India Strategy

Investment Strategy

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21 November 2008

2009 - A Year of 2 Halves

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Still bearish; expect index of 7000 in early 2009

We felt comfortable with our bearish views on the market last year when it was anti-consensus. We are concerned about the current consensus bearishness but think it is too early to turn bullish and expect markets to fall to 7000 in 1st quarter of 2009 led by:

1. **Slowing economy:** Though India is relatively insulated from a global slow-down, GDP growth should still slow to 5.8% in FY10E vs 7.5% in FY09E.
2. **Earnings growth stalling:** After a 25% CAGR in earnings past 6 years, we expect zero growth in earnings in second half of FY09 (full year FY09 growth 6%) and zero to negative in FY10 from a top-down perspective. Bottom up earnings will see substantial downgrades from current forecasts of 9% for FY09 and 11.4% for FY10.
3. **Election uncertainty:** With general elections likely by May 2009, we expect markets to be worried about prospects of a hung Parliament where no party gets a clear majority.
4. **Valuations to test lows of sub-8x PE:** Falling earnings are likely to lead the Sensex's valuation to its lows of sub-8x PE on CY10E EPS of around 850-900.

…. Late 2009 can see better markets

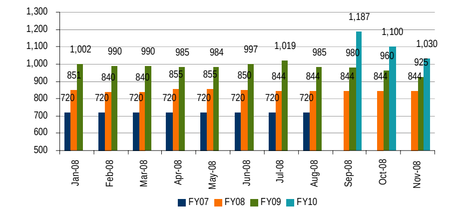
While economic news should continue to be negative in 2009, markets typically bottom ahead of economy and earnings bottoming out. Markets have historically given 30%+ returns 6 months after a bottom. Easing liquidity, interest rates and inflation could be drivers for better market performance in second half of 2009.

Sector strategy – Barbell portfolio

We continue with a barbell sector strategy that is largely defensive. We expect to get less defensive in the later part of 2009. Our favored sectors are telecom (Bharti), pharma (Glenmark), auto (Hero Honda), banks (SBI, ICICI) and industrials (BHEL).

Most preferred stocks: United Spirits, Hero Honda, SBI
Least Preferred Stocks: Reliance Petroleum, Nalco, Maruti Suzuki

Chart 1: More EPS downgrades likely



Source: Merrill Lynch Research

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Table 1: Indian Model Portfolio

	Symbol	Rating	Price	MSCI Wt	Recommended ML Wt.	Points O/W
Telecom				3.0%	10.5%	7.5
: Bharti Tele	BHTIF	C-1-9	Rs612		8.0%	
: Reliance Com	RLCMF	C-2-7	Rs199		2.5%	
Consumer Discretionary				4.0%	8.5%	4.5
:Hero Honda	HRHDF	C-1-7	Rs750		8.5%	
Financials				21.4%	23.5%	2.1
: ICICI Bank	ICIJF/IBN	C-1-7/C-1-7	Rs348/US$12.55		11.0%	
: SBI	SBINF/SBKFF	C-1-7/C-1-7	Rs1081/US$43.10		9.5%	
: PNB	PUJBF	C-1-7	Rs446		3.0%	
Pharma				4.6%	6.5%	1.9
: Glenmark Pharma	XVQWF	C-1-7	Rs318		6.5%	
Industrials/Cement				9.4%	11.0%	1.6
: BHEL	BHHEF	C-1-7	Rs1231		7.0%	
: L&T	LTOUF/LTORF	C-1-7/C-1-7	Rs732/US$14.68		4.0%	
Consumer Staples				6.5%	6.5%	0.0
:United Spirits	UDSRF	C-1-7	Rs779		6.5%	
Energy				22.1%	20.0%	-2.1
: Reliance Inds.	XRELF/RLNIY	B-1-7	Rs1132/US$43.10		14.0%	
: HPCL	XHTPF	C-1-7	Rs229		6.0%	
Software				16.9%	13.5%	-3.4
: TCS	TACSF	C-1-7	Rs483		3.5%	
: Infosys	INFYF/INFY	C-2-7/C-2-7	Rs1173/US$22.38		5.0%	
: Satyam	SAYPF/SAY	C-1-7/C-1-7	Rs233/US$11.71		5.0%	
Real Estate				1.2%	0.0%	-1.2
Utilities				5.7%	0.0%	-5.7
Metals				5.1%	0.0%	-5.1

Source: Merrill Lynch Research

All prices in this report are as at November 19th.

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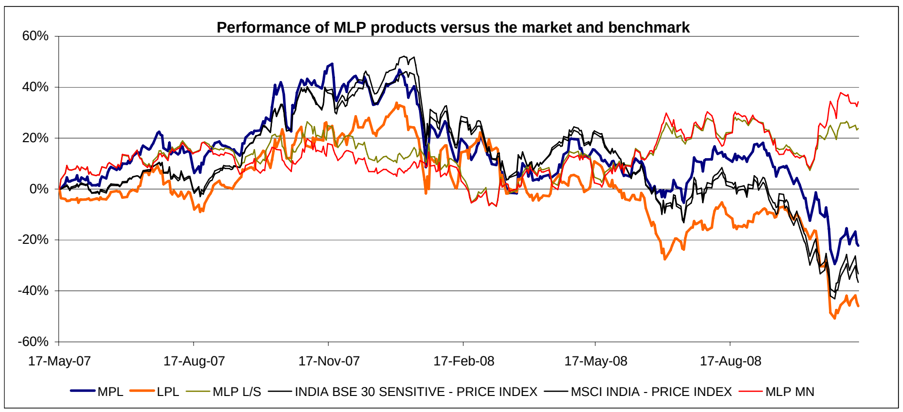
Table 2: Most-/Least preferred stock list

Company	ML Symbol	Recommendation	QRQ	Price (Rs)	Mkt Cap (US$mn)	PE FY08	PE FY09E	PE FY10E	EPS CAGR 08-10E	RoE (%) FY09E	P/BV FY09E
Top Buys											
SBI	SBINF	1 - Buy	C-1-7	1081	15599	10.1	8.8	7.4	17%	14.9	1.2
Hero Honda	HRHDF	1 - Buy	C-1-7	750	3403	15.5	11.9	10.0	24%	41.1	4.7
United Spirits	UDSRF	1 - Buy	C-1-7	779	1773	19.8	16.7	14.1	18%	17.7	2.7
Top Sells/ Under-performers											
Maruti	MUDGF	3 - Underperform	C-3-7	516	3390	8.4	10.6	9.9	-8%	15.6	1.5
Nalco	NAUDF	3 - Underperform	C-3-7	152	2232	6.0	5.5	5.7	2%	18.8	1.0
RPL	RPLUF	3 - Underperform	C-3-7	73	7476	NA	20.1	3.6	NA	11.5	2.2

Source: Merrill Lynch Research

Figure 1: Performance of India Most-/least preferred stock list



Source: Merrill Lynch Research

Table 3: Performance of India MLP product vs. benchmark indices

Performance Period	MPL	LPL	MLP L/S	MLP MN	Sensex	MSCI
1 Month	-11.1%	-32.6%	21.5%	24.0%	-9.4%	-9.7%
3 Months	-31.0%	-41.9%	11.0%	14.5%	-37.3%	-39.5%
Year To Date	-45.2%	-58.7%	13.6%	26.9%	-53.0%	-56.9%
12 Months	-44.2%	-54.6%	10.4%	17.2%	-49.1%	-51.9%
2007	42.0%	31.1%	10.9%	5.7%	41.9%	47.0%
Since Inception	-22.2%	-45.9%	23.7%	34.2%	-33.3%	-36.7%

Source: Merrill Lynch Research

Table 4: Key Economic and financial forecasts

	FY04	FY05	FY06	FY07	FY08	FY09 MLE	FY10 MLE
GDP (% real change)	8.5%	7.5%	9.4%	9.6%	9.0%	7.3%	5.8%
Components of GDP (% real change)							
Agriculture	10.0%	0.0%	5.9%	3.8%	4.5%	3.0%	3.0%
Industry	6.0%	8.5%	8.0%	10.6%	8.1%	5.0%	3.3%
Services	8.9%	9.9%	11.0%	11.2%	10.7%	9.3%	7.3%
Wholesale Price Index (Year end)	4.6%	5.1%	4.1%	5.9%	7.7%	6.3%	5.0%
Exports (fob ;US$ bn)	63.8	83.5	103.1	126.3	158.7	187.7	181.7
Exports (% YoY)	21.1%	30.9%	23.5%	22.5%	25.7%	18.3%	-3.2%
Imports (fob.;US$ bn)	78.1	111.5	149.2	190.6	248.5	302.6	295.2
- Oil imports (US$ bn)	20.6	29.9	43.9	57	77	97.2	75.2
- Non-oil imports, incl. defense (US$ bn)	57.6	81.6	105.3	133.6	171.5	205.4	220
Imports (% YoY)	27.2%	42.8%	33.8%	27.7%	30.4%	21.8%	-2.4%
- Oil imports (% YoY)	17.0%	45.1%	46.8%	29.8%	35.1%	26.2%	-22.6%
- Non-oil imports (%YoY)	31.3%	41.9%	29.0%	26.9%	28.4%	19.8%	7.1%
Trade Balance (US$ bn)	-14.3	-28	-46.1	-64.3	-89.8	-114.9	-113.5
Current account (% GDP)	2.3%	-0.4%	-1.2%	-1.1%	-1.5%	-2.4%	-1.8%
Current Account (US$ bn)	14.1	-2.4	-9.2	-9.6	-17.4	-29.9	-23.5
Capital Account (US$ bn)	17.3	28.6	24.3	46.2	109.6	6.5	43
Total Balance of Payments (US$ bn)	31.4	26.2	15.1	36.6	92.2	-23.4	19.5
Fiscal deficit (% of GDP)	4.5%	4.0%	4.1%	3.7%	3.1%	3.5%	4.5%
10-year G-Sec yield (Year end)	5.2	6.7	7.5	8.1	8	7	7

Source: Merrill Lynch Research

Table 5: Sensex Valuation Estimates

	FY07	FY08	FY09E	FY10E
P/E	12.4	10.4	9.5	8.5
EPS Growth	35.6%	21.5%	9.0%	11.4%
P/Cash EPS	9.7	7.9	7.3	6.4
CEPS Growth	28.7%	23.3%	9.2%	13.5%
P/BV	2.8	2.0	1.7	1.4
ROE	25.6%	23.0%	19.5%	18.2%
Cor Gearing	21.6%	44.9%	29.2%	19.8%
Dividend Yield	1.7%	2.1%	2.1%	2.4%
EV/EBIDTA	8.0	7.1	6.2	5.4

Source: Merrill Lynch Research

1. New lows likely in 1QCY2009 - index 7000

We continue to be bearish on markets and expect the Sensex to hit 7000 in 1QCY09 as earnings get downgraded and drag valuations to historic lows of below 8x PE. We expect FY10 to see a flat to negative EPS growth which would bring Sensex EPS to the 850-900 levels.

While economic news should continue to adverse through most of 2009, we expect equity markets to recover in 2HCY09. Markets have typically given a over 30% return from its bottom and we could see such a rally start towards Q4CY09 led by (a) lower spreads as liquidity eases and inflation and interest rates fall, and (b) earnings downgrades being behind us and the earnings revision ratio bottoming out.

Pain trade is up

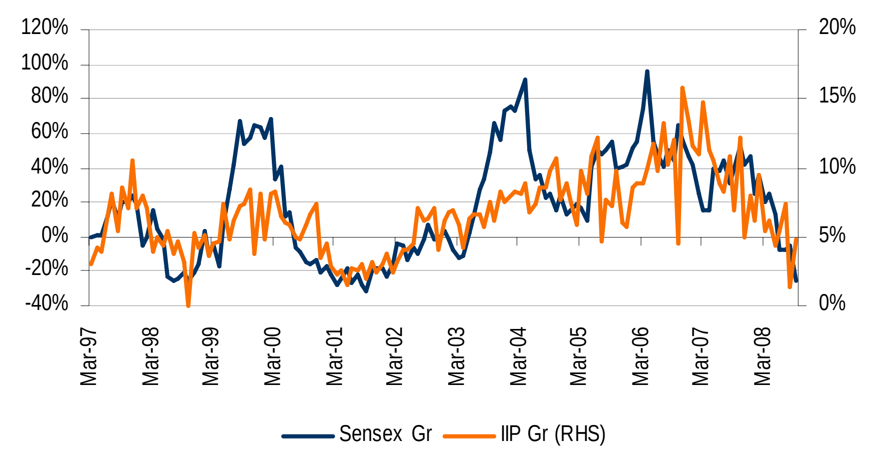
One of our biggest concerns with our current negative view is that it is totally consensus and a crowded trade. Last year at this time, we were very comfortable with our negative view on markets since the crowded trade was a continued bull market. But now the "pain trade" is clearly a market rally. However, given the likely spate of negative economic and earnings data, we find it difficult to be bullish on markets near term.

What will drive markets lower?

#1: Slowing economy

We expect GDP growth in India to slow to 5.8% in FY10, a substantial slow-down from the 7.5% growth we forecast in FY09. While India is a relatively domestic economy, we believe it gets hurt in 2 ways by the ongoing global slow-down: (a) export growth should be close to zero from the 20%+ in past few years, and (b) reduced availability of external funding to finance domestic capex, especially in infrastructure.

Chart 1: Sensex Gr vs. IIP Gr – Moderately correlated



Source: Merrill Lynch Research

#2: Earnings growth likely to stall and see downgrades

Earnings over past 6 years have grown at a compounded average of near 25%. We see significant slow-down in EPS growth over next one year and from a top-down perspective expect EPS growth for the Sensex companies to be nil in 2HFY09 (so FY09 EPS growth likely at 6%) and zero to negative in FY10. Secondly, we expect earnings to see further downgrades - our current analyst forecasts indicate an EPS growth of 9% and 11.4% for FY09 and FY10 respectively. We think Sensex EPS could be 850-900 in FY10, close to FY08 levels of 844. Our bottom up forecast for Sensex EPS for FY10 is substantially higher at 1030.

#3: Election worries could drag markets

India is likely to see general elections in first half of 2009. If initial opinion polls suggest a hung Parliament, this would likely be negative for the markets. Traditionally, markets rally ahead of elections. But we believe this time the market will be concerned ahead of elections given (a) the possibility of a hung Parliament with no party able to get a majority, and (b) memories of last elections where markets fell sharply when elections results shocked the market and the Congress-led UPA Government had to seek support of Left parties to form the Government.

#4: Valuations to test lows of sub-8x PE

While stocks are no longer expensive, falling earnings growth and downgrade momentum should lead to a de-rating of the Sensex to its lows of 8x 1-year forward earnings.

Better markets in H2

Economic news should continue to be adverse through most of CY09. However, markets typically bottom out ahead of the economy bottoming out. While returns in equity markets 3-6 months after a bottom are sharp, the trend thereafter is more mixed.

Table 6: Good returns post bottom

S.No	Sensex Peak	Date	Sensex Trough	Date	Total Fall	No. of Days	Recovery Phase 3m	6m	1 yr
1	4467	22-Apr-92	2037	26-Apr-93	-54%	369	6%	33%	86%
2	4631	12-Sep-94	2745	4-Dec-96	-41%	814	44%	41%	28%
3	4548	5-Aug-97	2764	20-Oct-98	-39%	441	20%	25%	79%
4	5883	22-Feb-00	2600	21-Sep-01	-56%	577	24%	36%	16%

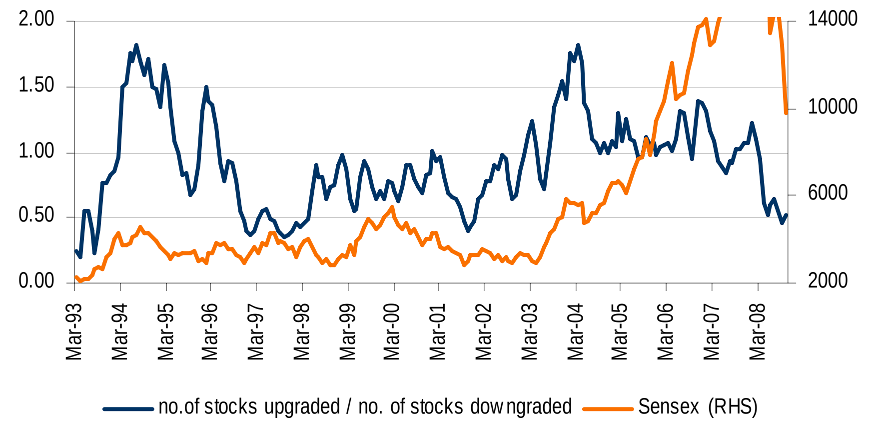
Source: Merrill Lynch Research

There are 2 factors that should help markets during the second half of 2009:

1. Lower spreads as central banks globally and in India pump in liquidity and interest rates and inflation fall.

2. The bulk of the earnings downgrades should be behind us and the earnings revision ratio (ERR) should start to bottom out, Typically, markets have bottomed 3-4 months before the ERR has bottomed out.

Chart 2: Earnings revision ratio- still going down



Source: Merrill Lynch Research

Table 7: Time lag between market and ERR bottom

Bottom Sensex	Bottom ERR	No. of months before bottom ERR
Jan-96	Jun-96	5
Dec-96	Jan-97	2
Oct-98	Apr-99	6
Sep-01	Oct-01	1
May-04	Sep-04	5
Jun-06	Sep-06	4
Apr-07	Jun-07	3

Source: Merrill Lynch Research

2. Sector Strategy- Barbell Strategy

We continue to play a barbell sector strategy which is defensive from a global and domestic slow-down but also has some sectors that benefit from easy liquidity and falling interest rates. There are 3 broad thoughts driving our sector strategy:

1. Defensives look safe in terms of risk in the current slowing environment. However, they have been strong outperformers YTD and are relatively expensive. While we continue to be overweight defensives currently, we expect to lighten up on defensives as we progress into 2009.
2. Easing liquidity, falling interest rates: Given the slow-down in the economy, the benefit on deep interest rate cyclicals should be felt with a lag. However, near term we are overweight the Government banks that should see an investment write-back on their bond portfolios.
3. Global deflation: is leading to falling material prices. Again some of the gainers like autos and industrials are suffering due to the economic slow-down. But among of the strong gainers are the Government marketing companies (HPCL, BPCL, IOC) due to the fall in oil prices.

Telecom (Overweight)

Strong earnings growth that should be relatively resilient to the economic slow-down drives our O/W view. We expect subscriber additions to soften (5% yoy) but less tariff competition than before. Bharti, our top pick, is likely to gain market share due to capex constraints of its leveraged competitors.

Consumer Discretionary (Overweight)

Our O/W view on auto is not a sector call but a stock call – we like Hero Hinda and expect strong earnings growth led by market share gains as it launches 10 new products over next 6 months and tax breaks from its new plant. We are negative on other auto stocks due to poor demand scenario. This is a sector where we may be more positive mid-2009.

Financials (Overweight)

Our O/W view on financials is driven by easing liquidity by the RBI (CRR, SLR cuts) that have given the banks room to cut interest rates without hurting margins. Secondly, falling bond yields should lead to investment write-banks. Government banks that should benefit the most from these factors are our favored picks. However, we may lower our weighting on Government banks post Q1CY09 when NPLs are likely to start showing an increase, especially in the SME segment.

Pharma (Overweight)

We expect relatively steady earnings growth driven by robust growth in developing markets and scale-up in US generics business. Its defensive characteristics make it safe in the current environment.

Industrials (Overweight)

Given the current order backlog, near term earnings are relatively secure. Sector is gaining from the fall in metal prices. However, this is a sector we may cut our weighting on early next year as incremental additions to order backlogs should slow down.

Consumer Staples (Neutral)

Steady earnings growth and margin expansion from falling raw material prices are positive. However, stocks quote at relatively high premiums to the market.

Energy (Underweight)

Reliance is likely to see strong earnings growth next year due to production from RPL and its gas business. However, existing business are seeing a squeeze in margins. Falling oil prices are likely to help the PSU marketing companies like HPCL, BPCL, IOC.

Software (Underweight)

We believe the contagion in the financial industry globally and the economic slow-down will severely hit discretionary IT spend. We forecast a below consensus 5% USD revenue growth in FY10 vs about 15% in FY09. In spite of low PEs, we remain negative on the sector.

Real Estate (Underweight)

We think real estate prices will correct in India as demand weakens and supply comes on stream. This should lead to further weakness in the real estate stocks.

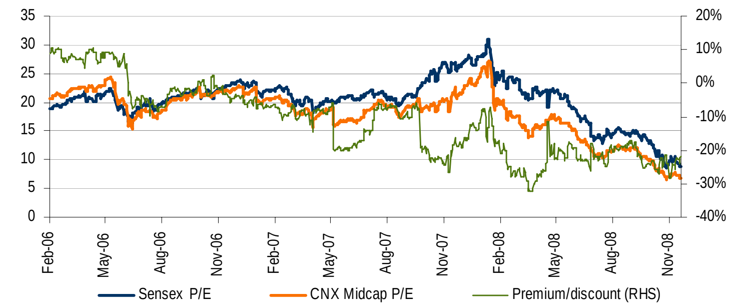
Metals (Underweight)

Global slow-down is likely to hurt demand for the sector and continue to keep prices under pressure. We expect sharp drop in earnings next year and further analyst downgrades to keep stock prices subdued.

We continue to avoid mid-caps

While mid-caps are looking substantially cheaper than large caps, we continue to avoid mid-caps as a group since (a) they are relatively more vulnerable to an adverse economic cycle and could see substantial earnings downgrades, and (b) liquidity could be a problem in these stocks as volumes in the market shrink.

Chart 3: CNX Midcap premium/discount to Sensex PE



Source: Merrill Lynch Research

Table 8: Top Mid Cap Ideas

Company	ML Symbol	Reco	QRQ	Price (Rs)	Mkt Cap (US$mn)	PE FY08	PE FY09E	PE FY10E	EPS CAGR FY08-10E	RoE (%) FY09E	P/BV FY09E
Top Midcap Buys											
Rolta	RLTAF	1 - Buy	C-1-7	186	679	14.4	7.9	7.5	39%	25.2	2.1
Tata Chemical	TTCXF	1 - Buy	C-1-7	154	822	9.3	7.2	6.2	22%	13.3	0.9
Exide	XEDRF	1 - Buy	C-1-7	44	793	13.4	10.6	8.8	24%	33.2	3.1
IVRCL	IIFRF	1 - Buy	C-1-7	117	355	7.9	6.6	5.0	25%	14.5	0.9
Educomp	EUSOF	1 - Buy	C-1-7	1931	758	50.5	25.3	15.5	81%	27.6	4.5
Renuka Sugars	SRNKF	1 - Buy	C-1-7	50	305	12.0	5.9	4.4	66%	30.3	1.6
Tech Mahindra	TMHAF	1 - Buy	C-1-7	256	708	5.0	4.0	3.4	22%	50.6	1.6

Source: Merrill Lynch Research

3: Global slowdown, impacting India

US recession dragging down global growth

Merrill Lynch economists expect global GDP growth to slow to 1.8% in 2009 (Table 9). This should be led by a particularly sharp GDP contraction of 2.1% in the US.

Table 9: World GDP growth sliding sub-2% since 1993

	2007	2008E	2009E
World	4.8	3.5	1.8
US	2.2	1.4	-2.1
Euro area	2.6	1.1	0.4
Japan	2.1	0.3	0.5
APR Region (excluding Japan)	9.1	7.2	5.7
Australia	4.2	2.5	0.2
China	11.9	9.5	8.6
Hong Kong	6.4	2.9	0
India	9	7.3	5.8
Indonesia	6.3	5.7	4
Korea	5	4	1.5
Malaysia	6.3	4.4	2.5
Pakistan	7	5.8	3.5
Philippines	7.2	4.3	3.1
Singapore	7.7	2	-0.5
Taiwan	5.7	3.2	-1
Thailand	4.8	4.5	3.3

Source: ML estimates. Fiscal year for India.

Asia sliding to ~5.5% growth of previous global recessions

We expect Asia to slide to the ~5.5% growth it saw during the previous global recessions. Our call is consistent with a recession in the region outside the twin giants of China, and to some extent, India. Within Asia, we estimate India to be the least sensitive to slowing global growth (Table 10). Our outlook assumes a backdrop of still-sluggish global growth in 2011. We see a modest upturn in 2010.

Table 10: India relatively resilient to global slowdown

	2009E global growth		
Global	2.1%	1.1%	0.0%
China	-1.9	-3.1	-4.5
Hong Kong	-5.4	-9.0	-13.0
India	-0.5	-0.8	-1.2
Indonesia	-1.7	-2.8	-4.1
Korea	-2.0	-3.3	-4.7
Malaysia	-4.5	-7.6	-10.9
Philippines	-2.3	-3.8	-5.5
Singapore	-5.4	-9.0	-13.0
Taiwan	-3.6	-6.1	-8.7
Thailand	-1.5	-2.6	-3.7

Reading the table: if, for example, global growth falls to 2.1% in 2009 (from 3.6% in 2008), the "external shock" to China would be 1.9 percentage points.

Source: ML estimates and projections.

India: Hit by global slowdown – exports, flows drying up

Although relatively resilient, we expect Indian growth to be impacted by the global slowdown in the absolute sense. This emanates from demand contraction as a result of weakening exports and supply constraints as a result of lower external funding for investment. At the same time, as noted above, India should fare relatively better than most Asian economies because of its domestic demand story, with exports, at about 15% of GDP, the least in the region.

Export contraction to hit growth. We expect an export slowdown, emerging from a sharp deceleration in global growth, to impact the Indian economy. We calculate that zero export growth, for example, impacts real GDP growth by ~150bp, taking into account knock on effects of slower job creation, spending and transportation.

Drying up of capital flows to contract investment. A sharp reduction in capital flows – external commercial borrowings, FII equity flows – will likely impact investment. This reflects India's reliance on capital flows for project finance given the lack of a local source of long-tenor funding.

Pro-growth monetary policy. We expect the Reserve Bank of India (RBI) to pursue a pro-growth monetary policy with global interest rates cycling down, on the one hand, and commodity prices falling sharply, on the other. In the absence of inflationary pressures, we expect a countervailing monetary package of cuts in the liquidity adjustment facility (LAF) repo rate and reverse repo rate, cash reserve ratio (CRR), statutory liquidity ratio (SLR) and rolling back market stabilization scheme (MSS) sterilization bonds to fund the fiscal deficit.

Table 11: Central banks likely to follow the US into cutting rates

Central banks/ %	2008E	2009E
US	1	1
Euro area	2.75	2.25
Japan	0.3	0.3
APR Region (excluding Japan)		
Australia	4.5	3.5
China	5.58	5.04
Hong Kong	1.23	1.15
India	5.75	5.25
Indonesia	9.5	10
Korea	3.75	3
Malaysia	3.25	2.75
Pakistan	15	12.5
Philippines	5.75	5.5
Singapore	0.75	0.75
Taiwan	2.75	1.5
Thailand	3.5	2.75

Source: ML estimates

Rupee likely to stabilize on falling oil prices, reduced global risk aversion. We expect the rupee to stabilize on account of falling oil prices and the RBI's measures to stem depreciation.

4. Economy – the gathering storm

We expect the Indian economy to grow 7.3% in FY09 and 5.8% in FY10 under the weight of a global recession. In view of the global fiscal and monetary stimuli, we expect a turnaround to 7.5% in FY11.

There are, in our view, two ways in which the global slowdown will impact the Indian economy. First, lower global growth will likely contract exports, on the demand side. Second, capital flows drying up will likely choke project finance, impacting investment plans, on the supply side.

Export contraction to impact demand; industry to bear brunt

We expect the global recession to contract exports and growth. The Indian economy, in fact, is yet to feel the pain of export contraction with ~30% 1HFY09 export growth still running ahead of 18% FY09 MLe.

India appears least exposed to global demand among Asian countries, as Table 10 shows. Even so, our ML-Liq India model indicates that zero export growth – exports actually declined in 1998 and 2001 – is sufficient to pull growth down ~150bp (Table 12). Industry should bear the brunt of the slowdown because it is largely export oriented. Knock-on effects will likely impact consumption, construction and trade and transportation segments in services. Note we assume an export multiplier of 1.2x: ie, Rs100 of exports swing growth Rs120.

Table 12: Contraction in external demand will impact the export-oriented ~20% of the Indian economy, will pull down growth by ~150bp at the margin

	Share of GDP (%)	FY09E growth rate (%)	Share in merchandise exports (%)	Merchandise exports (% of GDP)	Merchandise export content (% of GDP)	Export multiplier	Non-merchandise export content (% of GDP)	Services exports (% of GDP)	Non-export content (% of GDP)	Growth contribution
1	2	3	4	5	6 = 4*5	7	8 = 2 - (6*7)	9	10 = 8 - (7*9)	11 = 3*10
Agriculture	22.2	3	11.6	12	1.4	1.2	20.5		20.5	0.6
Industry	19.6	5	83.3	12	10	1.2	7.6		7.6	0.4
Services	58.2	9.3	5.1	12	0.6	1.2	57.5	4.5	53	4.9
Total	100	7.3	100	12	12		85.6		81.1	5.9

Source: ML estimates

Tight global credit markets likely constrain investment plans

We have long pointed out that the Indian economy is dependent on international finance – external commercial borrowings (ECBs), FII investment in IPOs – for project funding. There is, after all, no domestic source of long-tenor funding, no corporate debt market, and no significant "development financial institution" after ICICI and IDBI converted into banks. The extraordinary freeze in international credit markets, which is drying up capital flows. cannot but squeeze investment plans, in our view. Note that we calculate 100bps of GDP of investment lost impacts growth by 25bps, assuming an incremental capital output ratio of 4x. Can't the RBI bail the economy out? Not really, in our opinion, because all it can create is bank money and the relatively short-term liability profile of bank deposits cannot fund long-tenor funding.

Table 13: Investment plans will be impacted if ECBs, IPOs dry up

Year/% of GDP	Bank credit	Banks' non-SLR investments	DFIs	Capital market	ECBs	Total	FDI	Corporate savings investment gap
1980s	1.4		0.9	0.6		2.9		(2.5)
1990s	1.3		1.1	1.2	0.4	4.0		(3.0)
FY1993-97	1.4		1.3	1.9	0.4	5.0	0.4	(3.4)
FY1998-2002	1.3	0.8	0.5	0.2	0.1	2.9	0.8	(2.1)
FY05	3.4	0.1		0.6	0.7	4.8	0.5	(4.0)
FY06	3.4	(0.3)		0.8	1.0	4.9	0.6	(5.8)
FY07	3.5	0.0		0.8	1.7	6.0	0.9	(6.8)
FY08E	3.7	0.0		1.5	2.2	7.4	2.1	(7.0)

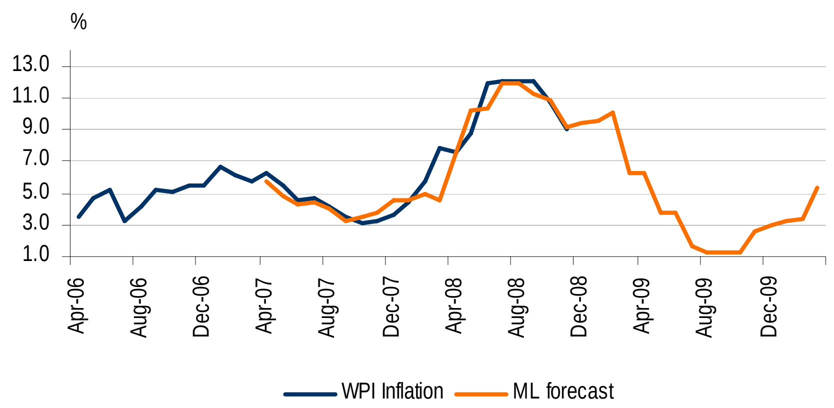
Notes: 1. Banks' credit is conventional credit to industry in the form of loans and advances and bills purchased and discounted.
2. Banks' non-SLR investments were non-substantial prior mid-1990s.
3. DFI credit includes flows in form of loans/investments.

Source: RBI.

Pro-growth RBI policy: Rates cycling down with lower inflation

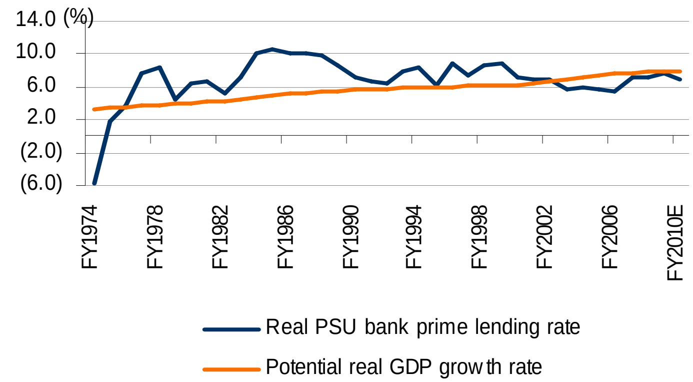
We expect monetary policy to switch to supporting growth, even taking a risk with inflation. We expect inflation to cool off to negligible levels in mid-09 on the back of a good harvest, falling commodity prices and base effects (Chart 4).

Chart 4: Inflation likely to ease on a good harvest, falling commodity prices, base effects



Source: Ministry of Industry, ML estimates

Chart 5: Monetary easing likely to pull real lending rates below neutral, defined by 8% potential growth rate



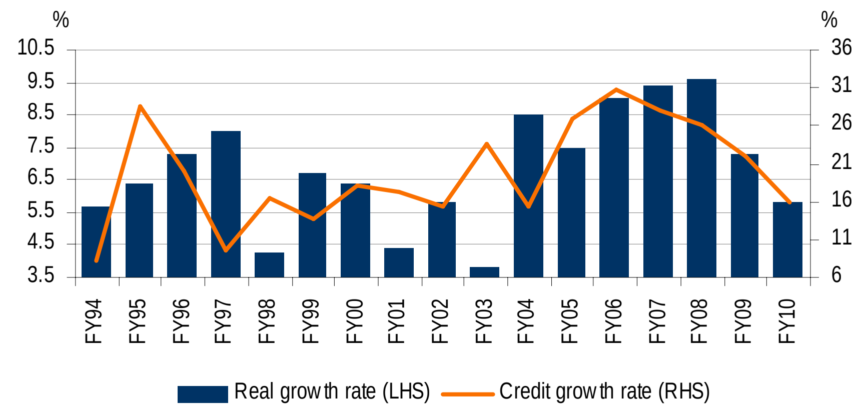
Source: CSO, RBI, ML estimates.

Taking advantage of low inflation, we expect the RBI to cut the LAF reverse repo rate 25bp in 2HFY09 and 50bp in FY10. We also expect the CRR to be cut 100bp by April 09. We continue to expect a 50bp LAF repo rate cut by January 09 and 100bp SLR cuts in 2HFY09 and 2HFY10, respectively.

Pushing down lending rates, yields

Delhi will likely push PSU banks for prime lending rate (PLR) cuts of 25-50bp in 2HFY09 and 50-75bp in FY10 to bring real lending rates, presently 8%, below our 8% neutral, defined by our estimated 8% trend real GDP growth rate. This will likely be aided by a slowdown in credit offtake to 15% levels with a slackening of the growth momentum as well as CRR/SLR cuts.

Chart 6: With slower growth softening credit demand



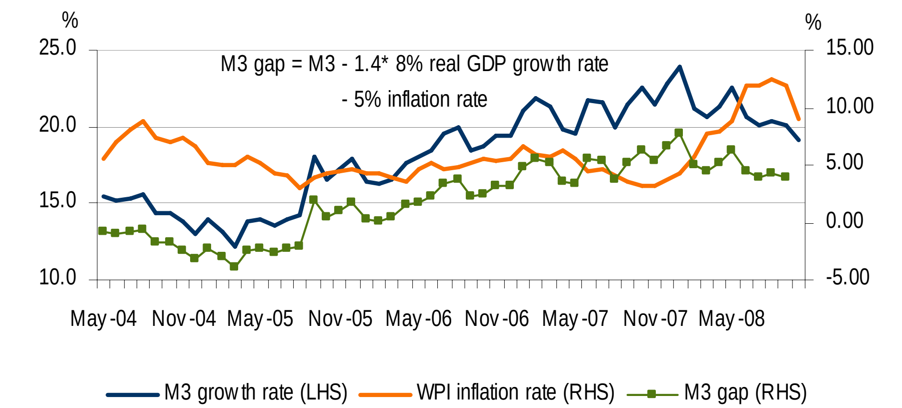
Source: CSO, ML estimates.

We expect a softening of 10-year yields to 7% in March 09 (Chart). We would expect slowing revenues to put pressure on the fiscal deficit. At the same time, falling oil subsidies, arising out of lower oil prices, should provide comfort. Besides, the RBI will likely continue to run down MSS sterilization bonds to fund the higher fiscal deficit.

Risk: Inflationary pressures from runaway M3 expansion

We nonetheless remain concerned about the inflationary risk of runaway monetary expansion which could surface at end-09 after the base effects work themselves out.

