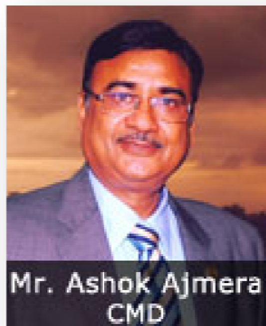
26 YEARS OF EXCELLENCE



Mr. Ajmera's column as on 27th July, 2013

"Banking stocks underperform amidst RBI actions of liquidity squeezing"...

During the week, domestic bourses came under tremendous pressure with the BSE Sensex breaking a four-week winning streak, after the RBI unleashed fresh measures on liquidity tightening to support the rupee. The cash rate jumped to 10%, government bond yields surged to 14-month high and banking stocks took a beating after the RBI's stepped up its defence of the rupee. The rupee rose to a five-week high on Friday, as the recent RBI measures to lift the fragile local currency from record low seemed to be working. The rupee has now gained for a third successive week, the longest winning streak since February. The rupee had plunged to 61.2125 on July 8. Ambuja Cements was in focus after Holcim announced a restructuring of its India operations. ITC, Hero Moto, Zee Entertainment, HUL, PNB, Gail, L&T, Maruti, Bank of India, Punjab National Bank, State Bank of Travancore and Cairn India were among the companies that reported results this week. Wockhardt shares tumbled amid lingering concerns about the USFDA warning on alleged violations of good manufacturing practices. As far as global markets are concerned, stock indices in the US continued to gain ground amid encouraging corporate results, especially from technology companies and positive economic data. China was in the spotlight after top government leaders were quoted as saying that they would take additional steps to boost economic growth following disappointing data points. On the Eurozone front, the composite PMI turned positive while UK GDP growth for the second quarter turned out to be pretty good.

Punjab National Bank (PNB) disappointed the street which dented market sentiments towards Banking sector. The Bank reported a muted rise of 2.3 percent year-on-year in its first quarter (April-June) net profit at Rs 1,275 crore, dented by significant surge in its bad loans or non-performing assets (NPAs).

Net interest income or the difference between interest earned and paid out, grew by 5.7 percent y-o-y to Rs 3,907 crore. While the net profit was below market expectations, NII was marginally higher than the estimates. Net interest margin was little changed at 3.52 percent quarter-on-quarter.

Analysts on an average had expected the bank to report net profit at Rs 1,196 crore and net interest income at Rs 3,829 crore.

In absolute terms, gross NPAs shot up 51 percent to Rs 15,091 crore while net NPAs ballooned 84 percent to Rs 9,060 crore. Gross NPA ratio stood at 4.84 percent versus 3.34 percent. Net NPA ratio was at 2.98 percent compared with 1.68 percent a year back.

The bank expanded its loans just by 4 percent y-o-y to Rs 3.05 lakh crore while deposits inched up 3 percent y-o-y to Rs 3.97 lakh crore. Provisions and contingencies upped 3.3 percent y-o-y to Rs 1,066 crore during the quarter. Other income increased 15 y-o-y to Rs 1,342 crore acting as the saving grace for the bank. Provision coverage ratio was 54.67 percent as on June 30, 2013 while capital adequacy ratio (as per Basel III) stood at 11.79 percent.

Bank of India (BOI IN) – Q1FY14 Quick Result update:

"Healthier balance sheet, good growth and attractive valuations demands re-rating of stock"

BUY, Target Price: Rs. 242 (Horizon: 6-9 months)

Bank of India (Bloomberg Code: BOI IN) Q1FY14 results delighted us after 10 previous quarters. Bank of India reported 8 percent rise in the June quarter profit at Rs. 964 crore, driven by a healthy rise in both interest and non-interest income components. Net profit growth has to be seen in the context of the overall economic conditions, where there has been a slowdown in growth," bank Chairperson and Managing Director Vijayalakshmi Iyer told media. Net interest income grew 24.15 percent to Rs. 2,044 crore during the quarter, while the non-interest income went up 40 percent to Rs. 1,181 crore on the back of treasury gains which is also plays a crucial role in Banking.

Gross non-performing assets (NPAs) ratio increased to 3.04 percent from 2.56 percent in the comparable period, driven down by fresh slippages of nearly Rs 1,900 crore during the quarter. Iyer, however, said the slippages are still below the peak of around Rs. 2,000 crore the bank witnessed throughout the past fiscal and added it is targeting to bring down gross NPA numbers to 2.90 percent. A majority of the slippages came from the textiles, steel and metals sector and only Rs. 271 crore worth of slippages was from one leading Gems and Jewellery Company. During the quarter, the bank restructured Rs. 755 crore of assets and Iyer said it has a pipeline of up to Rs 1,000 crore for restructuring in the second quarter.

