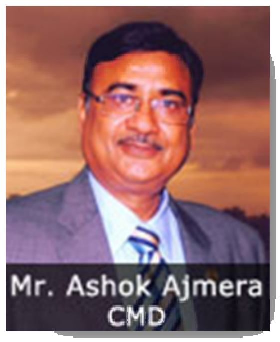
26 YEARS OF EXCELLENCE



Mr. Ajmera's column as on 20th July, 2013

"Market cheers TCS Q1FY14 results, Reliance Petchem segment fail to impress…

Domestically, the bourses ended the weak with a lacklustre trade as the equity benchmarks closed flat. We believe that although Nifty is above 6000 level, it may take a while to breach the range of 6000-6200. Nifty on Friday ended down 8.85 points at 6029.20, while Sensex was up 21.44 points to close at 20149.85. Among the upcoming first quarter corporate earnings, capital goods major Larsen and Toubro results (tyo be reported on Monday, 22nd July 2013) will be keenly eyed by the market. We believe L&T is probably the only one which in this sector will do better than most of the others in terms of both competitive pressures as well as in terms of their own order inflows and has excellent management quality which is a key driver for stringer execution of projects in this challenging stressful environment.

TCS (TCS IN), Quality deserves premium, Recommend "BUY"|Target Price: ₹ 1,815

India's largest software services exporter Tata Consultancy Services first quarter consolidated net profit rose higher-than-expected 16 percent year-on-year (6 percent quarter-on-quarter) to ₹3,831 crore, helped by new deal wins and a foreign exchange gain. It was another stellar quarter and momentum going ahead would be strong. The company's revenue growth was also better-than-expected 21 percent YoY (10 percent sequentially) at 17,987 crore in April-June. Street participants on an average had expected TCS to report net profit of ₹3,787 crore, on revenue of ₹17,705 crore. Dollar revenues increased by 4.1 percent quarter-on-quarter to US$ 3.17 billion in first quarter. Overall the environment is quite good from the industry point of view. Management sees a great momentum. The Company has delivered well rounded growth. US, UK, Europe have been spectacular this quarter. The growth has been across sector. The Company sees great momentum, not only in transformational deals but also in the digital space. Last quarter, TCS' operating profit margin was at 26.9 percent, which too was higher than forecast of 26.25 percent. Other income in the quarter was at ₹258 crore, up 39 percent from a year ago (down 42 percent QoQ). The IT firm added two new USD 100 million clients during the quarter. The gross employee additions were 10,611 in April-June quarter. Its utilisation rate, excluding trainees, was at 82.7 percent in the quarter. TCS' Bangalore-based rival Infosys, which has had to play a catch up game with its rivals in the last several quarters, had also surprised the street with a better-than-expected 4 percent year-on-year (1 percent sequential dip) in net profit at ₹ 2,374 crore, and a revenue growth of 17 percent YoY (8 percent QoQ) to ₹ 11,267 crore,

Kotak Mahindra Bank (KMB IN) Q1FY14 Update: Richly priced, Recommend: "Sell" Target Price: ₹640

Private sector lender Kotak Mahindra Bank's first quarter (April-June) standalone profit after tax (PAT) rose by a forecast-beating 43 percent year-on-year to ₹403 crore, driven by a spurt in the other income that nearly doubled to ₹462 crore from ₹241 a year ago. Standalone net interest income (NII or the difference between) grew by 27 percent Y-o-Y to ₹917 crore, which was slightly lower than expectations. Street had expected it to report standalone net profit at ₹388 crore and NII at ₹925 crore. During the quarter, the bank expanded its loans by 19 percent y-o-y to around ₹50,500 crore. The gross non-performing asset (NPA) ratio rose to 1.95 percent from 1.60 percent in the corresponding quarter of the previous year. Net NPA ratio stood at 0.98 percent as against 0.80 percent a year back. Provisions and contingencies shot up five times from ₹ 34 crore to ₹ 169 crore y-o-y. Deposits grew 26 percent to around ₹ 52,500 crore while savings deposits expanded at a faster pace by 45 percent to about ₹ 8,050 crore. The bank is offering a maximum 7 percent rate of interest in savings account deposits. The Reserve Bank of India had penalised the lender a sum of Rs 1.501 crore for violating Know Your Customer (KYC) norms. Meanwhile, the consolidated net profit, which included profit from its subsidiaries, increased 41.4 percent y-o-y to Rs 627 crore and NII grew by 25 percent to Rs 1,374 crore during the threemonth period. During the quarter, the net interest margin (NIM) improved marginally to 4.8 percent as against 4.7 percent in previous quarter. Among subsidiaries, Kotak Mahindra Prime reported the highest growth of 94 percent y-o-y at ₹ 117crore in its June quarter net profit while the bank's international subsidiaries incurred a loss of ₹ 10crore as against a net loss of ₹ 5 crore a year back. The bank's restructured loans stood at ₹6.3 crore during the quarter compared with ₹7.8 crore in the Jan-March quarter.