Chart 7: Runaway M3 expansion remains a major medium-term risk

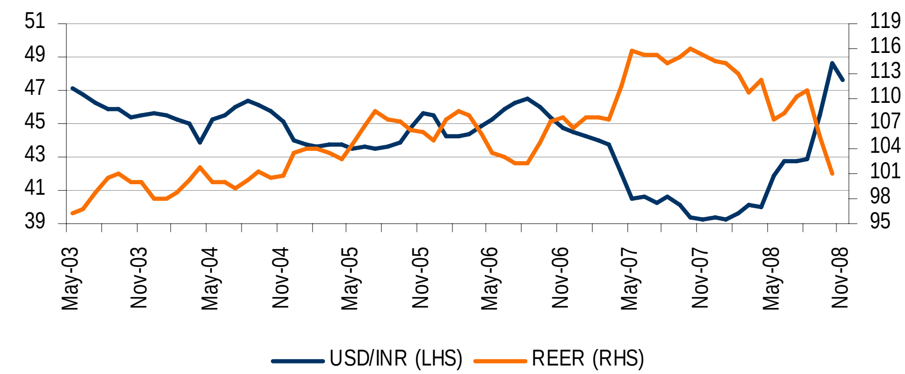


Source: Merrill Lynch Research

BoP: Weaker but stable; worst likely over for the INR

We believe India's balance of payments will be weaker but stable. This leads our Currencies Strategy team to believe that the worst is likely over for the INR. In our view, the RBI's INR policy will need to balance the conflicting imperatives of supporting growth and fending off imported inflation in 2009.

Chart 8: INR likely to stabilize with falling oil prices, likely reduced risk aversion ahead



Source: Merrill Lynch Research

We believe that India's current account deficit will contract in FY10. Falling oil prices – especially, in the ML commodity team's recessionary US$50/bbl case – will likely fund stagnant exports, as assumed above. Note we calculate that a US$10/bbl fall in the oil price has a positive US$6bn impact on the balance of trade. We point out higher FDI (US$17.2bn gross in 1HFY09) cushions FII outflows. This, in fact, poses upside risk to our US$15bn FY09MLe net FDI forecast.

We do not anticipate a run on the INR over BoP sustainability risks. We highlight that ~US$250bn fx reserves provide a comfortable 9 month cover of FY10MLe imports at US$90/bbl.

Table 14: India's balance of payments weaker but still manageable (US$bn)

Item	FY07	FY08	FY09E (US$97/bbl)	FY10E (US$90/bbl)	FY10E (US$50/bbl)
Current Account	-9.8	-17.4	-29.9	-36.5	-23.5
% of GDP	-1	-1.5	-2.4	-2.7	-1.8
Trade balance	-63.2	-90	-114.9	-126.5	-113.5
- Exports	128.1	158.5	187.7	207.7	181.7
- Imports	191.3	248.5	302.6	334.2	295.2
o/w Oil imports	57.3	77	97.2	99.2	75.2
Invisibles	53.4	72.6	85	90	90
o/w income from forex reserves	8		8	6	6
Capital Account	46.2	109.6	6.5	42	42
Foreign investment	15.5	44.8	0	17	17
- FDI	8.4	15.5	15	12	12
- FII+	7.1	29.3	-15	5	5
Banking capital	1.9	11.7	2.5	10	10
- NRI deposits	4.3	0.2	5	7.5	7.5
Short term credit	6.6	17.7	-5	5	5
ECBs	16.2	22.3	4	5	5
Others	6	13.1	5	5	5
Overall balance	36.6	92.2	-23.4	5.5	18.5
Memo					
RBI's forex intervention	26.8	78.2	-32.4	-0.5	12.5

Source: RBI, ML estimates.

US$89bn short-term external debt: US$25/89bn rollover risk

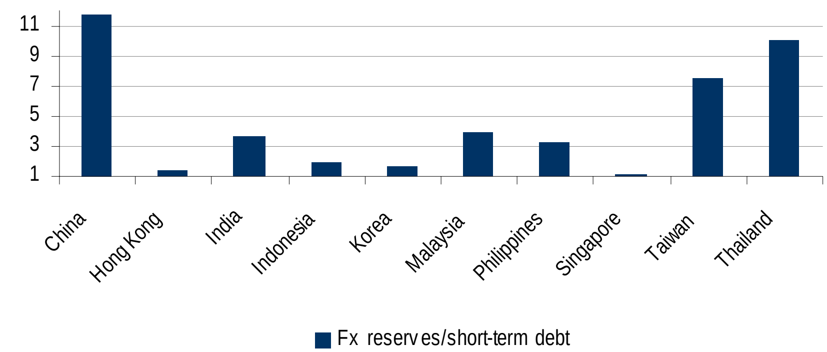
We note that US$89bn of short-term external debt matures by June 09 (Table 15). Note fx reserves, at a solid 2.8x short-term external debt, compare favorably with other countries (Chart 9). We believe that oil trade credit – half the US$45bn trade credits – is likely to be extinguished with oil prices falling. Non-resident rupee (NRE/NRO) deposits are unlikely to see withdrawals given a weak INR and attractive returns – Libor + 175bp. On the other hand, we believe funding part – conservatively 50% – of US$25bn of non-oil trade credit could be at risk unless international credit conditions improve in the months ahead. We could also see repatriation of part of the fx denominated US$10bn FCNRB deposits, especially given that a part of the money was likely leveraged to begin with. As a countervailing measure, we do expect the RBI to continue to hike the premia banks can pay over non-resident Indian deposits.

Table 15: US$89bn of short-term external debt matures by June 09

US$bn	Short term	Long term			Total
Components	Up to one year	1 to 2 years	2 to 3 years	More than 3 years	(2 to 5)
1.Sovereign Debt	2.8	3.2	4.6	44.6	55.2
2.Commercial Borrowing (including export credit)	7.4	7.4	10.5	52.9	78.1
3.NRI deposits (i+ii+iii)	33.5	5.9	2.0	1.2	42.6
(i) FCNR(B)	10.4	2.6	0.8	0.2	14.0
(ii) NR(E)RA	20.4	3.2	1.1	1.0	25.6
(iii) NRO	2.8	0.1	0.1	0.0	3.0
4.Short term debt (Original maturity)	45.3				45.3
Total (1 to 4)	89.0	16.5	17.1	98.7	221.3

Source: RBI.

Chart 9: India's US$253bn fx reserves likely ensure funding of external debt obligations



Source: BIS, ML estimates.

In such an eventuality, how much of its fx reserves can the RBI sell to prevent a run on the INR? We calculate that the RBI can comfortably sell a further US$20bn to protect the INR in 2HFY09. The constraint to intervention really arises on account of shrinking rupee liquidity (to buy fx) rather than availability of fx itself. The RBI has demonstrated its willingness to alleviate this by SLR/CRR cuts and MSS rollback. We estimate this policy mix will still fund the fiscal deficit, which is the other issue we see.

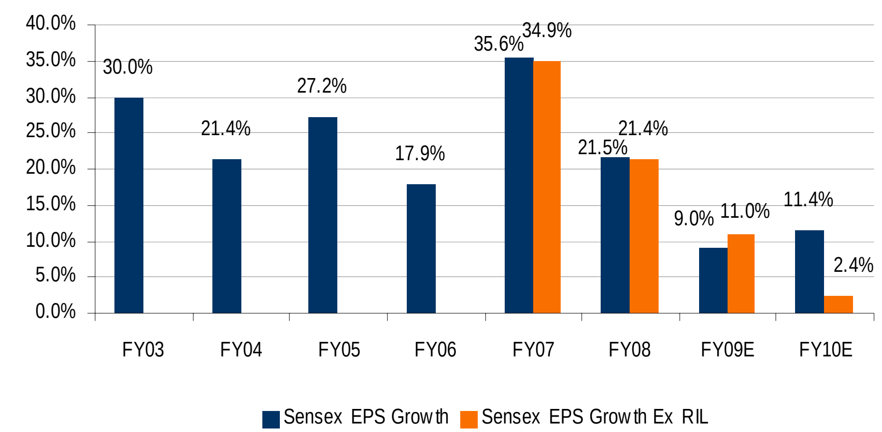
5. Earnings growth at 0%

We believe the peak in earnings growth is well behind us and expect a significant slow-down in earnings both from a top-down and a bottoms up view. We see further downgrades in earnings forecasts by analysts over next 6 months, Our top down view is that EPS growth for the Sensex companies in 2HFY09 will be nil (so FY09 EPS growth likely at 6%) and FY10 should also be zero to slightly negative. Our current analyst forecasts indicate an EPS growth of 9% and 11.4% for FY09 and FY10 respectively.

#1: Significant slow-down in earnings ahead

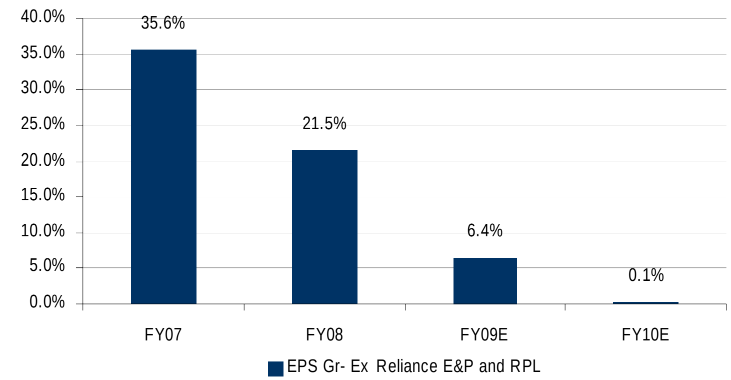
Our bottom-up forecasts are projecting a significant slow-down in earnings over the rest of FY09 and for FY10. Based on our bottom-up forecasts, EPS growth for 2HFY09 is 2% as compared to 17% in 1HFY09. While EPS growth in FY10 is forecast to be 11.4%, EPS growth ex-Reliance is practically flat at 2.4%. In fact, excluding the 2 projects of RIL gas and RPL which are not in FY09E earnings, forecast EPS growth for the Sensex companies is 0%.

Chart 10: Sensex EPS growth reflects slow-down



Source: Merrill Lynch Research

Chart 11: Slow-down more acute ex-Reliance E&P and RPL projects

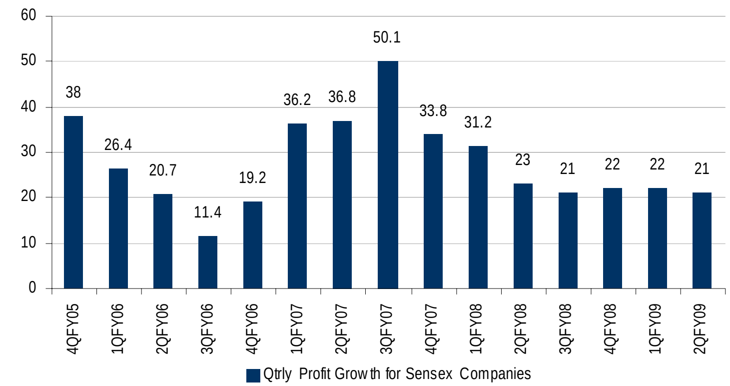


Source: Merrill Lynch Research

…..quarterly profit growth has been strong

The quarterly net profit growth even for 2QFY09 was strong at 21% though slower than the peak seen a few quarters earlier. However, strong earnings growth by Tata Steel of near 200% drove a large part of this growth. Excluding Tata Steel, there the last quarter results provided a glimpse of the slow-down with net profit growing only 8.3% (EPS growth less than 5%).

Chart 12: Interim earnings growth not yet slowing

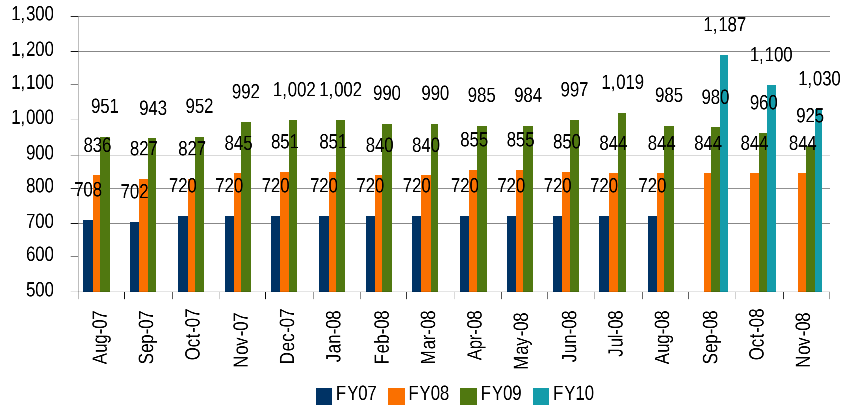


Source: Merrill Lynch Research

#2: Earnings downgrades accelerate; but more to go

We have seen drop in analyst forecasts over past 3-4 months. In fact, EPS growth for FY09E was cut from over 15% to 10% in during October. However, we believe, we are still not at the end of the EPS downgrade phase. We see downgrades in both FY09 and FY10 EPS estimates. Our top down view is that we will have a zero percent growth in earnings in 2HFY09E and FY10E. FY10E EPS growth should be flat to slightly negative in spite of Reliance – excluding Reliance EPS, growth should be negative in FY10E.

Chart 13: Sensex EPS- More downgrades to come



Source: Merrill Lynch Research

Commodities to drive downgrades but non-commodities vulnerable too

In spite of the gas and Reliance Petroleum projects, we believe earnings for Reliance are vulnerable to downgrades given falling refining and petchem margins. Metals have seen sharp downgrades already but slowing global growth is likely to lead to further downgrades.

Table 16: Sensex Earnings growth (including commodities)

	FY06	FY07	FY08	FY09E	FY10E
Sales Growth	21.8%	32.1%	55.9%	24.5%	13.9%
EBITDA Growth	19.2%	43.3%	29.8%	12.9%	12.6%
EBITDA Margin	22.2%	23.8%	19.4%	17.5%	17.4%
PAT Growth	22.5%	40.3%	25.9%	12.7%	12.4%
EPS Growth	19.5%	36.5%	21.5%	9.0%	11.4%

Source: Merrill Lynch Research

However, earnings growth for the Sensex companies (ex-commodity companies including Reliance, ONGC, Tata Steel, Hindalco and Sterlite) for FY10 are currently forecast to grow faster than in FY10. We believe this is likely to see downgrades too especially in banks.

Earnings are likely to slow in software, autos, cement while they could hold up in consumer staples, pharma and telecom. Banking is likely to be a mixed bag but NPLs are likely to be a cause for concern. Engineering companies too will likely see steady earnings growth though orders book inflows should start slowing down.

Table 17: Sensex Earnings Growth (Ex Commodities) shows growth in FY10

	FY06	FY07	FY08	FY09E	FY10E
Sales Growth	21.2%	29.4%	25.9%	33.2%	15.3%
EBITDA Growth	22.2%	47.9%	24.7%	18.5%	15.5%
EBITDA Margin	19.7%	22.2%	22.1%	19.2%	19.4%
PAT Growth	24.1%	42.5%	32.1%	9.6%	15.5%
EPS Growth	20.2%	38.9%	27.2%	6.7%	14.4%

Source: Merrill Lynch Research

#3: Can gainers from lower commodity prices offset profit drop from commodity companies?

Unfortunately, we believe earnings are more vulnerable to a global slow-down than the economy is. Given the high weight of software and global commodity companies like metals, Reliance and ONGC, earnings drops at these companies should more than compensate for the gain to commodity users like autos, pharma, engineering and consumer. Secondly, sensitivity of a 5% drop in profits for a metal company for example due to drop in metal prices is more than the corresponding gain to a user industry like auto or engineering. Just one point here is that we have not taken banks as a gainer – they should partially gain indirectly due to a drop in lending rates but this should be compensated by negative hits from higher NPLs.

Table 18: Sectors affected by global slowdown

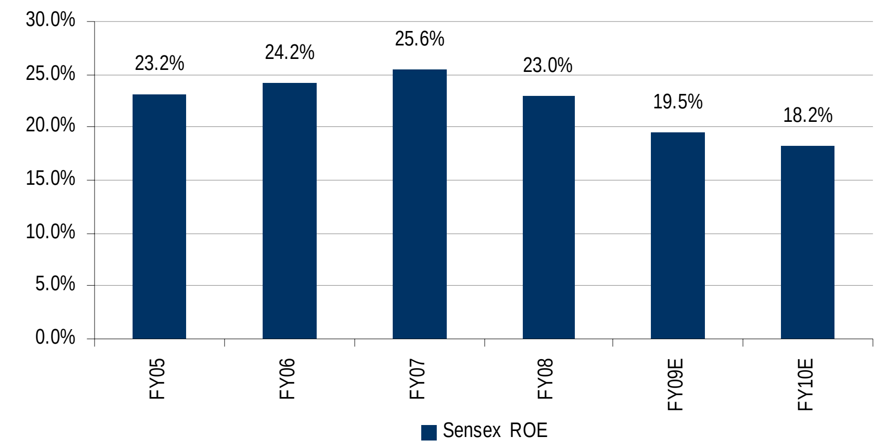
Sectors Positively effected by Global Slowdown		Sectors Negatively effected by Global Slowdown	
Sectors	Contribution to FY10 Earnings	Sectors	Contribution to FY10 Earnings
Auto	4.2%	IT	13.6%
Consumer	5.5%	Energy	25.5%
Pharma	0.9%	Metals	7.4%
Engineering	8.1%		
Total	18.7%	Total	46.5%

Source: Merrill Lynch Research

#4: RoEs to contract

RoEs appear set to contract both in FY09 and FY10 led by falling margins. Given our view of further downgrades to earnings, the contraction in RoEs could be even sharper than we are currently forecasting.

Chart 14: Sensex ROE



Source: Merrill Lynch Research

Table 19: Du Pont break up of ROE

	FY07	FY08	FY09E	FY10E
ROE	25.6%	23.0%	19.5%	18.2%
Du Pont Analysis				
PAT/PBT	75.1%	74.4%	76.4%	76.4%
PBT/PBIT	95.0%	91.1%	89.8%	90.3%
PBIT/Sales	22.1%	18.9%	16.9%	16.6%
Sales/Assets	31.4%	36.3%	36.8%	36.8%
Assets/NW	517.5%	494.5%	458.7%	432.6%

Source: Merrill Lynch Research

#5: India earnings may more secure than many Asian countries

While we expect slowing earnings and further downgrades in India, EPS growth may be relatively safer than many other countries in Asia given the more domestic nature of the economy. Valuation premiums to the rest of Asia have contracted considerable given the sharp fall in the market.

Table 20: Regional earnings (2009E)

	EPS Gth(%)	PER	P/B	ROE	EV/EBITDA
China	4.5	7.8	1.3	16.7	3.2
Hong Kong	9.1	8.9	1.3	15.3	9.0
India	11.3	9.7	1.7	18.3	5.9
Indonesia	12.1	20.0	2.6	28.4	2.8
Malaysia	6.4	9.3	1.4	22.0	n.a
Philippines	11.5	9.9	1.3	14.1	5.4
Pakistan	20.1	6.2	1.5	23.9	3.4
Singapore	(10.6)	11.0	1.1	10.3	8.3
South Korea	10.3	8.9	1.0	12.2	5.2
Taiwan	(6.4)	12.4	1.3	10.3	6.1
Thailand	(1.9)	6.8	1.5	14.9	4.9

Source: Merrill Lynch Research

6. Politics the focus till elections

2009 is the year of the general elections and the first half will likely be devoted to concerns on the nature and shape of the new Government. While it is early days yet, we believe initial opinion polls could predict a hung Parliament which would be negative for market sentiment.

Political Calendar gets active

We have a busy political calendar over next 6 months, which is generally not a positive sign for the market. Assembly elections to 5 states are being held over next 2 weeks with results likely to be announced on Dec 8. These are important states for the BJP and Congress since they are the main competing parties here and are regarded as the semi-finals for the general elections early next year.

Table 21: Election Timetable

State	Date	Incumbent Party
Chhattisgarh	Nov-08	BJP
Madhya Pradesh	Nov-08	BJP
Rajasthan	Dec-08	BJP
Delhi	Nov-08	Congress
Jammu and Kashmir	Dec-08	Congress +
Mizoram	Dec-08	MNF
General Elections	Apr-09	Congress +

Source: Merrill Lynch Research, Media

General elections are scheduled for April-May, 2009. However, there is a possibility the Government may prepone elections by a couple of months to February if (a) it wants to avoid another vote of confidence in Parliament and (b) it sees the economic slow-down worsening. From the market point of view, the earlier the elections are held the better it is since the economic uncertainty is resolved.

General elections: Fears of a hung Parliament

Election results in India are tricky to predict – who can forget the last elections when the markets discounted a BJP win as a foregone conclusion, only to be shocked by the UPA Government being forced to seek the support of the Left parties to form a Government. We believe early opinion polls could indicate the possibility of a hung Parliament.

Poll alliances may decide nature of new Government

The BJP has gained ground over past assembly elections winning in Karnataka following their comfortable sweep in Gujarat and win in Himachal Pradesh. They are looking to retain MP, Rajasthan and wrest Delhi from Congress to make them front runners for the elections next year. However, they have continued to lose ground in Uttar Pradesh which makes it difficult for the BJP-led NDA to form the Government on its own.

Table 22: Key State elections

State	Election Month	Party won	Incumbent Party
Maharashtra	Sep-04	Congress+	Congress+
Arunachal Pradesh	Oct-04	Congress	Congress
Haryana	Feb-05	Congress	INLD
Jharkhand	Feb-05	BJP+	BJP+
Bihar	Oct-05	BJP+	RJD + Congress
West Bengal	May-06	Left Front	Left Front
TamilNadu	May-06	DMK+ Congress	ADMK+
Kerela	May-06	Left Front	Congress
Assam	May-06	Congress	AGP
Uttarakhand	Feb-07	BJP+	Congress
Punjab	Feb-07	SAD+ BJP	Congress
Manipur	Feb-07	Congress	MPP
UP	May-07	BSP	SP+
Himachal Pradesh	Dec-07	BJP+	Congress
Gujarat	Dec-07	BJP	BJP
Karnataka	May-08	BJP	JD(S) + Congress

Source: Media

Similarly, for the Congress-led UPA, the Lok Sabha elections last time were probably a peak in terms of seats in 2 states – Andhra Pradesh and Tamil Nadu (its ally DMK and other affiliated parties) where it virtually swept most of the seats. It is likely to lose ground here which may make it difficult to form the Government on its own.

Will the Third Front form the Government or split up?

There are again attempts being made to form a Third Front consisting of those parties not aligned to the Congress or the BJP. This is being led by Uttar Pradesh Chief Minister Mayawati's BSP and consists of Jayalalita's AIADMK (Tamil Nadu regional party), Chandrababu Naidu's TDP (Andhra Pradesh regional party) and the Left parties. However, there is still not a formal agreement to fight the elections together.

Our view is that the Third Front is unlikely to get a majority on its own. It seems likely that the Third Front would split in case of a hung Parliament on the question of supporting the Congress or the BJP. Our view is that the Left would prefer supporting the Congress whereas the other parties are likely to support the BJP. For all the other parties, their fight in their state is with Congress (for TDP in Andhra Pradesh) or allies of Congress in the UPA Government – the SP (Mayawati in UP) and the DMK (for AIADMK in Tamil Nadu).

Nature of the Government more important than party forming Government

From a market point of view, we believe it is more important to have a stable Government that has a sufficient majority rather than whether it is a Congress-led or BJP-led. Our view is that most political parties would essentially follow similar reform policies (except for the Left parties who clearly are opposed to many of the economic liberalization measures). Hence for the market we see the negative scenarios as (a) a Third Front Government that is unstable since they are critically dependant on outside support of the BJP or Congress, or (b) Left parties being a significant player in the Government with an ability to influence economic policies.

Table 23: Parliament (Lok Sabha) current seat position

Congress & Allies	Seats	Opposition	Seats	Cross Voters	Seats
Congress Party	150	Bharatiya Janata Party	121	Bharatiya Janata Party	4
Rashtriya Janata Dal (RJD)	24	Shiv Sena	11	JDU	1
Dravida Munnetra Kazagam	16	Biju Janata Dal	10	TDP	1
Nationalist Congress Party (NCP)	11	Janata Dal (United)	6	JD(S)	1
Pattali Makkal Katch (PMK)	6	Shiromani Akali Dal	7	MDMK	2
Lok Janasakti Party (LJP)	4			TRS	1
Trinmool Congress	1	Communist Party (M)	43	BJD	1
AIMIM	1	Communist Party of India	10	Nagaland People's Front	1
PDP	1	RSP	3	Others	2
Muslim League Kerela State	1	All India Forward Block	3	Cross Voters for Govt	14
Republican Party of India	1	Mizo National Front	1		
Sikkim Democratic Front	1	Bahujan Samaj Party	17	Samajwadi party (SP)	6
Samajwadi Party (SP)	33	Telegu Desam Party	3	Congress	1
		TRS	2	Cross voters against Govt	7
National Loktantrik Party	1	Asom Gana Parishad	2	Abstensions	
Bhartiya Navshakti Party	1			Bharatiya Janata Party	5
		Rashtriya Lok Dal	3	JDU	1
Kerala Congress	2	MDMK	2	TDP	1
Jharkhand Mukti Morcha	5	Janata Dal (Secular)	2	Shiromani Akali Dal	1
NC	2			Shiv Sena	1
				Others	1
				Total Absentensions	10
Total Congress and Allies	275	Total BJP and Allies	253		
Total no. of seats	545				
Total Voted	538				
Seats required for majority	272				

Source: Media

Market historically has remained positive ahead of elections

Typically markets give a positive return in the run-up to elections since expectations of strong reform announcements post a new Government dominate the market. However, we think this time market will be concerned ahead of elections given (a) the possibility of a hung Parliament with no party able to get a majority, and (b) memories of last elections where markets fell sharply when elections results shocked the market and the Congress-led UPA Government had to seek support of Left parties to form the Government.

Table 24: Stock Market Returns- Pre & Post Elections

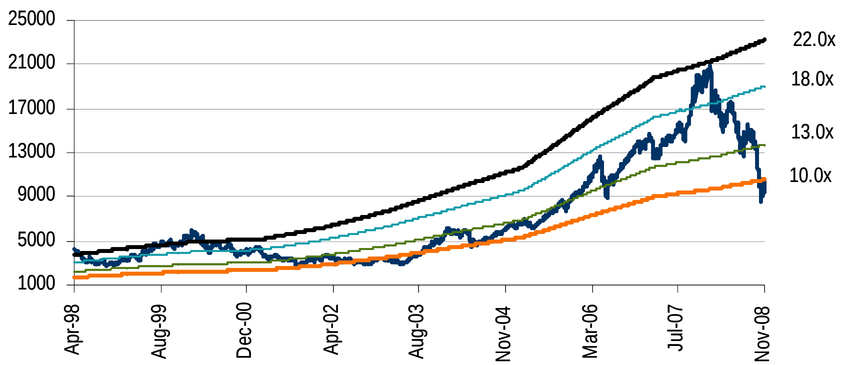
	% Return pre election			% Return post election			
Election Date	12 months	3 months	1 month	1 month	3 months	6 months	12 months
1-Jan-80	-5.6	-3.5	1.5	3.3	8	3.5	27.4
21-Dec-84	13.3	4.4	4.8	4.4	30.2	75.8	94
1-Dec-89	0.3	-2.4	-3.8	10	-2.8	12.2	69.1
21-Jun-91	67.3	16.9	3.1	4.2	34.6	40.6	126.2
16-May-96	14.9	9.3	6.5	6.4	-11.5	-17	-1.7
16-Feb-98	-3.7	-3.6	2	9.7	13.3	-15.4	-3
26-Sep-99	46.3	13.4	3.3	0.9	2.8	9.1	-11.7
20-Apr-04	93.7	-2.0	6.7	-11.0	-5.5	7.5	16.2
Average Return	28.3	4.1	3.0	3.5	8.6	14.5	39.6

Source: Media, Merrill Lynch Research

7. Valuations de-rated: nearing historic lows

Valuations at 9x PE have come down to reasonable levels relative to average levels of 14.7x. However, history suggests that as the economic cycle turns down, valuations tend to go below the 10x PE levels and hit the sub-8 levels, a level still to be reached. We believe valuations will hit an all time low in the coming months as earnings downgrades accelerate. The other issue is that the EPS should be downgraded making these valuations currently appear cheaper than they actually are.

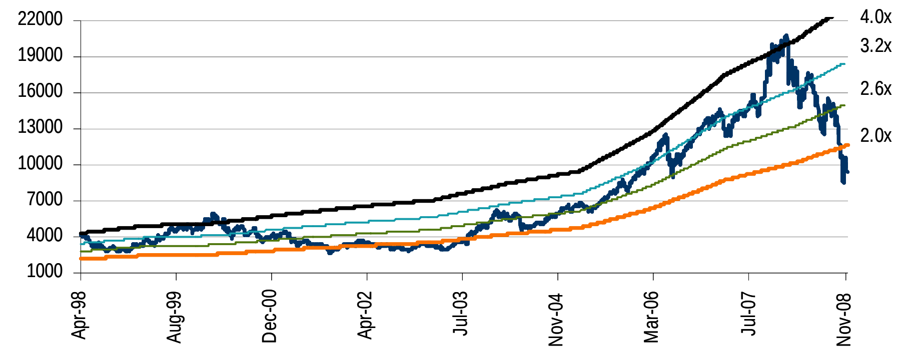
Chart 15: Sensex 1-yr forward PE chart



Source: Merrill Lynch Research

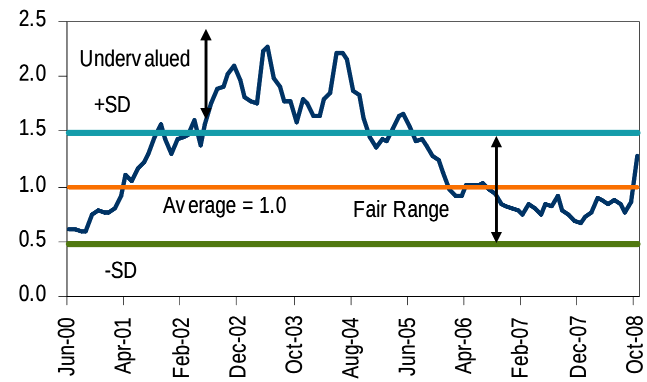
Similarly, on a P/B basis the market is trading at 1.65x 1-year forward P/B, well below the historic average of 2.8x. It is only slightly above the lowest level it has hit in the past 10 years of 1.5x. Again, earnings downgrades mean that current P/B is likely more expensive than it appears.

Chart 16: Sensex 1-yr forward P/B chart



Source: Merrill Lynch Research

Chart 17: Earnings yield

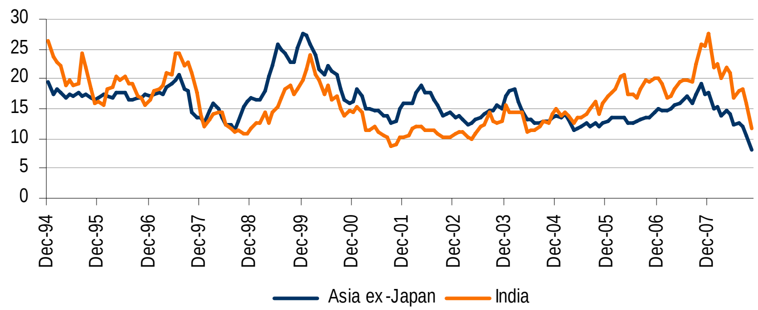


Source: Merrill Lynch Research

Relative premium to Asian peers narrowing

India continues to trade at a premium to regional peers but the gap has narrowed considerably this year with the sharp under-performance of India. Of course India has traded at a discount, with a maximum discount of 40% in past 14 years. We believe relative valuations are no longer expensive especially if Indian earnings see relatively lower downgrades.

Chart 18: India PE relative to Asia Pac ex Japan



Source: DataStream, Merrill Lynch Research

Embedded value vanishes

Embedded value, which accounted for close to 20% of the index valuations, has come down drastically to 5-6% levels (560pts). We continue to believe that embedded valuations will continue to go down as the valuations de-rate further.

Table 25: Embedded Value

	Shares Out (mn)	FF Mcap (Rs. Bn)	Embedded Value FF Mcap (Rs. Bn)	Embedded Value Pts
Jaiprakash	1173.8	47.9	20.4	31
DLF Limited	224.3	57.4	10.3	16
Larsen & Toubro	585.3	402.2	24.6	38
M & M	258.6	62.2	7.7	12
ONGC	2138.9	285.6	51.6	79
Reliance Infra.	232.0	77.0	51.5	79
Reliance Inds	1573.8	897.0	47.5	73
HDFC	284.4	343.2	30.5	47
ICICI Bank	1113.0	400.9	99.3	152
SBI	634.9	316.7	23.6	36
Total		2890	367	563

Source: Merrill Lynch Research

Valuations still not at earlier trough levels

While valuations are no longer expensive post the de-rating, they are still short of the levels where the previous bear market has ended. Valuations have reached a trough level of 7.9x forward earnings earlier, a level still 10-15% away. Moreover, estimate downgrades are likely to make this level appear further away.

Chart 19: 12 month forward PE chart for Sensex

Source: Source: Merrill Lynch Research

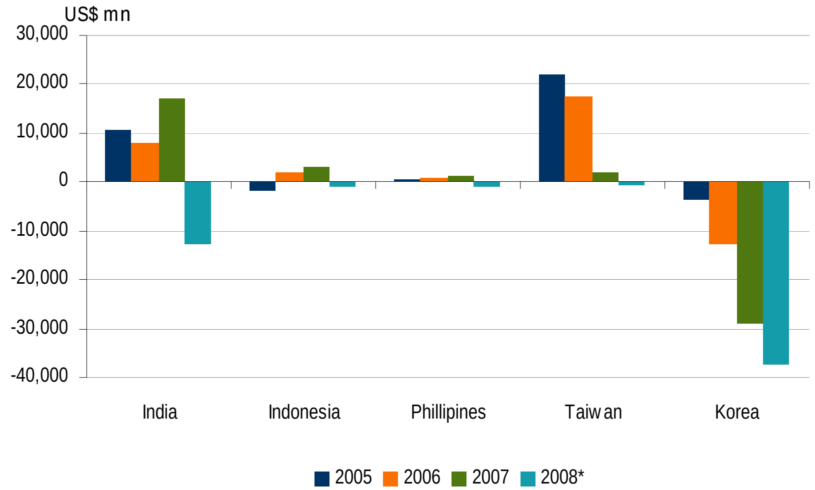
8. Liquidity – No retail panic yet

FIIs have been big sellers in the equity markets this year selling almost $13bn of Indian equity YTD. Unless global markets stabilize, however, we do not see this reversing. The good news, however, is that domestic institutions have been big buyers of equity this year. Life insurance companies are bigger players than domestic MFs and have pumped in almost an equal amount in the market. In addition, domestic MFs have bought equity of over $3 bn YTD. We would expect flows from domestic institutions to slow-down as retail investors are nursing large losses.

Negative FII flows during the year- A trend to continue

FIIs have been negative on India from the beginning of the year with only 2 months receiving marginally positive flows during the year. In spite of the FII selling, they still hold nearly 40% of the free float of the market (close to 16% of the Indian markets is still held by the FIIs).

Chart 20: FII flow in Asian countries

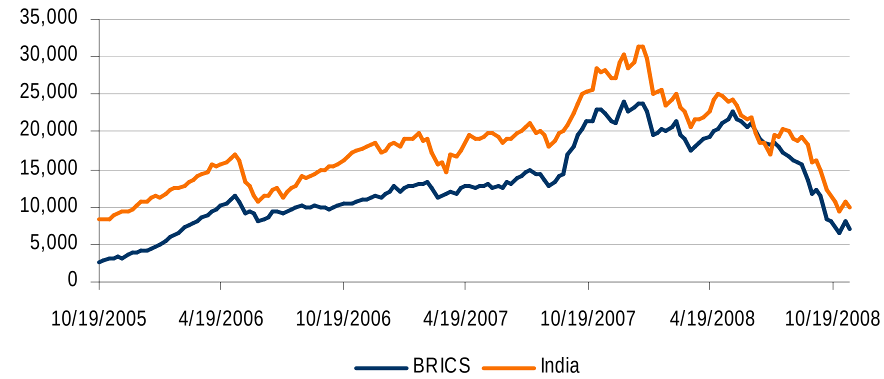


Source: Merrill Lynch Research, Bloomberg

India dedicated and BRIC funds have seen large redemptions

One of the reasons for the sharp selling in India has been redemptions from India dedicated and BRIC funds which were a popular asset class over past few years. As per data from EPFR, assets under management (AUM) of India dedicated funds fell from $31 bn in Jan, 2008 to $10 bn currently and that of BRIC funds fell from $24 bn to $7 bn. Another indicative trend is the AUM of the 22 India focused funds in Japan. Their AUM has fallen from $13.2 bn at the beginning of 2008 to $4.5 bn currently.

