



31st Annual Report 2005

Board of Directors

Mr. Hemendra Kothari
Mr. Shitin Desai
Mr. Amit Chandra
Mr. Ahmass' Fakahany
Mr. Christopher Reeves
Mr. Kevan Watts
Mr. Prem Saigal
Mr. Raymundo Yu
Mr. Yogesh Kothari
Mr. Ausaf Abbas

Chairman
Executive Vice Chairman
Joint Managing Director

Alternate to Mr. Raymundo Yu

Company Secretary

Ms. Jyoti Vineet Tandon

Auditors

Deloitte Haskins & Sells

Bankers

Bank of America
Citibank N. A.
Deutsche Bank A. G.
HDFC Bank Ltd.
ICICI Bank Ltd.
Standard Chartered Bank
State Bank of India
The Hongkong and Shanghai Banking Corporation Ltd.

Registered Office

Mafatlal Centre, 10th Floor
Nariman Point
Mumbai - 400 021



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Directors' Report to the Shareholders

Your Directors have pleasure in presenting the Thirty first Annual Report of the Company; the Audited Statement of Accounts and the Auditors' Report for the year ended 31st December, 2005.

The financial results for the period are summarised below:

	DSP Merrill Lynch Limited		Consolidated figures of DSP Merrill Lynch Limited and its subsidiaries	
	2005	2004	2005	2004
Gross Income	4,883.74	3,697.76	5,838.44	4,365.12
Profit before Depreciation and Tax	2,675.35	2,113.80	2,717.60	2,112.85
Depreciation	(66.85)	(62.99)	(79.07)	(72.84)
Profit before Tax	2,608.50	2,050.81	2,638.53	2,040.01
Provision for Tax:				
- Current	(911.14)	(697.45)	(927.38)	(700.96)
- Deferred Tax Credit/(expense) (net)	9.94	(29.73)	10.17	(29.52)
- Fringe Benefit Tax	(8.60)	—	(10.68)	—
Operating Profit after Tax	1,698.70	1,323.63	1,710.64	1,309.53
Reversal/(Provision) of Tax for earlier years	1.06	(0.28)	0.30	(0.53)
Net Profit after Tax	1,699.76	1,323.35	1,710.94	1,309.00
Less: Share of Minority Interest - Profit Rs. 4/- for the year, (Previous year Loss Rs. 6/-)	N.A.	N.A.		
Share of Profit/(Loss) in respect of investment in Associate Company	N.A.	N.A.	0.05	(0.10)
Balance brought forward from the previous year (excluding Share of minority)	1,073.30	631.59	1,117.81	690.56
Balance available for appropriation	2,773.06	1,954.94	2,828.80	1,999.46
Earnings per Share (in Rs.)	75.54	58.82	76.04	58.17

CORPORATE UPDATE

Hemendra Kothari and affiliates agreed to sell 47.73% stake to Merrill Lynch and/or its subsidiaries (Merrill Lynch) vide an agreement dated 7th December, 2005, signed with Merrill Lynch. Further, the public shareholders were invited to tender their shares in a delisting offer made by Merrill Lynch.

On closure of the Agreement and completion of the delisting offer, Merrill Lynch's stake in your Company will increase upto 90% and the shares of your Company, which were listed on the Bombay Stock Exchange Ltd. (BSE), would be subsequently delisted.

Your Company's stake in DSP Merrill Lynch Fund Managers Limited (DSPMLFM) has reduced, as Mr. Hemendra Kothari and affiliates, purchased a 60% stake in DSPMLFM from your Company on closure of the agreement dated 7th December, 2005, signed between your Company and Hemendra Kothari.

DIVIDEND

Your Directors recommend a dividend of Rs. 10/- per equity share. If approved, dividend will be paid to the members whose names appear in the Register of Members on 19th June, 2006.

TRANSFER TO RESERVES

Your Directors recommend the transfer of Rs. 169,976,000/- to the General Reserve. Additionally, Rs. 339,952,000/- has been transferred to the Reserve Fund as stipulated under Section 45-IC of the Reserve Bank of India Act, 1934.

SUBSIDIARIES**DSP Merrill Lynch Fund Managers Limited (DSPMLFM)**

The audited statement of accounts of DSPMLFM for the year ended 31st December 2005, together with the report of Directors and the Auditors, as required under Section 212 of the Companies Act, 1956, are attached.

