak.

Wipro discussions re- confirmed the tough near term industry demand outlook with poor visibility for next year, but the silver lining is the steps management is taking to optimise operations including just-in-time hiring.

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Key takeaways from presentations

Indian IT industry outlook

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

Key Takeaway: Keynote speaker Mr. Ramadorai, CEO and MD of TCS believes while the demand outlook is challenging over next couple of quarters, there are secular growth opportunities aided by demand from verticals like pharma, retail and media or overall in cost optimisation initiatives like application and IT infrastructure consolidation. Concerns arising out of 26/11 and Satyam are being addressed by governments/regulators/corporates and clients and investors recognise. Expects IT services industry to emerge stronger post this downturn.

We had Tata Consultancy Services CEO and Managing Director, Mr. S. Ramadorai present the keynote address on Day 2 of our conference.

Key messages were

- On Satyam's fallout on Indian corporates and the Indian IT sector, his view is that clients and investors appreciate its a specifc case. Infact Indian IT companies offer greater transparency and information sharing as compared to many global vendors and also present accounts to comply with both Indian and international accounting standards such as US GAAP and IFRS etc.
- Highlighted the Tata Group values and strong corporate governance standards at TCS including a strong Board, internal audit by Ernst and Young, metric monitoring by management dashboards etc.
- Believes verticals like healthcare, retail, utilities will drive growth. Demand opportunities also in Banking from greater demand for analytics and regulatory reasons. While overall deal pipeline strong, difficult to predict time of pick-up.
- Drive to optimise costs by consolidating platforms, adopting virtualisation etc.
- Exploring new models of just-in-time hiring of fresh engineering graduates
- Muted sentiment at Davos with fewer leaders from US and financial services industry this time. The overall view seemed to indicate that earliest recovery would be in 2010.
- Mr. Ramadorai believes concerns on physical security post 26/11 being addressed by various measures including increased cooperation between governments to control terror strikes and is not an issue for clients

BO

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

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

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

Aptech Ltd (XZUYF, Rs82, C-1-7)

Key takeaways

Aptech highlighted that 2009 would see significant margin improvement given phase out/ exit from loss making businesses. Also other than N power (hardware training) which would still be in investment phase, other new initiatives such as Avalon (Aviation) likely to turn around in CY09.

Other key highlights

Subdued India IT business: Domestic IT training expected to be flat yoy during CY08, though margin improvement to the tune of around 500 bps likely in CY08 in IT training.

New initiatives ramp on track : Avalon its Aviation training subsidiary has ramped as per expectation with nearly 50 centres already operational. Strong traction in N Power (networking training) subsidiary with 35 centres operational. Plans to double reach in CY09. Also plans to take Avalon and N Power International. Aims at entering Dubai, Singapore, Vietnam markets for these offerings.

Likely to unlock value in China subsidiary: Mgt highlighted that definitive agreement for restructuring of China JV has been signed with creation of holding company structure. It will aim at listing holding Co during 2nd half of CY09, subject to market condition. As per management growth in China IT training industry remains robust with growth rates exceeding 23% yoy. Aptech continues to be the leader in China market.

Conclusion

Believe margin expansion story is on track albeit lower than anticipated earlier. We believe listing of China holding company would be key to re rating.

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

Axis Bank (UTBKF, Rs396, C-3-7)

Key Takeaway - Market share focused

The key highlight from Axis bank was that it remains focused on market share grab. In addition, the bank highlighted how its 'sales process' and risk management systems were designed to take care of rapid loan growth, while managing asset quality. The bank did highlight that growth may moderate in coming quarters.

Other Highlights

- Asset Quality- manageable, as per bank: Axis bank highlighted that it believes asset quality is manageable. Axis bank mentioned that its strong provision coverage on current and through-cycle loan loss basis, the tenuous link between growth and NPLs, reasonable loan-to-value ratios, high percentage of self-originated loans, sensible sectoral exposures, intensive monitoring and even attempts to in-source collections should hold the bank in good stead. Additionally, it also highlighted that for home and car loans, SARFESI Act is working fine.

- Growth likely to moderate, margins stable: While Axis bank expects moderation in loan growth, it is still expecting loan growth at 30-35% yoy in FY10 (v/s +60% earlier) as capital and low-cost resources may not be able to support such high growth. However, the well-honed liabilities strategy, supported by increased bargaining power with borrowers, should continue to deliver stable margins.

- Network expansion to continue; key focus: Axis bank believes that distribution remains a key driver for growth. The bank has about 200 licenses on hand, which it believes will ensure growth for next 12 months (present branch strength of ~750).

- SME monitoring closely: SME exposure for Axis is about 20% of loans. While Axis acknowledged that there are stress points, as per Axis, it is paying close attention on this side of the business and has dedicated centers focused on assessing SME credit and also NPL recoveries, if any.

Our main conclusion

We believe Axis Bank's NPL's could rise 2.5x between now and Mar'10 owing to rapid loan growth (64% avg.) in past 2 years and 20% exposure to SME. We expect a sharp uptick in SME NPL's at sector level owing to weakening macro.