Figure 2: AUM of India/BRIC dedicated funds fall sharply

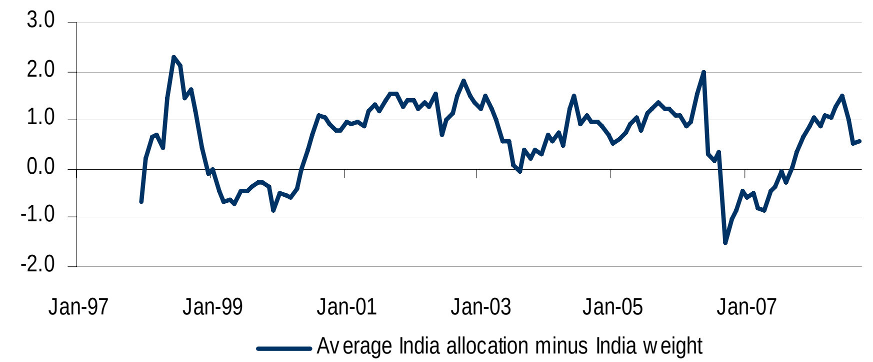


Source: EPFR, Merrill Lynch Research

GEM funds still overweight India

GEM funds are still overweight India though lower than they were at the beginning of the year.

Chart 21: India allocation

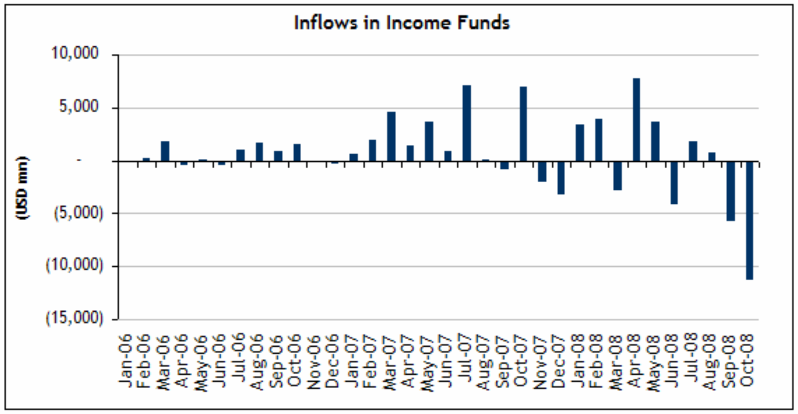


Source: Merrill Lynch Research

Domestic institutions yet to see redemptions in equity schemes - in contrast to debt funds

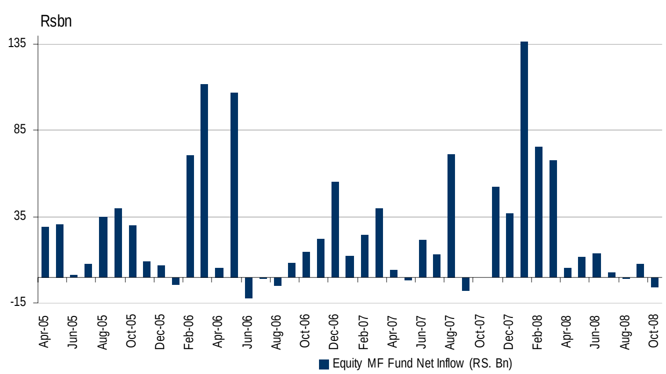
While Income/money market funds in India have seen significant redemptions in past few months, equity schemes have largely been immune to panic selling. Typically, equity market bottoms have been marked by retail panic. It would be interesting to see if this time is different.

Figure 3: Income funds see large redemptions



Source: Merrill Lynch Research

Chart 22: Equity MF – Not much redemption pressure yet

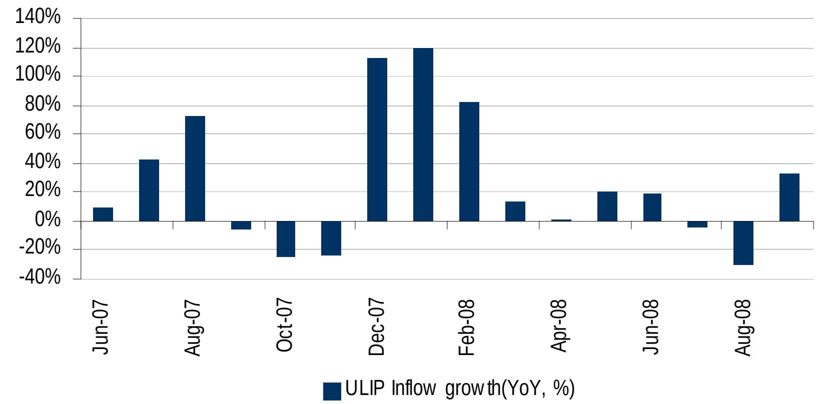


Source: Merrill Lynch Research

Insurance companies still getting ULIP money

Insurance companies are still seeing large inflows into Unit Linked Insurance Plans (ULIPs) that have found their way into equities. The trend, however, is likely to see a slow-down given the fall in equity markets

Chart 23: ULIP inflow growth



Source: Merrill Lynch Research

Insurance companies should become the biggest driver in increasing the equities proportion of household savings which is currently pegged at 6-7%.

Table 26: Estimated incremental equity flows by insurance companies

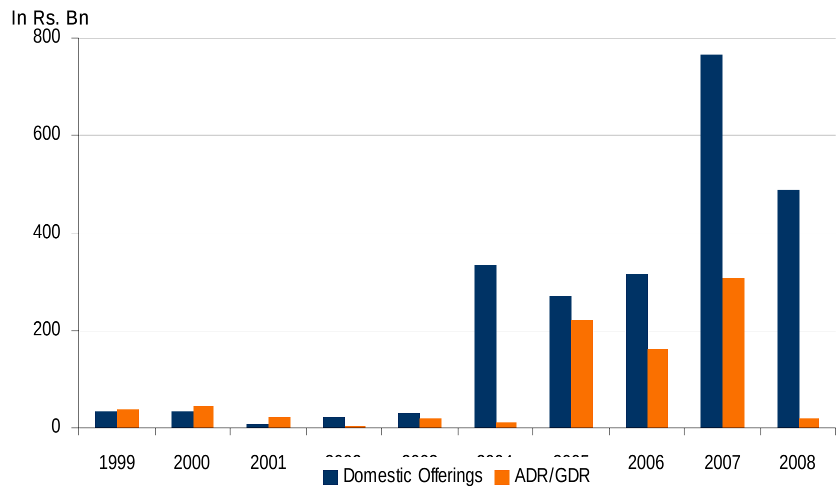
in Rs. Bn	2005	2006	2007	2008	2009E	2010E
- Pvt Sector	39	76	142	261	389	546
- LIC	129	167	261	309	332	357
Total Equity Inflows (Rs. Bn)	168	243	403	570	721	903

Source: Merrill Lynch Research

Supply of paper not a concern

Supply of paper has come down drastically in 2nd half of the year. We do not expect this to revive till equity markets improve. While this may be considered to be a positive for the secondary market performance since liquidity will not be sucked away, more and more corporates are likely to find it difficult to get funding from this source, hurting their growth plans.

Chart 24: Supply of paper- pipeline appears negligible



Source: Merrill Lynch Research

Automobile (S.Arun)

Overweight

Key Drivers of Sector Outlook

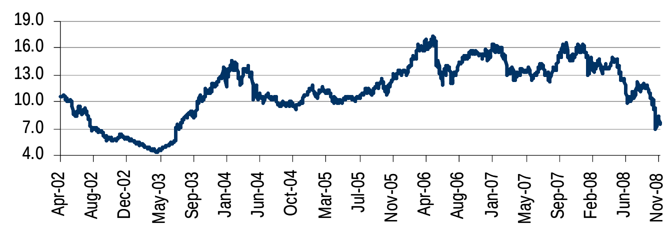
- We expect demand to continue to remain weak for most auto segments, on the back of weak macro-economic indicators i.e. IIP, as well as lack of financing.
- We expect commercial vehicles trends to worsen on de-stocking of inventory and overloaded dealers. Durables such as passenger cars and two wheelers are likely to see sluggish demand (low to mid-single digits) on falling disposable incomes. Our bearish outlook for tractors is premised on price elasticity as we believe demand has been satiated ahead of substantive price hikes this year. Auto component exports should be severely impacted by the global slowdown.
- We expect margins to remain subdued, albeit stable at lower levels due to falling demand even as supply continues to be high. This would restrict margin expansion despite softening commodity prices.
- We estimate overall earnings trajectory to remain negative for the sector at least for this fiscal and possibly through H1 FY09. Two wheeler companies are likely to register slightly better performance on relatively lesser competitive intensity.
- With respect to valuations, most segments trade at the mid or low end of historical average. As such, we expect relative underperformance to be restricted.

Top Buy: Hero Honda
Top Underperformers: Maruti Suzuki, Tata Motors

Top Stock Pick: Hero Honda

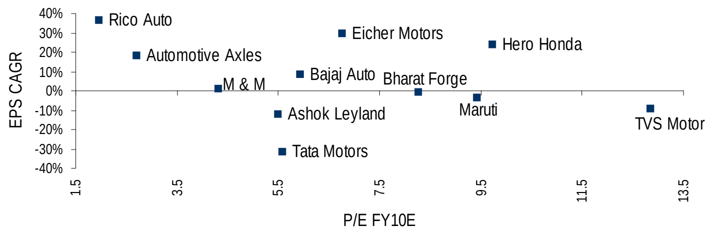
- Key drivers behind expectations of continuing out-performance by the stock: steady volume growth on market share accretion and robust margins, again due to limited competition.
- Hero Honda has grown 15.6% YTD even as the rest of the industry has grown at 9%.We expect Hero Honda to stay ahead of the competition on the strength of brand models, 10 new products over the next 18 months and their strong distribution in rural markets.
- Sixth pay commission and lower interest rates should also positively benefit the company through steady top-line and softening commodity prices should aid healthier margins.
- Trades at 11.5xFY09E and 9.7xFY10E EPs which is attractive, both in line with historical averages and relative to sector after adjusting for growth. Our PO of Rs997 implies potential ~40% upside.

Chart 25: Auto sector 1yr forward PE chart



Source: Merrill Lynch Research

Chart 26: PE(10E) vs EPS CAGR (08-10E)



Source: Merrill Lynch Research

Table 27: Stock Performance

	Absolute performance			
	1 month	3 month	YTD	1 year
Ashok Leyland	-31.0%	-54.8%	-72.2%	-66.7%
Automotive Axles	-36.9%	-64.8%	-84.1%	-79.3%
Bajaj Auto	-32.7%	-33.4%	NA	NA
Bharat Forge	-26.7%	-63.1%	-72.3%	-71.0%
Eicher Motors	16.0%	-18.3%	-45.7%	-52.9%
Hero Honda	-7.0%	-5.0%	7.7%	6.9%
M & M	-27.3%	-46.0%	-64.8%	-58.5%
Maruti Suzuki India	-21.3%	-16.3%	-48.1%	-48.7%
Rico Auto Ind	-25.1%	-42.4%	-81.3%	-73.1%
Tata Motors Ltd.	-44.9%	-67.1%	-81.3%	-80.4%
TVS Motor	-22.0%	-20.1%	-64.6%	-62.4%
Sensex	-14.2%	-39.7%	-56.8%	-54.5%

Source: Bloomberg, Merrill Lynch Research

Table 28: Bull & Bear Factors that can change views

Company	Bull Scenario	Bear Scenario
Maruti Suzuki	Strong competitive positioning in compact cars, to gain share at the expense of high priced vehicles New products to enable increase market share Successful foray into Europe through new model A-star	Declining incomes in slowing economy to hurt consumption, thereby impacting car demand Competitive scenario to intensify, with new launches by global majors
Hero Honda	Strong franchise, expanded distribution in rural markets to enable company raise share even from these levels Softening commodity prices and tax incentives to enable higher margins and profitability	Slowing economy and lack of financing could put pressure on volumes. Threat from new low - cost product offerings by competitors to impact sales
Tata Motors	New products to do well, and enable company to gain share despite sluggish demand scenario High earnings sensitivity to declining commodity prices, could drive margin surprise	Worsening global environment to hurt demand across key operating segments Tight credit situation a concern both for operating current business as well as refinancing obligations

Source: Merrill Lynch research

Table 29: Stock/Sector Valuations

			Price	Mkt Cap	P/E (x)			EPS CAGR	P/B (x)			EV/EBITDA (x)			Div Yield		RoE (%)		
Company	ML Code	QRQ	Rs	US$mn	FY08	FY09E	FY10E	FY08-10E	FY08	FY09E	FY10E	FY08	FY09E	FY10E	FY09E	FY10E	FY08	FY09E	FY10E
Automotive Axles	XATOF	C-1-7	125	38	3.3	2.9	2.3	18%	1.2	0.9	0.7	2.5	2.4	2.0	11.2%	12.8%	40.5	36.5	35.5
Bajaj Auto	XBJBF	C-2-7	360	1,055	NM	6.2	5.7	9%*	3.3	2.6	2.1	4.8	4.7	4.4	5.0%	5.3%		46.4	39.9
Bharat Forge	XUUVF	C-3-7	102	461	8.1	8.0	8.3	-1%	1.5	1.4	1.1	4.8	5.1	4.9	3.4%	3.4%	21.7	19.2	15.8
Hero Honda	HRHDF	C-1-7	720	2,913	14.9	11.4	9.6	24%	4.8	4.6	4.0	10.7	8.4	7.0	5.6%	5.6%	35.5	41.1	44.5
M & M	MAHHF	C-3-7	319	1,671	4.2	4.4	4.1	1%	1.2	1.0	0.8	5.0	4.9	4.7	4.1%	4.4%	32.8	24.7	21.1
Maruti Suzuki India	MUDGF	C-3-7	548	3,207	9.0	10.8	9.6	-3%	1.9	1.6	1.4	6.1	7.2	6.2	1.1%	1.3%	23.1	16.2	15.8
Rico Auto Ind	XINAF	C-1-7	11	27	3.4	2.8	1.8	36%	0.4	0.4	0.3	2.3	1.7	1.0	11.8%	11.8%	13.0	14.5	19.6
TVS Motor	XFKMF	C-3-7	25	122	-21.3	51.8	12.0	-9%**	0.8	0.8	0.8	(340.3)	14.8	10.2	3.4%	3.9%	(3.6)	1.6	6.6
Ashok Leyland	XDBVF	C-3-7	15	403	4.2	5.1	5.4	-12%	0.9	0.9	0.8	3.1	4.0	4.7	10.0%	10.0%	23.9	18.3	16.3
Eicher Motors	XEICF	C-1-7	218	124	11.2	7.1	6.6	30%	1.4	0.5	0.5	6.8	1.0	2.1	2.3%	2.3%	13.1	10.3	7.2
Tata Motors Ltd.	TENJF	C-3-7	141	1,285	2.7	5.0	5.7	-32%	0.6	0.5	0.4	3.3	5.8	5.0	3.5%	3.5%	24.7	11.6	8.0
Auto Sector Avg.					7.3	7.4	6.9		1.6	1.3	1.1	5.1	5.8	5.3	3.8%	4.0%	25.0%	19.7%	17.2%

Source: Merrill Lynch Research
* EPS GR FY09-10E ** EPS CAGR FY07-10E

RC

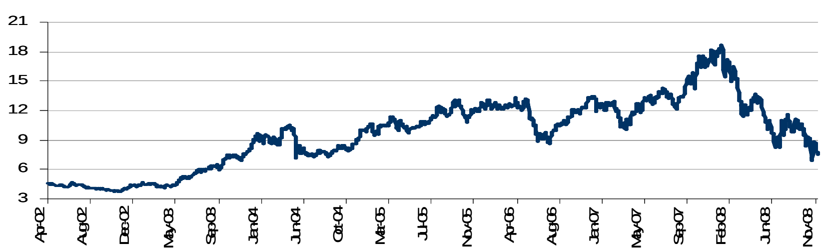
Banks (Rajeev Varma, Veekesh Gandhi)

Overweight

Key Drivers of Sector Outlook

- Loan growth, that could surprise on the upside in FY09 (at +21%) is likely to show a sharp moderation in FY10 to <15% owing to absence of subsidy financing and slowdown in new projects etc. As of Oct'08, loan growth is 29%.
- Margins may hold up through FY10 owing to the aggressive CRR and SLR cuts giving banks' the adequate cushion to cut lending (and deposit) rates. However, near term, margins may be under pressure owing to spike in borrowing costs in Oct'08 as the sector witnessed a liquidity squeeze.
- NPL's likely to rise more sharply in the SME segment as economic growth slows down adversely impacting revenue growth, high interest expenses and more stringent credit standards. This should lead to rise in credit costs, especially for the govt. banks that are more exposed to the SME segment and have lower credit costs. Amongst private banks, Axis Bank appears most vulnerable (having also grown its loan book the most rapidly in past 2 years). In contrast, we believe, we are past the mid-way mark in the *retail* NPL cycle.
- Fall in rates and bond yields should result in no investment hits on banks' G-sec portfolio and we could also see some sharp reversals in the ensuing part of FY09 (of write downs done in prior quarters).
- Sector earnings growth is estimated to be 15-20% CAGR in FY08-10E, with ROE for most banks expected to be between 16-20% during the period. HDFC Bk and Axis Bank may still deliver growth of ~30% due to market share gains and higher fees. Govt. banks earnings to be in sync with sector at 15-20%.

Chart 27: Bank sector 1yr forward PE chart



Source: Merrill Lynch Research Estimates

Top Buy: ICICI Bank
Top Underperformers: Canara

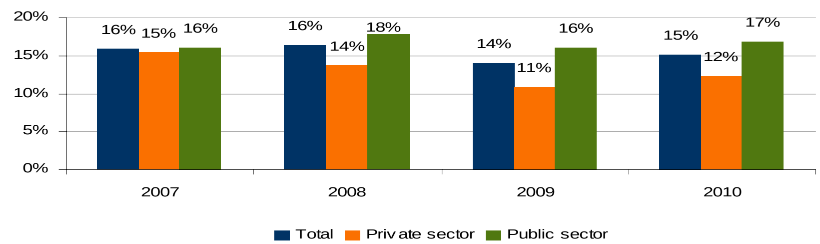
Top Stock Pick: ICICI Bank

- **Dominant franchise:** ICICI Bank is the second largest bank by assets and largest retail bank in India. Over the last 5yrs gained leadership position in various retail segments (#1 or #2 player) through aggressive marketing, robust risk management and superior technology platform.
- **Branch expansion to aid growth:** ICICI Bank's branch network has doubled in past one year to +1450, which would help the bank further expand its footprint while strengthening its deposit franchise. Should help the bank to further expand its CASA levels to 33% by FY10 (from 30% currently).
- **Amongst key beneficiary of falling rate cycle:** ICICI Bank is amongst the key beneficiaries of a falling rate cycle owing to its relatively higher proportion of wholesale funds (that should see greater re-pricing downwards) and high share of fixed rate loans (that do not get re-priced).
- **Compelling valuations.** Strong value play at <0.7x adjusted book (even after factoring its low ROE at 9-10%), if we were to deduct the value of subs (<1.0x without deducting subs. value). Moreover, BV is adjusted for sharp rise in NPL's and MTM hits. Risk return remains very positive.

Key risks

- Key risks include significantly higher provisions against the bank's CDO exposure on the UK sub, a marked slowdown in offshore growth, declining earnings growth due to softer revenues on weaker loan growth, and a material uptick in NPLs.

Chart 28: Sector Average RoEs



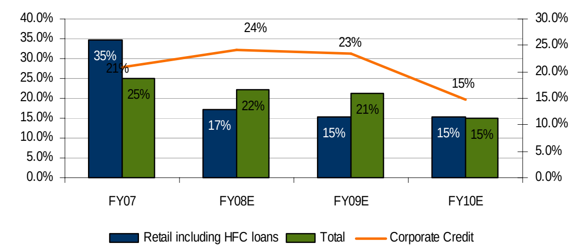
Source: Merrill Lynch Research Estimates

Table 30: Bull & Bear Factors that can change views

Company	Bull Scenario	Bear Scenario
ICICI Bank	■ Dominant retail franchise with 30% market share in most retail products ■ Key beneficiary of the changing demographics ■ PPP earnings growth strong at +20% CAGR over FY08-10; PPP, ex trading CAGR at +25% ■ Key beneficiary of a fall in interest rates ■ Value of subsidiaries rises if markets rebound; underlying growth remains strong	■ Hangover from international turmoil on bank's international balance sheet ■ Slow down in retail loan growth; sharp rise in interest rates ■ Worst impacted in case of rise in retail NPLs
Reliance Cap	■ Key beneficiary of the changing demographics due to its gaining dominance in key finance business, ex banking. ■ Rapidly building scale and distribution for all its businesses allowing it to rapidly gain market share across all businesses. ■ Growth could be stronger if equity markets rebound driving life premia and asset management products.	■ Earnings largely driven by monetizing strategic investments, most of its businesses are making losses due to relatively newer forays. Inability to scale up fast and report quality earnings could hurt valuations. ■ Moderation in key businesses (AMC. Cons. Finance, Broking, Life, etc) owing to slowdown in economy and market
SBI	■ Strong Loan growth led by recovery in credit cycle ■ Opening up of FII limit (20% current) in the stock could lead to a strong run-up SBI stock price ■ Margin Expansion due to changing loan profile re-pricing of high cost deposits ■ Strong fee income growth as it leverages its +90mn customer base by ■ effective cross selling ■ Rise in value of subsidiaries	■ Sharp rise in bond yields ■ Loosing market share to private sector players ■ Rise in SME and Retail NPLs could hurt earnings
HDFC	■ Strong franchise with a 30% market share in mortgage financing; Key beneficiary of the changing demographics ■ Strong growth trajectory (+18% CAGR); ROE at +22% (post dilution) is highest in region ■ Superior asset quality with gross NPL at 1%, net <0.5% ■ Rising value of subsidiaries	■ Premium valuations; amongst the most expensive financial stocks in the region ■ Rise in rates to impact funding costs; might put pressure on NIMs
HDFC Bank	■ Key beneficiary of the changing demographics due to its dominant presence in retail (30% market share in most retail products excl mortgages) ■ Strong growth trajectory: Loan and fee revenues to grow at +35-40%p.a ■ Benefiting from rising lending rates, higher proportion of low cost fixed demand deposit to help to sustain healthy NIMs (+ 4%)	■ Premium valuations: could contract if earnings growth decelerates ■ Rising proportion of unsecured personal loans could result in rise in NPLs ■ Margins could contract is funding costs increases significantly owing to liquidity pressures
PNB	■ Earnings growth to sustain at over +30% ■ Leveraged to the upswing in the agricultural and corporate credit cycle ■ Higher proportion of demand deposits to positively impact margins in rising rate scenario ■ Fee income to boost revenues as the bank leverages its technology initiatives to increase cross selling	■ Vulnerable to rising bond yields ■ Could face margin pressures due to re-pricing of investment portfolio ■ Relatively higher vulnerability to monsoons owing to a high % of agricultural credit ■ Deterioration in asset quality to increase credit costs
UBI	■ Leveraged to pick up in corporate credit cycle owing to its stronger presence in western India, the Corporate hub ■ Offers the best risk return ratio: Could re-rate owing to rebound in earnings ■ Estimated ROE to remain over +18% ■ Best positioned bank in a rising rate environment	■ Margins could be under pressure owing to rise in funding costs and re-pricing of investment portfolio ■ Lack of room to raise substantial capital could result in loan growth remaining below the sector average
BOI	■ Maximum initiative at the margin to a) improve asset quality b) technology ramp up and c) driving fee income ■ SLR cut could provide a big boost to earnings ■ Strong re-bound in earnings; Best positioned in a rising rate environment; ■ Beneficiary of the pick up in corporate credit cycle	■ Margin pressures owing to high proportion of international business where spreads are lower ■ Rise in SME and Retail NPLs could hurt earnings

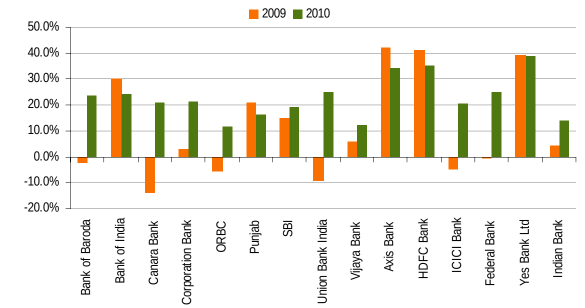
Source: Merrill Lynch Research

Figure 4: Loan growth to remain strong; come-off in FY10



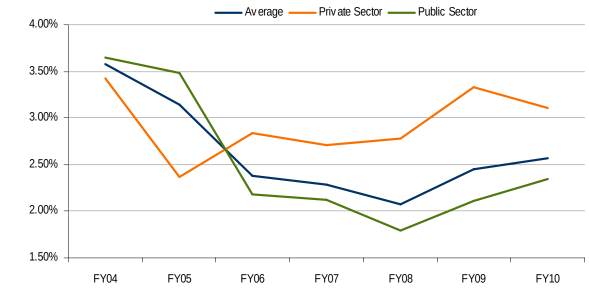
Source: Merrill Lynch Research Estimates

Chart 29: Bank earnings growth to remain strong



Source: Merrill Lynch Research Estimates

Chart 30: Building in an uptick in NPL cycle- Slippages



Source: Merrill Lynch Research Estimates

Table 31: Sector / Stock Valuation

			Price	Mkt Cap	PE (x)			EPS CAGR	P/BV (x)			Div Yield		RoE (%)		
Company	ML Code	QRQ	Rs	US$mn	FY08	FY09E	FY10E	08-10E	FY08	FY09E	FY10E	FY09E	FY10E	FY08	FY09E	FY10E
Axis Bank	UTBKF	C-1-7	457	3,346	13.6	10.7	8.0	31%	1.9	1.6	1.4	1.5%	1.8%	17.6	16.2	18.8
Bank of Baroda	BKBAF	C-2-7	271	2,012	6.9	7.1	5.7	10%	0.9	0.9	0.7	3.3%	3.7%	14.6	12.9	14.4
Bank of India	XDIIF	C-1-7	259	2,778	11.3	6.8	5.2	47%	2.1	1.3	1.1	1.8%	2.1%	20.6	24.4	22.5
Canara Bank	CNRKF	C-3-7	179	1,496	4.7	5.4	4.5	2%	0.7	0.6	0.6	4.2%	4.8%	15.0	12.2	13.4
Corporation Bank	XCRRF	C-1-7	209	613	4.1	4.0	3.3	12%	0.7	0.6	0.6	5.3%	5.3%	18.7	17.3	18.2
Federal Bank	XFDRF	C-3-7	147	512	5.1	6.9	5.5	-3%	0.6	0.6	0.6	3.4%	3.8%	13.6	9.0	10.4
HDFC Bank	XHDFF	C-1-7	936	8,126	19.8	16.7	14.2	18%	2.9	2.7	2.0	1.2%	1.4%	17.7	16.5	16.3
HDFC	HGDFF	C-1-7	1497	8,692	16.5	18.1	14.7	6%	3.6	3.2	2.8	1.8%	1.9%	27.8	18.7	20.6
ICICI Bank	ICIJF	C-1-7	386	8,780	9.3	10.9	9.0	2%	0.9	0.9	0.8	3.1%	3.4%	11.7	8.2	9.3
IDBI	XDBIF	C-3-7	65	965	7.5	6.5	6.8	5%	0.8	0.7	0.7	3.8%	4.6%	10.0	11.2	9.9
Indiabulls Finan	IBLFF	C-1-7	106	546	4.8	4.0	3.0	26%	0.8	0.7	0.6	9.5%	11.4%	24.9	19.1	22.1
Indian Bank	INDIF	C-1-7	127	1,110	5.6	5.3	4.7	9%	1.1	1.0	0.9	3.2%	3.6%	23.7	20.1	20.4
Infrastruct Dev	IFDFF	C-2-7	61	1,611	10.5	8.7	7.1	21%	1.4	1.3	1.1	2.8%	3.0%	17.6	15.2	16.6
Max India	XMXIF	C-1-9	128	579	-58.0	47.7	24.8	NA	1.8	1.7	1.6	0.0%	0.0%	(4.5)	3.7	6.7
ORBC	ORBCF	C-3-7	145	739	4.3	4.6	4.1	3%	0.6	0.6	0.5	3.5%	3.7%	14.8	13.0	13.0
Punjab	PUJBF	C-1-7	468	3,014	7.2	6.0	5.1	19%	1.2	1.0	0.9	3.0%	3.2%	18.0	18.6	18.6
Reliance Capital	RLCCF	C-1-7	557	2,792	13.6	15.6	13.5	0%	2.1	1.9	1.7	1.2%	1.3%	16.9	12.6	13.2
SBI	SBINF	C-1-7	1168	15,135	13.5	11.0	9.5	19%	2.0	1.5	1.3	1.8%	2.1%	15.4	16.8	14.9
Union Bank India	UBOIF	C-1-7	149	1,536	5.4	6.0	4.8	6%	1.2	1.0	0.9	3.0%	3.0%	24.0	18.3	19.6
Vijaya Bank	VJYAF	C-3-7	31	272	3.7	3.5	3.1	9%	0.6	0.5	0.5	6.5%	6.5%	17.8	16.6	16.4
Yes Bank Ltd	YESBF	C-1-9	71	432	10.3	7.6	5.5	37%	1.6	1.3	1.1	0.7%	0.7%	18.8	19.0	21.7
Sector Avg.					10.4	9.8	8.3		1.5	1.3	1.2	2.3%	2.5%	16.2%	14.5%	15.0%

Source: ML Research

Cement (Reena Verma Bhasin, CFA)

Underweight

Key Drivers of Sector Outlook

- **Undemanding valuations but profit upturn seems far away**: Sector valuations are at a deep discount to replacement cost but broadly on par with the local market on FY10E-EV/EBITDA. We remain cautious as sector news flow will likely remain negative and profit upturn seems far away.

- **Capacity pipeline on track:** We forecast cement capacity to grow 26% YoY in FY09 and 17% YoY in FY10E vs the industry's long-term demand CAGR of 8%. Bulk of the new capacities were ordered in early-CY06 and substantial push backs seem unlikely to us. We expect ~37mn tpa (+26% YoY) of composite cement capacity to be added in FY09E and ~31mn tpa (+17% YoY) to be added in FY10E.

- **Margin pressures likely to continue:** Despite easing energy prices globally, we think EBITDA margins of cement majors will stay under pressure in FY10E led by lower cement prices. We expect cement prices to fall from end-FY09 onwards due to rising capacity and slowing demand. We forecast the industry's capacity utilization at 75-80% over next 12 months vs 90-95% over last 12-18 months.

Chart 31: Cement sector 1yr forward PE chart

Source: ML Research

Top Underperformer: ACC

- **Higher sensitivity to cement prices**: ACC's CY09E earnings change by ~4.5% for every 1% change in cement prices. This compares with an estimated ~4% earnings sensitivity for other majors.

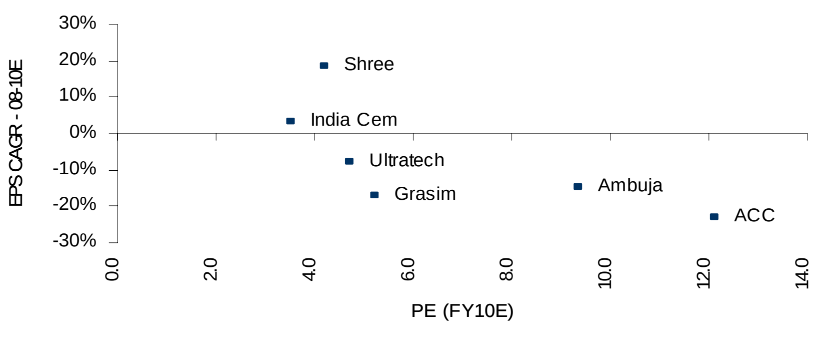
- **Low linkage to imported coal**: ACC uses ~10-15% imported coal vs 30-40% for other cement majors. Owing to relative stickiness of local coal (esp. linkage coal) prices, ACC may have relatively lower earnings cushion from falling prices of imported coal.

- **Capacity expansion to lag industry majors**: We expect ACC's cement capacity to grow 5% YoY in CY09E, lagging industry capacity growth of ~17% YoY in FY10E. For ACC, the next major expansion (Wadi expansion by 3mn tpa) is likely to commission only in CY10E.

- **Relatively high risk to consensus estimates**: Our CY09 profit forecast for ACC is 13% below consensus vs 5-6% variance for other cement majors.

- **Previous trough valuation equates to share price of ~Rs325-370/sh**: This uses previous trough valuation of ~US$45-50/ton witnessed in CY01-02.

Chart 32: PE(10E) vs EPS CAGR (08-10E)



Source: ML Research

RC

Table 33: Sector performance

Stock	Absolute performance 1month	3month	YTD	1Year
Ambuja Cements	3.1%	-31.1%	-62.4%	-62.7%
ACC	-12.8%	-28.6%	-61.0%	-63.1%
Grasim Industries	-22.3%	-52.7%	-74.7%	-75.4%
India Cements	0.9%	-39.4%	-71.9%	-71.4%
Shree Cements	-14.2%	-33.7%	-69.9%	-72.0%
UltraTech Cement	-15.8%	-49.6%	-69.6%	-70.4%
Sensex	-14.2%	-39.7%	-56.8%	-54.5%
Sector average	-10.2%	-39.2%	-68.3%	-69.2%

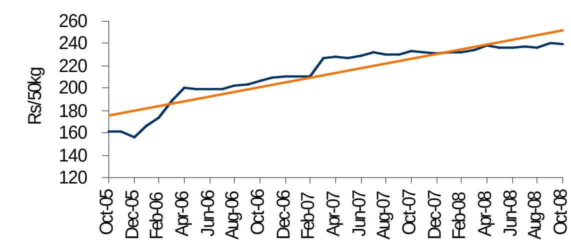
Source: ML Research

Table 32: Bull & Bear Factors that can change views

Company	Bull Scenario	Bear Scenario
ACC	Material push-back in capacity additions across the cement industry, acceleration in cement demand and further easing in energy prices, especially coal, would present upside	Timely commissioning of capacity additions in the cement industry, further demand slowdown & unforeseen rise in energy costs would hurt earnings and valuations.
Grasim	Material push-back in capacity additions across the cement industry, further easing in energy costs especially coal & demand recovery for cement & textiles would offer upside.	Timely commissioning of capacity additions in the cement industry, further demand slowdown, unforeseen rise in energy costs and further downturn in VSF prices would hurt both earnings and valuations.
UltraTech	Material push-back in capacity additions across the cement industry, acceleration in demand and further easing in energy prices, especially coal, would present upside	Timely commissioning of capacity additions in the cement industry, further demand slowdown & unforeseen rise in energy costs would hurt earnings and valuations.
Ambuja	Material push-back in capacity additions across the cement industry, acceleration in demand and further easing in energy prices, especially coal, would present upside	Timely commissioning of capacity additions in the cement industry, further demand slowdown & unforeseen rise in energy costs would hurt earnings and valuations.
Shree	Material push-back in capacity additions across the cement industry acceleration in demand & further easing in energy prices would present upside	Timely commissioning of capacity additions in the cement industry, further demand slowdown & unforeseen rise in energy costs would hurt earnings and valuations.
India Cements	Material push-back in capacity additions across the industry, acceleration in cement demand and further easing in energy prices, esp. coal, would present upside	Timely commissioning of capacity additions in the cement industry, further demand slowdown & unforeseen rise in energy costs would hurt earnings and valuations.