DSP Merrill Lynch (Jersey) Limited (DSPMLJ)

The unaudited statement of accounts of DSPMLJ for the period ended 31st December 2005, certified by the Directors, as required under Section 212 of the Companies Act, 1956, together with the report of Directors, are attached.

DSP Merrill Lynch Capital Limited (DSPMLC)

During the year, your Company incorporated a wholly owned subsidiary, DSP Merrill Lynch Capital Ltd. on 7th April 2005. DSPMLC has been registered with the Reserve Bank of India as a non-deposit taking Non-Banking Financial Company. The audited statement of accounts of DSPMLC for the period ended 31st December, 2005, together with the report of Directors and the Auditors, as required under Section 212 of the Companies Act, 1956, are attached.

DIRECTORS

Mr. Ahmass Fakahany and Mr. Raymundo Yu retire by rotation, and being eligible offer themselves for re-appointment. The Board recommends their re-appointment.

The Board re-appointed Mr. Hemendra Kothari as the Executive Chairman of your Company for a period of 5 years effective 8th July, 2004. In terms of the provisions of the Companies Act, 1956, your approval is sought for the re-appointment as detailed in the notice conveying the Annual General Meeting.

Mr. Rajeev Gupta, Joint Managing Director of your Company, resigned from the services of the Company effective 14th July, 2005.

DIRECTORS' RESPONSIBILITY STATEMENT:

Your Directors state that while preparing the accounts for the period:

- applicable accounting standards have been followed consistently, and proper explanation relating to material departures, if any, have been made;
- accounting policies have been applied consistently, and reasonable and prudent judgements and estimates have been made so as to give a true and fair view of Company's state of affairs at the end of the period and of the profit or loss of the Company for that period;
- proper and sufficient care has been taken in the maintenance of adequate accounting records in accordance with provisions of the Companies Act, 1956, to safeguard assets of the Company and prevent and detect fraud and other irregularities; and
- accounts have been prepared on a going concern basis.

AUDIT COMMITTEE

The Audit Committee comprises of the following non-executive directors:

- Mr. Prem Salgal (Chairman)
- Mr. Christopher Reeves
- Mr. Kevan Watts
- Mr. Yogesh Kothari

The above Committee functions as an Audit Committee for purposes of the Companies Act, 1956, as well as the Reserve Bank of India's directions for Non Banking Financial Companies.

AUDITORS

M/s. Deloitte Haskins & Sells, Chartered Accountants and Statutory Auditors of the Company retire at the ensuing Annual General Meeting and are eligible for re-appointment. The Company has received a letter from them stating that the re-appointment, if made, will conform with the provisions of Section 224(1B) of the Companies Act, 1956. The Audit Committee has also recommended their re-appointment.

PARTICULARS OF EMPLOYEES

The particulars in accordance with section 217(2A) of the Companies Act, 1956 read with the Companies (Particulars of Employees) Rules, 1975, as amended, forms a part of this report. However, according to the provisions of Section 219(1)(b)(iv) of the Companies Act, 1956, the report and accounts are being sent to all shareholders of the Company excluding the statement of particulars of employees under Section 217(2A) of the Companies Act, 1956. Any shareholder interested in obtaining a copy of the said statement may write to the Company.

INFORMATION IN ACCORDANCE WITH THE COMPANIES (DISCLOSURE OF PARTICULARS IN THE REPORT OF THE BOARD OF DIRECTORS) RULES, 1988

The Company has not been associated with any manufacturing activities. Hence, there is no report pertaining to conservation of energy or technology absorption. The details of earnings and expenditure in foreign currency are given in Note No.7 of Schedule 19 of the accounts.

ACKNOWLEDGEMENT

Your Directors wish to thank all shareholders for their strong support. In addition, the Directors also wish to place on record their appreciation and thanks for the excellent contribution made by the employees.