BO

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

GMR (GMRLF, Rs69, REVIEW)

Key Takeaway - Airports to turn-around with Govt. help

Govt. support to concessionaires at airports via allowing user / airport development fees is likely to help GMR turnaround all its loss making airports in FY10. GMR remains on track to deliver earnings from its energy projects, the Hyderabad and Delhi airports and urban infrastructure projects including toll roads.

Other Highlights

- **Financing:** GMR highlighted that its Delhi Airports is well financed. Should the real estate monetization get delayed, there may be other options such as airport development fee (Rs22-25bn) contributing to quasi equity, could be used to fill the funding gap. Also its 1050MW Kamalanga power project and captive coal mines in Indonesia and South Africa are well funded from its Rs16bn cash chest.

- **New Delhi airport on-track despite delay in real estate monitization:** When real estate prices peaked, the 46 acres of land surrounding the Delhi airport was considered extremely lucrative for GMR. The company is now auctioning 13 plots, with nine expected to lead to hotel development. Anecdotal evidence suggests that many of the real estate developers / hotel developers have slowed their expansion plans in response to the slowdown in global economic growth and the subsequent fall-out of the highly cyclical hotel industry. This could lead to a short term reduction or delay in cash inflows for GMR. Should the bids fall below GMR expectations, they are likely to consider options such as airport development fee to complete the New Delhi airport by March 2010 (55% complete till now).

BO

Hindustan Unilever (HINLF, Rs266, C-1-7)

Vandana Luthra
Research Analyst
DSP Merrill Lynch (India)
+91 22 - 6632 8670
vandana_luthra@ml.com

Anuj Bansal >>
Research Analyst
DSP Merrill Lynch (India)
+91 22 - 6632 8690
anuj_bansal@ml.com

Key Takeaway - Earnings to remain resilient, rural growth is strong

Given the staple nature of HUL's products, demand cutbacks due to economic slowdown are unlikely to be significant. Strong rural growth should continue to provide support. Also we expect any weakness in topline growth to be offset by weaker input costs. Overall risk to earnings is thus low.

Other Highlights

- **Focus on volume growth and market share expansion:** 2008 was a year of sharp retail price increases and hence strong acceleration in topline growth to 20%, but margins declined on higher input costs. And, volume growth reached a bottom of 2.3% in Dec Q. In 2009, these dynamics should reverse. We expect prices to either decrease or have minimal increases as focus shifts on driving volume growth and regaining of some of the lost market share in key categories.

- **Expect margin expansion on lower input costs:** Expect margin expansion in 2009 based on expectations of lower commodity prices. Media inflation has also eased. These cost savings should also give opportunity for enhanced investment in promotion of new products and brand building.

- **Long term fundamentals remain strong:** Secular growth trend expectations from India remain intact in the longer term. Strng growth in rural markets augurs well this could be the potential long term growth engine. Also, the scope for premiumization in India remains immense. Demographic changes in India are inevitable in our view. Any slowdown in rise of affluence and increasing consumer spending is likely to be short term.

- **Investments to rise in new business initiatives:** HUL sees new product categories as key future growth drivers. To that extent it is investing in initiatives like Knorr range of packaged foods, Out of Home consumption and Pureit water purifiers. Post the national roll out of *Pureit*, the level of investments is expected to rise as HUL ramps up its sales force from 7,500 currently to 10,000 by 2HCY09. HUL will also be looking to ramp up its rollout of Amaze brand of health foods which would require additional investment.

Our main conclusion

In 2009 we forecast HUL EPS to grow 20% to Rs11.3 led by falling input prices. HUL is trading at 23xCY09E, at ~10% discount to its last five yr trading multiple. However, HUL is unlikely to rerate to its historical average unless the volume growth picks up. We maintain Buy with PO of Rs265 and expect HUL to continue outperforming the market based on defensive qualities and strong cash flows.

BO

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 Bank Ltd. (XHDFF, Rs898, C-1-7)

Key Takeaway - In-house customer focus

HDFC Bank highlighted that the bank is targeting in-house customers for retail loan growth and thereby ensuring that delinquencies remain under check. It did, however, concede, that delinquency rates in SME segment (<20% of loans) could double as we begin to see stress; though it may not hurt earnings as the loans are priced on risk-adjusted basis.

Other Highlights

- Solid deposit franchise should help the bank to ride the storm: Barring 3QFY09 when the bank saw its CASA levels declining due to variety of reasons (lower flats; Co's. drawing down cash surplus; savings account moving to FDs and; shift of FDs to 'safer' banks like HDFC Bank), Margins have consistently increased over the past 5 years, reflective of the bank's robust low-cost deposit franchise which has helped it to keep a tight leash on cost of funds irrespective of the interest rate cycle in which the bank has been operating.

- SME book priced on risk-adjusted basis: HDFC bank mentioned that its SME book (~20% of total) continues to be priced at 150bps higher to capture the losses on the SME book, although to date actual losses in the SME book are only at 75bps. The bank said that going forward, losses in this segment are likely to escalate not only for itself for the sector as well.