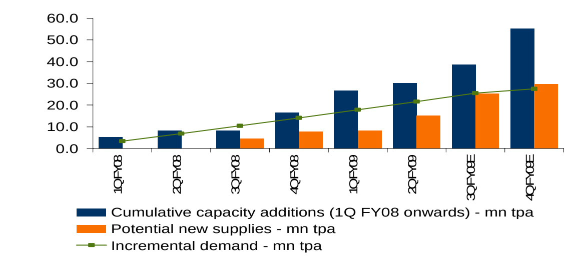
Source: ML Research

Chart 33: Trend in average cement prices over last 3 years



Source: CMA

Figure 5: Time-sheet of new supply vs incremental demand



Source: CMA, Company data, ML Research

Table 34: Supply-demand outlook

As on 31 March (mn tpa)	FY07	FY08	FY09E	FY10E
Cement Capacity	166	189	233	267
Composite Capacity Growth	4%	12%	26%	17%
Cement Demand	155	168	182	196
Demand growth	10%	8%	8%	8%
Cement - Capacity Utilisation	93%	89%	78%	73%

Source: CMA, Company data, ML Research

Table 35: Sector / Stock Valuations

Company	ML Code	QRQ	Price Rs	Mkt Cap US$mn	P/E (x) FY08	P/E (x) FY09E	P/E (x) FY10E	EPS CAGR 08-10E	P/B (x) FY08	P/B (x) FY09E	P/B (x) FY10E	EV/EBITDA (x) FY08	EV/EBITDA (x) FY09E	EV/EBITDA (x) FY10E	Div Yield FY09E	Div Yield FY10E	RoE (%) FY08	RoE (%) FY09E	RoE (%) FY10E	Corp Gearing FY08	Corp Gearing FY09E	Corp Gearing FY10E
UltraTech Cemen	XDJNF	C-3-7	323	821	4.0	4.3	4.7	-8%	1.5	1.1	0.9	3.2	3.5	3.4	1.5%	1.3%	45.2	29.8	21.5	56%	49%	29%
Shree Cements	SREEF	C-2-7	439	312	5.9	3.4	4.2	18%	3.0	1.6	1.2	2.2	1.7	1.9	1.9%	1.9%	59.3	61.7	32.0	73%	-10%	-25%
India Cements	INIAF	C-3-7	83	476	3.8	3.4	3.5	-11%	1.6	0.9	0.8	5.1	3.3	3.2	2.4%	2.8%	55.0	35.9	23.5	56%	54%	44%
Assoc. Cement	ADCLF	C-3-9	416	1,592	6.2	7.2	9.3	-23%	1.9	1.6	1.5	3.5	4.1	5.5	4.8%	3.7%	34.3	24.2	16.6	-23%	-18%	-4%
Ambuja Cements	AMBUF	C-3-7	54	1,684	6.1	6.8	7.7	-11%	1.7	1.4	1.2	3.5	3.8	3.8	5.4%	3.8%	31.1	22.5	17.0	-23%	-18%	-23%
Grasim	GRSJF	C-3-7	1024	1,917	3.6	3.9	5.2	-17%	1.3	1.0	0.8	2.7	3.0	2.9	2.7%	2.0%	44.0	28.3	17.2	57%	42%	24%
Cement Sector Avg.					4.9	5.2	6.4		1.5	1.2	1.0	3.3	3.5	3.5	3.0%	2.4%	34.6%	25.0%	17.0%	26.0%	18.7%	8.2%

Source: Merrill Lynch Research

RC

Consumers (Vandana Luthra, Anuj Bansal)

Neutral

Key Drivers of Sector Outlook

FMCG

- 2008 was a year of sharp input cost increases. Most companies were able to pass this on through retail price hikes and hence sales growth accelerated but margins were under pressure.
- We expect these trends to reverse in 2009. With falling input prices, margin are expected to improve. The concern however is on the topline. Pricing has likely peaked and hence the key parameter we'd track is volume growth. Given that FMCG tends to be non-discretionary we expect volume growth to be positive but the rate of growth could likely slowdown in the current weak economic outlook.
- Overall, we expect the FMCG sub segment to deliver earnings growth in the mid teens in 2009. This will be way ahead of broader market growth.

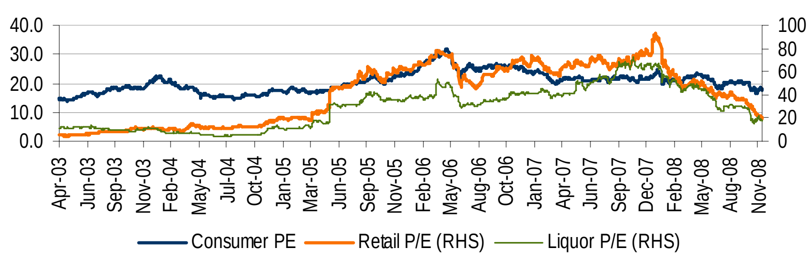
Alcoholic Beverages

- Volume growth in 2008 accelerated to mid teens. We believe beverages will be resilient despite the economic downturn owing to regulatory upside (banning of country liquor). Further margin outlook is positive as molasses and bottle prices have likely peaked.

Retail

- We believe the balance of power has shifted from mall developers to retailers. Rent and salary costs have likely peaked. We also believe interests costs have peaked with the rate cycle likely to turn. However, retail balance sheets continue to be stretched and we believe this is becoming a growth constraint for smaller players. Overall the biggest challenge we see is falling discretionary spending.

Chart 34: FMCG, Retail and Liquor sectors 1 yr forward PE Chart



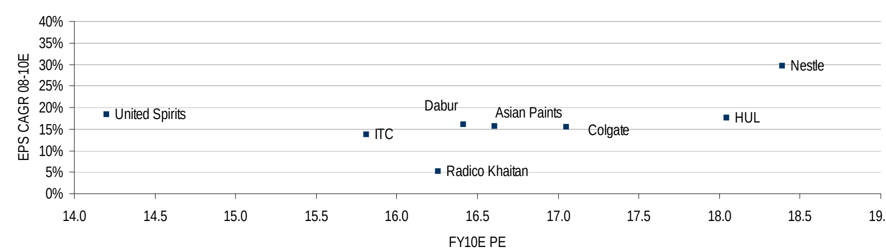
Source: Merrill Lynch Research

Top Buys: United Spirits, HUL

Top Stock Buy: United Spirits

- **Strong earnings growth:** 1HFY09 profit grew a robust 26% led by strong sales growth. Given that sales momentum is strong and input costs have peaked, we believe there is upside to our forecast EPS CAGR of 18% over FY08-10E.
- **Improving margin outlook from 3Q:** Molasses and bottles prices are likely to fall on easing ethanol pressure and lower soda ash prices. In addition, retail prices hikes key markets (Andhra Pradesh & Maharashtra) is a positive.
- **Market concerns on debt are overplayed:** We note: (1) Over 40% of UNSP's debt is at fixed cost, (2) Re depreciation hit is limited as loans are underpinned by significant foreign currency assets, and (3) repayment in FY10 is small at ~US$93m with total repayment term on the loans being over next 5-7 years.
- **Price correction is a buying opportunity:** UNSP has corrected ~40% over last two months. We believe for a structural growth story, valuation is attractive at 15xFY10E. A key trigger is strategic sale of treasury stock (~14% of share capital). Applying our target PO value of Rs1350 on the treasury, we estimate UNSP is trading at mere 11xFY10E.

Chart 35: PE (10E) vs EPS CAGR (08-10E) scatter graph



Source: Merrill Lynch Research

Table 36: Sector performance

Stock	Absolute performance 1month	3month	YTD	1Year
Asian Paints	-1.9%	-20.1%	-14.0%	-6.0%
Colgate Palmolive (India) Ltd.	1.7%	-7.3%	-4.3%	-0.7%
Dabur India Limited	-1.7%	-12.3%	-31.0%	-32.7%
Hindustan Unilever Ltd.	-2.1%	-3.8%	9.6%	14.0%
ITC Limited	-0.1%	-10.0%	-21.2%	-16.0%
Nestle India Ltd.	-11.2%	-21.6%	-10.2%	-3.7%
McLeod Russel	-30.8%	-57.7%	-56.1%	-41.6%
Radico Khaitan Ltd	-2.4%	-22.2%	-66.9%	-65.6%
United Spirits Limited	9.2%	-40.0%	-61.0%	-59.2%
Sensex	-14.2%	-39.7%	-56.8%	-54.5%

Source: ML Research

Table 37: Bull & Bear Factors that can change views

Company	Bull Scenario	Bear Scenario
HUL	We expect HUL to be re-rated should volume growth exceed our forecast of ~9% in 2009.	Key risk to our Buy call is sharp slowdown in demand and intensive competition.
ITC	Cigarette tax increases, both at the Central and State levels are benign and hence cigarette volume growth beats our expectations	2009 is another year of sharp tax increases. Consumers down-trade to cheaper bidis and hotels are hit sharply in the economic downturn.
Asian Paints	Discretionary paint demand remains buoyant and hence retail prices are not cut despite input costs falling.	Weaker economic growth leads to paint volumes declining. Depreciating Rupee negates benefit of lower input costs.
Nestle	Strong structural growth drivers as processed foods is huge under-penetrated and Nestle dominates most of its categories. Input costs begin to ease.	Urban demand weakens. Prices of input costs such as milk and coffee do not fall.
United Spirits	Volume growth and mix up-trading is higher than our expectations and W&M becomes earnings accretive earlier than expected.	W&M's business slows down sharply owing to weak consumer demand hitting bulk scotch prices.
Pantaloon	Rent, salary and input costs fall sharply. Same stores sales growth remains positive as Pantaloon gains share from weaker players exiting the market.	Same store sales growth falls sharply owing to weaker economic environment. High leverage constrains new store roll outs.

Source: Merrill Lynch Research

Table 1: Table 38: Stock / Sector Valuations

Company	ML Code	QRQ	Price Rs	Mkt Cap US$mn	P/E (x) FY08	P/E (x) FY09E	P/E (x) FY10E	EPS CAGR 08-10E	P/B (x) FY08	P/B (x) FY09E	P/B (x) FY10E	EV/EBITDA (x) FY08	EV/EBITDA (x) FY09E	EV/EBITDA (x) FY10E	Div Yield FY09E	Div Yield FY10E	RoE (%) FY08	RoE (%) FY09E	RoE (%) FY10E	Corp Gearing FY08	Corp Gearing FY09E	Corp Gearing FY10E
ITC Limited	ITCTF	C-1-7	165	12,446	19.9	18.1	15.4	14%	5.2	4.5	3.9	12.9	11.6	9.9	2.3%	2.7%	27.9	26.8	27.3	-3%	0%	-3%
Hindustan Unilever	HINLF	C-1-7	234	10,206	25.0	20.8	18.0	18%	33.5	31.4	29.3	18.4	15.1	12.9	4.1%	4.7%	137.9	155.9	168.3	-33%	-53%	-73%
Nestle India	XNTEF	C-1-7	1339	2,582	31.2	23.0	18.6	30%	30.9	25.6	21.1	17.1	14.9	12.0	3.3%	4.0%	102.5	121.6	124.6	-8%	-29%	-42%
Dabur India	DBUIF	C-2-7	79	1,363	20.4	17.7	15.1	16%	11.0	8.0	6.1	16.7	14.5	12.0	2.0%	2.3%	61.9	52.6	45.8	4%	0%	-16%
Asian Paints	XAPNF	C-2-7	946	1,814	21.7	19.0	16.2	16%	9.2	7.3	5.9	14.0	12.2	10.4	2.2%	2.5%	46.5	43.0	40.3	17%	18%	12%
Colgate India	CPIYF	C-2-7	390	1,061	22.8	19.7	17.1	16%	32.7	26.5	21.8	22.0	18.9	15.9	3.8%	4.4%	105.1	149.0	140.0	-152%	-168%	-184%
Mcleod Russel	XCVFF	C-1-7	38	83	29.9	4.1	3.2	207%	0.4	0.3	0.3	12.8	3.6	2.6	3.7%	4.7%	1.2	8.6	10.3	38%	25%	13%
Pantaloon	PFIAF	C-2-8	203	647	27.7	21.7	16.3	31%	1.7	1.3	1.2	11.8	9.1	8.4	0.2%	0.3%	8.4	7.0	7.7	116%	105%	172%
Consumer Sector Avg.					22.6	19.2	16.4		8.01	6.85	5.98	14.8	12.6	10.7	3.0%	3.5%	38.6%	38.5%	39.0%	-3.0%	-4.5%	-10.1%
United Spirits	UDSRF	C-1-7	779	1,560	19.8	16.7	14.1	18%	3.2	2.7	2.3	12.8	11.0	9.8	0.4%	0.4%	19.9	17.7	17.8	283%	235%	189%
Radico Khaitan	RKHAF	C-3-7	57	117	17.8	18.6	16.0	5%	2.4	2.1	1.9	12.9	14.1	12.8	0.5%	0.6%	15.2	12.1	12.6	185%	181%	169%
Liquor Sector Avg.					19.6	16.9	14.3		3.1	2.7	2.3	12.0	10.5	9.4	0.4%	0.5%	19.4%	17.1%	17.3%	272.7%	229.3%	186.8%

Source: Merrill Lynch Research

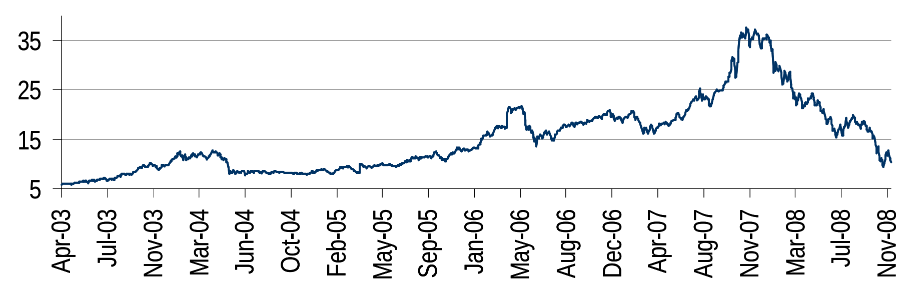
Engineering & Construction (Bharat Parekh)

Overweight

Key Drivers of Sector Outlook

- **An extended cycle:** Govt. of India plans total infra spends at Rs20,272bn (US$414bn) over FY08-12E – ~3x rise compared with the FY03-07 spend at 27% CAGR. We expect power sector to be the biggest driver accounting for 30% of this spend followed by oil & gas, railways, roads, airports and ports.
- Our top-down model forecasts that pent-up demand (deficit of 9.9% on base demand & 13.5% on peak load) and an expanding economy should lead to 44% growth in per capita consumption of power by FY12E.
- India plans to more than triple the power generation capacity addition by 60GW (government plans to add 77GW) during the XI Plan, +182% over the X Plan.
- We expect funding constraints could limit total private sector participation, which was expected to rise to 32-33% from 20-22%; despite a much greater regulatory progress seen & improved acceptance of PPP models across sectors. Hence, we prefer companies dependant on Govt. capex such as BHEL & IVRC.
- We expect the soft material prices and demand led return of pricing power as the key driver of margins. We also note that the financing of our infrastructure spend forecasts are not primarily dependant on budgetary support as Govt. companies have well funded balance sheets.

Chart 36: Engg & Const Sector 1yr forward PE Chart



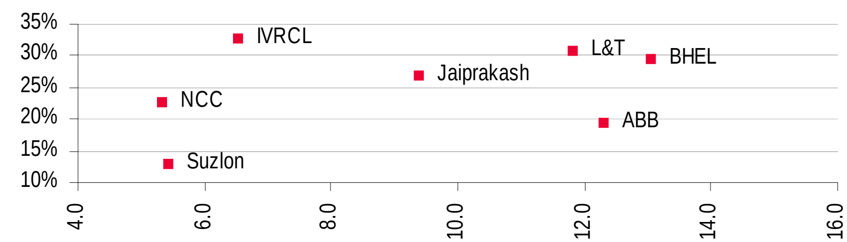
Source: Merrill Lynch Research Estimates

Top Buys: BHEL, JP Associates, IVRC, L&T, NCC

Top Stock Pick: BHEL

- Given BHEL's well funded balance sheet, market dominance and order book driven by Govt. orders, we believe it would be the primary beneficiary of tripling of power generation capex especially as it has fixed technology issues, expanding capacity to 15GW by FY10E and leveraging its economies of scale.
- To capitalize on the power capex, BHEL has tied-up with 3 MNCs to acquire advanced technologies: i) super critical boilers from Alstom, ii) generators from Siemens and iii) Advance class gas turbine from GE. It is in-process of tie-up of technology for nuclear reactors, where talks are on with Areva.
- We believe that BHEL may get significant new orders on the new super-critical technology. In fact, BHEL has already locked-in 4520MW of orders on this technology in last one year. This could result in a potential order of US$4-5bn (20% increase on current US$21bn) from NTPC / JVs / states in FY10E.
- Believe BHEL will witness stable pipeline of orders led by likely setting-up of i) Sub-critical plants at NTPC / SEBs / IPPs, and ii) 660/800MW super-critical coal-based & gas based projects of the states / NTPC. MLe 30% EPS CAGR over FY08-10E for BHEL led by 25% sales CAGR, falling material prices and leverage drive up margins.

Chart 37: PE(10E) vs EPS CAGR (08-10E)



Source: Respective Company, Merrill Lynch Research

Table 39: Stock Performances

	Absolute Performance			
	1month	3 month	YTD	1year
ABB India	-35.2%	-51.5%	-72.2%	-73.6%
BHEL	12.1%	-26.6%	-52.5%	-53.5%
IVRCL	-8.6%	-63.3%	-79.0%	-76.7%
Larsen & Toubro	-9.8%	-45.3%	-64.9%	-66.2%
Nagarjuna Constru	9.9%	-57.9%	-84.8%	-83.5%
Suzlon Energy	-43.9%	-80.0%	-87.7%	-88.3%
Sensex	-14.2%	-39.7%	-56.8%	-54.5%

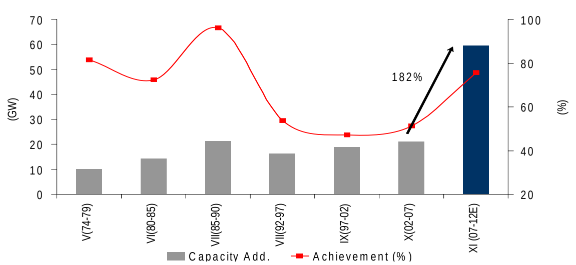
Source: ML Research

Table 40: Bull & Bear Factors that can change views

Company	Bull Scenario	Bear Scenario
ABB India	Improved tailwind for automation capex in India led by resurgence in Industrial capex, while T&D capex continues	Extended order execution cycle, competition, delay in power sector reforms / capex.
BHEL	Key beneficiary of tripling of power capex in XI Plan & potential orders of US$4-5bn from NTPC's / states super-critical mega power projects	Competition from Chinese / Japanese players, project execution and capex slowdown near general elections in 2QCY09
IVRCL	India's continued focus on water capex, IVRCL's SPV achieving financial closure for road projects, Turnaround of Hindustan Dorr Oliver & value un-locking at IVR Prime, its real estate venture & new oil and gas acquisition	Slowdown in Government capex around elections, raw material costs, Competition, Denial of tax benefits, Traffic/Interest rate risk in toll/annuity projects, and Project execution risk.
L&T	Rebound in domestic / Middle East Infra capex cycle to drive order backlog & sales; value un-locking in Infra / Manufacturing subsidiaries / associates	Dependence on private / Middle East capex, entry into long gestation projects such as Shipyard, Power equipment, Increasing competition & execution.
NCC	Rebound in road capex, continued momentum in water, irrigation & Electrification capex, order inflows from NCC's export initiatives & pay-off from its real estate initiatives. Value accretive addition of Infra projects drive SOTP	Slowdown in Government capex around elections, raw material costs, Competition, Denial of tax benefits, Traffic/Interest rate risk in toll/annuity projects, and Project execution risk.

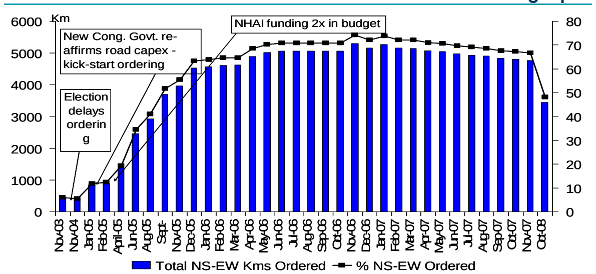
Source: Merrill Lynch Research

Chart 38: India 5-yr Plan wise Power Capacity Creation & MLe



Source: Ministry Of Power, ML Research estimates

Chart 39: NHAI's Execution Of NS-EW Corridor Is Picking-Up



Source: NHAI

Table 41: E&C companies witnessing healthy order books

(Rsmn)	Sep'07	Sep'08	% YoY
ABB	49,011	71,469	45.82%
BHEL	726,000	1,040,000	43.25%
L&T	432,220	629,560	45.66%
IVRCL	96,000	140,000	45.83%
Nagarjuna	90,040	124,200	37.94%
Suzlon	163,280	241,719	48.04%
Sector	1,556,551	2,246,948	44.35%

Source: Respective Company

Table 42: Sector/Stock Valuation

			Price	Mkt Cap	P/E (x)			EPS CAGR	P/B (x)			EV/EBITDA (x)			Div Yield		RoE (%)			Corp Gearing		
Company	ML Code	QRQ	Rs	US$mn	FY08	FY09E	FY10E	08-10E	FY08	FY09E	FY10E	FY08	FY09E	FY10E	FY09E	FY10E	FY08	FY09E	FY10E	FY08	FY09E	FY10E
ABB	ABVFF	C-3-7	462	1,996	17.6	15.0	12.3	20%	4.7	3.8	3.1	9.2	7.4	5.6	1.0%	1.0%	30.1	28.0	27.6	-110%	-108%	-106%
Bharat Heavy	BHHEF	C-1-7	1281	12,795	21.9	17.2	13.1	30%	5.8	4.6	3.6	14.4	10.4	6.9	1.1%	1.2%	29.2	29.8	30.9	-77%	-87%	-92%
IVRCL Infrastruc	IIFRF	C-1-7	115	314	11.5	7.7	6.5	33%	1.1	1.0	0.8	8.1	6.7	5.7	1.2%	1.3%	15.7	14.4	14.5	25%	55%	66%
Larsen & Toubro	LTOUF	C-1-7	792	9,462	20.2	15.2	11.8	31%	4.4	3.6	2.9	14.3	10.2	8.0	1.4%	1.6%	27.3	26.6	27.7	101%	67%	44%
Nagarjuna Const	NGRJF	C-1-7	60	281	8.0	7.3	5.3	23%	0.8	0.8	0.7	5.7	5.9	4.4	2.2%	2.4%	12.4	11.5	13.8	42%	65%	50%
Suzlon Energy	SZEYF	C-1-7	55	1,668	6.9	6.3	5.4	13%	1.0	0.9	0.8	5.6	7.6	6.2	2.2%	2.7%	20.3	15.3	15.9	37%	123%	112%
Jaiprakash	JPRKF	C-1-7	73	1,757	15.1	13.8	9.4	27%	1.9	1.4	1.3	13.8	9.6	6.9	1.0%	1.3%	16.3	13.5	15.2	141%	87%	92%
E&C Sector Avg.					17.8	14.4	11.1		3.5	2.9	2.4	12.2	9.6	7.1	1.3%	1.4%	24.3%	22.4%	23.6%	27.2%	27.0%	14.9%

Source: Respective Company, Merrill Lynch Research

RC

Food commodities (Sanjaya Satapathy)

Underweight

Key Drivers of Sector Outlook

We note that sugar industry is poised to witness improvement in profitability after over two bad years driven by lower production. However, the extent of turnaround is likely to be muted:

- **Supply shortfall in 2009.** Sugar production in India is likely to decline by around 25% to 20mn tonne in the year ahead as farmers have reduced sowing following two years of excessive production. This should help reduce demand supply mismatch as production is likely to be 3mn tonnes less than consumption. Existing inventory of over 10mn tones of sugar, however, should restrain sugar price gains for next six month.

- **Byproduct opportunity.** Integrated sugar mills are also likely to benefit from higher prices for ethanol and greater demand for ethanol for blending with petrol.

- **Import threat.** Indian sugar mills face the risk of competition from imported sugar. However there are a lot of restrictions on the import of sugar, including a 60% duty. More importantly, global supply of sugar is likely to fall on reduced investment following due to the credit crunch. The benchmark price for Indian mills is also likely to change to the landed cost instead of the export parity price as India turns from a net importer to a net exporter.

- **Input cost pressure.** Indian sugar mills are likely to see a sharp rise in input costs in the form of the price they pay farmers to buy sugarcane, as we expect sugarcane to be in short supply.

- **Regulatory uncertainty.** The Indian sugar industry continues to suffer from heavy regulation and more so in the state of Uttarpradesh where most of private sector sugar mills listed in the stock exchange are present. Regulatory bottlenecks are unlikely to be removed anytime soon.

- **High level of leverage.** The key risks we see facing the Indian sugar sector are low capacity and high debt levels, which we attribute to overinvestment in the past five years.

Top Buy: Renuka Sugar

Top Underperformer: Bajaj Hindusthan

Top Stock Pick: Renuka Sugar

- Renuka Sugar is fast emerging as a leading sugar manufacturer of India with a strong risk management practice that allows it to achieve secular earnings growth despite volatility in end product prices and input costs.

- We believe Renuka's key advantage is its location. The company, being present in western India, falls under the statutory minimum price regime of central govt which permits it to adjust its input costs according to the outlook of end product price. This allows the company to maintain profitability.

- Renuka's growth strategy of expanding cane crushing capacity through acquisition of distressed asset is proving to be quite effective given the fragmented and poor financial condition of the industry.

- The company's focus on exploiting the strong demand for sugarcane byproducts, including ethanol and electricity, around its area of operation is likely to help it achieve strong earnings growth on a sustainable basis.

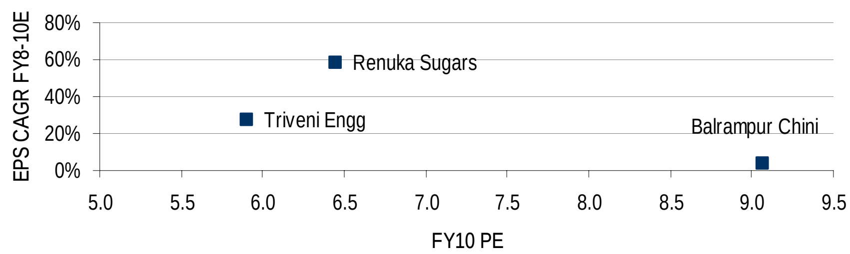
- Renuka is also in a position to exploit the volatile external market for sugar through a coast based sugar refinery.

- Strong and sustainable earnings growth despite market uncertainty is likely to be the key value proposition of Renuka Sugar.

Chart 40: Sugar Sector 1yr forward PE Chart

Source: Merrill Lynch Research

Chart 41: PE(10E) vs EPS CAGR (08-10E)



Source: Respective Company, Merrill Lynch Research

Table 43: Sector/Stock Valuation

			Price	Mkt Cap	P/E (x)			EPS CAGR	P/B (x)			EV/Ebitda (x)			Div. Yield (%)		RoE			Corp Gearing		
Stock	ML Code	QRQ	Rs	(US$mn)	FY08	FY09E	FY10E	08-10E	FY08	FY09E	FY10E	FY08	FY09E	FY10E	FY09E	FY10E	FY08	FY09E	FY10E	FY08	FY09E	FY10E
Bajaj Hindusthan	BJJHF	C-3-7	48	136	-55.0	12.7	8.2	NA	0.5	0.5	0.4	12.7	6.7	6.4	0.4%	0.6%	(0.9)	3.7	5.5	247%	222%	193%
Balrampur Chini	BMPRF	C-3-7	38	198	9.8	9.8	9.1	4%	1.0	0.8	0.8	7.0	6.1	5.6	1.3%	2.6%	10.6	9.3	9.0	126%	98%	84%
Renuka Sugars	SRNKF	C-1-7	54	296	16.2	13.1	6.4	58%	4.0	2.3	1.7	15.7	9.0	4.9	0.4%	0.9%	29.7	26.7	30.3	184%	124%	82%
Triveni Engg	TVIEF	C-1-7	40	207	9.6	6.9	5.9	27%	1.3	1.1	1.0	6.6	5.3	4.6	1.9%	2.5%	14.5	17.6	17.7	126%	96%	73%
Sector Avg.					14.4	10.1	7.0		1.1	1.0	0.9	9.5	6.7	5.5	1.0%	1.7%	8.3%	10.8%	13.4%	179%	144%	116%

Source: Respective Company, Merrill Lynch Research

Media (Bharat Parekh, Yasmin Shah)

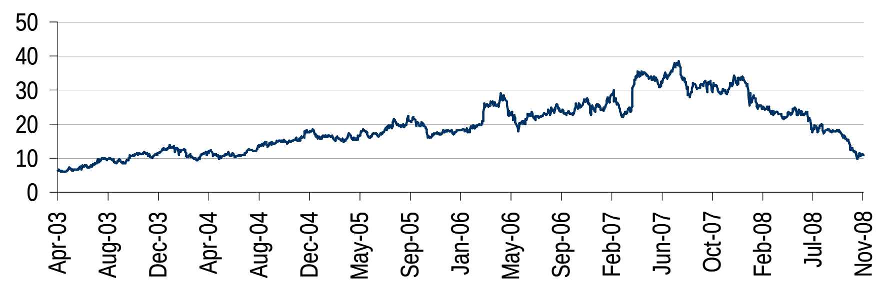
Underweight

Key Drivers of Sector Outlook

While the media industry is poised to witness a take off in growth trajectory led by digitization of distribution, we do see signs of weakness in ad markets on vanishing 'feel-good-factor' and that could keep check on stocks. Key drivers of media outlook:

- **Solid demographics.** More than two-thirds of Indian population is below the age of 35 years which represents the major consuming class. Besides, growing education levels and urbanization add to a solid demographic profile.
- **Ad growth to slowdown to single digit:** Ad spends to grow at 9% in CY09E after rising at a CAGR of 18% CAGR over 2006-08 on economic slowdown. Big media spenders – BFSI, Real Estate, Telecom – are likely trim spends.
- **Increasing competition to impact viability of players:** All the genres have seen proliferation of new players. The advertising pie will likely get further divided, leading to increasing margin pressures on incumbent.
- **Pay revenues to be un-impacted by a slowdown:** New platforms like DTH, CAS, and IPTV should expand the pay TV market. India is expected to add 17mn C&S homes over CY08E-10E.

Chart 42: Media Sector 1yr forward PE Chart



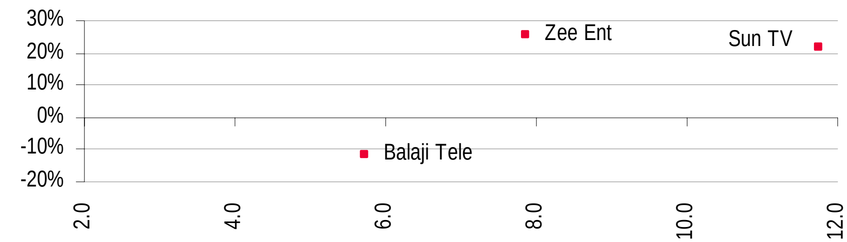
Source: Merrill Lynch Research

Top Buy: Zee Entertainment
Top Underperformer: Balaji Telefilms

Top Stock Pick: Zee Entertainment - defensive growth @ value

- **Counter cyclical pay-TV revenue to support growth as Ads slow**: With improved content and all-encompassing bouquet, we believe Zee offers best play on ensuing digitization of distribution through DTH, digital cable and IPTV. Digital pay-TV revenue could potentially double to 8% of FY10E sales.
- Rupee depreciation by >20% YTD should drive international pay revenue growth by 12%YoY to 18% of FY10E sales and that should compensate for slower ad growth of 12%YoY.
- Sustained ratings of Zee TV have made it a strong challenger to #1 broadcaster Star Plus and #2 Colors in the general entertainment space.
- Ad rate hikes in 1QFY09 to monetize the improved rating at Zee TV.
- Leadership of Zee Cinema and improving performance of the sports channels should drive strong double digit growth in network PAT.
- In our opinion, Zee is the key Indian media conglomerate set to capitalize on the emerging opportunity across content-to-conduit.

Chart 43: PE(10E) vs EPS CAGR (08-10E)R



Source: Respective Company, Merrill Lynch Research

Table 44: Stock Performances

	Absolute Performance			
	1month	3 month	YTD	1year
Balaji Telefilms	-38.9%	-65.3%	-83.1%	-82.8%
Sun TV LTD	-19.3%	-43.2%	-66.3%	-56.8%
Zee Entertainment	-21.9%	-46.3%	-65.7%	-64.3%
Sensex	-14.2%	-39.7%	-56.8%	-54.5%

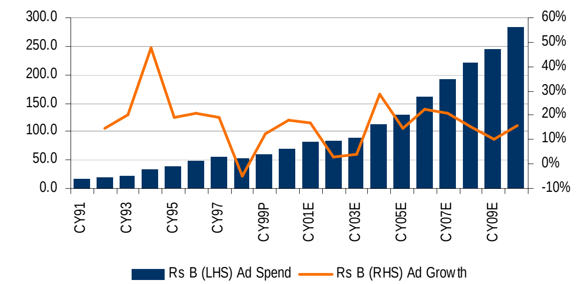
Source: Merrill Lynch Research

Table 45: Bull & Bear Factors that can change views

Company	Bull Scenario	Bear Scenario
Balaji Telefilms	Regain leadership position in the Hindi General Entertainment space, increase in content offerings in the sponsored category, diversification of content such as movies or markets such as international markets and deployment of surplus cash into productive businesses	To maintain creativity & ratings of serials on Star Plus and retaining talent / rise in cost of actors.
Zee Entertainment Enterprises	Regain ratings on Zee TV, acceleration of subscriber adds in DTH business, implementation of addressability (CAS) likely to improve subscription revenues and new channels achieving break-even.	New competition from Colors / NDTV Imagine, failure of CAS system again, Cap of cable tariffs by TRAI and slowdown in Ad markets / penetration of Zee Turner / Dish TV.
Sun TV	Continued market dominance across South India, monetization of Sun's market leadership, de-risking of business across 4 states	Political links of promoters, expansion in lower margin radio, rise in competition led by Zee group, Star Vijay & Kalaingar TV and programming costs.

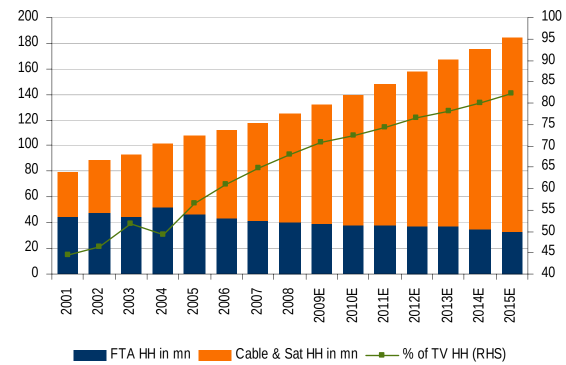
Source: Merrill Lynch Research

Chart 44: Indian Advertisement Spends (Rs bn)



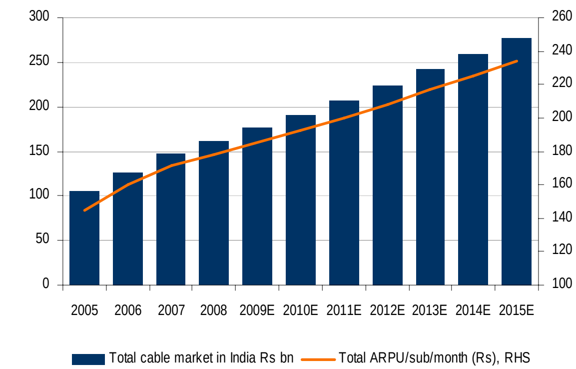
Source: Merrill Lynch Research

Chart 45: Cable TV Penetration On Rise



Source: Merrill Lynch Research

Chart 46: Cable Revenues



Source: Merrill Lynch Research

Table 46: Sector/Stock Valuation

Company	ML Code	QRQ	Price Rs	Mkt Cap US$mn	P/E (x) FY08	P/E (x) FY09E	P/E (x) FY10E	EPS CAGR 08-10E	P/B (x) FY08	P/B (x) FY09E	P/B (x) FY10E	EV/EBITDA (x) FY08	EV/EBITDA (x) FY09E	EV/EBITDA (x) FY10E	Div Yield FY09E	Div Yield FY10E	RoE (%) FY08	RoE (%) FY09E	RoE (%) FY10E	Corp Gearing FY08	Corp Gearing FY09E	Corp Gearing FY10E
Balaji Telefilms	BLJIF	C-3-7	66	88	4.5	4.5	5.7	-11%	1.2	1.0	0.9	3.1	3.1	4.2	5.3%	5.3%	28.4	23.7	16.3	-2%	-2%	-2%
Sun TV	SUTVF	C-2-7	161	1,296	17.3	14.5	11.7	21%	4.3	3.7	3.2	10.8	8.7	6.9	2.8%	3.4%	27.3	27.6	29.3	-28%	-55%	-62%
Zee Entertainment	XZETF	C-1-7	110	977	12.3	10.0	7.9	25%	2.7	2.2	1.9	9.2	7.0	5.5	2.3%	4.5%	23.3	24.4	26.2	12%	10%	1%
Media Sector Avg.					13.6	11.4	9.4		3.2	2.7	2.3	9.3	7.4	6.1	2.6%	3.9%	25.4%	25.6%	26.4%	-5.6%	-17.2%	-24.3%

Source: Respective Company, Merrill Lynch Research

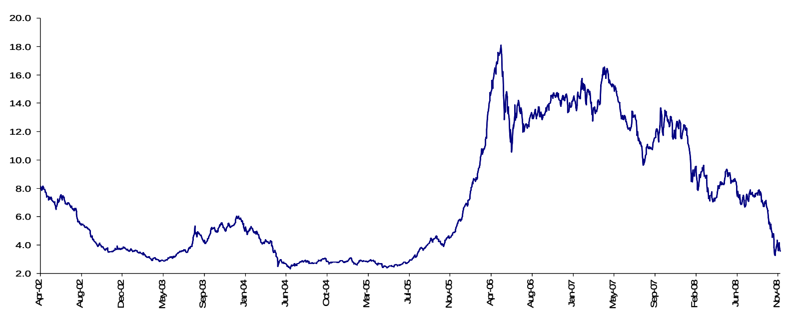
Metals (Vandana Luthra, Bhaskar Basu)

Underweight

Key Drivers of Sector Outlook

- We see no triggers to support a positive performance in the next few Qs. Demand is fast slowing down, prompted led by the global credit crisis. OECD countries appear likely to be in recession. China, the bellwether of commodity demand, is not immune to global slowdown. The Chinese govt has announced stimulus packages, but China alone is not strong enough to support higher commodities demand. Supply cuts are likely but may take 3-12 months to be fully realized.
- Aluminum – Ally prices have been hit by rising inventories and demand slowdown. Emerging metals surplus in China is prompting cuts among the producers and any potential slip in Chinese demand growth pose downside risks to Ally prices near term. We forecast ally prices of US$2564/t in FY09 and US$2508/t in FY10 but spot prices are running much lower.
- Zinc – Outlook for zinc remains weak given the large surplus, and slowdown in US & European economic activity. We forecast a surplus of zinc of 304kt in CY2009 and 643kt in CY2009. We forecast Zinc prices of US$1551/t in FY09 and US$1599/t in FY10 but current spot prices are much lower.
- Steel – Outlook appears weak given weaker macro, slowdown in China and risk of Chinese exports. Possibility of 10% import duty is rising but domestic prices are already higher. Production cuts are a positive but it may take time to restore balance. We forecast HR prices of Rs37,800/t in FY09 and Rs33,400/t in FY10.