We are cautious on the Company because of the challenging tough times. The past strategy of the of aggressive lending growth might backfire in the current environment. In addition, the management has given a dim outlook ahead by reducing its advance growth guidance to 15 percent (from 20-25 percent earlier) and raised its credit cost guidance to 60 bps (from 40-50 bps earlier). At CMP, the stock is expensively valued at 3x FY15E P/BV considering management's outlook for future and an expectation of a reduced ROE of 15% as compared to ROE of 20 % plus of HDFC Bank which has got a better loan book profile, good number of branches & ATMs and better business size.

Reliance Industries (RIL IN): "Petrochemicals segment and KGD6 output fail to impress street" Recommend: "Sell" for short term with a target of Rs. 860 in the immediate term. For long term investors recommend "Accumulate" on dips for medium to long term with a target of ₹1038 (14x at estimated FY14 EPS of ₹74)

Reliance Industries has posted a 19 percent year-on-year rise in June quarter profit to ₹5352 crore, boosted by stronger margins in its main oil refining business. Sales have, however, declined to ₹87,645 crore, down 4.5 percent Y-o-Y. Gross refining margins (GRMs – a measure of the differential between the cost of raw material and revenues from selling finished products) stood at USD 8.4/bbl versus USD 7.6/bbl YoY. Refining EBITDA margin stood at 3.6% vs. 4.5% qoq. Refining revenue of the company is at ₹81,458 crores versus Rs 77,872 crores qoq. Petrochemical EBITDA margin stood at 8.6% versus 8.5% qoq. Petroleum refining revenue of the company is ₹21,950 crore versus ₹22,158 crore in the previous quarter. Shale Gas Revenue improved 84% on year. Retail revenue improved 53%. Other income of the company was ₹2,535 crores vs Rs 2,243 qoq. EBITDA at 8.1%. **Revenue fell 4.6% to Rs 90,589 crore on back of lower output from RIL's flagship KG-D6 gas fields.** GRM was at $8.4 bbl versus

$8.5 in the previous quarter. Street had predicted profit to go up by 17-20% given the low base last year. Reliance Industries' (RIL) FY13 annual report indicated management focus on next capex cycle, so as to leverage integration capabilities at Jamnagar.

The petchem earnings reduced due to the lack of improvement in oil and gas sector. Their refining segment was also not performing well and there was not much capacity addition, he says. As a result, we are slightly bearish on petchem segment. Even the refining segment is also not performing very well because when US$ hit 10.1 per barrel as the gross refining margin (GRM) Q4 quarter, market took a positive cue because it had fallen to USD 8.4 per barrel. At Ajcon, we believe, unless the petchem has to really start outperforming from current scale. There has not been much capacity addition. We believe the Company should have gained slightly better because of the currency gain. Structurally, the Company's Profitability metrics are under pressure, led by cash and business downturn: Despite better performance in refining, weak performance of the Petchem and E&P businesses has led to sharp decline in EBITDA margin from 15.4 percent in FY11 and 10.2 percent in FY12 to 8.5 percent in FY13. RoCE for the Petchem/E&P segments has declined from 20 percent/10 percent a year ago to 13 percent/7 percent in FY13. In the interim period from present to 2015 gross refining margin volatility would definitely hurt investor confidence and Roe reaching sub 12% in FY13. RIL trades at 12x FY15E adjusted EPS of ₹74.