- Retail focus on in-house customer base: Retail book of HDFC bank has ~25% unsecured loans (~15% of total loans), with 6-8% delinquencies in personal loans and 10-12% delinquencies in credit cards. HDFC bank highlighted that it continues to focus on in-house customers for these segments and also uses risk-assessment systems from CIBIL.

- Network expansion to continue; Integration of CBOP complete: HDFC bank believes that distribution remains a key driver for growth. The bank will apply for about 200 licenses, which we believe will ensure growth for next 12 months (present branch strength of ~1400). Further, its integration of CBOP is complete in respect of both people and technology. It expects the benefits of the merger to become more visible in the coming year.

Our main conclusion

We still believe HDFC Bk still has the highest earnings visibility (+24%) in FY10E, a year when most banks' earnings growth may collapse. In our view, as the environment becomes more challenging, a banks' ability to deliver quality growth is likely to be rewarded more. The bank is also likely to capitalize on the expanded distribution and benefit from integration of its CBOP network. We build in doubling of NPLs for HDFC BANK between now and FY10

BO

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

Idea Cellular (IDEAF, Rs45, C-2-9)

Key Takeaway

- Idea said they are unperturbed by investor nervousness over their margins as the cost increases are temporary and largely reflect a planned effort to deepen presence.

Other highlights

- Idea expects its overall margins to remain stressed for next one year due to further rollout, including launches in Tamil Nadu, West Bengal and Orissa. However, the Co expects its capex to ease beyond FY10E. Also, in its new circles, Idea expects to at least recover its WACC.

- The Co said it has gained brand strength over last 12months. This brand recall has allowed Idea to gain velocity in its Mumbai launch despite pricing itself on par with market leaders. The Co said its recent tariff changes in Mumbai are a localised effort and do not reflect -Idea's pricing policy in other circles.

- Idea said its operations are at a significant advantage versus greenfield licensees as the Co holds 900Mhz spectrum in 50% of its pan-India licences versus 1800Mhz available to new operators. Unlike new licensees, Idea already has a strong nationwide brand presence. Also, Idea has built significant organisational scale in recent years.

- Regarding 3G Idea said it would be good to get spectrum everywhere at a certain price. However, 3G is more important to circles where Idea's 2G presence is already well established.

Stock outlook

- We maintain our Neutral rating on Idea. We believe the company presents low technology risks and management is focused. However, lack of headline profit growth (due to new launches) will likely drag investor enthusiasm.

BO

Larsen & Toubro (LTOUF, Rs658, C-1-7)

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

Key takeaway- Order book decline still away

Company expects spill orders from existing order book and domains such as power to result in order book increase in FY10-11. Expect order book decline to be away by 2-3years, while margin pressure and working capital expansion are possible in FY10E.

Other highlights

- **Growth areas in a downturn-** As per the company Hydrocarbons driven by i)green fuel programs of oil companies, ii) pipeline connectivity for GAIL and Reliance will create new orders. In infrastructure, road and rail transport are expected to see new RFQs. Power order could grow strongly driven by NTPC bulk ordering tender. New orders in airports and ports are expected to pause.

- **Satyam investments: an attempt to scale up in the IT services business-** L&T has increased its stake in Satyam Computers to 12% and views this strategically. As per the company, L&T infotech shares many clients with Satyam through co-delivery. Moreover Satyam will impart BFSI vertical knowledge to L&T infotech's horizontal capability in ERP.

- **Order book is intact as yet:** Company has not seen any order cancellations or even 'go-slow' demand from the clients and implementation of the order book is on track. Currently the order book stands at INR686bn with avg. duration of 23 months. Company could end the year with Rs750bn of order backlog for FY09E. Moreover, given 20-30% penalties for the clients on order cancellations, company doesn't expect order cancellations in the order book.

Conclusion

We have a Buy on the stock with a PO of Rs1110. The stock currently trades at 10.2x FY10e EPS and 8.1x FY11e EPS.

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

Reliance Capital (RLCCF, Rs376, C-1-7)

Key Takeaway - Focus on profitability v/s. growth

Reliance Capital has shifted towards profitability v/s growth across all businesses incl. even life insurance biz. Given the moderation in growth, R-Cap is now even focusing on enhancing profitability in its life insurance through introducing higher margin products; wile growth is estimated to moderate to <50% in FY09 and 20-25% in FY10.

Other Highlights

- Growth to moderate; but margins may hold up in insurance: As indicated, RCAP expects growth to moderate sharply owing to weakening demand, especially in consumer finance. Even in life insurance, the segment where the growth has still been at --% yoy as of Dec'08, R-Cap is now focusing on higher margin (>25-30%) products. These account for almost 24% of incremental premia. Hence, the co. remains confident of sustaining or even expanding NBAP margins in the life insurance biz. In most other biz., it is not seeking to grow the biz.

- Shift towards debt in insurance AUM positive step: A positive takeaway is the shift in R-Ca's AUM (of its life insurance co) towards debt which now accounts for almost 45%. Further, incrementally, almost 60-65% is in debt – suggesting that investor may still take ULIPs by lowering the equity risk.