Chart 47: Metals 1 yr forward PE Chart



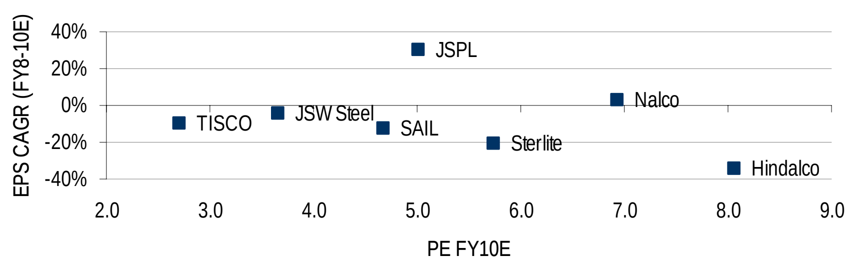
Source: Merrill Lynch Research

Top Underperformers: Tata Steel, NALCO, JSW Steel

Top Underperform: Tata Steel

- Steel fundamentals appear weak owing to weaker macro, slow down in China and risks of Chinese exports. We expect Tata's earnings to decline sharply in FY10 owing to lower steel prices. Also we believe Tata is more vulnerable to the steel cycle downturn owing to higher sensitivity and gearing.
- We forecast Tata Steel's earnings to decline by 56% in FY10 owing to lower steel prices. Also given concerns on global growth, steel prices could fall lower leading to earnings being lower than our forecasts. Tata has high sensitivity to steel prices – we calculate that a 1% change would lower FY10E earnings by 15%.
- Valuations are nearing trough on a P/B basis post a sharp correction over the past few months. However negative catalysts including weak industry fundamentals, falling steel prices and resulting earnings downgrade will keep valuation depressed.
- Upside risks are 1) sharp increase in steel prices owing to recovery in steel demand led by Chinese govt fiscal stimulus; 2) large production cuts leading to restoration of demand supply balance; 3) sharp fall in input costs; 4) synergy benefits from Corus acquisition.

Chart 48: PE(10E) vs EPS CAGR (08-10E)



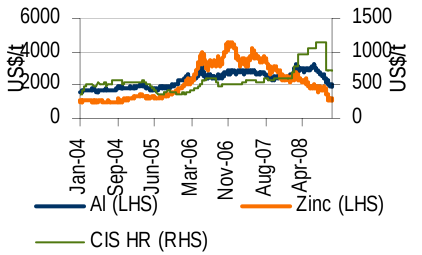
Source: Merrill Lynch Research

Table 48: Stock Performances

	Absolute Performance			
	1month	3 month	YTD	1year
Hindalco	-23.3%	-58.2%	-74.2%	-71.4%
NALCO	-42.1%	-61.9%	-68.6%	-59.2%
SAIL	-45.3%	-58.0%	-79.3%	-77.6%
Sterlite Ind.	-20.0%	-63.8%	-79.0%	-77.2%
Tata Steel	-35.8%	-72.9%	-82.7%	-81.2%
JSPL	-8.5%	-62.3%	-76.8%	-67.4%
JSW Steel	-8.4%	-69.0%	-81.9%	-75.0%
Sensex	-14.2%	-39.7%	-56.8%	-54.5%

Source: Merrill Lynch Research

Chart 49: Key Metals – Historic price Trends



Source: Bloomberg, Merrill Lynch Research

Table 47: Bull & Bear Factors that can change views

Company	Bull Scenario	Bear Scenario
Sterlite Industries	Higher Zinc prices due to recovery in global demand and large zinc production cuts especially in China. Also Balco and Zinc stake hike goes through.	Continued decline in zinc prices owing to high metal surplus, slowdown in global economy and zinc production cuts fail to materialize.
Hindalco	Recovery in ally prices owing to recovery in global economy and production cuts by ally producers. Also Novelis' financial's improves significantly.	Ally inventory is rising and further slowdown in China could create sharp downside risks to Ally prices.
NALCO	Recovery in ally prices owing to recovery in global economy and production cut by ally producers. This appears unlikely in our view.	Ally inventory is rising and further slowdown in China could create sharp downside risks to Ally prices.
Tata Steel	Steel prices recover owing to recovery in global economy, better Chinese steel demand and tighter supply owing to large production cuts.	Global steel prices declines owing to weak demand especially in China. Corus's profitability turns negative owing to sharp fall in European prices.
SAIL	Higher steel prices owing to recovery in global steel demand and steel production cuts.	Steel prices continue to decline owing to weak global demand. China stimulus and production cuts fail to restore steel market balance. SAIL's margins could come under pressure as a result.
JSW Steel	Global Steel price recover owing to recovery in global economy, better Chinese demand and large steel production cuts. Input costs for JSW Steel could decline owing to fall in spot raw material costs.	Steel prices continue to fall owing to weak global demand. JSW Steel has high leverage to steel prices. Also net gearing is highest among its steel peers.
JSPL	Higher steel price owing to recovery in steel demand and production cuts. Power business report strong earnings owing to higher tariff.	Steel prices decline owing to weak fundamentals. Also merchant tariff declines owing to lower demand, i supply and tariff caps imposed by regulator.

Source: Merrill Lynch Research

Table 49: Metal Price Forecast

	FY08	FY09E	FY10E
Domestic HR - Rs/t	27761	37816	33040
Ally- US$/t	2593	2564	2508
Alumina spot - US$/t	395	391	320
Zinc - US$/t	3044	1551	1599
Copper - US$/t	7531	6185	5402
Cu- TCRC Usc/lb	21	12	12

Source: Merrill Lynch Research

Table 50: Earnings sensitivity to metal price changes

1% Chg in	HNDL	NALCO	Sterlite	Tata	JSW Steel	SAIL	JSPL
Steel				15.0%	12.0%	5.0%	3.0%
Ally	5.0%	2.2%	1.0%				
Alumina	1.0%	0.2%	0.7%				
Zinc	0.5%		0.7%				
Copper	0.3%		0.2%				
Cu TCRC			0.1%				

Source: Merrill Lynch Research

Table 51: Stock/Sector Valuations

				Price	Mkt Cap	P/E (x)			EPS CAGR	P/BV (x)			EV/EBITDA (x)			Div. Yield		RoE (%)			Net Gearing		
Company	ML Code	QRQ	Recco	Rs	USD m	FY08E	FY09E	FY10E	FY08-10E	FY08E	FY09E	FY10E	FY08E	FY09E	FY10E	FY09E	FY10E	FY08E	FY09E	FY10E	FY08E	FY09E	FY10E
Hindalco	HNDFF	C-2-7	Neutral	55	1,879	3.4	5.7	8.1	-35%	0.5	0.4	0.4	4.4	4.5	4.8	3%	1%	12%	7%	5%	111%	74%	74%
Nalco	NAUDF	C-3-7	U/P	184	2,406	7.3	6.6	6.9	2%	1.3	1.2	1.0	4.4	3.9	3.8	3%	2%	20%	19%	16%	-40%	-33%	-37%
Sterlite	XTNDF	C-2-8	Neutral	227	3,261	3.6	4.8	5.7	-21%	0.7	0.6	0.6	1.4	2.2	2.4	2%	1%	28%	14%	11%	-42%	-50%	-52%
JSW Steel	XJWJF	C-3-7	U/P	255	965	3.3	2.9	3.7	-5%	0.6	0.5	0.5	4.9	3.7	3.7	6%	1%	24%	21%	15%	144%	165%	172%
TISCO	TAELF	C-3-7	U/P	166	2,462	2.2	1.3	2.7	-10%	0.5	0.4	0.3	3.8	3.2	4.3	9%	1%	29%	32%	12%	142%	103%	103%
JSPL	XJDLF	C-3-7	U/P	762	2,388	8.4	4.4	5.0	30%	3.2	2.0	1.5	7.7	3.9	4.2	4%	2%	45%	56%	35%	169%	82%	63%
SAIL	SLAUF	C-3-7	U/P	66	5,495	3.6	3.3	4.7	-12%	1.2	1.0	0.8	1.6	1.4	2.0	7%	2%	37%	32%	19%	-47%	-42%	-23%
Sector Avg					2693.7		4.1	5.3		1.2	0.9	0.7	4.0	3.2	3.6	5%	2%	28%	26%	16%	63%	43%	43%

Source: Merrill Lynch Research

Oil & Gas, Petrochemicals (Vidyadhar Ginde)

Underweight

Key Drivers of Sector Outlook

R&M companies

- **Large loss in 1H FY09 hit by inventory loss, burgeoning subsidy and inadequate oil bonds.** R&M companies were deeply in the red in 1H hit by burgeoning subsidy as oil price averaged US$119/bbl and inadequate issue of oil bonds. Large inventory loss in 2Q and also significant loss in 1H after neutralizing 1Q gains also hurt R&M companies

- **Subsidy is set to decline sharply in 3Q/2H but large inventory loss and weaker refining margins will mean 2H outlook is not good.** With oil price declining to US$50/bbl subsidy is set to sharply decline in 3Q and in 4Q if oil prices remain low. Gasoline and diesel are no longer subsidized and are actually earning healthy margins. However decline in oil price by US$45/bbl in 3Q will likely mean a large product and crude inventory loss. Weakening of refining margins should also hurt R&M companies. 4Q should be better due to lower subsidies and no inventory loss assuming oil prices stabilize at current levels. FY09E earnings outlook is not very good given the losses in 1H and likely bad 3Q.

- **FY10E outlook good if oil prices remain weak and better if oil price reforms are implemented:** FY10E earnings outlook is good if oil prices remain weak. Outlook would be even better if oil price reforms are initiated by the new central government after elections due in mid-2009.

Upstream oil companies

- **17% YoY earnings growth in 1H:** ONGC's 1H FY09 earnings increased by 17% YoY higher. 1Q growth was 44% YoY as upstream companies were made to bear 23% of subsidy. However with upstream being required to bear one-third of subsidy in 2Q earnings declined by 6% YoY

- **Modest earnings growth likely in 2H despite lower oil prices; hit from lower oil price less than gain from lower subsidy:** We expect modest earnings growth for ONGC in 2H despite assuming oil price to be 36% YoY lower at US$60/bbl. We expect oil prices in 2H in Rs. terms to be 19% YoY lower. We expect 2H subsidy at Rs63bn to be 57% YoY lower. 2H subsidy is expected to be Rs83bn YoY lower. 2H Oil and product revenue is likely to be Rs66bn YoY lower.

- **9-21% earnings decline in FY10E if oil price at US$50-60/bbl unless oil sector reforms :** We expect ONGC's FY10E earnings to decline by 9% YoY if oil price is US$60/bbl and by 21% YoY if oil price is US$50/bbl. Oil sector reforms if implemented could reduce subsidy and mean much lower earnings decline.

- **Improved exploration success and strong reserve accretion.** Exploration success rate was up to 25% and 44% respectively in FY07 and FY08 respectively from less than 10% in FY01-FY06. Its FY08 reserve replacement ratio of 2.04 was its highest in over a decade. FY09 also begun on a promising note with 16 oil & gas discoveries being made in 1H vis-à-vis 28 in FY09.

Top Buy: Reliance Industries

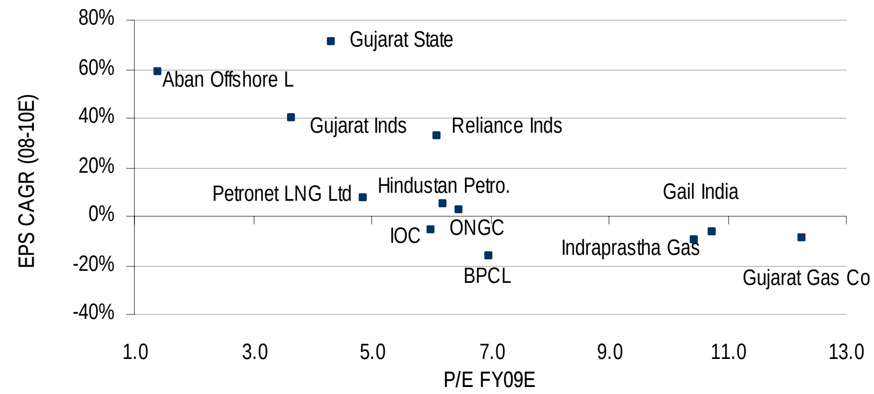
Top Stock Pick: Reliance Industries

- **Strongest performer among oil companies.** RIL is expected to have among the strongest earnings growth of oil companies in our global universe and even within India. We expect 2-year EPS CAGR in FY08-FY10E to be 33%. FY10E EBIT is expected to be 72% YoY higher driven by KG D6 oil and gas. Even in worst case we expect 40-50% EPS growth if refining margins are lower than expected
- **Positive news flow on E&P to continue.** Positive news flow on E&P in terms of discoveries and reserves accretion likely to continue. RIL to drill in at least 3 highly prospective blocks in next 12 months.
- **Strong growth prospects beyond FY10E, too.** RIL's prospects beyond FY10E should be driven by (i) 2 large petrochemical projects, (ii) rise in gas reserves and production, (iii) City gas distribution in 54 cities, (iv) organized retail,
- (iv) SEZ.
- **Some main risks also appear to be receding.** There are indications that some of the risks like no tax holiday for gas production and windfall tax are receding.
- **Attractive valuation.** RIL's valuation is compelling now at 6.1x on FY10E base case EPS and 7.6x 'worst case' EPS, in the context of the strong earnings growth in FY10E and strong growth prospects beyond FY10E.

Chart 50: Energy Sector 1yr forward PE Chart

Source: Merrill Lynch Research

Chart 51: PE(10E) vs EPS CAGR (08-10E)



Source: Merrill Lynch Research

Table 52: Stock Performances

	Absolute Performance			
Stock	1month	3 month	YTD	1year
Aban Offshore L	-20.8%	-65.9%	-73.4%	-84.5%
BPCL	-10.2%	3.0%	-24.8%	-23.7%
Cairn India	-12.0%	-43.8%	-40.8%	-39.4%
Gail India	-21.4%	-27.2%	-32.0%	-35.9%
Gujarat Gas Co	-0.4%	-16.4%	-9.3%	-40.9%
Gijarat State	-18.1%	-54.5%	-49.9%	-63.7%
Hindustan Petro.	-2.2%	6.7%	-10.2%	-23.8%
IOC	-8.0%	-15.1%	-17.5%	-37.9%
Indraprastha Gas	-2.1%	-2.9%	-17.3%	-33.4%
ONGC	-14.0%	-37.9%	-33.8%	-47.3%
Petronet LNG Ltd	-10.9%	-43.6%	-52.6%	-69.1%
Reliance Inds	-12.7%	-48.8%	-51.4%	-60.0%
Sector Average	-11.1%	-28.9%	-34.4%	-46.6%

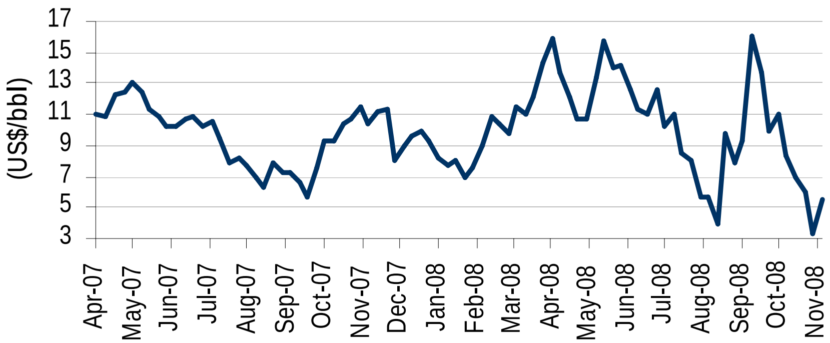
Source: Merrill Lynch Research

Table 53: Bull & Bear Factors that can change views

Company	Bull Scenario	Bear Scenario
Reliance Industries	i) RIL, RPL premium to Singapore margins is higher than expected ii)Singapore margins higher than expected iii) large oil & gas discoveries iv) Weakening of rupee (USD=43 Rs assumed)	i) Refinery margins sharply lower than expected ii) Strengthening of rupee iii) Delay in commissioning of RPL iv) Delay in start and ramp up of KG D6 gas output
ONGC	i) Oil sector reforms, which may reduce industry subsidy and thus ONGC's share therein ii) Oil prices rebound sharply from current levels iii) Strong refining margins that may boost MRPL's (subsidiary) earnings	i) Lack of oil sector reforms; ii) Oil prices remaining at current levels or declining further iii) Weak refining margins iv) ONGC required to bear more subsidy than expected
HPCL, BPCL, IOC	i) Oil prices sustaining at current levels or declining further ii) Refining margins higher than expected. iii) Favorable oil sector reforms being implemented	i) Refining margins sharply lower than expected ii) Oil prices rebounding to high levels iii) Steep cut in domestic prices of petrol and diesel followed by a rise international prices iv) Concerns on viability new refining projects being implemented.

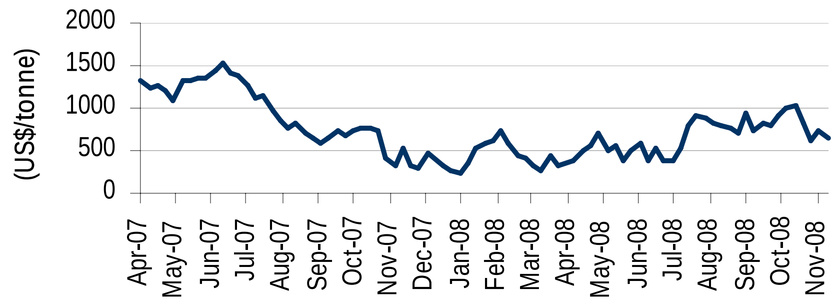
Source: Merrill Lynch Research

Chart 52: Trend of Singapore refining margins



Source: Merrill Lynch Research

Chart 53: Trend of Asian Naphtha cracking margins



Source: Merrill Lynch Research

Table 54: Sector/Stock Valuations

Company	ML Code	QRQ	Price Rs	Mkt Cap USD m	P/E (x) FY08	P/E (x) FY09E	P/E (x) FY10E	EPS CAGR 08-10E	P/B (x) FY08	P/B (x) FY09E	P/B (x) FY10E	EV/EBITDA FY08	EV/EBITDA FY09E	EV/EBITDA FY10E	Div Yield FY09E	Div Yield FY10E	RoE FY08	RoE FY09E	RoE FY10E	Corp Gearing FY08	Corp Gearing FY09E	Corp Gearing FY10E
Gujarat Inds	GUJIF	C-2-7	39	120	7.1	4.9	3.6	40%	0.5	0.5	0.5	5.7	6.9	4.5	6.4%	6.4%	7.6	10.4	12.9	58%	122%	107%
Aban Offshore L	XBWTF	C-2-7	783	595	3.5	1.7	1.4	58%	2.5	1.0	0.6	5.8	2.6	1.7	1.9%	1.9%	121.3	83.2	51.3	921%	253%	89%
BPCL	XBPCF	C-2-7	316	2,298	4.9	7.1	7.0	-16%	1.0	0.9	0.8	4.7	3.8	4.8	1.3%	3.8%	21.3	13.4	12.4	86%	20%	26%
Cairn India	XCANF	C-1-9	138	5,244	49.7	34.5	2.4	357%	0.8	0.8	0.7	26.3	21.1	1.8	0.0%	17.5%	1.7	2.3	30.3	-6%	4%	-8%
Gail India	XGLAF	C-2-7	192	4,902	9.4	8.0	10.8	-7%	1.9	1.7	1.5	5.4	4.8	6.8	3.6%	3.1%	21.3	22.0	14.8	-25%	-17%	2%
Gujarat Gas Co	GJGCF	C-3-8	212	273	10.2	12.3	12.3	-9%	2.0	1.7	1.6	6.1	6.8	6.5	1.2%	1.9%	20.7	15.0	13.4	7%	3%	-1%
Gujarat State	GJRSF	C-1-7	30	334	12.7	9.4	4.3	71%	1.4	1.3	1.0	6.7	4.9	3.0	2.1%	4.6%	12.3	14.2	26.2	104%	101%	77%
Hindustan Petro.	XHTPF	C-1-7	229	1,559	6.8	6.1	6.2	5%	0.7	0.7	0.6	8.0	4.5	3.9	6.1%	5.7%	11.2	11.5	10.6	45%	40%	22%
IOC	IOCOF	C-1-7	370	8,885	5.4	6.5	6.0	-6%	1.0	0.9	0.8	5.3	4.9	4.1	5.4%	5.9%	20.6	15.0	14.8	55%	37%	24%
Indraprastha Gas	IAGSF	C-3-7	106	299	8.5	9.7	10.4	-10%	2.6	2.3	2.0	4.7	4.5	4.4	4.1%	4.0%	33.4	24.7	20.4	-12%	-23%	-32%
ONGC	ONGCF	C-1-7	653	28,095	6.9	6.1	6.5	3%	1.8	1.5	1.3	3.1	2.8	2.8	5.2%	5.1%	28.1	26.9	21.7	-20%	-25%	-27%
Petronet LNG Ltd	POLNF	C-3-7	32	490	5.6	4.8	4.9	7%	1.5	1.2	1.0	4.0	4.3	4.3	4.1%	4.1%	29.8	27.4	22.5	63%	67%	71%
Reliance Inds	XRELF	B-1-7	1132	35,878	10.7	10.6	6.1	33%	2.0	1.5	1.3	9.7	8.3	4.6	1.1%	1.3%	20.5	16.8	22.6	55%	27%	11%
RPL	RPLUF	C-3-7	73	6,622	-	20.1	3.6	-	2.4	2.2	1.5	-	21.0	3.5	0.5%	6.9%	-	11.5	49.6	95%	84%	28%
Energy Sector Avg.					8.8	8.2	5.5		1.6	1.4	1.1	6.0	5.3	3.6	2.8%	4.4%	19.4%	17.9%	22.6%	30.7%	16.0%	4.6%

Source: Merrill Lynch Research

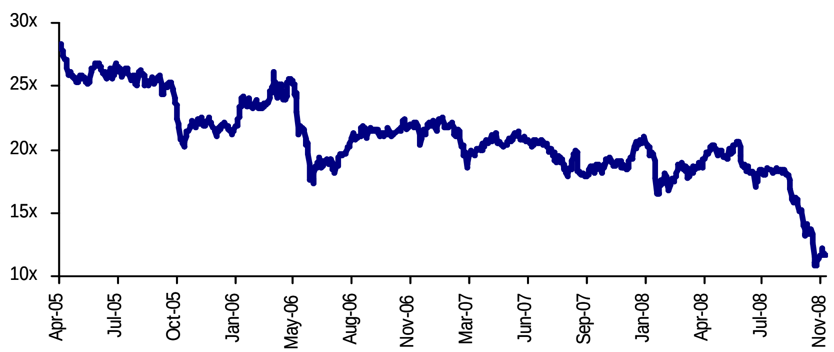
Pharmaceuticals (Arvind Bothra)

Overweight

Key Drivers of Sector Outlook

- Robust growth in developing markets, scale-up in US generics business, greater pipeline visibility (driven by exclusivity opportunities and new launches), and sustenance of EBITDA margin trend is expected to drive EPS growth of 14% for FY09E and 35% for FY10E (aided by low base). Glenmark, Divi's and Panacea Biotec are our top picks in the sector.
- The BRICS/Emerging market is expected to drive overall growth (59% of revenues) and we forecast 18% revenue CAGR (FY08-10E) with 18-22% stable margin. Ranbaxy, Glenmark and Sun are the best-positioned companies.
- We estimate the sector's US generics business (16% of revenues) to deliver 24% revenue CAGR over next two years with possible upsides driven by patent settlements for all the major generic players. Steady launch of new products and moderate price erosion may sustain margins and profitability in this market.
- Driven by buoyant macro environment for pharma outsourcing, we expect the sector's custom manufacturing companies to register 26%+ revenue growth for next few years. Divi's is our top pick in this space owing to strong revenue visibility, superior margin profile and stable balance sheet.

Chart 54: Pharma sector 1-yr forward PE chart



Source: Bloomberg, Merrill Lynch Research

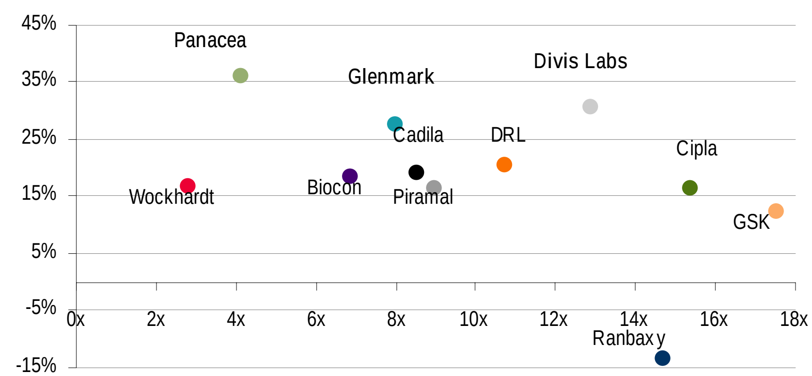
Top Buys: Glenmark, Divis Labs, Panacea Biotec

Top Underperformers: Dr Reddy's, Wockhardt, Cipla

Top Stock Pick: Glenmark Pharma

- We expect 37% YoY profit growth in FY09 largely on the back of a 36% growth in top-line as the US generic business is in a scale-up phase. Robust visibility on revenues expected on the back of strong pipeline of filings in niche areas.
- We expect Glenmark to sustain 30%+ EBITDA margin in core business as well as achieve its guidance for milestones (US$69mn) for next 2 years.
- Outlicensing deal for Oglemilast (GRC-3886; asthma/COPD) for the EU markets – we estimate the deal size at US$180mn.
- We expect launch details on key product portfolio comprising dermatology, XR and controlled substances products (potential US$100mn+ revenue opportunities over the long term)
- Potential re-licensing of GRC 8200 (diabetes) and likely new NCE outlicensing deal for one of the developmental candidates.
- Delay in milestone receipts of slippage on the guidance front may lead to stock overhang.

Chart 55: PE (10E) vs EPS CAGR (08-10E)



Source: Merrill Lynch Research

Table 55: Stock Performances

	Absolute performance			
	1month	3 month	YTD	1year
Biocon	-15.9%	-49.7%	-65.1%	-66.7%
Cadila	-6.8%	-23.4%	-22.1%	-17.0%
Cipla	-10.8%	-26.9%	-19.4%	-8.4%
Divi's Lab.	20.4%	-22.6%	-36.7%	-30.7%
Dr Reddy's Lab.	-13.8%	-30.6%	-42.9%	-32.4%
GlaxoSmithKline	-2.2%	-3.8%	7.8%	6.9%
Glenmark	-32.7%	-52.1%	-46.6%	-32.5%
Matrix Lab.	-46.3%	-61.0%	-77.5%	-76.2%
Panacea Biotec	-34.9%	-56.2%	-66.5%	-64.2%
Piramal Healthcare	-10.5%	-30.8%	-30.8%	-21.0%
Ranbaxy Laboratories	-16.7%	-55.9%	-49.0%	-47.6%
United Phosphorus	-1.1%	-41.5%	-46.3%	-45.2%
Wockhardt	-35.1%	-52.7%	-77.5%	-76.8%
Sensex	-14.2%	-39.7%	-56.8%	-54.5%

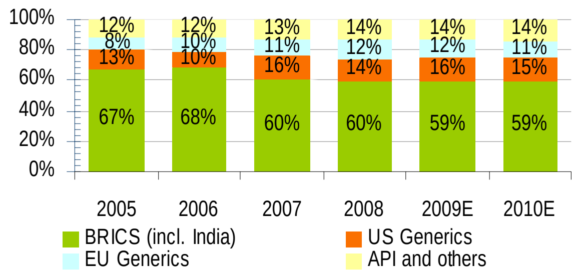
Source: Merrill Lynch Research

Table 56: Bull & Bear Factors that can change views

Company	Bull Scenario	Bear Scenario
Glenmark	Beating guidance for FY09E for research milestones by closing more than 2 NCE deals, launch of exclusivity products in FY10 with marginal price erosion and continued strong base business margins	Disappointment in FY09 guidance, delay in research pipeline and milestone receipts, deteriorating working capital (esp in emerging markets)
Ranbaxy	Early resolution of FDA issue at Poanta Sahib and Dewas plants, likely pickup of US generic business in 2009, regaining much of lost market share. Timely launch of generic Imitrex exclusivity with handsome market share and margins	Persisting issues with US FDA, with steep loss of mkt share in US generics, high inventory losses and possible litigation spend. Other developing markets taking strong stance against Rbxy's products post US ban.
Dr. Reddy's	Likely improvement in German business environment with much of write-offs done away with and possible annulment of new AOK tender, improvement in margins could be an upside trigger	Higher than expected generic pricing pressure, sharp rupee appreciation, litigation failure, acquisition challenges. Pressure on margins with high S,G&S spend
Cipla	Higher than expected margin improvement, significant product-mix change, OTC initiative take-off. Strength in exports business and higher than expected tech income	Higher than expected pricing pressure in API, sharp rupee appreciation, further deterioration in product-mix, DPCO litigation settlement expense

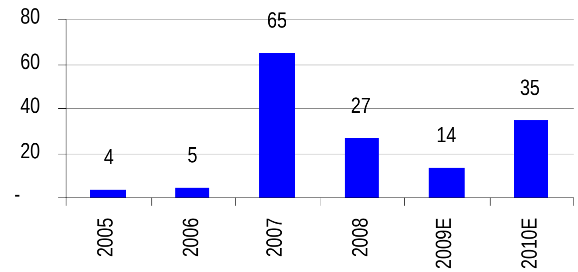
Source: Merrill Lynch Research

Chart 56: Sector Revenue split-market wise



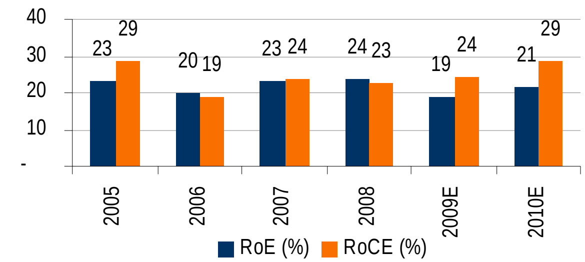
Source: Merrill Lynch research, Company

Chart 57: Robust PAT growth for the sector ahead



Source: Merrill Lynch research, Company

Chart 58: Stable return ratios for Indian Pharma sector



Source: Merrill Lynch research, Company

Table 57: Sector/Stock Valuation

Stock	ML Code	QRQ	Price Rs	Mkt Cap (US$mn)	P/E (x) FY08	P/E (x) FY09E	P/E (x) FY10E	EPS CAGR 08-10E	P/B (x) FY08	P/B (x) FY09E	P/B (x) FY10E	EV/Ebitda (x) FY08	EV/Ebitda (x) FY09E	EV/Ebitda (x) FY10E	Div. Yield (%) FY09E	Div. Yield (%) FY10E	RoE (%) FY08	RoE (%) FY09E	RoE (%) FY10E	Corp Gearing FY08	Corp Gearing FY09E	Corp Gearing FY10E
Ranbaxy Lab	XIZZF	C-1-7	214	1,839	11.0	17.7	14.7	-13.31%	2.9	1.0	1.0	13.9	7.7	7.2	3.6%	3.6%	28.7	9.3	10.7	132%	8%	7%
Dr Reddy's Lab	DRYBF	C-3-7	406	1,394	15.6	12.6	10.7	20.65%	1.5	1.4	1.2	9.6	7.1	6.1	0.9%	0.9%	31.8	10.3	11.4	27%	29%	18%
Cipla Ltd.	XCLAF	C-3-7	188	2,978	20.8	20.9	15.3	16.47%	3.9	3.4	2.9	17.8	13.7	12.1	1.2%	1.3%	20.1	17.4	20.4	13%	6%	3%
Glenmark Pharm	XVQWF	C-1-7	325	1,661	13.0	10.5	8.0	27.65%	5.1	3.5	2.5	11.2	9.1	6.9	2.2%	2.2%	57.3	41.2	36.9	55%	27%	10%
Cadila Healthcare	CDLHF	C-1-7	255	653	12.1	10.2	8.5	19.09%	3.0	2.5	2.0	8.6	6.3	5.3	2.2%	2.6%	27.4	26.4	25.8	70%	33%	15%
Wockhardt	XDUVF	C-3-7	104	232	3.8	3.1	2.8	16.87%	0.9	0.7	0.6	6.1	5.0	4.2	9.6%	9.6%	26.7	26.1	23.5	174%	140%	100%
Divi's Lab	XXQPF	C-1-7	1201	1,588	21.9	17.6	12.8	30.69%	9.0	6.0	4.1	18.2	15.1	11.6	0.2%	0.2%	50.6	41.0	38.1	8%	1%	0%
Biocon Ltd	BCLTF	C-1-7	108	439	9.6	11.4	6.8	18.54%	1.5	1.3	1.1	8.0	6.7	5.2	2.3%	2.3%	17.6	12.0	17.6	17%	23%	15%
Piramal	XNIGF	C-2-7	213	910	12.2	10.5	9.0	16.61%	4.1	3.2	2.5	9.5	7.8	6.3	2.0%	2.0%	33.7	33.9	30.9	61%	56%	33%
GSK India	GXOLF	C-2-7	1073	1,854	22.2	19.6	17.5	12.59%	6.6	6.1	5.4	15.9	14.3	13.0	3.4%	3.4%	31.7	32.2	32.8	-11%	-10%	-9%
Panacea Biotec	XPEAF	C-1-7	139	189	7.7	5.3	4.1	36.10%	1.5	1.2	0.9	5.1	3.6	2.8	0.7%	0.7%	21.6	24.9	25.1	25%	15%	7%
Matrix Lab Ltd	MXLBF	C-3-7	68	214	11.6	6.4	5.2	49.58%	0.9	0.8	0.7	10.0	7.5	6.7	2.7%	2.7%	8.2	13.8	15.0	136%	141%	143%
Pharmaceuticals Sector Avg					13.5	12.1	9.6	21%	3.4	2.6	2.1	11.2	8.6	7.3	2.6%	2.6%	29.6	24.1	24.0	59%	39%	29%

Source: Merrill Lynch research

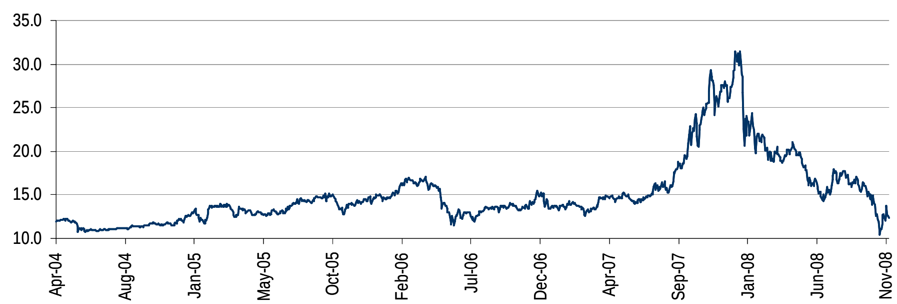
Power Utilities (Bharat Parekh)

Underweight

Key Drivers of Sector Outlook

- Our top-down model forecasts that pent-up demand (deficit of 9.9% on base demand & 13.5% on peak load) and an expanding economy should lead to 44% per capita consumption growth by FY12E.
- We see a substantial opportunities in the power sector with 60GW (government plans to add 78GW) to be added during the XI Plan (FY08-12E) +182% over the X Plan.
- As demand is forecast to grow at 8% CAGR by FY12E, we expect continuing power shortages. This should retain pressure on central /state governments to continue to offer attractive returns for utilities of 14%. However, the recent rich valuations runs the risk of deficits getting fixed earlier and that creates return risk.
- Besides, the following salient features offer an attractive proposition for IPPs
  - Attractive incentives allowed for efficient Utilities.
  - Stable & long term (FY04-09) regulatory regime reduces earnings risk.
  - Full cost (variable & fixed) pass-through reduces earnings volatility.
- However, relatively expensive valuations and limited near term growth catalysts creates room for potential stock weakness.