Its total provisions nearly doubled to Rs 694.56 crore from Rs 472.23 crore. The bank, which cut its lending rates on a finance ministry diktat earlier this month, was able to expand its domestic net interest margin to 3.07 percent from the 2.56 percent year ago, even though the share of the low-cost current and saving account deposits fell marginally.

The incremental lending and some reduction in the cost of funds will help it expand the domestic margins to 3.15 percent for the fiscal.

The bank is not affected much on the liquidity and the costs front as a result of the recent RBI moves to tighten liquidity, conceding that treasury operations can face some pressure going forward if the measures continue for long. The bank's capital adequacy stood at 10.66 percent, with the core tier-I capital at 7.98 percent. Iyer said the bank requires a total capital of Rs 6,200 crore during the fiscal, excluding the ploughback of profits.

BOI will be raising Rs 2,000 crore through a mix of QIP or bonds and we will be applying to the government for it.

The bank scrip tanked 4.55 percent to Rs 183.50 on the BSE, whose 30-share benchmark Sensex ended the session with 0.29 percent losses.

Ajcon's view

At CMP, the stock is available at attractive valuation of P/BV: 0.49x (FY13 Book value) which we feel is undervalued considering Bank's good performance in all fronts despite stressful economic conditions and peer PSU banks reporting dismal numbers with higher P/BV ratio.. The Bank stood out as a winner amongst all the PSU's which declared results so far. We believe the Bank deserves premium as compared to other PSU's owing to a) positive spirit enthused by new Chairperson – Mrs. VR Iyer, b) no major exposure to chunky accounts, c) healthy growth in domestic and international loans aided by rupee depreciation, d) improvement in domestic NIMs, e) Bank confident of reducing its NPA levels, f) lower fresh restructuring of around Rs. 760 crores in Q1FY14 and Bank's guidance of Rs. 800-900 crores of restructuring in Q2FY14 in depressed macro conditions instills confidence which makes us optimistic on future performance. At current levels, we recommend investors to "BUY" with a target price of Rs. 245 (P/BV of 0.65x at FY13 EPS) an upside of 32% from current levels.

Global Scenario

Globally, the coming week on Wall Street could be a summer blockbuster, with the marquee featuring a triple bill: the Fed, jobs and earnings. Fed Chairman Ben Bernanke jolted markets in late May by saying the US central bank planned to ease back on its stimulus efforts once the economy improves. Investors have been glued to his every comment since then. Of the three, the Federal Reserve has the most potential to upset the market. The Federal Open Market Committee is expected to release a statement on Wednesday after a two-day meeting. As part of its quantitative easing policy, the Fed has been buying Treasury debt and other bonds each month to keep interest rates low and promote growth. Stocks have rallied for most of this year, with both the Dow and the Standard & Poor's 500 hitting record highs, partly because of the Fed's stimulus efforts. The market slid after Bernanke's comments on May 22, with the S&P 500 dropping nearly 6 percent in the month that followed. But remarks from Bernanke and other Fed officials since then have calmed the market and erased those declines. Bernanke reassured markets last week, saying the timeline for winding down the US central bank's stimulus program was not set in stone. The S&P 500 was up 18.6 percent for the year so far. Trading has been more subdued this week, with more focus on earnings. The S&P 500 ended the week with just a slight loss of 0.03 percent, breaking its four-week winning streak.

FII and MF activity

FIIs pulled out ~US$19.47mn from Indian stocks between July 19 and July 25. 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.

On the other hand, Mutual Funds had unloaded Indian shares worth Rs. 269.0 crore in June. They offloaded shares worth Rs. 3,508.0 cr from Indian equities in May. Mutual Funds were net sellers of ~Rs. 894.00 crore in April. They had net sold Indian shares worth Rs. 1,767 crore in March. They were net sellers of Indian equities worth Rs. 847.90 crore in February after being net sellers of Rs. 5,212 crore in January.

The Rupee closed the week at 59.04 per dollar on Friday as against the previous week's close of 59.35

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). 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. 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.

In the Banking space, we recommend buying State Bank of India, Bank of India, State Bank of Travancore, State Bank of Bikaner and Jaipur, Bank of Baroda, Union Bank of India, Syndicate Bank, Bank of Maharashtra, ING Vyasa Bank, HDFC Bank, ICICI Bank, Axis Bank, DCB and Standard Chartered. 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 Advanced Research, Merck and Glenmark Pharma In the Consumption space, we recommend accumulating ITC and Nestle. In the midcap space, we recommend investors to accumulate Petronet LNG, GAIL, DCW, 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.

Your friendly advisor since 1986,

Ashoka Ajmera

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