- Cross-sell and building distribution key for growth: R-Cap believes for significant traction in financial services space it would be effective if it cross sells its retail products across its rapidly rising retail client base across its various businesses (in the group) including mobile customers and utility customers. Currently, it has 20,000 touch points in retail, 10,000 branches (v/s 700), 150,000 agents in life insurance (and 1145 offices) and +1500 dealers.

Our main conclusion

We believe that RCAP will continue to gain market share in life and general insurance – it is already the largest AMC in India, is gaining mkt share in the life insurance biz. and is likely to eventually emerge as the top 3-4 players in the financial services segment.

BO

State Bank of India (SBINF, Rs1092, C-1-7)

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

Key Takeaway - Still bullish on growth

SBI remains confident of growing its loans by 20-25% over the next few years and also highlighted that it has the requisite capital to do so. SBI also highlighted that it is sitting on huge unrealized gains on its treasury book, which it may book over the next few quarters.

Other Highlights

- Under-leveraged: SBI is bullish given (i) its strong, undervalued deposit franchise with 100 mn customers and 20% mkt share; (ii) leverage to investment cycle: and (iii) strong balance sheet and also a play on its subsidiaries. SBI mentioned that through itself and its group companies (offers mutual fund, life insurance, investment banking and credit card services) there are abundant cross-sell opportunities.

- Capital not a constraint for growth: SBI has Tier 1 of +9% and can sustain a Rs450-500bn of credit in-take with existing Tier 1 capital. Also, it highlighted that it still has ~20% of assets remain unrated, which can further expand its capital base.

- Asset quality manageable, as per SBI: While SBI acknowledged the possibility of NPL's rising, it believes the asset quality would be very manageable. Moreover, as per SBI, rate cuts may help spur the economy and keep NPL's in check.

Our main conclusion

SBI remains our preferred play within the govt. banks owing to its dominant franchise, less impacted by liquidity issues and ability to manage the likely uptick in NPLs. It is also a key beneficiary of falling bond yields, having excess SLR. We think the risk return is positive at 0.8x FY10E adj. book; ROE of 15-16%; though earnings growth is likely to collapse to 1-2% in FY10E as loan growth moderates and credit costs rise.

Sterlite Industries (XTNDF, Rs267, C-2-8)

Key Takeaway - Large capex ahead despite slowdown

Bhaskar Basu >>
Research Analyst
DSP Merrill Lynch (India)
+91 22 - 6632 8674
bhaskar_basu@ml.com

Vandana Luthra
Research Analyst
DSP Merrill Lynch (India)
+91 22 - 6632 8670
vandana_luthra@ml.com

We believe downside risk is lowest in case of zinc with ~60% of global zinc capacity making cash losses at current zinc prices. At current prices 30-40% of aluminum capacity is making losses and hence current aluminum prices are not sustainable in the medium term in our view.

Other Highlights

- Sterlite expects its aluminum cost of production to fall over the next few quarters. Cost of production at 2/3rd of Balco's capacity has fallen from US$1969/t in 2Q to US$1467/t in 3Q. Management expects this to fall further to US$700-800/t. In the older higher cost capacity -1/3rd of the total, management expects to cut production by 25% owing to falling ally prices.

- Sterlite's proposed capex over the next 5 years is US$4.8bn. This includes US$2.0bn for aluminum expansions, US$0.9bn for zinc expansions and US$1.9bn for its 2400MW power expansion. In addition Sterlite expects cost savings of 20% at its zinc and aluminum projects which would reduce capex to ~US$4.4bn. Besides this capex, Sterlite would also contribute to Vedanta Aluminum Ltd (VAL) capex where Sterlite has a 30% stake.

- Aluminum capacity is 395ktpa and is expected to expand to 700ktpa by FY12. Zinc capacity is currently 658kt and will further increase to 868kt by FY11. Copper capacity is 405kt which will remain flat.

- 2400 MW coal based thermal power project is progressing well and is on track for progressive commissioning from late 2009. Sterlite is in the process of obtaining financial closure for the Talwandi Sabo 1980MW project. The project may be deferred in case Sterlite is unable to tie up the financing for the project.

- Balance Sheet remains strong with net cash of US$2.5bn as on Dec 2008 ~70% of Sterlite's market cap.

Investment Conclusion - Maintain Neutral

We reiterate our Neutral rating as zinc appears to be bottoming out and net cash of US$2.5bn (over 70% of mkt cap) provides support. We believe Sterlite is well positioned to deliver on its expansion plans given strong balance sheet. Further its low cost position implies that even on current depressed zinc prices, it should earn margins of ~25%. However, we believe sharp negative earnings momentum implies that catalysts for stock performance are missing.

BO

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

Suzlon (SZEYF, Rs43, C-1-7)

Key takeaway- New order ramp-up to start from 4QFY09

Company expects new orders to pick-up in India and abroad led by improving regulation, new players and credit flows. We see new order of ~500MW in the next 3-4 months, while company guides for 1GW for the next six months.