With due consideration to above factors and the given the recent rally in the stock price, Ajcon Global recommends: "Sell" for short term with a target of ₹ 860 in the immediate term as historically RIL's other income showed a steep increase of 33 percent as compared to last year of ₹2,535 crore, a historic high . Ideally its earnings should have been bolstered by core business income rather than treasury gains which disappointed us.

For long term investors recommend "Accumulate" on dips for long term with a target of ₹1,038 (14x at estimated FY14 EPS of ₹74). Commenting on longer-term perspective, we are bullish owing to positive factors like Company possessing a strong Balance sheet (Cash reserves of the company reported at ₹ 93,000 crores which translates into ₹288 per share (31% of CMP). Book value as on FY13 stood at ₹554 per share (P/BV – 1.66x and 60% of CMP), Company would be a key beneficiary of gas price hike: as unlike PSU upstream companies it does not bear any subsidy burden. We believe that the increase in gas volumes from KG D6 block would be a key trigger for RIL. We give thumps up to reliance for using low cost foreign currency debt – US$ 12 bn to fund its capital expenditure plans which would yield better PAT margins in future. Positive momentum building in the domestic upstream business with the successful discovery in MJ1 (in the KG-D6 block) and approval of the new gas price formula will give a kick to its earnings.

Global Scenario

US markets has experienced its best month since January and looks poised to extend the rally with a deluge of earnings next week, though significant gains may be harder to come by with major indexes at record highs. Eight Dow components and Apple are among the companies that will report in one of the busiest weeks of the earnings season. Some 157 companies in the S&P 500 index will release results. Second-quarter earnings have been above forecasts so far, but street estimates have dropped precipitously since the start of the year. Earnings for S&P 500 companies are seen rising 2.9 percent, down from an 8.4 percent growth expected at the start of the year. Revenue is seen growing 1.1 percent. For this week, the Dow rose 0.5 percent; the S&P added 0.7 percent and the Nasdaq fell 0.3 percent. The benchmark S&P is up 18.6 percent for the year.

Economic indicators next week include sales of new and existing homes. Sentiment among builders remains bullish; though housing starts and permits for future homes hit a 10-month low in June, obviously a big surprise there to the downside will cause a lot of caution. The housing sector's been a core part of what the Fed is focusing on. June existing-home sales, which are due Monday, are seen rising 0.6 percent compared with a 4.2 percent jump in the previous month. New-home sales for June are also seen rising.

FII and MF activity

FIIs pulled out ~US$954mn from Indian stocks between July 12 and July 18. Their net outflows for July stand at US$1.0bn after being net sellers of US$1.85bn in June. Their net investment into Indian shares for May was at ~US$4.0bn versus US$1.0bn in April and ~US$1.67bn in March. FIIs poured in US$4.57bn into Indian shares in February after pumping US$4bn in January. FIIs invested US$24.0bn into Indian shares in 2012.

They had unloaded Indian shares worth ₹269 crore in June. They offloaded shares worth ₹3,508 cr from Indian equities in May. Mutual Funds were net sellers of ~₹894.00 crore in April. They had net sold Indian shares worth ₹1,767 crore in March. They were net sellers of Indian equities worth ₹847.90 crore in February after being net sellers of ₹5,212 crore in January.

The ₹closed the week at 59.35 per dollar on Friday as against the previous week's close of 59.63 to the dollar. The local currency touched a high of 59.05 and a low of 60.08 during the week.

Ajcon's view

Indian markets trade at 14.0x FY14E and 12.0x FY15E versus historic average of 16x. We believe that valuations have room for upside.