Chart 59: Utility Sector 1yr forward PE Chart



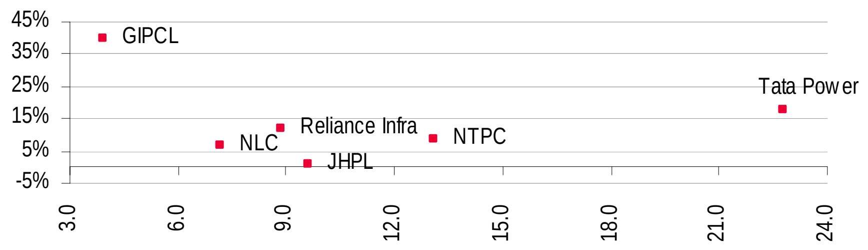
Source: Merrill Lynch Research

Top Underperformer: JP Hydro

Top Underperform Pick: JP Hydro

- We recommend JP Hydro as our top Underperform in the sector based on 3 key catalysts:
- **Expensive valuations.** JHPL stock currently trades at an EV/MW of Rs80mn, which is at 23-33% above its replacement cost. Besides, the stock appears expensive stock in our universe at 1.3x FY09E P/BV for a no growth situation.
- **Limited growth opportunity**. Given that JHPL is an IPP with just one 300MW station functioning, it has limited growth opportunity ahead. Company is trying to diversify by adding a transmission-line but, in our opinion, it is not adding material value to justify a relatively expensive IPP business.
- **Markets hope for corporate action misplaced.** We understand that markets' have been hoping for JHPL to be the holding company for JP group's hydro power assets. However, JP group has already announced a new holdco (JP Power), which is likely to monetize power assets through an IPO in future.

Chart 60: PE(10E) vs EPS CAGR (08-10E)



Source: Respective Company, Merrill Lynch Research

RC

Table 58: Stock Performances

	Absolute Performance			
	1month	3 month	YTD	1year
Gujarat Inds.	-18.3%	-53.9%	-71.2%	-67.0%
Jaiprakash Hydro	-17.7%	-53.0%	-81.1%	-76.5%
Neyveli	-13.4%	-53.8%	-79.0%	-74.1%
NTPC	-10.2%	-25.2%	-45.8%	-47.7%
Reliance Infra	-4.7%	-54.0%	-78.6%	-74.5%
Tata Power	-6.0%	-33.4%	-53.9%	-44.0%
Sensex	-14.2%	-39.7%	-56.8%	-54.5%

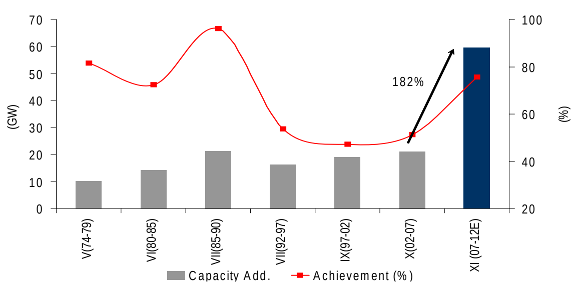
Source: Bloomberg, Merrill Lynch Research

Table 59: Bull & Bear Factors that can change views

Company	Bull Scenario	Bear Scenario
NTPC	Incremental power capex would be value accretive as it helps convert low yielding (7%) cash surplus to high yield power assets, which can potentially generate high RoE (20%) through capital base.	Delay in capacity addition, delay captive coal mining, gas supply to existing / new plants till 1QCY09, Upstream Oil and power equipment Investments and Power reforms.
Reliance Infra.	Reliance Infra/Reliance Natural Resources concluding gas purchase contract with RIL, Start construction of 5600MW Dadri project, Expand generation/acquire distribution franchise and Improve visibility on infrastructure SPVs.	Ability to source quality power / viable gas supply and Discontinuity / delay of power sector reforms.

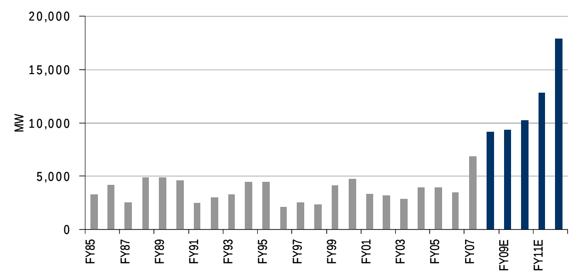
Source: Company, Merrill Lynch Research

Chart 61: India 5-yr Plan wise Power Capacity Creation & MLe



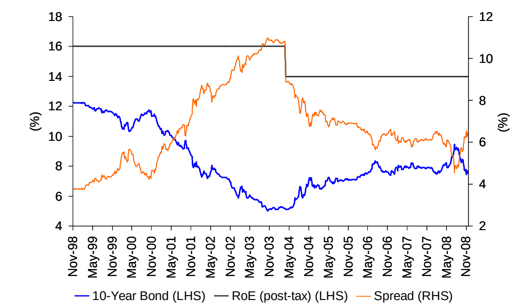
Source: Ministry of Power, ML Research estimates

Chart 62: India Capacity Addition – Towards Next Level



Source: Ministry of Power, ML Research Estimates

Chart 63: Power RoE vs Indian 10-yr Yield Curve



Source: RBI, Merrill Lynch Research

Table 60: Sector/Stock Valuation

			Price	Mkt Cap	P/E (x)			EPS CAGR	P/B (x)			EV/EBITDA (x)			Div Yield		RoE (%)			Corp Gearing		
Company	ML Code	QRQ	Rs	US$mn	FY08	FY09E	FY10E	08-10E	FY08	FY09E	FY10E	FY08	FY09E	FY10E	FY09E	FY10E	FY08	FY09E	FY10E	FY08	FY09E	FY10E
Gujarat Inds	GUJIF	C-2-7	42	131	7.7	5.3	3.9	40%	0.6	0.5	0.5	5.9	7.1	4.6	5.9%	5.9%	7.6	10.4	12.9	58%	122%	107%
Jaiprakash Hydro	XJSHF	C-3-7	28	284	9.8	9.6	9.6	1%	1.3	1.3	1.2	7.9	7.9	7.7	5.3%	5.3%	14.7	13.6	12.9	77%	70%	55%
Neyveli Lignite	NEYVF	C-2-7	59	2,007	8.2	8.2	7.2	7%	1.1	1.0	0.9	5.8	5.9	3.5	3.4%	3.4%	13.8	12.8	13.3	-22%	-11%	-25%
NTPC Ltd	NTHPF	C-1-7	149	25,137	15.4	14.9	13.1	8%	2.3	2.2	2.0	12.6	11.3	10.4	2.7%	2.9%	15.8	15.1	15.7	23%	27%	50%
Reliance Infra.	RCTDF	C-1-7	512	2,425	11.1	10.0	8.8	12%	1.1	1.0	0.9	33.9	27.2	11.2	1.4%	1.4%	11.0	10.4	11.0	44%	30%	-20%
Tata Pwr. Co.	XTAWF	C-2-7	747	3,374	31.5	26.5	22.8	18%	2.0	1.9	1.7	21.1	17.3	14.7	1.7%	1.9%	12.4	8.7	9.1	38%	37%	32%
Utility Sector Avg.					14.9	14.2	12.4		2.0	1.8	1.7	13.1	11.6	9.8	2.6%	2.7%	14.1%	13.4%	14.0%	23.8%	26.0%	31.8%

Source: Respective Company, Merrill Lynch Research

Real Estate (Amit Agarwal, Gagan Agarwal)

Underweight

Key Drivers of Sector Outlook

We note that real estate industry is slowing down sharply on account of:

- **Deteriorating macro conditions.** In the past 2 months, the macro conditions deteriorated rapidly with reports of salary cuts and job losses across different industries like financial services, retail, real estate and retail. With this negative sentiment we expect the sales volume will remain depressed in medium term.
- **Slowdown in the IT/ITES sector.** We expect a slowdown in the IT/ITES sector due to worsening macro conditions. IT/ITES sector accounts for 50-70% of commercial and residential sales and the current slowdown implies low sales volume growth. Our IT team in a recent report noted that there is a sharp demand slowdown and the hiring for 4 top Indian vendors has declined 36% YoY
- **Prices for residential units still high:** The developers have not yet reduced the average residential prices to more affordable levels.
- **Weakening commercial outlook**: The leasing activity in both office and retail segment has slowdown in last 6 months. This is likely lead to pressure on rentals and delay in projects.

Top Buy: DLF

Top Underperformer: Omaxe

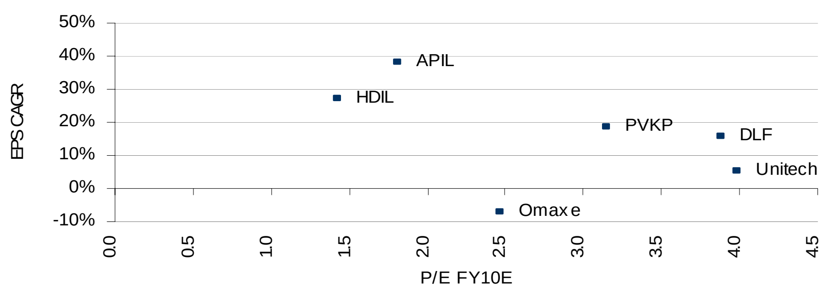
Top Stock Pick: DLF

- **Focus on mid income housing:** Shift in residential strategy to focus on mid income housing has helped it to maintain sales in a weakening macro environment. It has sold approximately 4.8mn sq ft in 1H FY09.
- **Healthy Balance sheet**: DLF has a healthy balance sheet with debt equity ratio of 0.5 which should enable it to tide over the current liquidity crisis.
- **Strong brand in a weak environment**: A strong brand should enable DLF to maintain sales even in a deteriorating environment as buyers shift to quality.
- **Steady income from commercial space**: DLF already has 8mn sq ft of Grade A office under lease generating lease rentals of approx Rs.4bn annually. Long term relationship with clients should enable DLF to maintain occupancy
- **Risks:** Increasing debtors from DAL, slowdown in mid income housing demand, prolonged slowdown in IT/ITES sector, more than expected deterioration in domestic economy.

Chart 64: Real Estate Sector 1-yr forward PE chart

Source: Bloomberg, Merrill Lynch Research

Chart 65: PE (10E) vs EPS CAGR (08-10E)



Source: Bloomberg, Merrill Lynch Research

Table 61: Stock Performance

	Absolute Performance			
	1month	3 month	YTD	1year
APIL	-43.3%	-67.5%	-92.0%	-86.4%
DLF	-17.3%	-55.0%	-79.0%	-75.2%
HDIL	-22.3%	-68.5%	-88.2%	-82.5%
Omaxe	-27.3%	-59.5%	-91.1%	-86.1%
Puravankara	-57.4%	-76.3%	-90.1%	-89.2%
Unitech	-48.2%	-76.5%	-92.1%	-89.8%
Sensex	-14.2%	-39.7%	-56.8%	-54.5%
Sector Average	-36.0%	-67.2%	-88.7%	-84.9%

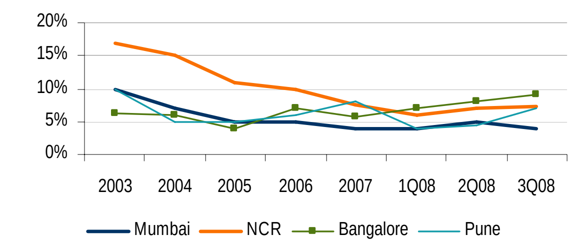
Source: Bloomberg, Merrill Lynch Research

Table 62: Bull & Bear Factors that can change views

Company	Bull Scenario	Bear Scenario
DLF	Repayment of outstanding from DAL, increase in demand for office/ residential improvement in IT/ITES industry	Inability of DAL to repay amount owed to DLF, further slowdown in demand for mid-income housing
Unitech	Timely completion of Telenor deal, project launches in newer cities where it has a big land bank like Chennai/Hyderabad	Delay in closure of Telecom deal with Telenor, further investment in telecom venture, inability to refinance debt maturing in next 6 months.
HDIL	On schedule progress of Airport project, sale of FSI at Kurla project, increase in TDR rates	Delay in Airport project, inability to sell TDRs due to lack of demand, increase in debtors leading to higher debt
Puravankara	The successful launch of low income hosing project could help to generate much needed cash flow in the short term.	Prolonged slowdown in IT/ITES could impact demand severely since most of its land bank is concentrated in IT/ITES centric cities/towns

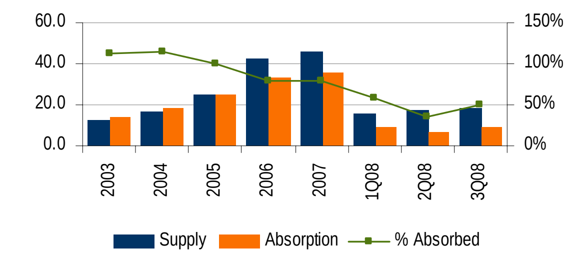
Source: Merrill Lynch Research

Chart 66: Rising Vacancy Rates in Grade A Office



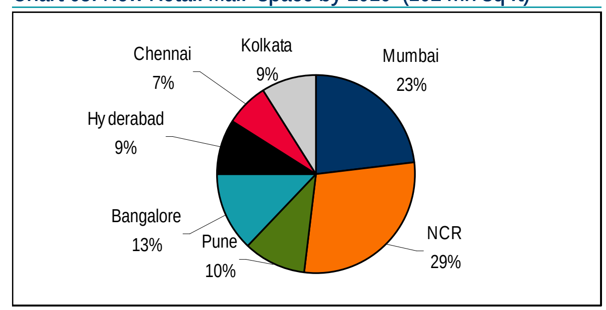
Source: Cushman & Wakefield, Merrill Lynch Research

Chart 67: Supply & Absorption of Grade A Office (mn sq ft)



Source: Cushman & Wakefield, Merrill Lynch Research

Chart 68: New Retail Mall space by 2010 (102 mn sq ft)



Source: Knight Frank

Table 63: Stock/Sector Valuations

			Price	Mkt Cap	P/E (x)			EPS CAGR	P/B (x)			EV/Ebitda (x)			Div. Yield (%)		RoE (%)			Corp Gearing		
Stock	ML Code	QRQ	Rs	(US$mn)	FY08	FY09E	FY10E	08-10E	FY08	FY09E	FY10E	FY08	FY09E	FY10E	FY09E	FY10E	FY08	FY09E	FY10E	FY08	FY09E	FY10E
DLF Limited	XVDUF	C-1-7	233	8,091	5.0	4.7	3.7	16%	2.1	1.5	1.1	5.2	4.1	2.3	3.4%	5.2%	69.5	36.6	33.8	56%	12%	-23%
Unitech Ltd	UTKIF	C-2-7	43	1,415	4.1	3.5	3.7	5%	1.9	1.3	0.9	6.3	5.7	5.2	0.8%	0.8%	59.9	43.5	28.9	198%	152%	124%
APIL	ANSFF	C-1-7	39	91	3.2	2.3	1.7	38%	0.5	0.4	0.3	3.6	1.4	0.6	3.1%	4.3%	24.2	18.1	20.8	25%	-5%	-15%
HDIL	XGHSF	C-1-7	112	630	2.2	2.2	1.4	27%	0.8	0.6	0.4	3.5	3.2	1.0	3.6%	5.5%	64.5	32.5	38.4	76%	71%	5%
PVKP	XPJVF	C-1-7	48	210	4.3	3.5	3.1	18%	0.8	0.7	0.6	7.7	3.6	1.8	5.2%	6.0%	33.5	21.9	21.4	51%	14%	-13%
Omaxe	XOMXF	C-3-8	55	194	2.0	2.6	2.3	-7%	0.7	0.5	0.4	4.2	3.9	2.2	3.4%	3.8%	50.3	23.5	21.2	127%	72%	19%
Real Estate Sector Avg.					4.4	4.1	3.3		1.7	1.3	0.9	5.1	4.2	2.5	3.1%	4.6%	64%	35%	32%	78%	40%	2%

Source: Merrill Lynch Research

Software Services (Mitali Ghosh/ Pratish Krishnan/ Prasad Deshmukh)

Underweight

Key Drivers of Sector Outlook

Macro headwinds gather speed, Reversal of Rupee depreciation a risk

- We forecast a below consensus mere 5% USD revenue growth in FY10 vs about 15% in FY09. Key risks are bill rate pressure and Rupee appreciation vs USD and Pound. Hence though stocks are at historic low PEs, we do not expect no re-rating near term, given our muted earnings growth outlook of 4 to 12% across the majors over FY09-11, in part due to tax hit in FY11.
- **Economic headwinds intensify:** The contagion in the financial industry & the US has spread rapidly over the globe in the last 2 months, and could severely impact discretionary IT spending. Visibility is severely impaired, as is reflected in SAP recently withdrawing its guidance for 4Q. We now expect volume acceleration closer to FY11 and see growing risk of bill rate pressure.
- **Risks to cuts in discretionary IT spending:** Discretionary spending linked revenues include Application Development and at least half of Enterprise Solutions (i.e. roll out of SAP/Oracle etc), testing and engineering services. Thereby, we believe Satyam is most exposed with 50% revs linked to discretionary IT spending. TCS, Infosys and Wipro likely derive 35 to 40% of revs from discretionary spending.

Chart 69: IT Sector 1yr forward PE Chart

Source: ML Research

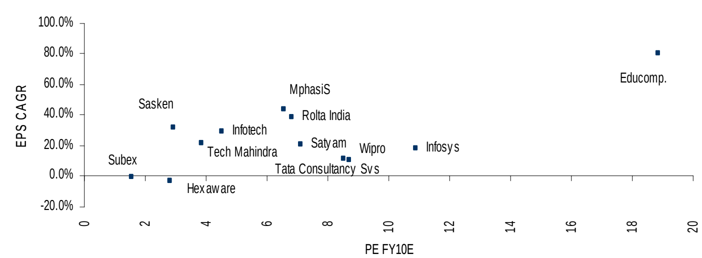
- **Verticals at risk:** IT majors are currently seeing weakness in the verticals of Banking, Financial Services & Insurance, Telecom OEM and technology and Retail, which form 60-65% of revs for Wipro and 50-55% for peers. However, it could rapidly spread to other verticals like manufacturing, wherein Satyam/Wipro for example could see challenges in autos.
- **Risk of Rupee volatility:** This year near 25% Rupee depreciation was a key earnings and stock driver. Our economics team expects the Rupee to recover somewhat given likely reduction in risk aversion, falling price of oil and intervention by the central bank.
- **Ability to manage costs, key:** We believe Infy and TCS are best placed to manage costs based on variable comp, management stability/track record and scope to tighten utilization. TCS additionally has levers to shift work offshore and increase fixed price contracts.

Top Buy: TCS; Top Underperformer: Wipro

Top Stock Pick: TCS

- **Valuation**: TCS is trading at a reasonable 2yr PEG of <1 vs peers at 1-2x and is at a historical high PE discount to Infosys at over 30%.
- **Operating leverage**: TCS stacks up well on cost levers with scope to grow offshore, at 43% today vs Infy & Satyam at 53-54%. This qrt TCS showed a 200bps offshore shift. It also has a higher proportion of fixed price projects at 43% vs peers at 28 to 34% which should help squeeze productivity benefits.
- **Stable management team**: TCS stands out for its stable management team, which should help manage revenues and steer costs in a downturn.

Chart 70: PE(10E) vs EPS CAGR (08-10E)



Source: ML Research

Table 64: Stock Performance

	Absolute Performance			
	1 month	3 month	YTD	1 year
Aptech	-7.6%	-66.7%	-82.5%	-81.1%
Educomp	12.3%	-41.1%	-59.4%	-41.6%
Infosys	-9.4%	-30.7%	-33.0%	-24.3%
Infotech	-24.0%	-44.6%	-63.6%	-57.2%
Mphasis	-16.1%	-31.0%	-49.5%	-43.9%
Rolta	-0.9%	-43.3%	-48.1%	-46.8%
Sasken	-35.2%	-61.7%	-82.8%	-80.2%
Satyam	-19.2%	-42.3%	-48.4%	-44.2%
Subex	-19.8%	-71.6%	-89.9%	-88.6%
TCS	-1.8%	-42.6%	-55.2%	-49.8%
Tech Mahindra	-30.4%	-66.4%	-77.4%	-75.4%
Wipro	-21.1%	-48.5%	-57.7%	-50.4%
BSE IT Index	-12.1%	-38.2%	-46.8%	-39.5%
Sensex	-14.2%	-39.7%	-56.8%	-54.5%

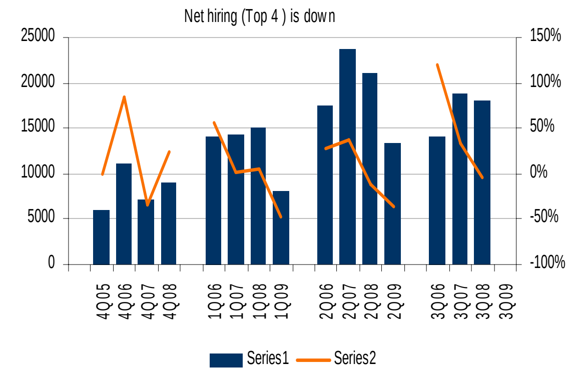
Source: ML Research

Table 65: Bull & Bear Factors that can change views

Company	Bull Scenario	Bear Scenario
TCS, Buy	Long term deals, moderate exposure to cuts in discretionary IT spending at 30-40% of revs and lower exposure to technology/telecom OEM verticals outweighs revenue vulnerability from large Banking/insurance exposure. Well placed to manage margins by shifting work offshore and growing fixed price contracts. A mature hedging policy protects against Rupee volatility. Beaten down valuation at over 30% PE discount to Infosys.	Higher exposure to financial services vertical at over 40% of revs vs peers at 25 to 35%. Lower visibility given absence of guidance and promoter overhang given they hold over 75% of shares and may need to monetize to fund other group ventures.
Wipro, Underperform	Low exposure to banking vertical at ~25% of revs and higher exposure to annuity revenues at 60-65%, including Application Maintenance, Infrastructure Management Services and Business Process Outsourcing	Highest revenue vulnerability given telecom OEM/technology, retail and banking verticals form 60-65% of revs vs 40 to 50% for peers. Relatively limited operating levers given highest utilization among peers. Management team may take longer to settle down post recent restructuring in May. Higher risk profile given ECB of USD350m. Given 70% of cash flow hedges are forwards, it can restrict upside from a weaker Rupee environment.
Infosys, Neutral	Low revenue vulnerability given diversified revs and best placed to handle recessionary pressures given high variable comp at 30% of revs vs 10-20% for peers, scope to tighten utilization and nimble management track record.	At trough PE but not trough PEG, as below. Positives largely priced in at a 2yr PEG of over 1x. Risk to top client BT revs, ~8% of sales could cause volatility. Low utilization at 69% including trainees poses risks.
Satyam, Neutral	Over 30% PE discount to Infosys in line with historic average does not take into account improved metrics on employee attrition, utilization and leadership in enterprise solutions. Beaten down at 5x FY10E PE ex-cash.	Unfavorable risk-reward given higher exposure to cuts in discretionary spending at ~50% vs peers at 35 to 40%, given it has 45% of revs from consulting and enterprise solutions. Most sensitive to Rupee appreciation.
Educomp, Buy	Educomp is a play on the growing Kindergarten to Class 12 education space in India, a non discretionary spend. Increasing penetration levels in Smart Class (animated content) business given recent investments in Sales and Marketing. Increasing adoption of its consulting School Management offering which entails low capex and provides higher return ratios	Worsening credit situation could sharply increase cost of funding in K-12 school project.
Tech Mahindra, Buy	Play on increasing offshoring by telecom service providers to India and ramp in committed business from BT Global Services, BTGS. See further scope for penetration with BTGS given limited offshoring so far by BTGS.	Severe cut in IT budgets by BT and appreciating rupee vs GBP are risks
Rolta, Buy	Rolta is a leader in high growth Plant/Process design and Geographic Information Systems, GIS segments, deriving ~60% revs from India. Our estimates could see upside on better than expected performance in the Thales JV and higher than expected synergy benefits in the TUSC acquisition	Our concerns revolve mainly around reversal of the global capex cycle. Our estimates could see downside in case of worse than expected impact of slowdown in infrastructure spends and any deceleration in the govt. spend in defense in favor of civilian spend

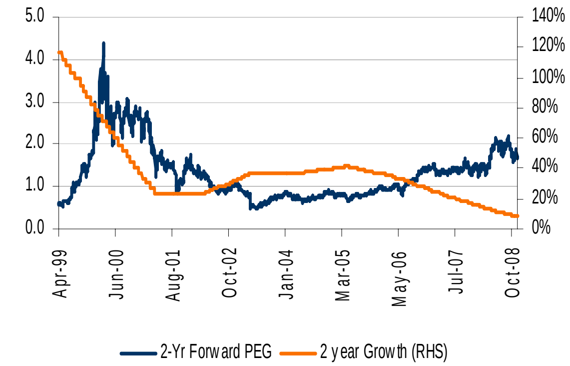
Source: Merrill Lynch Research

Chart 71: Fall in net hiring – a red flag



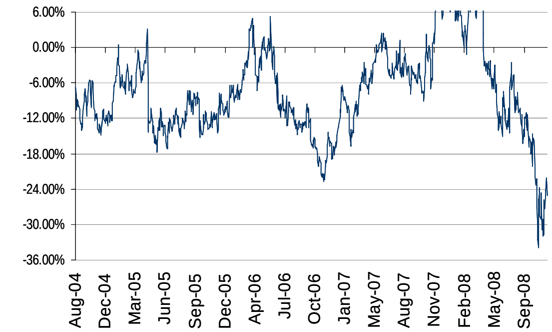
Source: Merrill Lynch Research

Chart 72: Infosys PEG chart



Source: Merrill Lynch Research

Chart 73: TCS vs Infosys PE discount



Source: Merrill Lynch Research

Table 66: Sector/Stock Valuations

			Price	Mkt Cap	P/E (x)			EPS CAGR		PEG	EV/EBITDA (x)			Div Yield		RoE (%)			Corp Gearing		
Stock	ML Code	QRQ	Rs	US$mn	FY08	FY09E	FY10E	08-10E	09-11E	FY09 PE/ FY09-11EPSg	FY08	FY09E	FY10E	FY09E	FY10E	FY08	FY09E	FY10E	FY08	FY09E	FY10E
Infosys	INFYF	C-2-7	1232	14,297	15.3	11.9	10.9	18.2%	11%	1.1	11.6	8.2	6.9	1.6%	1.6%	36.2	36.0	29.9	-61%	-71%	-76%
Satyam	SAYPF	C-2-7	252	3,439	10.4	7.6	7.1	20.6%	4%	2.1	7.3	4.3	3.6	1.5%	2.0%	26.0	28.1	24.0	-59%	-63%	-66%
Tata Consultancy Svs	TACSF	C-1-7	519	10,292	10.6	9.7	8.5	11.3%	12%	0.8	8.4	6.7	5.5	3.2%	3.6%	45.9	36.2	30.3	-25%	-19%	-34%
Wipro	WIPRF	C-3-7	252	7,477	10.7	9.1	8.7	11.0%	7%	1.3	8.6	6.3	5.5	2.6%	2.9%	30.8	29.3	25.1	-8%	-20%	-30%
Educomp.	EUSOF	C-1-7	2353	824	61.6	30.9	18.9	80.7%	54%	0.6	32.8	14.3	8.8	0.1%	0.1%	35.1	27.6	27.4	30%	12%	25%
Hexaware	XFTCF	C-3-7	20	58	2.6	3.9	2.8	-3.2%	22%	0.2	1.7	2.2	1.9	4.0%	4.4%	17.0	8.0	8.1	-13%	-6%	-7%
MphasiS	MPSSF	C-1-7	165	698	13.5	7.1	6.5	43.6%	10%	0.7	8.0	4.7	3.6	2.4%	2.4%	23.6	36.0	29.8	-8%	-9%	-26%
Sasken	SKNCF	C-3-7	68	39	5.1	3.3	2.9	32.0%	12%	0.3	3.4	1.3	1.0	6.2%	5.3%	8.9	12.5	12.9	7%	1%	-11%
Subex	SBXSF	C-3-7	35	25	-1.8	-1.5	1.6	0.0%	425%	0.0	(15.2)	8.7	6.1	0.0%	0.0%	(15.0)	0.2	3.8	118%	113%	97%
Tech Mahindra	TMHAF	C-1-7	293	722	5.7	4.5	3.9	21.6%	13%	0.3	4.2	2.5	1.9	2.2%	2.6%	61.1	50.6	39.3	-5%	-17%	-30%
Infotech	IFKFF	C-1-7	115	123	7.5	5.5	4.5	29.4%	21%	0.3	3.7	2.1	1.4	1.3%	2.2%	17.7	15.9	16.7	-11%	-20%	-26%
Rolta India	RLTAF	C-1-7	176	573	13.0	9.0	6.8	38.5%	24%	0.4	8.0	5.8	4.3	2.1%	2.8%	20.6	25.4	27.5	37%	18%	8%
Information Technology Sector Avg					12.1	9.8	8.9				9.3	6.6	5.5	2.2%	2.4%	34.2%	32.4%	27.8%	-30.3%	-36.3%	-45.4%

Source: ML Research

Telecom (Reena Verma Bhasin, CFA)

Overweight

Key Drivers of Sector Outlook

- **Revenue growth likely to remain healthy:** We forecast FY10E revenue growth at ~25% vs ~35% growth for FY09E. We expect the pace of subscriber additions to soften (-5% YoY) but likely less tariff competition than before, esp. in 1H FY10E, should support revenues.
- **Capex cut-backs may drag subscriber growth but help margins**: We expect wireless majors in India to go-slow with their capex plans in view of the constrained credit environment, globally. In the short-term, slower network penetration may hurt subs-growth but help margins due to lower network opex.
- **Regulatory outlook seems less threatening:** One-time spectrum charges, cap on SMS tariffs and lower termination charges are pending regulatory issues.
- **3G auctions remain a risk:** Despite the difficult funding environment, we are concerned that 3G auctions may be aggressive (at least in select circles), partly owing to expected participation of global majors.

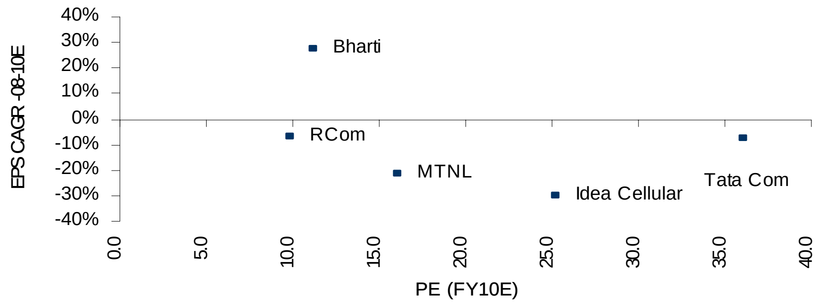
Top Buy: Bharti

- **Likely fewer competitive pressures over next 6 months:** Bharti could witness market share gains due to capex constraints faced by its relatively leveraged competitors. We currently forecast ~110bps YoY decline in net add share for Bharti in FY10E; we think there is room for positive surprise.
- **Relatively strong earnings visibility:** We expect Bharti to post ~24% YoY EBITDA growth & 32% YoY profit growth in FY10E, led by 31% YoY growth in wireless sub base. Consolidated EBITDA margin is forecast to fall 70bps YoY.
- **Wireless margins may inch-up in FY10E**: We forecast ~50bps YoY rise in wireless EBITDA margin for FY10E for 3 reasons: 1) we think opex pressures will ease going forward partly owing to slower network rollout; 2) risk of aggressive pan-India tariff cuts seems lower as competitors will likely scale back launch plans; 3) potential 200bps licence-fee concession in certain areas.
- **Visibility on infrastructure sharing:** Likely tie-up with Telenor for tower-sharing both via Indus and Bharti InfraTel could present near-term upside trigger.
- **Price target of Rs900/sh**: Our PO is based on an EV/EBITDA of 9x FY10E and PE of 16x FY10E, and is supported by DCF. We expect valuations to remain at a premium to regional peers due to stronger underlying growth & returns.

Chart 74: Telecom Sector 1-yr forward PE Chart

Source: Respective Company, Merrill Lynch Research

Chart 75: PE(10E) vs EPS CAGR (08-10E)



Source: Respective Company, Merrill Lynch Research

Table 67: Sector performance

	Absolute performance			
Stock	1month	3month	YTD	1Year
Bharti	-13.5%	-22.7%	-38.5%	-32.3%
Reliance Com	-14.1%	-50.3%	-73.4%	-71.9%
Idea	-29.0%	-46.3%	-68.4%	-65.1%
Tata Comm	-4.5%	3.0%	-41.9%	-21.0%
MTNL	9.3%	-31.0%	-62.5%	-59.0%
Sensex	-14.2%	-39.7%	-56.8%	-54.5%
Sector average	-10.4%	-29.4%	-56.9%	-49.9%

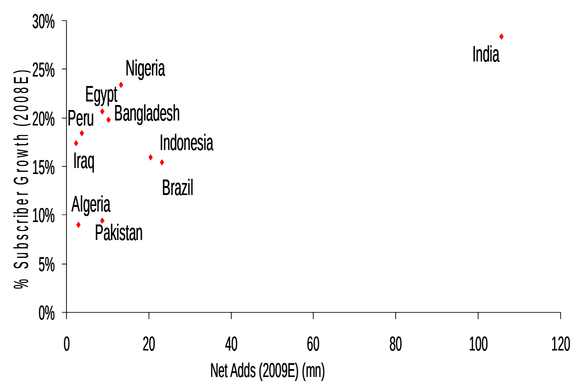
Source: Merrill Lynch Research

Table 68: Bull & Bear Factors that can change views

Company	Bull Scenario	Bear Scenario
Bharti	Continued acceleration in subscriber market share, stronger-than-expected wireless margins and visibility on tower sharing present upside potential.	Unexpected regulatory changes and weaker than expected subscriber quality are key operating risks. Overseas expansion and irrational 3G bidding are also key concerns.
Reliance Com	Stronger than expected revenue market share from parallel GSM launch, unexpected easing in the credit environment and visibility on tower sharing.	Weaker than expected market impact of GSM launch and higher-than-expected margin hit owing to dual networks. Irrational 3G bidding could further strain the balance sheet.
Idea	Stronger than expected revenue market share in new circles and better-than-expected scale economies in established operations would be positive.	Weaker than expected subscriber quality and higher than expected cost pressures would hurt. Irrational 3G bidding also presents risks.
MTNL	Revenue uplift from broadband and sharp cost cutting would be positive	Weaker than expected FL usage and high 3G spend would hurt.
Tata Com	Revenue acceleration in international ops would be a key positive catalyst	Pressure on data margins and potential equity issuance are key risks

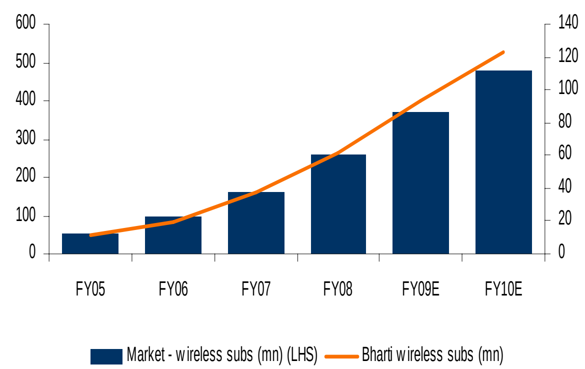
Source: Merrill Lynch Research

Chart 76: Top 10 global markets by subscriber growth



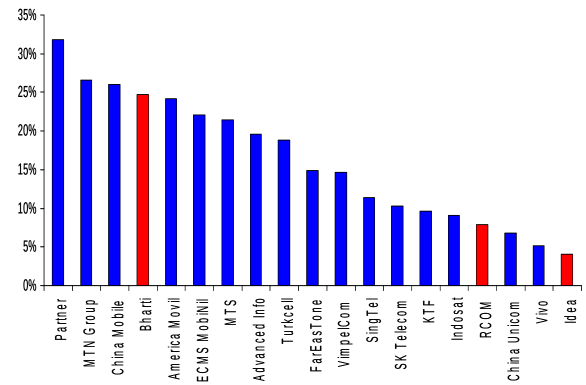
Source: Merrill Lynch Research

Chart 77: trend in wireless sub base-Indian Market & Bharti



Source: Merrill Lynch Research

Chart 78: RoCE of wireless majors in emerging markets (2009E)



Source: Merrill Lynch Research

Table 69: Stock /Sector Valuations

			Price	Mkt Cap	P/E (x)			EPS CAGR	P/B (x)			EV/EBITDA (x)			Div Yield		RoE (%)			Corp Gearing		
Company	ML Code	QRQ	Rs	US$mn	FY08	FY09E	FY10E	08-10E	FY08	FY09E	FY10E	FY08	FY09E	FY10E	FY09E	FY10E	FY08	FY09E	FY10E	FY08	FY09E	FY10E
Bharti	BHTIF	C-1-9	648	25,088	18.3	14.8	11.2	28%	5.5	4.1	3.2	11.2	8.4	6.8	0.0%	2.2%	37.4	31.9	32.3	19%	18%	16%
RCVL	RLCMF	C-2-7	219	9,221	8.6	8.5	9.9	-7%	1.8	1.5	1.3	7.4	7.5	7.0	0.4%	0.4%	24.0	19.9	14.6	61%	84%	98%
Idea Cellular	IDEAF	C-2-9	49	3,091	12.3	17.6	25.2	-30%	4.8	0.9	0.8	9.2	6.1	6.5	0.0%	0.0%	34.4	7.8	3.4	205%	10%	27%
MTNL	XMTNF	C-3-7	72	923	9.9	16.5	16.1	-22%	0.4	0.4	0.4	(0.8)	(0.1)	(0.2)	5.6%	5.6%	3.9	2.3	2.4	-43%	-39%	-39%
Tata Communications	VSLSF	C-3-8	490	2,851	44.2	36.0	44.1	-0%	2.1	2.1	2.0	21.7	16.8	15.6	0.9%	0.9%	4.9	5.9	4.7	-8	-2%	1%
Telecom Sector Avg.					14.2	13.3	12.0		2.9	2.1	1.8	9.4	8.0	7.0	0.3%	1.6%	23.0%	18.5%	16.3%	28.7%	29.2%	37.0%

Source: Merrill Lynch Research

Textiles (Manish Sarawagi)

Underweight

Key Drivers of Sector Outlook

We remain negative on the sector driven by:

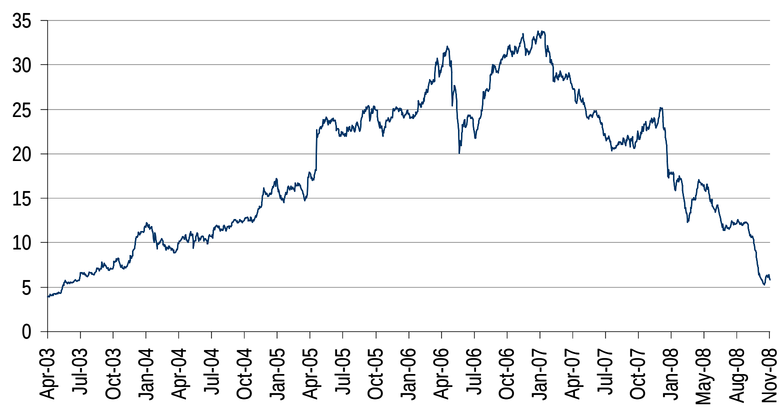
- **Slowdown in key markets.** Key markets of US & EU are witnessing a slowdown and hence put at risk the sales volume and realization/ margin assumptions for textile companies. Indian economy too is expected to slowdown impacting the growth outlook for domestic retailing business of some textile companies.
- **Benefits to be passed on to the buyers.** We believe that companies might have to pass on the benefits of a weaker Re, lower input costs and improving cost competitiveness versus China, in order to keep their capacities running full.
- **Subdued earnings outlook.** As a result we expect the earnings outlook for most textile companies to remain subdued with the exception of Bombay Rayon where we expect robust earnings growth of 44% CAGR over FY09E-11E.