Other highlights

- **To focus on maintaining balance sheet strength:** Suzlon to focus on improving balance sheet strength. It has shelved a capex of INR6.9bn in building a tower unit plan. Also the Euro77mn it received from its stake sale in Hansen to Ecofin has been kept aside for repayment of M&A debt. It expects significant reduction in Rs50bn plus inventory by April 2009 to fund majority of Martifer payment in May, 2009.

- **Order booking in non India geographies to pick-up:** Company said that long term order bookings as well as long term advances are down as a result of credit access problems especially at the end of small developers. However, current order book is completely backed by advances to the tune of 5-20% in case of projects. It expects new order to start kick-in following good reports for its V3 version of 2.1MW turbines, from Australia and USA. We expect 400-500MW new orders inflows by 1QFY10E from Australia (repeat), China (sole bidder for 100MW world-bank funded project), South Africa and USA.

- **India order to pick-up led by PSUs and Utilities, while cash-rich corporate dwindle.** Indian demand to get support despite fall in demand from cash-rich corporates, on demand for cheaper green, predictable electricity coming from utilities and PSU's targeting wind power development. Suzlon has emerged as the lowest bidder for a GSPC tender of 200MW.

- **Successful in taking steps to get over the rotor blade issue in the USA:** The company said that its V3 turbines at Horizon Wind has received funding in Dec, 2008 from JPM, reinforcing that the new V3 is bankable. Moreover, the technical issue in the v2 rotor blade crack has been solved post the rotor blade failure analysis done by Navigant consulting. Going ahead the company expects to target 25% of revenue from the US geography at the end of the next 3 years.

Conclusion

Maintain Buy on the stock with a PO of INR103. The stock currently trades at 4.5x FY10e EPS and 4.0x FY11e EPS.

Tata Steel (TAELF, Rs171, C-3-7)

Key Takeaway - domestic demand slightly better, Europe weak

Bhaskar Basu >>
Research Analyst
DSP Merrill Lynch (India)
+91 22 - 6632 8674
bhaskar_basu@ml.com

Vandana Luthra
Research Analyst
DSP Merrill Lynch (India)
+91 22 - 6632 8670
vandana_luthra@ml.com

Domestic demand remains weak but has recovered slightly from Oct lows especially in long products due to better infra demand. However domestic pricing is likely to remain weak. Europe demand continues to be very weak and Corus production cuts should continue in Mar Q.

Other Highlights

- Tata Steel's India capacity has increased to 6.8mtpa after the commissioning of 1.8mtpa expansion project. Tata expects to sell ~ 6.5mt of steel in FY10. It also expects its 2.9mtpa expansion at Jamshedpur to be on track for commissioning by FY11.
- Demand continues to remain weak in Europe and Corus order book is down 30-40% on weaker demand. Corus has increased production cut in March Q to 40% from 30% in Dec Q.
- Tata expects cost savings of ~GBP600mn in 2H FY09. This includes savings on personnel costs, maintenance costs, sale of excess carbon credits and unwinding of US$ hedges. Benefits from sale of excess carbon credit and unwinding of US$ hedges are nonrecurring in nature.
- Tata is implementing a number of initiatives including 3500 job cuts (~8.3% of Corus headcount) which will reduce Corus's overall fixed cost by GBP150-200mn in FY10.
- Tata Steel standalone net debt as on Dec Q was Rs240bn. Liquidity situation at its South East Asian and European operations remain comfortable. It has prepaid Corus debt of GBP295mn during 1HFY09. Next principal payment for Corus is due Dec 09.
- Tata does not expect any breach in debt covenants in the Dec Q or the Mar Q. Debt covenants are based on trailing 12month EBITDA and on a worst case scenario, debt covenants could potentially come under stress by Sept-09 if steel pricing remains weak and production cuts continue.

Investment Conclusion - Maintain Underperform

Steel outlook remains weak given macro concerns, weak demand and lower cost support due to lower raw material costs in 2H. We expect Tata's profits to decline sharply in FY10 due to lower steel prices. Also negative earnings momentum and concerns around stretched balance sheet is likely to weigh on the stock's valuation multiples in our view.

BO

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

Wipro (WIPRF,Rs225,C-3-7)

Key Takeaway

Discussions re confirmed the tough near term industry demand outlook with poor visibility for next year, but the silver lining is the steps management is taking to optimise operations including just-in-time hiring.

Other Highlights

- Could consider doing away with guidance given uncertainty in economic environment.
- After pushing out salary hikes for on-site employees, company hinted that it would also not rule out more stringent variable compensation, as it focuses on managing margins. Likely that there would be no annual offshore wage hike (due Sep 09)
- On the muted hiring this year, with company likely having made only ~7500 gross offers so far this year vs. 14,000 campus offers, management mentioned it believed it was a prudent strategy given easy availability of engineers. It would honor all offers but defer them. It is offering access to training to the freshers whose joining is being staggered, to shorten training period when they join, to about 3 weeks.
- Management hopes that 4Q would mark the worst quarter and decisions and demand start picking up over the next couple of quarters. Maintained 4Q guidance of sequential revenue decline of 5% (7% decline on organic basis) in constant currency basis
- Vertical-wise outlook: Semi-conductors challenged, expect Telecom OEM to show flat trajectory, retail looks healthy. Enabler acquisition giving them an edge.
- Don't see anti-offshoring trends manifest yet. Believes economic rationale will win

Conclusion

Maintain Underperform on muted 6% FY09E-11E EPS growth. In our view, the risk-reward is unfavorable given management churn last year & exposure to vulnerable technology/banking verticals at 46%. View more muted hiring as an indicator of uncertain revenue outlook.