Going ahead, all eyes would be on the following events:

26-31 Jul: Parliament Monsoon Session
27-Jul: Fortnightly Credit Growth Update
30-Jul: RBI Monetary Policy Review
31-Jul: Monthly Old CPI YoY% for June, Centre's Gross Fiscal Deficit and it's Financing
1-Aug: India July Manufacturing PMI
6-7 Aug: Ownership Data for QE
1-12 Aug: India Local Car Sales
12-16 Aug: Exports and Imports YoY% for July
12-Aug: Fortnightly Credit Growth Update, Industrial Production YoY for June, Monthly New CPI YoY% for July
14-Aug: Monthly Wholesale Prices YoY% for July, MSCI Indices Quarterly Index Review
20-21 Aug: Promoter Pledging Data for QE Jun-13
27-Aug: Fortnightly Credit Growth Update
30-31 Aug: Aug Centre's Gross Fiscal Deficit and its financing, Qtrly GDP for 1Q F2014, Monthly Old CPI YoY% for July

We see the main Indian indices ending FY14 on a positive note although in the short-term there could be some temporary hiccups due to political uncertainty, weakness in the rupee and some uncertainty surrounding Fed's QE exit. The Indian government has moved on a number of important policy reforms in the form of FDI in multi-brand retail & aviation, besides unleashing other measures like SEB debt restructuring, diesel price deregulation, gas price hike, Cabinet Committee on Investment (CCI) and direct cash transfer (DCT). This week, the Government agreed to further liberalize FDI in several key secto₹ The Union Budget has also been balanced and credible one with more emphasis on fiscal correction. The RBI and the Government continue their efforts to fix the macro-economic imbalances. More policy measures are expected to be unveiled in the near future as the rupee remains fragile despite a series of steps taken by the Government and RBI. FII flows have turned negative in both equity and debt markets for the past couple of months while Mutual Funds too continue to witness redemptions. The global economic landscape too remains uncertain amid growing tension over the impending QE exit by the US Federal Reserve. Corporate earnings will continue to be in focus for next week.

The Indian government has moved on a number of important policy reforms in the form of FDI in multi-brand retail and aviation, besides unleashing other measures like SEB debt restructuring, diesel price deregulation, Cabinet Committee on Investment (CCI) and direct cash transfer (DCT). The Union Budget has also been balanced and credible one with more emphasis on fiscal correction. The biggest reform has been the curtailment of the fiscal deficit and the diesel price deregulation. The Finance Minister has also promised that the Government will stick to the reforms agenda, notwithstanding the political uncertainty surrounding the Lok Sabha elections. As a result, the Indian markets could gradually advance over the next 12 months, as the Government's policy measures start to bear fruit. In the Banking space, we recommend buying State Bank of India, Bank of Baroda, Union Bank of India, Syndicate Bank, Bank of Maharashtra, ING Vyasa Bank, HDFC Bank, ICICI Bank, DCB, Bajaj Finserv, Bajaj Finance and Standard Chartered.

In the Infrastructure space, we recommend investors to accumulate stocks like Larsen and Toubro (Q4FY13 topline was as per our expectation, it expects sales to rise 15-17 percent for the fiscal year to March 2014 and order inflows to be up about 20 percent this fiscal year, valuations too attractive with regards to scale of business and excellent management quality), Pratibha Industries, KEC International and IL and FS Engineering and Construction Company. In the NBFC space, we prefer Bajaj Finance, Bajaj Finserv and M&M Financial Services Ltd.

In the Oil space, we recommend buying Oil India, ONGC and Cairn. In the Commodities space, we recommend investors to accumulate NMDC. In the Pharma sector, we advise to accumulate stocks like Sun Pharma, Sun Pharma Advanced Research, Lupin, Merck, Glenmark Pharma and Dr. Reddy's. In the Consumption space, we recommend accumulating ITC and Nestle. In the midcap space, we recommend investors to accumulate Petronet LNG, GAIL, DCW, Page Industries, Sangam (India), Rallis India, Ramky Infrastructure, Liberty Phosphate, Wheels India, VaTech Wabag, Voltas, CanFin Homes, United Phosphorous, KSB Pumps, Hathway Cable, Industrial Prudential and Investment Company.

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