For and on behalf of the Board of Directors

Hemendra Kothari
Chairman

Mumbai

Date: 23rd March, 2006

MANAGEMENT DISCUSSION AND ANALYSIS**INDUSTRY STRUCTURE AND DEVELOPMENTS**

CY2005 witnessed one of the most exciting years for the Indian capital markets. Total equity raisings for the year was over Rs. 580 bn, highest ever in the history of Indian Capital Markets out of which approximately 37% were in the form of domestic offerings and approximately 63% International equity & equity linked offerings.

The Indian stock market has been one of the best performing Asian markets in CY2005 with a 42% return, second only to Korea with a return of 55.5%. Sectors which outperformed the markets were capital goods, FMCG and technology with sectors to watch in 2006 being construction, telecom, media & real estate.

In CY2005, India witnessed the highest ever FII flows amounting to approximately Rs. 470bn. The new FII registrations were also up by 245, taking the total registrations to 823 by the end of 2005.

For the Debt business, CY2005 continued to be another bearish year with very high volatility due to monetary tightening, rate hikes, inflationary concerns and liquidity concerns. In line with the global 'removal of accommodation', the Reserve Bank of India hiked key rates twice on the back of strong economic growth and inflationary concerns, resulting in over 50 basis points increase in the benchmark 10-year Gilt yield.

Overall your company performed well in CY2005.

OPPORTUNITIES & THREATS

Your Company continues to believe that India offers tremendous opportunities to further build on a strong franchise driven by:

- *Positive macroeconomic parameters*
- *Continued emphasis on economic/social reforms*

The risk to your Company's performance stems from a significant competition in the Indian market, particularly from players seeking to establish themselves. The challenges of operating in such a highly competitive and volatile business environment could continue to pressurize margins.

SEGMENT-WISE/PRODUCT-WISE PERFORMANCE

Your Company has identified two reportable segments in accordance with Accounting Standard 17 on Segment Reporting issued by The Institute of Chartered Accountants of India. The Advisory and Transactional Services segment consists of revenues from merchant banking, broking and other transactional services and the Trading segment derives income from trading of securities (including equity and debt derivatives). Revenues from the Advisory and Transactional Services segment rose 30% YoY from Rs. 3,226mn in CY2004 to Rs. 4,186mn, resulting in a 25% YoY increase in pre-tax profit from this segment (before unallocable expenses) in CY2005. The Trading segment generated revenues of Rs. 577mn in CY2005 from Rs. 308mn in CY2004, registering an 87% YoY increase. This segment posted much higher increase in pre-tax profit (before unallocable expenses) at 154% YoY in CY2005.

BUSINESS ENVIRONMENT**GLOBAL MARKETS & INVESTMENT BANKING***Equity Sales/Broking*

CY2005 was a record year for both, primary and secondary Indian Capital market. BSE Sensex for the year saw a 42% YoY rise and the year ended at near life time highs. Volumes in the Cash and Derivatives segment soared to record levels. Net FII inflows too zoomed and were at a record high in 2005 at US\$ 10.7bn vs US\$ 8.5bn in 2004. Your Company maintained its leadership position in the Institutional Segment of Equity Broking Business with the Equity Sales division scoring another record year.

Your Company continues to be consistently rated highly as:

- Best Domestic Equity House in India by *Asiamoney*.
- No.1 in Sales by *Asiamoney*
- No.1 in Sales & Trading by *Asiamoney*

Research

Your Company's research and research analysts continue to be highly ranked in various surveys and was voted No.1 for Indian Research by *Asiamoney* in 2005. It scores a high ranking among most large Institutional clients across the globe. Your Company has built an international quality research franchise to ensure that its equity-related services are on par with the best international practices and is consistently striving towards improving this further.

Equity Issuance

In CY2005, your Company led the league table with participation in large marquee offerings. Your Company was at the forefront of the domestic and International Equity & Equity-linked offering league table for CY2005, having raised to the tune of US\$ 6.1bn. Most issuers raised money for expansion during the calendar year, given the rise in corporate profits and growth visibility.

The domestic offerings successfully completed by your Company during the year were:

- **ICICI Bank Ltd.** : Comprising domestic and international capital raisings totaling Rs. 80.5bn. The domestic IPO is the largest ever primary raising by an Indian issuer.
- **Punjab National Bank** : Largest ever public offer of Rs. 31.2bn by a Public Sector Bank. Issue was subscribed within minutes of book opening with 90% of initial demand contributed by your Company's clients.
- **Jet Airways** : Largest ever IPO of Rs. 19bn in the Indian aviation sector.
- **Oriental Bank of Commerce** : An add-on offering of Rs. 14.5bn by a public sector bank.
- **IDFC Ltd.** : First ever offering of Rs. 13.7bn from a specialized "Infrastructure" financing institution.
- **Allahabad Bank** : An add-on offering of Rs. 8.2bn by a public sector bank.