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

Zee Entertainment Enterprises (XZETF, Rs97, C-3-7)

Key Takeaway - Ad markets collapse, Q4 to be muted

There has been a virtual collapse in the advertising markets owing to a downturn in economy. Though few contracts have been negotiated we believe that rates have come under pressure, competition from Colors also adding to the woes. Growth in DTH revenues main driver of subscription revenues will likely not grow in line with the subscriber addition growth given reduction in the packages to Rs100 /month by the operators. Cost rationalization has begun, albeit competition from Colors and launch of Real from Tuner group could cap savings. Further, Rs5.4bn of loans taken by the group companies is likely to be returned only by March 2010.

Other Highlights

- **Increasing competition and slowing ad markets to impact ad revenues:** The collapse in the ad markets in the third quarter came as a shocker to the management. In the recently signed contracts, ZEEL is offerings more frills, in light of competition from Colors and slowing ad markets. Advertising growth in Q409E is expected to be flatish.

- **Subscription growth to be domestic led:** ZEEL expects international subscription (50% of subscription revenues) to grow at 6-7% given slower subscriber additions and peak subscription rates. On the domestic side, DTH would continue to be the driver however, growth is unlikely to be linear in line with the subscriber additions given a la carte pricing and reduction in overall package prices to Rs100/month by the operators, leading to lower revenues accrual to the broadcasters.

- **To bring in an investor in the movie business:** ZEEL has capped it's spend on the movie business to Rs1.5bn for next year up from Rs750mn in FY09E. The company is in talks with PE players and is raising funds for this business. It would be transferring its movie library of 3000 movies to the new entity which in-turn would be renting movies to ZEEL for a fee. In FY09 YTD the motion picture business has clocked sales of Rs260mn with a loss of Rs20mn.

- **Costs rationalizations have started:** There has been a reduction in the carriage fees on account of easing competition both from 9X and NDTV Imagine. Further, the company has started negotiations with content providers to bring down its content costs, effects of which will be felt in few quarters. Further, it had increased the original programming from 28/hrs/week to 34/hrs/week resulting in higher content costs in FY09E, which is unlikely to go up as much in FY10E. Lastly, FY10E would not have the loss on currency swap of Rs450mn along with Rs550mn loss on Zee Next (as it is being closing down).

- **Group companies likely to return loans only by March 2010**: ZEEL expects group companies DISH and WWIL to return loans of Rs5.4bn plus interest accrued in FY2010. The company changes 14% interest on the same. YTD it has a cash balance of ~Rs3bn and debt of Rs6.25bn outstanding.

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Conclusion

We maintain Underperform rating as we foresee a significant challenge for the company to grow its ad revenues given challenging macro environment. The stock is trading at a P/E of 10.3x FY2010E. Its flagship channel, Zee TV has witnessed stabilization in GRPs on the back of its new programs like Choti Bahu (TVR of 4 in 7.30p.m. band). However, sustenance of the same will have to seen in light of new GEC launch from Turner. This new competition may put pressure on the content costs and may prevent them from coming down resulting in muted earnings growth.

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Price objective basis & risk

Aptech Limited (XZUYF)

Our PO of Rs310 is set at 20x CY09E, which is near the lower end of its historical trading band of 16-30x and implies PEG of 0.4x in line with PEG range of 0.4-0.6x for our mid cap coverage. We expect stock to re-rate as market should appreciate Aptech's evolution from an India IT training co. to a diversified training co. The company's IT training in China contributes 40percent to revenue while non-IT services, including animation, aviation and online testing account for 50percent. We expect the stock to re-rate on strong 70percent 2-year EPS CAGR, ROE increase from 16percent to 24percent and 5x jump in cash flow. Risks:
a) Incremental revenues from the new holding company for China business compensating for reduced holding in China JV. b) Higher than expected slowdown in Indian economy and Indian IT services exports resulting in higher student dropouts than factored in by us.

Axis Bank (UTBKF)

We set our PO at Rs465 for Axis owing to concerns of a sharp rise in NPLs in ensuing quarters and the weak quality of earnings. We believe Axis Bank could see NPLs rising 2.5x between now and Mar10 owing to rapid loan growth (64% avg.) in the past 2 years and 20% exposure to SME. We expect a sharp uptick in SME NPLs at sector level. Going forward too, we think recurring earnings growth could fall to <12% in FY10 owing to a rise in credit costs, margin pressure and weakening loan growth. Hence, with FY10 RoE of 17%, and earnings growth of 12%, we think the stock is unlikely to trade beyond 1.5x FY10E book, assuming no premium under Gordon model (hurdle rate at 12%), underpinning our new PO of Rs465. Downside risks to our PO are a sharp rise in NPLs leading to higher credit costs or the MTM hits arising from the forex derivatives exposure or inability to grow in sync with expectations owing to moderation in the growth cycle. Upside risks to our POs are improvement in macro and NPLs rising much lower than expected providing a fillip to earnings in FY10.