Top Buy: Bombay Rayon
Top Underperformer: Arvind

Top Stock Pick: Bombay Rayon (BRFL)

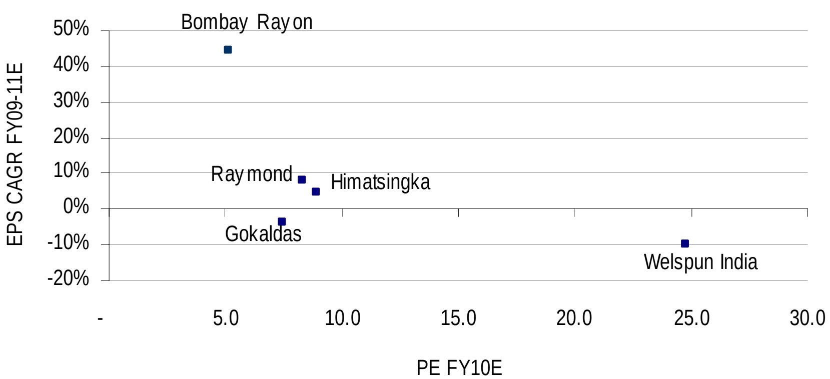
- De-risked business model with focus on both domestic and export opportunity. In exports, the company focuses on apparel (shirts) where India has limited capacities.
- Cost competitiveness helped by fiscal benefits given by the State Govt for the new facility in Maharashtra. This should help company gain market share.
- Earnings growth of 44% CAGR over FY09E-11E driven by new capacities coming on stream.
- Valuations cheap – trading at ~5x FY10E PE with strongest earnings visibility in the sector and high RoE of 22%.
- PO of Rs270 based on 7.5x FY10E EV/E.

Chart 79: Textile Sector 1-yr forward PE Chart



Source: Merrill Lynch Research

Chart 80: PE(10E) vs EPS CAGR (08-10E)



Source: Respective Company, Merrill Lynch Research

Table 70: Stock Performances

	Absolute Performance			
	1month	3 month	YTD	1year
Arvind Ltd	-16.9%	-62.1%	-84.5%	-81.2%
Bombay Rayon	-21.2%	-57.8%	-59.2%	-54.5%
Gokaldas	3.8%	-47.0%	-61.7%	-60.7%
Himatsingka	-6.3%	-44.7%	-78.0%	-74.7%
Raymond	-15.9%	-59.9%	-81.8%	-81.0%
Welspun India Ltd	-8.6%	-50.1%	-81.6%	-77.0%
Sensex	-14.2%	-39.7%	-56.8%	-54.5%

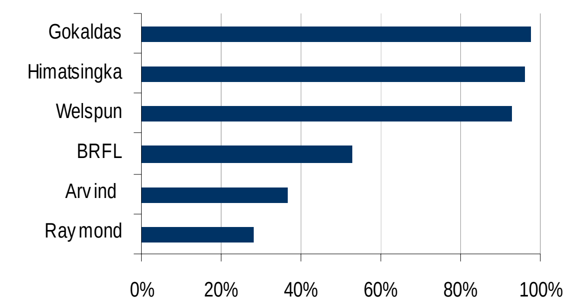
Source: Merrill Lynch Research

Table 71: Bull & Bear Factors that can change views

Company	Bull Scenario	Bear Scenario
BRFL	Higher margins helped by low cost new facilities and weaker Re.	Lower than expected sales on the back of slowdown in export markets.
Raymond	Closure of overseas denim facilities resulting in substantial reduction in losses from the JV. Thane worsted facility closure and shift to low cost Vapi.	Continued losses by denim JV. Slower sales growth in worsted textiles business due to slowdown in Indian economy.
Arvind	Higher operating profits helped by lower cotton prices and weaker Re.	Benefits get passed on to the buyers resulting in flat margins while sales growth dips.

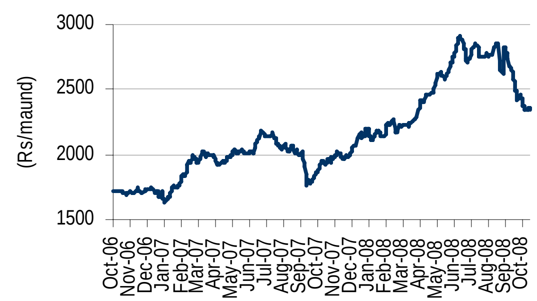
Source: Merrill Lynch Research

Chart 81: Proportion of sales from exports (mainly to US/EU)



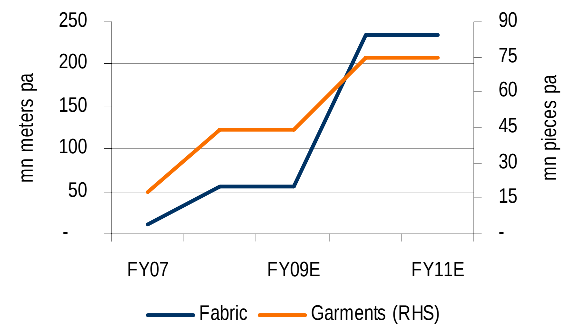
Source: Merrill Lynch Research

Chart 82: Cotton price trend



Source: MCX, Merrill Lynch Research

Chart 83: BRFL capacity ramp-up



Source: Merrill Lynch Research

Table 72: Stock/Sector Valuations

			Price	Mkt Cap	P/E (x)			EPS CAGR	P/B (x)			EV/Ebitda (x)			Div. Yield (%)		RoE (%)			Corp Gearing		
Stock	ML Code	QRQ	Rs	(US$mn)	FY08	FY09E	FY10E	FY09-11E	FY08	FY09E	FY10E	FY08	FY09E	FY10E	FY08	FY09E	FY08	FY09E	FY10E	FY08	FY09E	FY10E
Bombay Rayon	BORYF	C-1-7	170	237.40	8.7	7.2	5.1	44%	1.9	1.3	1.1	5.8	3.8	2.4	-	-	22.2	22.0	23.3	141%	264%	222%
Raymond	XRAMF	C-3-7	81	101.18	78.3	9.2	8.8	5%	0.4	0.3	0.3	3.4	2.2	1.8	1.9	1.9	0.4	3.8	3.9	103%	112%	109%
Arvind Mills	ARVZF	C-3-7	16	69.89	27.3	NM	17.2	NM	0.3	0.3	0.3	1.2	1.3	1.1	-	-	1.0	(2.8)	1.7	154%	139%	128%
Welspun India	WPNIF	C-3-9	21	31.18	16.1	18.0	22.7	-10%	0.3	0.3	0.3	1.1	0.9	0.7	6.1	7.4	1.8	1.6	1.3	304%	302%	273%
Gokaldas	GKLDF	C-3-7	107	74.43	6.5	6.1	6.8	-4%	0.8	0.7	0.7	4.1	3.7	3.7	2.2	4.1	13.1	12.7	10.3	63%	54%	41%
Himatsingka	HMKFF	C-2-7	28	56.77	168.2	9.2	8.4	8%	0.5	0.4	0.4	6.2	3.2	2.3	-	-	0.3	5.1	5.1	96%	91%	84%

Source: Merrill Lynch Research

RC

Price objective basis & risk

ABB (ABVFF)

Our PO of Rs490 is based on 15x of 1 year forward PER. We have valued ABB at PEG of 0.8x v/s past range of 1-1.1x to factor-in recent deceleration of growth, which deserves de-rating, in our view. This PO implies limited potential upside. Hence, we have an Underperform rating on the stock. Downside risks: raw material costs, execution risk, increasing competition and potential delay in power sector reforms/capex. Upside risk: rebound in metal & power capex and rupee appreciation.

Ambuja Cements (AMBUF)

We have a price objective of Rs55/sh for Ambuja. We value the company at an EV/capacity of around US$75/ton based on a 40% discount to the industry's current replacement cost of US$125/ton. Our PO places the stock in line with the trough valuation of industry majors during the previous down-cycle. Ambuja appears cheap on PE and EV/EBITDA but forecast YoY earnings downtrend may deter investors from leaning on these metrics. Downside risk to our PO stems from unforeseen further rise in energy prices. Upside possibilities would stem from unexpected delays in commissioning of new capacities and unforeseen easing in energy prices especially coal.

Arvind Ltd (ARVZF)

Our PO of Rs13 is based on a SOTP-based valuation. (1) We have valued the textile business (74pct of EV) at 5x FY10E EV/EBITDA, at par with other textile companies and at the lower end of Arvind's historical one-year forward EV/EBITDA band. (2) The retail business (26pct EV) has been valued at 0.7x FY10E EV/sales at a discount to other Indian retailers as the format is still evolving and the profitability is lower. Upside risks: Lower cotton prices, improvement in denim volumes and higher-than-expected value unlocking from real estate. Downside risks: Lower-than-expected growth in its brands and retail business, stronger rupee and higher input costs.

Asian Paints (XAPNF)

Our preferred valuation methodology is a target P/E multiple on one year forward EPS. Our target multiple for A Paints is 18x which on CY09E EPS of Rs58.4 gives us our price objective of Rs1050. Our target multiple is slightly lower than what A Paints is currently trading at and is also slightly lower than its last five year average trading multiple. We believe the discount is justified given slowing construction demand and likely also slower consumer demand. Hence we expect earnings growth to be slower than the trend of the last few years. Upside risks are better than expected topline growth. Downside risks are stronger Rupee depreciation and slowdown in the international business.

Assoc. Cement (ADCLF)

We have a price objective of Rs500/sh for ACC. We value the company at an EV/capacity of around US$75/ton based on a 40% discount to the industry's current replacement cost of US$125/ton. Our PO places the stock in line with the trough valuation of industry majors during the previous down-cycle, at around 40% discount to replacement cost. ACC appears cheap on PE and EV/EBITDA but forecast YoY earnings downtrend may deter investors from leaning on these metrics. Downside risk to our PO stems from unforeseen further rise in energy prices. Upside possibilities would stem from unexpected delays in commissioning of new capacities and unforeseen easing in energy prices especially coal.

Axis Bank (UTBKF)

We set our PO at Rs890 and US$23 on GDR. Our current PO captures earnings increase by 3-6% for FY09-10, post 2QFY09 to factor in the higher fee revenues and topline as it further expands and leverages distribution after assuming credit costs increasing to 100bps by FY10 from 83bps in FY08. We now expect earnings to grow at +38% CAGR through FY08-10. We believe the stock, trading at 2.5-2.6x FY09 book, could continue to trade at around 2.8-3.0x book, 1-year forward (lower end of its historic trading multiples 2.5-4.0x) given the +38% earnings growth thorugh FY10 and RoE bouncing back to +18.5% by FY10. Hence, we maintain out PO of Rs890 on the domestic and US$23 on the GDR. 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.

Bajaj Hindusthan (BJJHF)

Our PO of Bajaj Hindusthan at Rs45/sh is based on 50% discount to the current replacement cost of the company. We have used replacement cost as the basis of our PO as we expect the company to trade atleast at 50% discount to its replacement cost in the face of modest earnings outlook. We have valued the total replacement cost of Bajaj Hindusthan's factory at Rs76.5bn. Bajaj Hindustha is the largest sugar mill in India with sugarcane crushing capacity of 142000TCD, ethanol distillery capacity of 800KLPD and cogen capacity of 442MW. Bajaj Hindusthan also has set up bagasses base wood panel facility having 210,000m3 capacity with an investment of Rs2.5bn. Upside risks to our PO are (1) restoration of capital subsidy scheme, (2) successful capital restructuring, and (3) a higher than expected increase in sugar prices. Downside risks to our PO are (1) a sharp increase in interest costs, and (2) significantly higher sugarcane costs.

Balaji Tele (BLJIF)

Our PO for Balaji of Rs90 is based on PER of 8x FY10E for its content business - at in-line with its current multiple and 20pct mid-cap discount to market. We see this discount as justified due to peak in ratings of its programmes on Star Plus, which creates the risk of a slowdown down in its earnings ahead. Downside risks to our PO: increasing segmentation / fragmentation in viewership, shift of audience preferences to differentiated kinds of shows, increase in rating of competing programs and sustaining creativity. Upside risk to our PO: a rebound in ratings of its key shows on Star Plus or on Zee TV.

Bank of India (XDIIF)

Our PO of Rs415 is based on the stock currently trading at 1.5x FY09 book could arguably rerate to 1.6-1.7x FY09 book given a) profit growth of 27% CAGR over FY08-10, b) rising ROE (+23% in FY10), amongst the highest in Indian govt. banks, c) manageable asset quality, and d) only large govt. bank that FIIs can invest in. As banks net NPLs shrink, the PE may gain some relevance. We believe the stock could trade up to 6.6-6.7x FY10E earnings, at par with its historical trading range. A spike in NPLs as the cycle turns, ability to sustain strong earnings/loan growth (premium valuations implies market is pricing in stronger delivery for BOI) and ensuring margins are maintained as it expands its overseas loan book are risks to our PO.

Bharat Heavy (BHHEF)

Our Price Objective of Rs1750 is based on 18x FY10E earnings which is premium to its current multiples, 25pct discount to peak PE in the last cycle (94-97) and mid-range of PE bands. BHEL currently trades at 15x FY09E PER vs BSE Sensex at 12x. However, we believe that the premium valuation is justified given BHEL's superior market position, earnings growth (30pct for BHEL vs Market 17pct) and RoE (30pct v/s market 20pct). Risks to our price objective are Chinese, Japanese & Korean competition, rise in metal prices, higher than expected wage hike and on-ground project execution challenges.

Bharti (BHTIF)

We have a price objective of Rs900/sh for Bharti. Our PO is based on an EV/EBITDA of 9x FY10E and PE of 16x FY10E, and is supported by DCF using 11.5% WACC and 5% terminal growth. Our target PE & EV/EBITDA multiples broadly 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 (25-30%) 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 viz sharp, asymmetrical increase in spectrum charges or sharp cut in mobile termination charges are key risks. Irrational 3G bidding would also pose risks.

Bombay Rayon Fashions Ltd (BORYF)

Our PO of Rs270 is based on 7.5x FY10E EV/EBIDTA, which we believe is reasonable considering EBIDTA growth of 43% CAGR over FY09E-11E. Also, this is at the mid-end of the stock's historical 1-year forward rolling EV/EBIDTA band. We have chosen to value Bombay Rayon and other textile companies on EV/EBIDTA as we believe this appropriately captures their core business value.
At our PO the stock will trade at P/Es of 11x FY09E and 8x FY10E. We believe this is reasonable considering the strong earnings growth of 44% CAGR over FY09E-11E and a high ROE of 22% in FY09E. Risks are slowdown in key markets including the US, slower demand in the domestic market, exchange fluctuation, rise in input costs and execution risks.

BPCL (XBPCF)

Our PO of Rs342/share is based on P/E of 7.0x on BPCL's FY09E consolidated EPS of Rs45.2/share. It also includes the market value of investments in Indraprastha Gas (IGL) and Petronet LNG (PLNG) of Rs26/share. Our FY09E earnings for BPCL are marginally higher than FY08 but lower than FY07 earnings. The P/E multiple we use to value BPCL is below the average FY09E/2008E P/E for Asian refiners. At our PO BPCL's FY09E EV/EBITDA is below average EV/EBITDA for Asian refiners universe. We have not used DCF based valuation as given the huge uncertainties it is very difficult to forecast earnings reasonably accurately beyond a 1 year timeframe. Hence we have based our PO on P/E basis. Upside risks: (1) The amount of oil bonds issued by the government is higher than our expectations, (2) Government eliminates subsidies on all products, (3) Refining margins are higher than forecast by us, (4) Rise in market prices of IGL and PLNG. Downside risks: (1) Government fails to issue enough oil bonds to keep BPCL in the black, (2) government reverts to a cost-plus-based regulated pricing mechanism, (3) steep decline in regional and hence BPCL's refining margins to levels below assumed by us, and (4) steep decline in market prices of IGL and PLNG.

Canara Bank (CNRKF)

Our PO of Rs190 factors in that the stock, trading at 1.0x FY09 book may not re-rate further owing to the 14% earnings contraction in FY09, RoEs of 12 and13%, and higher risks on asset quality (cover at 35%). Moreover, operating earnings also weak (2% yoy in FY09) due to lower other income. We think risk return is less attractive relative to banks like Corporation or UBI both of which trade at similar multiples (>1.0x FY10 book) but have better risk-return (RoA >1% and RoEs >18%). Upside risks are the ability of the bank to build a strong liability franchise, improve margins and leverage distribution to increase fee income, which would improve earnings quality, and trigger a modest price rally. Downside risks to PO are a rise in NPLs and margin pressure, and the overall weak quality of earnings.

Cipla Ltd. (XCLAF)

We estimate PO of Rs196 for Cipla based on 16x FY10E EPS which is at a premium to Indian generics sector average and in line with its Indian peers (large cap Pharma stocks) and at discount to the stock's two year historical average to reflect correction in sector multiples. In terms of PEG, Cipla trades at significant premium to the sector PEG on our PO (0.9x PEG vs. sector PEG of 0.7x for FY09E) which we think is sustainable given stable 16pct EPS growth outlook. We expect Cipla to trade at best in line with its large cap Pharma peers average multiples given downside risks arising from (a) lower margin profile, (b) higher competition, (c) risks from litigation liability (DPCO related upto US$250mn+). Upside risks are (a) higher than expected margins from generic exclusivity launches and (b) higher than expected scale-up of international generic revenues.

Divi's Lab (XXQPF)

Our PO of Rs1550 is based on SoTP which includes Rs1400/sh for the base business and Rs150/sh for neutraceuticals (carotenoids). In our view, Divis' above sector average multiple (15x on FY10E EPS) is justified by strong earnings momentum, improving product-mix towards high margin CMS business and take-off of neutraceuticals business. Our PO for the base business represents 0.5x PEG for the base business (a discount to the sector PEG). Scale-up of eight neutraceutical products launched under the Vivital brand is the key catalyst in the coming months. Risks: (a) Severance of existing CMS relationships, (b) exchange rate fluctuations, (c) pricing pressure in generics.

DLF Limited (XVDUF)

Our PO of Rs640 is based on FY09E NAV of Rs642, which reflects 1) lower sales volume due to increase in mortgage rates 2) increase in cap rate and debtors due to delay in DAL lisitng c) higher discount rate due to increase in borrowing cost and risk free rate. On P/E basis, at our PO, the stock would trade at 13x FY09E earnings. We believe the high earnings, which is due to the low cost of landbank historically are not sustainable, given the high prices of land now. Hence, we do not view P/E as a correct indicator and therefore prefer to value the stock on NAV. Risks are some of the land bank is not fully transferred to the company, sale of assets to DLF Assets Ltd, a group company, could be delayed if DOT does not get listed, falling real estate prices could hit profitability (we estimate a 1 percent drop in prices would reduce profits by about 2 percent), execution risks in view of large projects and spread of geographies/verticals could hurt profitability.

Dr Reddy's Lab (DRYBF / RDY)

Our PO of Rs531 (US$10.77 for ADR) is based on 14x FY10E EPS which is in line with the large cap Indian generics sector average as well as to the stock's two year historical average. On our PO, in terms of PEG, the stock would likely trade nearly in line to sector PEG (0.7x) for FY09E based on 20pc EPS CAGR (FY08-10E). Downside risks are (a) concerns on German generics business (b) lower margin profile and supply issues in CPS business, (c) concerns on further writedowns in Betapharm. Upside risks are (a) improved growth outlook for Betapharm generics operations in Germany (b) increased visibility on generic FTF exclusivities and (c) positive progress in research programs.

Educomp Solu (EUSOF)

Our PO of Rs3700 is at PEG of 0.9 (FY09/FY09-11e), lower than historical PEG of 1.2, and implies a PE of 30x FY10e. We believe premium valuations are fair considering the high 68 percent earnings growth over FY08-11E and derisked revenue model given focus on non discretionary education spend and high exposure to domestic economy. Risks to our valuation are delays in execution of contracts in government schools, acquisition related risks and managing multiple growth initiatives.

Exide Indus Ltd (XEDRF)

Our price objective of Rs77 for Exide is based on sum-of-the-parts value including Rs68 for its lead acid battery business and Rs9 for its 51% stake in ING Vysya Life Insurance. We have valued its battery business at Rs68 per share on the basis of DCF. We have assumed 13% cost of capital and 5% terminal growth in our DCF. Our DCF value implies PE of 13.5x FY10E EPS of Rs4.97/sh and in line with comparable peers in terms of ROE and line of business. We have valued the life insurance business at Rs9 per share, based on 12x FY10E NBAP. Value of life insurance business arrived above is also at an implied valuation of 1.5x the amount invested by

Exide by end FY08. This is about 12pct of our price objective. Exide is likely to be a key beneficary of falling lead cost. It is also in a strong position to achieve higher exports. However, Exide is likely to face higher competition as the number of competitors has increased with the entry Tata GY Batteries and Amara Raja Batteries (the second-largest battery company of India, it is planning significant capacity addition). Exide also faces the risks of demand slowdown, as a slower economy could lead to less demand for automobiles, and hence, for batteries.

Glenmark Pharm (XVQWF)

Our PO of Rs650 is based on SoTP comprising Rs489 for the base business and Rs161 for research valuation. Our Rs489 valuation of Glenmarks base business is based on 16x FY10E core EPS which is a slight discount to its 2-year historical average but premium to the US generic sector average. We believe Glenmark's premium base business valuation is justified, noting strong 34pct EPS CAGR for the core business (FY08-10E). Our base case research valuation of Rs161 is based on NPV of three research candidates - Oglemilast (asthma/COPD), Melogliptin (diabetes) - as well for one more research deal expected in FY09E and assumes 40-45pc success chance. This suggests an overall fair value of Rs650/sh. Risks: a) Delay in progress/failure of research molecules, leading to delay in milestone receipts (b) Execution risks in the base business (c) Volatile market conditions may delay the IPO plans for Glenmark generics (d) Litigation and regulatory risks for the generics entity (e) High debtor position implying high working capital position.

Grasim (GRSJF)

We have a price objective of Rs1300 (GDR of US$27) for Grasim. We value the company's dominant cement business at 40% discount to the industry's current replacement cost of US$125/ton. The VSF business is pegged at an FY10E-EV/EBITDA of 3x and FY10E-PE of about 5x, i.e. 30% discount versus Lenzing AG which is one of the few listed VSF plays globally, outside of the Aditya Birla group. We also value Grasim's 5 percent stake in Idea using a DCF (WACC of 12%, terminal growth of 5%). Sharper than expected margin squeeze in VSF and unforeseen rise in energy prices for the cement business present downside risks to our PO. Upside risks are unexpected recovery in textile demand, delays in commissioning of new cement capacities, and unforeseen easing in energy prices.

HDFC Bank (XHDFF / HDB)

We set our PO at Rs1550 and US$120 on ADR. We believe the stock, trading at 3.3-3.5x FY09E book, could continue to trade at these levels as earnings visibility improves as the benefits of the merger, distribution become visible. The risk return is still likely to be positive given P/B of 3.3-3.5x and RoE of +16-17%. Moreover, post merger, earnings could sustain on a higher growth trajectory for a longer period as the bank capitalizes on the expanded distribution and also benefits from a high level of capitalization (Tier I to be +9-10% through FY10E) as we anticipate HDFC pumps in US$900mn to maintain its holding in HDFC Bank by Dec09. This could, in our view, see the stock trading back at historical levels. We believe the stock price is likely to mirror the growth in its earnings and adjusted book value. Inability to expand distribution would be an added risk to the implementation of its growth strategy.

HDFC (HGDFF)

Our PO of Rs2450 is based on our expectation of the stock's ability to trade at 3.0-3.2x book (close to trough valuations of past 5 years), one year forward given its sustained earnings growth and strong asset quality. These aspects still hold very true in our view, though headline earnings may show a contraction. We still expect recurring earnings to be at +20%, asset quality to be amongst the best and think HDFC is likely to have the lowest interest risk. Given the current market environment, we believe companies such as HDFC that are less impacted by regulatory reserve requirements (CRR, SLR), can deliver visible earnings growth, and are improving the risk profile of the loan book could trade at even the higher end of the trading range (3.3x book). Moreover, it is also the least impacted from the global events and in our view could be the biggest beneficiary of any uptick arising from a potential cut in retail lending rates likely to get underway in ensuing months. Hence, at 3.2x FY10E book, we get a price of Rs1740. Adding the reduced subs value of Rs701/sh., we get a PO of Rs2450. We reiterate our Buy on the stock and expect +35% upside as there is no material change in the underlying business as seen in the 2QFY09 earnings (loan growth at +30%, core earnings growth at 32%). A sharp rise in NPLs and inability to maintain growth are risks to our Price Objective.

HDIL (XGHSF)

Our PO of Rs.585 is based on 0.85x estimated NAV of Rs.688 per share.To calculate the NAV we assume that the entire land bank will be developed over the next 15-18 years. For each property, our gross value is based on expected sales less the cost of construction. From the gross value we deducted the marketing costs and the income tax payable to arrive at the NAV as on Mar 2009E. We then added NAV of all the individual projects and reduced the net debt and unpaid land bank. At our PO of 585 the stock would be trading at 12x FY09E earnings but we think PE in the current scenario may be less preferred than NAV due to expectation of substantial future growth as compared to past operations and high current margins due to low cost of land bought historically. Risks are delays in SRS projects due to changes in government policies, concentration risk as 92% of the NAV is derived from Mumbai Metropolitan Region, political risks, diversification into unrelated businesses and fall in property prices.

Hero Honda (HRHDF)

Our PO of Rs997 is based on 8.5x FY10E EV/EBITDA, a 5% premium five-year historical average, which reflects the growth premium. At our PO, the stock would trade at 13.3x FY10E EPS, which is similar to the historical average. Risks: Continuing withdrawal of financing intermediaries, and new competing models, both of which could impact sales.

Hindalco (HNDFF)

Our PO of Rs60 is based on 40% discount to our DCF valutation (WACC of 13.7%, terminal growth rate of 0%). Our DCF currently assumes aluminum prices of US$2564/t in FY09E, US$2508/t in FY10E and long term price of US$2646/t. However, we believe there is downside to our forecasts in the medium term given continuing turmoil in financial and commodity market and risks to demand growth. Hence, we expect Hindalco to trade at a discount to DCF. Upside risks: higher aluminum and alumina prices. Downside risks: Lower aluminum prices, execution risks and delays in capacity expansions.

Hindustan Petro. (XHTPF)

Our PO of Rs282 is based on a modest PE of 6.0x on FY09E EPS of Rs37. It also includes the market value of 17pct stake in refiner MRPL (ONGC's subsidiary) of Rs58. The PE multiple we use to value HPCL is lower than the average 2008E PE for Asian refiners. At our PO HPCL's FY09E EV/ EBITDA is below average EV/EBITDA for Asian refiner's universe. We have not used DCF based valuation because uncertainties makes it is very difficult to forecast earnings reasonably accurately beyond a one-year timeframe. Hence we based our PO on P/E. Upside risks: (1) PO does not include any value for its E&P assets. Its service contract to produce 180mn bbls of oil from ONGC's cluster-7 marginal field may be worth Rs32/share. Downside risks: (1) Government does not issue enough oil bonds to keep HPCL in the black, (2) government reverts to a cost-plus-based regulated pricing mechanism, (3) steep decline in regional and hence HPCL's refining margins, and (4) steep decline in the market price of MRPL.

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 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.

ICICI Bank (ICIJF / IBN)

Our PO of Rs650 (US$29 on ADR) is premised on 1) Cut in the value of the subs to factor in sharply lower value for the life ins. and AMC biz. given the current equity markets, 2) 15-18% cut in FY09E-10E earnings to capture lower loan and fee growth owing to weaker macro trends and higher investment and NPL provisions, and 3) Assigning lower multiples of 1.2x book owing to weaker macro outlook and a more challenging global environment (26% of the banks loan book is overseas). However, key positives 1) manageable asset quality, 2) lower exposure to the SME (3%), 3) sustained rise in CASA levels and decline in opex levels, 4) the expanded branch distribution, 5) key beneficiary of the downward trend in the interest rate cycle, 6) and finally, absence of large investment hits to aid future growth. The stock is trading at 0.8x book (no value to subs) and after deducting Rs228/shr for subs value, stock is trading at 0.3x FY09E book. We do believe the stock offers compelling value at these levels. Hence, we believe the stock could still trade up to 1.2x book given its ability to constantly acquire customers owing to its strong value proposition, high level of capitalization (critical in current scenario), manageable asset quality (even assuming NPLs were to rise by +50%) and operating earnings growth of +20% through FY09E-10E. Risks are a sharp rise in NPLs or the investment hits arising from the CDO / domestic investment book or inability to grow.

Idea Cellular (IDEAF)

Our price objective of Rs60/sh for Idea is based on DCF assuming 12% WACC and 5% terminal growth. Our revised PO places Idea's headline EV/EBITDA at 8x FY10E implying 10-15% 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 viz potential sharp increase in spectrum charges or sharp cut in mobile termination charges are risks. There is also risk of irrational bidding for 3G licences.

India Cements (INIAF)

We have a price objective of Rs110/sh (GDR of US$2.2) for India Cements. We value the company at an EV/capacity of around US$65/ton based on a 40-45% discount to the industry's current replacement cost of US$125/ton. Our PO places the stock in line with the trough valuation of industry majors during the previous down-cycle. India Cements appears cheap on PE and EV/EBITDA but forecast YoY earnings downtrend may deter investors from leaning on these metrics. Downside risk to our PO stems from unforeseen further rise in energy prices. Upside possibilities would stem from unexpected delays in commissioning of new capacities and unforeseen easing in energy prices especially coal.

Infosys Tech (INFYF / INFY)

Our PO of Rs1,400 (US$31 for ADR) is at 13x FY10E PE in line with trough valuations seen in 2001. Risks are steeper and longer than anticipated global slowdown, greater competition from global and Indian vendors, and Rupee appreciation. Upside risks stem from weaker than expected Rupee and lower than estimated pricing pressure.

IOC (IOCOF)

Our PO of Rs507/share is based on PE of 7.0x on IOC's FY09E consolidated EPS of Rs57/share. Our PO also includes market value of IOC's investments in ONGC, Petronet LNG and GAIL of Rs142/share. The PE multiple used by us to value IOC is lower than average Asian refiners FY09E/2008E PE. At our PO, IOC's FY09E EV/EBITDA is below average EV/EBITDA for the Asian refiners universe. We have not used DCF based valuation as the huge uncertainties make it very difficult to forecast earnings reasonably accurately beyond a one-year timeframe. Hence we based our PO on a P/E basis. Downside risks: (1) Government fails to issue enough oil bonds to keep IOC in the black, (2) government reverts to a cost-plus-based regulated pricing mechanism, (3) steep decline in regional and hence IOC's refining margins to levels below assumed by us, and 4) Steep decline in market price of ONGC, Petronet LNG and GAIL.

ITC Limited (ITCTF)

Our preferred valuation methodology is a target P/E multiple on one year forward EPS. Our target multiple for ITC is 17.4x which on FY109E EPS of Rs10.7 gives us our price objective of Rs187. Our target multiple is what ITC is currently trading and it is also in line with its last five year trading average. We expect the current multiple to sustain given our expectation of earnings acceleration from 2HFY09 onwards. We forecast EPS growth of 15.5% in 2H versus 3.4% in 1H. Inherent strengths of ITC remain intact. It is a virtual monopoly in the Indian cigarette market. It possesses perhaps the strongest distribution network in India and is among the most liquid stocks in the FMCG sector in India. Downside risks: Continuing high promotional costs in cigarettes and higher than expected losses in FMCG.

IVRCL Infrastruc (IIFRF)

Our PO of Rs421 is based on SOTP valuation. We have valued IVRCL core construction business 12x estimated 1 year forward earnings, a 25pct discount to E&C majors at Rs304 per share. Hind-dorr-Oliver where IVRCL has 52.8pct stake is valued at CMP giving a per share value of Rs6 IVR Prime where IVRCL has 62.3pct stake is valued at 60pct discount to NPV at Rs62 per share in line with Mid Cap real estate companies. Chennai desalination plant where IVRCL has 75pct stake is valued on a DCF basis at Rs12 per share. Similarly, Jalandhar-Amritsar project, Kumarapalayam-Chengapally project, and Salem-Kumarapalayam project where IVRCL has 100pct stake are valued based on DCF of Rs7, Rs12 and Rs17 per share respectively. We arrive at an SOTP value of Rs421. Risks: Unrelated acquisition in Oil & Gas space, Government capex, raw material costs, competition, traffic/interest rate risk in toll/annuity projects and project execution risk.

Jaiprakash Hydro (XJSHF)

We value JHPL at Rs39 per share at 1.6x FY10E P/BV - 30% premium to the current sector average - which we believe is fair considering the premium power RoE of 27pct FY10E JHPL is able to generate v/s sector range of 14-20pct. This equates to EV/ MW of Rs80mn/MW v/s replacement cost of 60-65mn. Expensive valuations and limited growth/yield prospects are thesis for Underperform rating on stock. Downside risks: Hydrology and project execution. Upside risks: change in business model to growth Utility.

Jaiprakash (JPRKF)

Our PO of Rs285 for JPA is based on the base case valuation for all parts ex-JP Infratech, which is valued on bear-case valuations. Jaypee Infratech is valued at Rs49/share on DCF basis. E&C business is valued at Rs64/share, 10x 1-yr forward EBITDA - 10-15pct discount to target multiples of E&C majors - BHEL & L&T. JP Greens is valued at Rs10/share based on DCF at WACC 13.6pct. Jaypee Ganga Infrastructure is valued at book value of Re1/share. Captive coal mine is valued at Rs17/share based on DCF at Cost of Equity 12.6pct. Stake of 46.9-100pct in Power projects are valued on DCF basis at Rs110/share . Cement business is valued at Rs70/share - Cement & captive power (Parent) at Rs65/share based on 8x 1-yr forward EV/EBITDA (down cycle), Gujarat Anjan at Rs3/share based on US$100/tn for its 98.9pct stake and SAIL Bhillai JV at book value of Rs1/share. Hotel business is valued at 2.5x FY10E Sales at Rs4/share. Malvika Steel is valued at Rs2/share at Book Value. Projects under construction are valued at Rs11/share based on 5pct premium to book value. Removing net debt of Rs53/share we arrive at an SOTP value of Rs284/share. JPA offers a blend of asset play & 26pct CAGR in parent EPS over FY08-10E. Risks to our PO: a) Political/land acquisition hurdles at Yamuna Expressway, b) slowdown in hydro power capex, c) demand-supply imbalance in cement business, d) delay in monetization of assets and e) hydrology.