- **Punj Lloyd Ltd.** : An IPO of Rs. 6.4bn of a leading Engineering & Construction company in India.
- **Yes Bank Ltd.** : An IPO of Rs. 3.2bn in the Indian private banking space.
- **3i-Infotech Ltd.** : An IPO of Rs. 2.3bn in the Indian Technology space.
- **Trent Ltd.** : Rights Issue offering of Rs. 1.2bn
- **Piramyd Retail Ltd.** : An IPO of Rs. 600mn in the Indian Retail space.

Apart from the above domestic offerings, your Company was also involved in the followings offerings:

- **Hindalco Ltd** : Largest rights Issue offering of Rs. 22.2bn in the Indian Capital Market, with the rights being extended to GDR holders by an Indian issuer for the first time.
- **HDFC Bank** : ADR issue of US\$ 300mn.
- **ICICI Bank** : Sponsored ADR Issue of US\$ 466mn.
- **Indiabulls Financial Services Ltd.** : Raised US\$ 60 million via a Global Depository Receipts (GDR) offering.
- **UTI Bank** : Raised US\$ 257 million through the issue of GDRs.
- **Indiabulls Financial Services Ltd.** : Raised US\$ 150 million through its add-on GDR issue.
- **Nagarjuna Constructions Ltd.** : Raised US\$ 120 million through the issue of GDRs.

In view of the continuing challenging equity issuance environment, your Company remained focused on equity products, which included open offers and buyback of shares.

Indirect Sales

Your Company has a strong network of over 2,700 Channel Partners reaching out to the retail investors with presence in more than 260 cities across India. Moreover, tie-ups with National Alliance Partners & Regional Alliance Partners such as Private, Foreign & Public Sector Banks for distribution of various primary market products enhances its distribution strength to cover the institutional investor universe.

Mergers & Acquisitions

Your Company commenced CY2005 with a path-breaking US\$ 1bn deal, advising the cement major Holcim in its acquisition of 50% stake in ACC Ltd. This is was the largest transaction in the Indian cement sector and also the largest amount paid by any foreign company for an Indian acquisition.

Other deals completed in CY2005 included:

- Merger of IDBI Bank with IDBI.
- Acquisition of 10% stake in Mid Day Multimedia by Indian Express.
- Acquisition of stake in Hispano Carrocera, a Spanish bus body building company, by Tata Motors Ltd.
- Private Equity funding of Malladi Drugs & Pharmaceuticals by consortium.

- Consolidation of stake in Piloni Investments by BK Birla and Aditya Birla Group.
- Acquisition of 49.9% stake in Sundaram Asset Management by BNP Paribas Asset Management.
- Sale of 31.61% holding in SIFY by Satyam Computers to Infinity Capital Partners.
- Sale of 100% shareholding in Doom Dooma Tea Co. by Hindustan Lever.
- Sale of Specialty polymer business by Gharda Chemicals to Solvay of France.

Fixed Income

The uncertainty in the gilt markets and lower liquidity kept players largely away from the corporate bond segment. New debt issuance activity was largely limited to bank capital and PSU issuance where the fee margins were quite low. Despite the sluggish market conditions, your Company mobilized over Rs. 145bn for its clients in 2005 with clear market leadership in the short tenor and structured debt segments. Your Company, together with Merrill Lynch, lead managed a US\$ 500mn bond issue for ICICI Bank Ltd. This was the largest ever global bond offering by any Indian corporate and the first Indian bond offering to tap the US institutional market.

The fixed income business continued to face challenges as fixed income investments by Banks and Mutual Funds shrunk significantly and Mutual Fund investors continued to stay away from the longer tenor debt funds. However, your Company managed to perform well in this segment through diversification into new product segments like fixed income derivatives.