HDFC Bank (XHDFF)

We set our PO at Rs1365 (US$96 per ADR). We still expect high earnings visibility (+24%) in FY10, a year when most banks earnings growth may collapse, as higher credit cost provisioning, low SME exposure, high capitalization levels, and the benefits of the merger, distribution become visible. Hence, the stock trading at 2.5x one year forward book (3.0x FY09, 2.4x FY10 book), could arguably trade up to 2.7x book, one year forward if the bank continues to deliver the growth. Further, in the context of its historic trading range, a multiple of 2.7-2.8x book is closer to trough valuation levels (2.3x v/s peak multiples of +5x). Inability to expand distribution would be an added risk to the implementation of its growth strategy. A sharp rise in NPLs and inability to maintain growth are risks to our Price Objective.

Hindustan Unilever (HINLF)

Our preferred valuation methodology is a target P/E multiple on one year forward EPS. Our target multiple for HUVR is 24x which on CY09E EPS of Rs11.3 gives us our price objective of Rs265. Our target multiple is what HUVR is currently trading at but is at 10% discount to its last five year average trading multiple. We believe the discount is justified given the slightly tougher competitive environment versus the past. We expect the current multiple to sustain given our expectation of earnings upside from falling commodity prices that include crude oil, vegetable oil and packaging costs. Moreover, inherent strengths of HUVR stand out in the

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current tough economic environment. Its business of staple consumer products is relatively recession proof which ensures continuing strong cash flows. Downside risks are slower than expected demand and stiffer competition.

Idea Cellular (IDEAF)

Our price objective of Rs53/sh for Idea is based on DCF assuming 12% WACC and 5% terminal growth. Our revised PO places Idea's headline EV/EBITDA at 6.5x FY10E and 6x FY11E implying 15-20% discount versus our target valuation for Bharti, which remains our top pick. Our PO does not factor any separate value for Idea's stake in the tower (Indus) business. Hence, stronger-than-anticipated tower-sharing could be an upside risk. Possible dramatic regulatory changes and irrational bidding for 3G licences pose risks.

Larsen & Toubro (LTOUF)

Our PO of Rs1110 (1385) / US$23 (30) for L&T is based on 5% discount to sum-of-the-parts valuation. We have valued the core business at Rs980 (1154) per share at a PER of 13.5x (19x) 1-year forward, to factor in the anticipated de-rating. Its 11.5pct stake in Ultratech Cemco is valued at Rs13 (11) per share based on ML PO of Rs525. Its 78.4pct stake in Infrastructure SPVs is valued at 1.6x (1.7x) the private equity deal valuation at Rs55 (58) per share. Its 100pct stake in L&T Infotech is valued at 6x (8x) PER 1-yr forward EPS - in line with niche 2nd tier stocks, giving per share value of Rs40 (53) per share. The stake of 100pct in L&T Finance is valued at 1.2x (1.5x) FY10E P/BV at Rs25 (31) per share. The stakes in Dhamra Port (50pct) and L&T Urban Infra (58.8pct) are valued on a DCF basis at Rs14 (14) and Rs10 (13) per share respectively. Other subsidiaries are valued at 2.5x (3.5x) book value at Rs37 (52) per share. Risks to Price Objective: Slowdown in EPS growth on a higher base, Raw materials, Competition, Project execution.

Reliance Capital (RLCCF)

Our SOTP-based PO at Rs650 captures weakness in the cons. fin. biz. and the broking biz. Key changes in SOTP post 3QFY09 are driven by 74% cut in value of cons. fin. biz. and the broking business (52% cut) given the recent equity markets capitulation and building in moderation in growth. Other significant changes are in AMC business (27% cut) capturing the headwinds worsening risk profile. The cut in gen. insurance is 21% reflecting our assigning lower multiples, despite both this business being ahead of our est. in terms of growth. Other Investment Risks: sharp correction in equity markets is a key risk to our PO. Finally, owing to the higher risk aversion markets may want to be surer of the growth delivery prior to re-rating the stock.

SBI (SBINF)

SBI trades at around 1.4x FY09E book if we were to assign no value to its subs. However, if we were to assume that the market is assigning the full value to the subs of Rs473/shr for FY10E, then the stock trades at just 0.8x FY09E book with ROE forecast about 15% by FY10. We think the stock could trade up to 1.3-1.4x FY10E book (as per Gordon's model. the theoretical P/B is est. at 1.25x, assuming hurdle rate of 12%), especially given its dominant franchise, strong FY09E earnings and likely ability to manage the asset quality better than most banks, though it also remains vulnerable owing to its 20% SME exposure and fairly rapid growth of +25-30% in the past few years. At 1.3-1.4x FY10E book, we get a value of Rs1035/sh. and adding Rs473/shr we get our PO of Rs1500 on the stock. Risks are a sharp rise in rates and in NPLs.