Jindal Steel and Power Limited (XJDLF)

Our PO of Rs738 is set at a 20% discount to our NPV. We believe a discount is justified because of sharp near term 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 recession. Our NPV for the group is Rs922. This implies Rs467 for steel business and Rs455 for the power subsidiary. Our NPV calculation is based on a WACC of 13.7% and terminal growth rate of 0%. We have assumed steel volumes of 1.6mn tons in FY09 and 2.1mn tons in FY10. We have assumed average realization of Rs36,573/t in FY09 and Rs32,152/t in FY10. For the power business, we have assumed 57% of saleable output to be sold on short-term/spot tariff. We assume merchant tariff of Rs6.3/unit in FY09, Rs5.5/unit in FY10 and Rs4.5/unit in FY11. We expect capacity bunching to lead to decline in merchant tariff to Rs2.8/unit in FY12. We assume blended power tariff of Rs4.65/unit in FY09, Rs4.20/unit in FY10 and Rs3.63/unit in FY11. Upside risks to our valuation are higher steel prices, higher power tariff, better visibility on the execution of Bolivia mine project. Downside risks to our valuation are sharper than expected fall in steel prices, lower than expected steel production, and lower power tariff.

JSW Steel (XJWJF)

Our PO of Rs219 is set at a 40% discount to our NPV. We believe a discount is justified because of sharp near term demand slowdown, cyclical downturn in the steel sector and higher earnings from falling steel prices. Also, investor risk aversion is likely to be higher given the challenging macro environment and prospects of recession. Our NPV calculation assumes a WACC of 13.7% and perpetuity gorwht rate of 0%. We assume steel volumes of 4.2mn tons in FY09 and 6.2mn tons in FY10. We now forecast benchmark HR realizations of Rs37,800/t in fFY09 and Rs33,041/t in FY10. Upside risks are higher than expected steel prices owing to better steel fundamentals, lower raw material costs, commissioninng of mines and higher import duties. Downside risks are lower than expected steel prices, delays in commissioning of capacities and mines, higher than expected raw material costs and potential government intervention.

Larsen & Toubro (LTOUF / LTORF)

Our PO of Rs1385 / US$30 for L&T is based on sum-of-the-parts valuation. We have valued the core business at Rs1154 per share at a PER of 19x 1-year forward, which is at 25pct discount to its current multiples to factor in the anticipated de-rating. Its 11.5pct stake in Ultratech Cemco is valued at 10pct strategic premium to CMP at Rs11 per share. Its 78.4pct stake in Infrastructure SPVs is valued at 1.7x the private equity deal valuation at Rs58 per share. Its 100pct stake in L&T Infotech is valued at 8x PER 1-yr forward EPS - in line with niche 2nd tier stocks, giving per share value of Rs53 per share. The stake of 100pct in L&T Finance is valued at 1.5x FY10E P/BV at Rs31 per share. The stakes in Dhamra Port (50pct) and L&T Urban Infra (58.8pct) are valued on a DCF basis at Rs14 and Rs13 per share respectively. Other subsidiaries are valued at 3.5x book value at Rs52 per share. Risks to Price Objective: Slowdown in EPS growth on a higher base, Raw materials, Competition, Project execution.

Maruti Suzuki India (MUDGF)

Our PO of Rs500 is based on 4.0x EV/EBITDA FY10E, equivalent to trough valuations, on weak growth trajectory. We expect domestic car demand to decelerate sharply, restricting overall sales growth. At our PO, the stock would trade at 9.6x FY10E EPS, also at trough values. Upside risks: Stronger sales following sixth pay commission payout, and moderation of commodity prices. Downside risks: Financing constraints, and economic slowdown which would adversely volume growth.

MTNL (XMTNF / MTE)

We have a price objective of Rs65 (ADR of US$2.7) for MTNL. Our PO values the company's core telecom business at 25% discount versus DCF using 15% WACC and 5% terminal growth. The discount captures risk of potential large cash outgo towards its assured 3G licences. MTNL's return on equity at 2-3% is much below the average 13-14% RoE of many full service majors in Asia. This low RoE explains implied 60-65% discount on Price/book. Government initiative to privatise MTNL or significantly cut its current large employee base would present strong upside. Similarly, any dramatic improvement in MTNL's broadband penetration could offer upside. Downside risk is possible 20-25% government-initiated wage increase.

Nagarjuna Const (NGRJF)

Our PO of Rs189 is based on a sum-of-the-parts valuation. We have valued NCC's core construction business at PER 10.5x estimated 1-year forward - a 30pct discount to E&C majors - at Rs120 per share. The effective stakes in Road projects of Brindavan Infra (33pct), Western UP Tollway (30pct), Bangalore Elevated Tollway (33.5pct) and Orai-Bhognipur Infrastructure (64pct) are valued on a DCF basis at Rs2, Rs8, Rs9 and Rs7 per share respectively. Similarly, the effective stakes in Himachal Sorang Power (33.3pct), Machalipatnam Port (25.5pct) and NCC Urban Infra (80pct) are valued on a DCF basis at Rs4, Rs16 and Rs11 per share respectively. Gautami Power, Jubilee Hills Land Mark Projects and Telapur JV with Tishman & ICICI Venture are valued based on Book value of Investment at Rs2, Rs2 and Rs9 per share respectively. Risks: Government capex, raw material costs, competition, traffic/interest rate risk in Infra projects, and project execution.

NALCO (NAUDF)

Our PO of Rs188 is based on 40% discount to our DCF valuation (WACC of 13.7%, terminal growth rate of 0%). Our DCF currently assumes aluminum prices of US$2564/t in FY09E, US$2508/t in FY10E and long term price of US$2646/t. However, we believe there is downside risk to our forecasts in the medium term given continuing turmoil in financial and commodity market and risks to demand growth. Hence, we expect Nalco to trade at a discount to DCF. Upside risks: Higher aluminum and alumina prices. Downside risks: Lower aluminum prices, execution risks and delays in capacity expansions.

Nestle India (XNTEF)

Our preferred valuation methodology is a target P/E multiple on one year forward EPS. Our target multiple for Nestle is 25x which on CY09E EPS of Rs82 gives us our price objective of Rs1800. Our target multiple is in line with what Nestle is currently trading at and is slightly higher than its last five year average trading multiple. We believe this multiple is justified as Nestle will be able to maintain its high growth rate through market leading brands and innovative new product launches. Nestle continues to rank among the fastest growing stocks in the Indian FMCG sector. It offers leadership position, strong brands and quality management. Risks: Slower demand, stiffer competition and higher-than-expected raw material cost increase.

NTPC Ltd (NTHPF)

Our PO of Rs165 for NTPC is based on a 5pct discount to our DCF valuation, which assumes WACC of 11.7pct on higher ERP and a terminal growth rate of 2pct. It is led by greater capacity, utilization rates & efficiency gains on the back of increased fuel security. Risks to our Price Objective are - (a) Gas supply to existing/new plants till 2008. (b) Likely end to the negotiated project allocation window from FY12E. (c) Potential cut in RoE with likely improved demand-supply gap of power. (d) Potential entry into unrelated businesses (boilers). (e) Increased competition from private sector.

Omaxe Limited (XOMXF)

Our PO of 112 is based on 0.7x NAV of Rs.160 per share. We expect the stock to trade at 30% discount to NAV in comparison to 1x NAV for DLF due to inferior land bank quality located mostly in Tier II and Tier III towns and higher debt equity ratio. On P/E basis, at our PO the stock would trade at 4x FY09E earnings. We prefer NAV based valuation due higher volatility in earnings of real estate firms. Upside risks are increase in sales volume and prices. Downside risks are high debt equity ratio, cash flow risk if a sharp fall in prices lead to cancellations, declining margins due to higher costs and execution risk.

ONGC (ONGCF)

Our DCF-based PO of Rs1,384 incorporates the DCF of 2P reserves and resources, exploration upside, as well as net cash and market value of investments. We have assumed WACC of 14pct and a long-term oil price forecast of US$90/bbl (Brent) while calculating DCF of ONGC. We assumed that the current scenario of a rise in subsidy taking away most of gains from rise in oil price continues in perpetuity. Thus we believe our subsidy assumptions are conservative. We think that DCF is the most appropriate measure to value E&P assets. Risks are (1) Standard oil and gas industry operating risks which include exploration, development and production risks, oil price fluctuations, currency risk and reserve estimation, (2) lower-than-expected gas price rise which may adversely hit our valuation of ONGC, and (3) sovereign risks, which include changes in the government and/or policies (eg, withdrawal of the tax holiday) which may have a direct impact on the business, cashflow and profit.

Panacea Biotec (XPEAF)

Our PO of Rs435 is based on our target multiple of 13x FY10E EPS, which is at a discount to the Indian pharmaceutical sector average but in line with the stock's historical average. Since Panacea is a growth story we value the stock on PEG as well. On our PO, Panacea would trade at PEG of 0.5x for FY10E (discount to sector average) using EPS CAGR of 36pc over FY08-10E. Despite recent delays in new launches, we believe Panacea is on track to deliver milestones relating to WHO approval for combination vaccines and progress on NDDS projects. Risks: (a) Regulatory delays (b) execution risks (c) domestic market slowdown.

Pantaloon (PFIAF)

Our PO of Rs240 is based on SOTP valuation comprising standalone retail at Rs204, home at Rs13 and Future Capital at Rs23. Retail is based on DCF using WACC of 13pct, steady state EBITDA margin of 8pct from FY10E onwards and terminal growth rate of 5pct. Home is based on 0.5x FY09E sales owing to high gestation costs in the medium term. Future Capital is based on 40pct discount to market price. Downside risks: Stiffer competition, store cannibalization in retail, and inability to grow the consumer credit and asset management businesses in Future Capital. Upside risks: Stronger-than-expected consumer demand.

Punjab (PUJBF)

Our PO of Rs600 captures the +19-20% CAGR earnings growth over FY08-10 driven by topline and fees, controlled opex and higher NPL provisions- insync with our macro call for an up tick in NPL cycle. We believe the stock could trade at 1.3x FY10E book, given earnings CAGR of +19% over FY08-10, RoE of 18-19%, and comfortable asset quality, underpinning our PO of Rs600. On a PE basis we believe the bank can continue to trade at least at 6.6-6.8x FY10E earnings, as banks' net NPL's shrink. Sharp rise in rates/NPLs and inability to manage growth are risks. Also, inability to maintain margins in the event of rate cut mismatch remains a risk to our PO.

Puravankara Projects Ltd (XPJVF)

Our PO of Rs.245 is based on 15 percent discount to our estimated NAV of Rs.290 per share. We expect the stock to trade at 15 percent discount to NAV in comparison with 1x NAV for DLF due to higher exposure to IT/ITES centers and the expected slowdown in the IT/ITES sector. On P/E basis, at our PO, the stock would trade at 18x FY09E earnings. We believe high earnings which are due to low cost of land bank, historically acquired are not sustainable, given the high prices of land now. Hence we do not view P/E as a correct indicator and prefer NAV based valuation. Company specific risks are concentration risk since most of the land bank is in Bangalore, slowdown in IT/ITES since land bank is in IT/ITES growth cities, weaker operating cash flow if sharp decline in the prices leads to cancellations leading to lower cash flows and execution risk. Sector risks are declining prices, and sales.

Ranbaxy Lab (XIZZF)

Our PO of Rs330/sh is based on SoTP comprising Rs205/sh for the core business and Rs125/sh for the first to file (FTF) launches expected till 2014. Our Rs205/sh valuation of Ranbaxy's core business is based on 14x CY09E core EPS, at the lower end of the stock's historical valuations and in discount with the US generic sector average. We believe that lower multiple is justified given continuing uncertainties with the business. Our Rs125/sh valuation for Ranbaxy's FTF products (Imitrex, Valtrex, Flomax, Lipitor, Caduet, Nexium deal) is based on NPV of the expected launches in each of the years. Overall we forecast 30pc core EPS CAGR (CY08-10E). Risks: (a) Regulatory delays in product launches (b) litigation risks (c) higher than expected impact of FDA import ban (d) prolonged FDA manufacturing issues and (e) EU healthcare reform pressure. We believe Ranbaxy's exposure to foreign currency through foreign exhange liabilities poses risk to earnings in view of appreciating US dollar against the domestic currency.

Raymond Ltd (XRAMF)

Our PO of Rs75 is based on a SOTP-based valuation. We have valued Raymond's textile business (63pct of EV) at 6x FY10E EV/EBITDA, which is a 20pct premium to other textile companies. We believe this premium is justified, given Raymond's strong brand franchise. We value the retail business (30pct of EV) at 0.8x FY10E EV/sales similar to other retail companies in India. The engineering and auto ancillary business (7pct of EV) has been valued at 4x EV/EBITDA similar to other auto ancillary companies. Upside risks: News flow on Thane land sale, restructuring of denim business, lower input costs and weaker rupee. Downside risks: Lower-than-expected growth in worsted business, slower retail ramp-up and higher costs of retailing.

RCVL (RLCMF)

Our PO of Rs265/sh for RCom is based on 10-15% discount to DCF using 12% WACC and 5% terminal growth. Our PO also pegs RCom's FY10E-EV/EBITDA at a 10-15% discount versus our target valuation for Bharti at 9x FY10E. The discount versus DCF and Bharti allows for potential execution challenges in the current environment, due to RCom's relatively leveraged balance sheet. Upside surprise could be led by stronger-than-expected market share gains post GSM-launch, and unexpected easing in the credit environment allowing access to low-cost capital. Higher-than-expected cost pressures from GSM rollout and irrational bidding for 3G licences could present downside risk to our outlook.

Reliance Capital (RLCCF)

Our PO at Rs1030 captures stronger traction in operating earnings and also discounts future investments in the businesses. Key changes in SOTP, post 2QFY09 are driven by 38-40% cut in value of life insurance and the AMC business given the recent equity markets capitulation and building in moderation in growth. Other significant changes are in consumer finance business capturing the headwinds worsening risk profile. The cut in R-Money and General insurance is 25-34% reflects our assigning lower multiples, despite both these business are ahead of our est. in terms of profitability. Other Investment Risks- sharp correction in equity markets is a key risk to our PO. Additionally, the market may be unwilling to provide higher multiples to its consumer finance foray in the event that the growth trajectory is slower than envisaged. Finally, owing to the higher risk aversion markets may want to be surer of the growth delivery prior to re-rating the stock.

Reliance Inds (XRELF / RLNIY)

Our PO of Rs1,927 (GDR US$98.82) 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 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 6x 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 32pct of PO, E&P valuation (Rs909) 47pct, petrochemicals 16pct and organized retail 5pct. RIL offers strong EPS CAGR during FY08E-10E,which is far higher than peers, in our view. It is the cheapest among its peer group on a PEG basis. 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 Rs181/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 Rs1210 is based on 5pct discount to our SOTP valuation. The parent business is valued at Rs.254/share based on DCF. We value the stake of 33-45pct in power projects of Reliance Power at Rs.855/share on DCF basis, while we value the stake of 26pct in Power distribution business at Rs53/share. Its 74-100pct stake in Power Transmission business is valued at Rs23/share at 1.2x book value, and stakes of 69pct in the Metro project and 51pct in road projects are valued based on DCF at Rs59/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 Rs1281/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.

Renuka Sugars (SRNKF)

Our PO for Renuka of Rs71/sh is based on 6x FY09E EV/EBITDA, equivalent to the long term average multiple of the sector since 1996 excluding periods of very low (or negative) profit. Our PO is a 40% discount to our DCF based fair value arrived at using 17% cost of capital and zero growth beyond FY12E. Risks to our price objective are (1) a lower than estimated price for sugar (we calculate the company's FY09E EPS would be 31% lower if sugar price realization is 10% lower than we currently expect), (2) higher than estimated cost of sugarcane, and (3) delays in the commissioning of new facilities.

Rolta India (RLTAF / XLROF)

Our PO on local at Rs220 is at 9x FY10e PE, 2yr PEG of 0.0.5 (FY09 PE to FY09-11 EPSg). Our GDR PO, at USD5, is at par with the local PO. Risks: a) Non annuity nature of business b) Risk related to possible acquisitions c) Risk posed due to high dependence on partnerships d) Industry wide risk of increasing taxes & Rupee appreciation.

RPL (RPLUF)

Our PO of Rs142 is based on DCF valuation assuming WACC of 11.2pct. Our assumptions are a long-term refining margin of US$12.3/bbl from FY12E and RPL's capacity being debottlenecked to 33mmtpa by FY13E from 29mmtpa. Upside risks: (1) Stronger-than-expected refining margins, (2) RPL implementing new projects which have the potential to add substantial value, and (3) RPL enjoying very high P/E multiple which is possible given its low floating stock of 25pct. Downside risks: (1) Weaker-than-expected refining margins for RPL, and (2) problems stabilizing the refinery and therefore utilization rates could be lower than assumed.

Satyam (SAYPF / SAY)

Our PO of Rs295 is at 8x FY10 PE, in line with its trough PE seen in 2001. ADR PO of USD15.7 is at 20% premium to the local PO in line with the last 12m avg. Risks: Cuts in discretionary IT spending could impact enterprise solutions revenue - a high proportion of Satyam's revenues. Industry specific risks include increasing competition from global vendors & risk of Rupee appreciation. Upside risks stem from weaker than expected Rupee and lower than estimated pricing pressure.

SBI (SBINF / SBKFF)

Our PO for SBI of Rs1650 (US$74) captures strong earnings growth of 17% CAGR over FY08-10E, driven by strong topline and fees. Although the stock trades at 1.5x FY09E book assuming no value for subs, if we were to assume that the market is assigning the full value to the subs of Rs484/shr for FY09E and Rs542/shr for FY10E, then the stock would trade at just 0.8x FY09E book with ROE forecast to rise to about 16% by FY10E. Given its strong brand franchise, dominant deposit franchise (market leader with 18-19% share), core operating profit growth of +20% CAGR through FY08-10E, low interest risk and manageable asset quality, we believe the stock could arguably trade up to 1.4-1.5x book. While this reflects a significant rerating, we reckon, the market is assigning much lower value to the subs itself making the valuations of 0.8x look more understated. Moreover, the markets are also pricing in worst case valuations which, in our research implied a value of Rs911/shr (assuming target multiple pf 0.8x book, seen at the trough of the cycle). Moreover, it is also likely to be a beneficiary of the expected downtrend in the interest rate cycle. At 1.5x FY10E book, we get a value of Rs1110/sh. and adding Rs542/shr we get our PO of Rs1650 on the stock. As banks' net NPLs shrink, the PE may gain some relevance. We believe the stock could trade up to 7.5-8.0x FY10E earnings, which is still at a 20-30% discount to its historical trading range. Risks are a sharp rise in rates and in NPLs.

Shree Cements (SREEF)

We have a price objective of Rs620 for Shree. We value the company at an EV/capacity of around US$55/ton i.e. 55% discount to the industry's current replacement cost benchmark of US$125/ton. Our valuation of Shree is comparable with the stock's trough valuation historically in the midst of the previous down-cycle. We think Shree will trade at trough valuations sooner than other players owing to complete revenue exposure to north India - the region where visibility of upcoming overcapacity is already high. The stock appears cheap on PE and EV/EBITDA but forecast YoY earnings downtrend may deter investors from leaning on these metrics, in our view. Downside risk to our PO stems from unforeseen rise in energy prices and consequent steeper than expected margin downturn. Upside possibilities would stem from unexpected delays in commissioning of new capacities and unforeseen easing in energy prices, especially pet coke.

Steel Authority (SLAUF)

Our PO of Rs85 is based on a 20% discount to our NPV valuation of Rs360.share. Our NPV assumes a WACC of 13.7% and a perpetuity growth of 0%. We believe a discount is justified because of sharp near term demand slowdown, cyclical downturn in the steel sector and higher risks to earnings from falling steel prices. Also, invesor risk aversion is likely to be higher given the challenging macro environment and prospects of recession. Upside risks to our valuation are higher steel prices, lower input costs, export tariff on Chinese exports and higher import duty. Downside risks are lower than expected steel prices, volumes, and higher input costs.

Sterlite Industr (XTNDF)

Our PO of Rs321 (USD6.5) is based on sum of parts for the metals and merchant power business. We value the metals business at Rs287/share, at a 40% discount to 12 month DCF value of Rs479.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 $1654/t and long term aluminum prices of $2646/ton. Near term our zinc price forecast is $1551/t for FY09E and $1599/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%. Key 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.

Sun TV LTD (SUTVF)

We have valued Sun TV at Rs225 based on our SOTP valuation. The broadcasting business is valued at Rs200 per share - 15x of estimated FY10 earnings, which is 10pct premium to its current multiple and in line with Indian media peers. Stake in Radio subsidiaries (94.9pct in South Asia FM and 89pct in Kal Radia) are valued at Rs24/share - 20pct discount to their DCF. Risks: Political links of promoters, expansion in lower-margin radio, rise in competition led by Zee, Star Vijay, Raj TV and programming costs.

Suzlon Energy (SZEYF)

Our PO of Rs125 is based on our sum-of-the-parts analysis. We have valued Suzlon's wind business at 9x FY10E earnings, at Rs71 per share. This we believe is fair given Suzlon's long term superior growth and return profile. We value Suzlon's 71.3pct stake in Hansen by taking a 10% discount to our DCF valuation assuming WACC of 10%, which equates to Rs54 per Suzlon share. Risks: Headwinds for wind turbine business and execution risk in the wake of component shortages and blade retrofit issues.

Tata Chemicals Ltd (TTCXF)

We set our PO of INR165 at 6.7x FY10E EPS and 4.5x FY10E EV/EBTIDA, which are at an about 20% discount to the 7 year average. Given likely weakening in the soda ash business, we believe the 20% discount is reasonable. Risks are drastic correction in soda ash prices can impact earnings, integration risk from new acquisition of General Chemicals and any adverse change in government policy.

Tata Communications Limited (VSLSF / TCL)

We have a price objective of Rs405 (ADR of US$17) for Tata Communications. Our PO is based on sum-of-parts reflecting 1) TCom's core telecom business, 2) surplus real estate entitled to shareholders, 3) embedded value of TCom's stake in the wireless major - Tata Teleservices, and 4) asset value (at cost) of TCom's submarine cable network. We value the company's core telecom business at an implied EV/EBITDA of 6x FY10E versus the long-term trading range for wholesale carriers globally at 5-7x. Currently, there are few listed comparables of TCom as most of the large undersea cable providers are unlisted or bundled into last-mile providers. Greater visibility on the international operations of Tata Comm (not yet reported on a qtrly basis) could present upside to our PO, At this stage we do not have sufficient visibility to project long-term cashflows & use DCF. Risks are: 1) sharper than expected slowdown in global bandwidth demand, 2) erosion of real estate upside due to poor visibility on monetisation, and 3) possible dilution of equity stake in Tata Teleservices.

Tata Consultancy (TACSF)

Our PO of Rs580 is at an FY10E PE of 9x based on a 25% discount to Infosys target PE, 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.

Tata Motors Ltd. (TENJF / TTM)

Our SOTP-based PO is Rs172 (US$4.95 for ADR). The core autos business is valued at 5.0x FY10E EV/EBITDA, in line with mid-cycle valuations. JLR is also valued at 5.0x EV/EBITDA, a marginal discount to European peers due to lower scale. We have imputed a 30pct holding company discount to operating subsidiaries. Upside risks: Moderation of commodity prices during the year. Downside Risks: Economic slowdown which would adversely affect volume growth, and rising input costs.

Tata Steel (TAELF)

Our PO of Rs216 is based on a 40% discount to our NPV valuation of Rs360/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 loer than expected steel prices, volumes and higher input costs.

Tech Mahindra (TMHAF)

Our PO of Rs430 is at 25% discount to larger peers like Satyam and implies one year forward PE of 5x. We believe this is fair given high client concentration and single vertical risk. Downside risks to our price objective are rapid growth-related execution risks, sharp cut in IT spends by top client . Industry-wide risks include growing competition, wage and attrition pressures and risk of rupee appreciation against GBP.

UltraTech Cemen (XDJNF)

We have a price objective of Rs525/sh for UltraTech. We value the company at an EV/capacity of around US$75/ton based on a 40% discount to the industry's current replacement cost of US$125/ton. Our PO places the stock in line with the trough valuation of industry majors during the previous down-cycle, at around 40% discount to replacement cost. UltraTech appears cheap on PE and EV/EBITDA but forecast YoY earnings downtrend may deter investors from leaning on these metrics. Downside risk to our PO stems from unforeseen further rise in energy prices. Upside possibilities would stem from unexpected delays in commissioning of new capacities and unforeseen easing in energy prices especially coal.

Union Bank India (UBOIF)

Our PO of Rs195 is owing to 1) EPS cut by 18-22 percent for FY09-10 driven by higher MTM hits and much lower trading profits and 2) moderation in growth on macro headwinds. We value the stock at 1.2x FY10 book (RoE of +19-20 percent), a discount to Gordon growth model (g = 0 pct), wherein it can arguably trade up to 1.4x. However, given the near term earnings contraction, rising macro headwinds, and capital constraints which could also hurt growth we value the stock at 1.2x given the PPP growth at +15 percent CAGR over FY08-10 and comfortable asset quality. As banks' net NPL's shrink, the PE may gain some relevance. We believe the stock could trade up to 6-6.5x FY10E earnings on estimated PPP earnings growth of 17 percent CAGR through FY08-10E, improved quality of earnings arising from lower trading profits and lower risk from interest rate changes. Sharp rise in NPLs, managing moderation in growth (owing to capital constraints) and ability to raise fresh capital to avoid sacrificing growth are risks to our PO.

Unitech Ltd (UTKIF)

Our PO of Rs160 is based on a 20pct discount to our NAV estimate of Rs198 per share. We expect the stock to trade at a 20pct discount to NAV in comparison with 1x NAV for DLF due to its high debt to equity ratio, higher exposure to IT/ITES centers and focus on the residential segment where the sales have slowed. On a P/E basis, at our PO, the stock would trade at 13x FY09E earnings. We prefer NAV-based valuation due to higher volatility in earnings of the real estate firms. Risks are high debt to equity, increasing debtors, slowdown in IT/ITES since most of the land bank (48pct of NAV) is in the IT/ITES growth cities, 35pct of the land bank not been acquired, customer advances being utilized to fund land purchases implying cash flow risk, execution risk and fall in property prices.

United Spirits (UDSRF)

We value UNSP at Rs1,350/share. This is a combination of the base business at Rs1,150 and treasury stock at Rs200. For the base business, we use PEG since UNSP is a growth stock. We take a target PEG of 1.1x for FY10E using EPS CAGR of two years over FY08-10E. We forecast EPS to grow at an average of 18pct over the next two years and our target PEG of 1.1x is lower than the sector average of 1.2x to capture the higher regulatory risks associated with alcohol business in India. Based on this methodology, we arrive at the base business value of Rs1,150. At Rs1,150, the base business would trade at FY10E P/E of 21x. Treasury stock accounts for 13pct of shares outstanding and we assume that these will be sold at market value of Rs1,300/share which implies per share price of Rs200. Upside risks: Stronger-than-expected demand and higher-than-expected value of treasury stock. Downside risks: Sharp input cost increases.

Wipro (WIPRF / WIT)

Our PO of Rs360 is at 9x FY10E PE, a 25% discount to Infy target PE to factor in enhanced macro risk to the technology vertical, over 20% of revs. Wipro has a richer valuation on PEG basis at 1.4x vs TCS at 0.8x and Infosys at 1.2x and compares unfavorably to Satyam on valuation metrics of EV/sales, P/E ex cash and implied 5 yr growth per DCF which stands at 13% vs Satyam at 8% and TCS at 11%. Risks: Any near term business impact of recent management changes. Industry specific risks include increasing competition from global vendors, risk of Rupee appreciation and sharper than expected macro slowdown. Upside risk to estimates from any large deal wins.

Wockhardt (XDUVF)

Our PO of Rs310 is based on 10x FY09E EPS which is at significant discount to the Indian generics sector average but in line to the stocks one year historical average. In terms of PEG, the stock would likely traded at slight discount to sector PEG of 0.7x for FY09E based on 17pc EPS CAGR (CY07-09E). We expect Wockhardt to continue to trade at discount to sector average multiples given balance sheet issues and concern on potential equity dilution. Downside risks are (a) integration risks and delays post recent acquisitions (b) forex derivative write-offs. Upside risks are (a) improved growth outlook for generics operations (b) increased visibility on generic FTF exclusivities.

Zee Entertainmen (XZETF)

Our PO of Rs245 is based on 18x estimated FY10E PER. We highlight that it is reasonable, in our view, given we believe the stock offers a compelling play on improving demographics, defensive nature of its growth, strengthening market leadership of the Zee platform and valuation in line with the Indian media sector average. At our PO, ZEE would trade at 2-year FY08-10E PEG of 0.7x vs the Indian market PEG of 0.65x, which is below its historical averages. Risks: Competition from Star & New channels from 9X, NDTV & Viacom, lack of penetration of CAS system, continued cap of cable tariffs by TRAI and slowdown in penetration of Zee Turner/Dish TV.

Analyst Certification

We, Jyotivardhan Jaipuria, Vandana Luthra, Rajeev Varma, Reena Verma Bhasin, CFA, Bharat Parekh, Mitali Ghosh, S.Arun, Prasad Deshmukh, Vidyadhar Ginde, Manish Sarawagi, Pratish Krishnan, Amit Agarwal, Arvind Bothra and Bhaskar.N.Basu,CFA, 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

In accordance with the SEBI (Foreign Institutional Investors) Regulations and with guidelines issued by the Securities and Exchange Board of India (SEBI), foreign investors (individuals as well as institutional) that wish to transact the common stock of Indian companies must have applied to, and have been approved by SEBI and the Reserve Bank of India (RBI). Each investor who transacts common stock of Indian companies will be required to certify approval as a foreign institutional investor or as a sub-account of a foreign institutional investor by SEBI and RBI. Certain other entities are also entitled to transact common stock of Indian companies under the Indian laws relating to investment by foreigners. Merrill Lynch reserves the right to refuse copy of research on common stock of Indian companies to a person not resident in India. American Depositary Receipts (ADR) representing such common stock are not subject to these Indian law restrictions and may be transacted by investors in accordance with the applicable laws of the relevant jurisdiction. Global Depository Receipts (GDR) and the Global Depository Shares of Indian companies, Indian limited liability corporations, have not been registered under the U.S. Securities Act of 1933, as amended, and may only be transacted by persons in the United States who are Qualified Institutional Buyers (QIBs) within the meaning of Rule 144A under the Securities Act. Accordingly, no copy of any research report on Indian companies' GDRs will be made available to persons who are not QIBs.

Important Disclosures

Investment Rating Distribution: Autos Group (as of 01 Oct 2008)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	31	36.47%	Buy	3	10.00%
Neutral	16	18.82%	Neutral	9	69.23%
Sell	38	44.71%	Sell	7	24.14%

Investment Rating Distribution: Banks Group (as of 01 Oct 2008)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	99	33.33%	Buy	45	55.56%
Neutral	76	25.59%	Neutral	33	47.83%
Sell	122	41.08%	Sell	54	51.92%

Investment Rating Distribution: Beverages - Alcoholic Group (as of 01 Oct 2008)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	20	57.14%	Buy	0	0.00%
Neutral	7	20.00%	Neutral	4	66.67%
Sell	8	22.86%	Sell	2	28.57%

Investment Rating Distribution: Building Group (as of 01 Oct 2008)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	30	30.30%	Buy	5	17.86%
Neutral	24	24.24%	Neutral	4	19.05%
Sell	45	45.45%	Sell	2	4.65%

Investment Rating Distribution: Chemicals Group (as of 01 Oct 2008)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	41	45.56%	Buy	10	28.57%
Neutral	23	25.56%	Neutral	4	21.05%
Sell	26	28.89%	Sell	3	12.50%

Investment Rating Distribution: Consumer Products Group (as of 01 Oct 2008)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	28	40.58%	Buy	5	20.00%
Neutral	17	24.64%	Neutral	2	12.50%
Sell	24	34.78%	Sell	5	23.81%

Investment Rating Distribution: Education & Training Services Group (as of 01 Oct 2008)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	13	76.47%	Buy	4	30.77%
Neutral	2	11.76%	Neutral	1	50.00%
Sell	2	11.76%	Sell	0	0.00%

Investment Rating Distribution: Electrical Equipment Group (as of 01 Oct 2008)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	16	39.02%	Buy	6	40.00%
Neutral	13	31.71%	Neutral	2	18.18%
Sell	12	29.27%	Sell	4	33.33%

Investment Rating Distribution: Energy Group (as of 01 Oct 2008)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	170	63.43%	Buy	57	37.25%
Neutral	50	18.66%	Neutral	12	30.00%
Sell	48	17.91%	Sell	9	22.50%

Investment Rating Distribution: Engineering & Construction Group (as of 01 Oct 2008)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	21	67.74%	Buy	4	23.53%
Neutral	7	22.58%	Neutral	1	16.67%
Sell	3	9.68%	Sell	2	66.67%

Investment Rating Distribution: Financial Services Group (as of 01 Oct 2008)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	125	42.23%	Buy	47	38.21%
Neutral	92	31.08%	Neutral	31	34.83%
Sell	79	26.69%	Sell	20	25.64%

Investment Rating Distribution: Food Group (as of 01 Oct 2008)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	29	37.18%	Buy	6	23.08%
Neutral	24	30.77%	Neutral	3	15.79%
Sell	25	32.05%	Sell	2	8.70%

Investment Rating Distribution: Health Care Group (as of 01 Oct 2008)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	92	45.10%	Buy	24	27.91%
Neutral	47	23.04%	Neutral	15	34.09%
Sell	65	31.86%	Sell	14	23.33%

Investment Rating Distribution: Industrials/Multi-Industry Group (as of 01 Oct 2008)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	60	60.00%	Buy	10	18.87%
Neutral	17	17.00%	Neutral	5	31.25%
Sell	23	23.00%	Sell	2	10.00%

Investment Rating Distribution: Media & Entertainment Group (as of 01 Oct 2008)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	59	47.97%	Buy	20	37.74%
Neutral	22	17.89%	Neutral	4	22.22%
Sell	42	34.15%	Sell	11	26.83%

Investment Rating Distribution: Non-Ferrous Metals/Mining & Minerals Group (as of 01 Oct 2008)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	80	56.74%	Buy	15	21.13%
Neutral	32	22.70%	Neutral	11	44.00%
Sell	29	20.57%	Sell	6	27.27%

Investment Rating Distribution: Real Estate/Property Group (as of 01 Oct 2008)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	42	33.60%	Buy	7	20.00%
Neutral	28	22.40%	Neutral	6	24.00%
Sell	55	44.00%	Sell	8	14.81%

Investment Rating Distribution: Retailing Group (as of 01 Oct 2008)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	64	44.44%	Buy	4	6.56%
Neutral	30	20.83%	Neutral	8	29.63%
Sell	50	34.72%	Sell	5	10.42%

Investment Rating Distribution: Steel Group (as of 01 Oct 2008)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	37	71.15%	Buy	6	20.00%
Neutral	5	9.62%	Neutral	0	0.00%
Sell	10	19.23%	Sell	2	22.22%

Investment Rating Distribution: Technology Group (as of 01 Oct 2008)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	113	42.97%	Buy	21	20.59%
Neutral	60	22.81%	Neutral	12	22.22%
Sell	90	34.22%	Sell	13	15.66%

Investment Rating Distribution: Telecommunications Group (as of 01 Oct 2008)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	86	47.25%	Buy	17	24.64%
Neutral	51	28.02%	Neutral	14	35.00%
Sell	45	24.73%	Sell	6	15.38%

Investment Rating Distribution: Textiles/Apparel Group (as of 01 Oct 2008)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	8	33.33%	Buy	3	42.86%
Neutral	5	20.83%	Neutral	2	40.00%
Sell	11	45.83%	Sell	1	9.09%

Investment Rating Distribution: Utilities Group (as of 01 Oct 2008)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	80	44.94%	Buy	31	42.47%
Neutral	41	23.03%	Neutral	19	50.00%
Sell	57	32.02%	Sell	17	34.00%

Investment Rating Distribution: Global Group (as of 01 Oct 2008)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1647	45.31%	Buy	429	28.83%
Neutral	858	23.60%	Neutral	240	31.41%
Sell	1130	31.09%	Sell	227	22.02%

* Companies in respect of which MLPF&S or an affiliate has received compensation for investment banking services within the past 12 months. For purposes of this distribution, a stock rated Underperform is included as a Sell.

RC

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster*
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

* Ratings dispersions may vary from time to time where Merrill Lynch Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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