In spite of the bearish market scenario, the Primary Dealership business of your Company continued to perform well on the back of active trading strategies in the cash bond segment and diversification into fixed income derivatives. Your Company was highly successful in meeting all underwriting commitments made to the RBI in its capacity as a Primary Dealer.

Global Private Client (GPC)

The GPC Group has successfully capitalized on the extremely buoyant capital markets, and is aggressively growing its business. The financial advisor teams have been strengthened in terms of recruitment, technology and staff support and this will continue, to enable your Company to maximize profit from the interest in the India story.

Your Company is very pleased to report that for the second consecutive year, your Company's GPC business was awarded the "Best Private Bank" by Euromoney.

During the year your Company further strengthened its relationship with clients by introducing securities based lending products. GPC also focused on tapping the NRI business globally, and offering the offshore investment platform to clients locally.

GPC aims to offer the best wealth management platform to its clients and continues to enhance its investments in technology, operations and administration to facilitate this.

OUTLOOK

Your Company is working towards meeting the new challenges and opportunities by concentrating on improving performance through continuously evaluating a host of initiatives in existing businesses.

Your Company continues to focus on risk management and compliance procedures and its efforts are aimed at creating long term value for shareholders.

RISKS & CONCERNS

While your Company remains optimistic about future business prospects, the overall outlook will remain contingent upon continuing strong economic indicators and political stability.

INTERNAL CONTROL SYSTEMS AND THEIR ADEQUACY

Your Company has an independent internal audit function with direct reporting responsibility to the Audit Committee of the DSPML Board of Directors. The internal audit department evaluates and reports on the adequacy of the internal control system within the Company. The department performs continuous monitoring of business and support functions from a risk perspective. This activity includes co-ordination of control committee meetings and participation in various oversight committees.

FINANCIAL PERFORMANCE WITH RESPECT TO OPERATIONAL PERFORMANCE

Your Company's Gross Income of Rs. 4.88bn in 2005 was 32% higher than last year's gross income of Rs. 3.70bn. Your Company's leadership position across business segments and diversified revenue streams helped in maintaining this growth. Buoyant Capital Markets supported by stock market rally and strong FII inflows boosted the equity broking and investment banking businesses. Your Company achieved a Profit Before Tax of Rs. 2.61bn, up 27% compared with Rs. 2.05bn posted in 2004.

TECHNOLOGY

Technology stabilisation and support for increased business volumes continued to be a key focus area for the year. Your Company also continued to invest in upgradation of infrastructure in terms of upgraded bandwidths, server consolidation, etc.

HUMAN RESOURCES

To support various businesses, your Company is actively focused on creating a culture of excellence and leadership that inspires every employee. Your Company is continuing its policy of implementing specialised training programs (both, functional and soft-skills), facilitating secondment avenues, providing on-the-job training and lateral transfers, all aimed at strengthening employee capabilities and motivating them. These processes are strongly supported by a robust performance evaluation and reward system.

Your Company had 314 employees on its rolls as on 31st December 2005, spread across various departments, of which nearly 24% were female employees.

CORPORATE SOCIAL RESPONSIBILITY

Your Company continued with its focus on Corporate Social Responsibility related initiatives within the three key focus areas of Wildlife/Environment, Youth/Education and Health. Your Company continues its active association with Akanksha Foundation, REAP, Helpage India, Bombay Natural History Society, Akshaya Patra and others.

In addition, your Company also undertook the following key philanthropy initiatives in CY2005:

- Conducted a Thalassaemia detection and blood donation camp. Blood was donated for children suffering from Thalassaemia
- Organized sale on behalf of several NGOs such as *Shraddha and Akanksha*
- Made monetary donations to various noteworthy institutions
- Encouraged employee participation in the second Mumbai Marathon conducted in Mumbai for the support of NGOs
- Supported the relief activities for natural calamities such as Mumbai floods and Jammu & Kashmir earthquake.

The statements in the Management's Discussion and Analysis may be forward-looking statements about management expectations, strategic objectives, business prospects, anticipated expense savings, financial results and other similar matters. A variety of factors, many of which are beyond the control of the Company, affect its operations, performance, strategy, and results, and could cause actual results and experience to differ materially from the expectations and objectives expressed in these statements. The Company undertakes no responsibility to update or revise any forward-looking statements.