Sterlite Industr (XTNDF)

Our PO of Rs272 (USD5.4) is based on sum of the parts for the metals and merchant power business. We value the metals business at Rs238/share, at a 40% discount to 12 month DCF value of Rs397.The discount emanates from continuing weak metal prices and hence the significant downside risk to our earnings estimates. We value the merchant power business at Rs34/share.

Our DCF valuation for the metals business builds in long term metal prices from FY16E onwards and we take a WACC of 13.7% and perpetuity growth of 0%. We forecast long term zinc prices of $1657/t and long term aluminum prices of $2646/ton. Near term our zinc price forecast is $1576/t for FY09E and $1323/t for FY10E. Our valuation of the power business is based on capacity of 2400MW by FY11, capex of $1.9bn and gearing of 70%.

Upside risks to our PO are higher than forecast metal prices and higher than forecast power capacity over the next two years. Downside risks are lower metals prices and continuing hurdles in minority stake increase.

Suzlon Energy (SZEYF)

Our PO of Rs103 (125) is based on our sum-of-the-parts analysis. We have valued Suzlon's wind business at 9x FY10E earnings, at Rs72 (71) per share. This we believe is fair given Suzlon's long term superior growth and return profile. We value Suzlon's 61.3pct stake in Hansen by taking a 10% discount to our DCF valuation assuming WACC of 10%, which equates to Rs31 (54) per Suzlon share. Risks: Headwinds for wind turbine business and execution risk in the wake of component shortages and blade retrofit issues.

Tata Steel (TAELF)

Our PO of Rs128 is based on a 50% discount to our NPV valuation of Rs256/share. Our NPV assumes a WACC of 13.7% and perpetuity growth rate of 0%. We believe a discount is justified because of sharp demand slowdown, cyclical downturn in the steel sector and higher risks to earnings from falling steel prices. Also, investor risk aversion is likely to be higher given the challenging macro environment and prospects of OECD recession. Upside risks to our valuation are higher steel prices, synergy benefits, lower input costs, export tariff on Chinese exports and higher domestic import duty. Downside risks are lower-than-expected steel prices, volumes and higher input costs.

Wipro (WIPRF)

Our PO of Rs225 is set at about9x FY10 PE, in line with current 30% discount to Infy target PE. Risks: Any impact of recent management churn in May 08, over 60% revs from the vulnerable verticals of technology, banking and retail/transportation and quarterly lumpiness of infrastructure management services business. Industry specific risks are increasing competition from global vendors, risk of Rupee appreciation and sharper than expected macro slowdown. Upside risk to estimates from any large deal wins or stronger-than-expected Rupee.

Zee Entertainmen (XZETF)

Our PO of Rs90 (197) is based on 9x (15x) estimated one-year forward PER. We highlight that the de-rating is reasonable, given the flattish near term growth and cloudy outlook in FY10E on weak economy, in our view. We note that the long term macro story of the stock offering a play on improving demographics, defensive nature of its growth and valuation in line with the Indian media sector average remain. At our PO, ZEE would trade at 2-year FY09-11E PEG of 1x vs the Indian

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market PEG of 1x, which is in line with its historical averages. Risks: Recovery in ad markets earlier than 2H FY10E, accelerated cash burnout at its competition and improved paid connectivity from cable and DTH subs. Downside risk are: potential negative growth in advertising market, further loss of market share for Zee TV led by entry of Turner in the space and slowdown in DTH penetration.

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Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	76	28.57%	Buy	28	43.75%
Neutral	73	27.44%	Neutral	29	46.77%
Sell	117	43.98%	Sell	48	47.52%

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

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	27	39.71%	Buy	5	20.00%
Neutral	19	27.94%	Neutral	4	23.53%
Sell	22	32.35%	Sell	5	25.00%

Investment Rating Distribution: Education & Training Services Group (as of 01 Jan 2009)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	14	82.35%	Buy	4	28.57%
Neutral	2	11.76%	Neutral	1	50.00%
Sell	1	5.88%	Sell	0	0.00%

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

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	8	24.24%	Buy	2	25.00%
Neutral	10	30.30%	Neutral	3	33.33%
Sell	15	45.45%	Sell	4	30.77%

Investment Rating Distribution: Engineering & Construction Group (as of 01 Jan 2009)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	21	60.00%	Buy	4	23.53%
Neutral	7	20.00%	Neutral	1	16.67%
Sell	7	20.00%	Sell	2	28.57%

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: Media & Entertainment Group (as of 01 Jan 2009)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	50	39.68%	Buy	17	38.64%
Neutral	33	26.19%	Neutral	9	31.03%
Sell	43	34.13%	Sell	10	23.81%

Investment Rating Distribution: Non-Ferrous Metals/Mining & Minerals Group (as of 01 Jan 2009)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	54	39.42%	Buy	19	40.43%
Neutral	30	21.90%	Neutral	5	20.00%
Sell	53	38.69%	Sell	8	20.00%

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

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	18	39.13%	Buy	3	20.00%
Neutral	10	21.74%	Neutral	2	28.57%
Sell	18	39.13%	Sell	1	6.25%

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: 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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