Index

Tata Consultancy Services

Evergreen

Stock Update

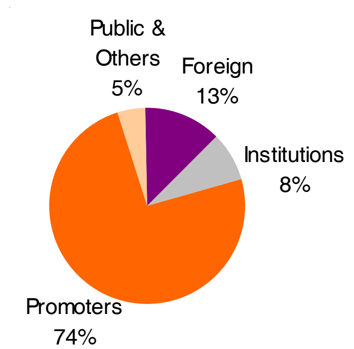
Price target revised to Rs1,250

Buy; CMP: Rs1,120

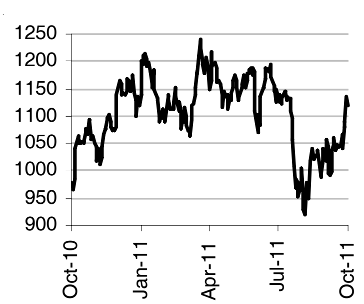
Company details

Price target:	Rs1,250
Market cap:	Rs219,111 cr
52 week high/low:	Rs1,247/903
NSE volume: (No of shares)	17.6 lakh
BSE code:	532540
NSE code:	TCS
Sharekhan code:	TCS
Free float: (No of shares)	50.7 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	10.0	-4.6	-8.8	11.5
Relative to Sensex	7.2	4.7	5.1	34.6

Result highlights

- **Performance in line with expectations:** Tata Consultancy Services (TCS)' performance for Q2FY2012 was quite in line with our as well as the Street's expectations. The top line grew by 4.7% quarter on quarter (QoQ) to $2,525.3 million (our expectation was of $2,547.4 million). The growth in the top line was aided by a 9% sequential volume growth in international business, whereas India business declined by 6.6% QoQ. The blended volume grew by 6.25% QoQ, whereas the pricing on reported currency declined by 95 basis points (bps) QoQ. The cross currency impact was of a negative 50bps. On a constant currency basis, revenues in US dollar (USD) terms were up by 5.2% QoQ to $2,539 million. In Indian Rupee (INR) terms the consolidated revenues were up by 7.7% QoQ to Rs11,633.5 crore, aided by a higher rupee realisation of Rs46.1, up by 2.9% QoQ.

  For the quarter under review, the earnings before interest and tax (EBIT) margin has improved by 90bps to 27.1%, which is ahead of our expectation, largely aided by a favourable currency movement. The net other income has fallen sharply by 65.5% QoQ to Rs99.7 crore, primarily impacted by higher foreign exchange (forex) losses to the tune of Rs80 crore as compared to a profit in Q1FY2012. The net profit was higher by 2.5% QoQ to Rs2,439 crore, in line with our as well as the Street's expectations.

Result table (Rs cr)

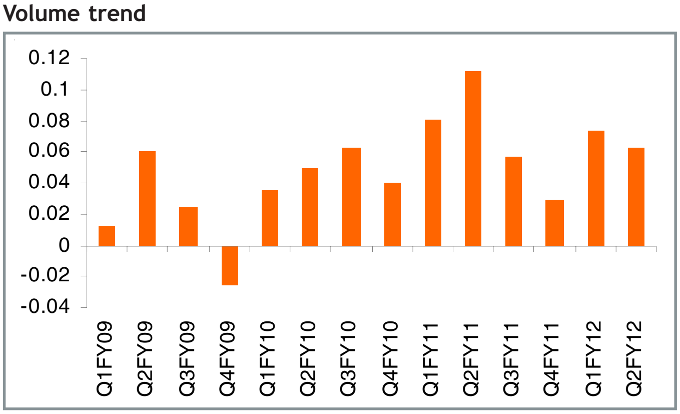
Particulars	Q2FY12	Q2FY11	Q1FY12	% YoY	% QoQ
USD/INR	46.1	46.3	44.8	-0.6	2.9
Revenues ($ mn)	**2525.3**	**2004.0**	**2412.0**	**26.0**	**4.7**
Net sales	11633.5	9286.4	10797.0	25.3	7.7
Direct costs	6214.1	4995.6	5879.1	24.4	5.7
Gross profit	5419.4	4290.8	4917.9	26.3	10.2
SG&A	2036.5	1513.3	1886.9	34.6	7.9
EBITDA	**3382.9**	**2777.5**	**3031.0**	**21.8**	**11.6**
Depreciation & amortization	228.6	166.0	204.9	37.7	11.6
EBIT	3154.3	2611.5	2826.1	20.8	11.6
Other income	99.7	44.3	288.6	125.1	-65.5
PBT	3254.0	2655.8	3114.7	22.5	4.5
Tax provision	791.3	500.1	706.3	58.2	12.0
PAT	**2462.7**	**2155.7**	**2408.4**	**14.2**	**2.3**
Minority interest	23.7	29.4	28.1	-19.4	-15.7
Net profit	**2439.0**	**2126.3**	**2380.3**	**14.7**	**2.5**
EPS (Rs)	12.5	10.9	12.2		
Margin (%)					
GPM	46.6	46.2	45.5		
EBITDA	29.1	29.9	28.1		
EBIT	27.1	28.1	26.2		
NPM	21.0	22.9	22.0		
Tax rate	24.3	18.8	22.7		

- **Management remains upbeat:** TCS' management continues to remain upbeat on the demand environment despite the macro economic uncertainty. The management is seeing a robust demand environment and is not seeing any delay in decision making. The pipeline continues to be strong across verticals and geographies with deal signing remaining on track. The client interactions also indicate at a positive demand outlook. The investments are seen in the efficiency improvement, cost saving and regulatory spends. The discretionary spending is also looking up with spending towards analytics, digital consumer as well as cloud as clients expand their operations to emerging economies. The clients' budgeting cycle is as per plans and initial signals indicate at stable budgets with no major cuts. The pricing environment is stable with no major upward or downward pressure.

- **Valuation and view:** TCS' performance for the quarter under review was broadly in line with expectations and the management commentary continues to remain optimistic on growth outlook, despite macro uncertainties. We continue to remain positive on TCS and expect it to continue with its strong growth momentum. We have increased our earnings estimates for FY2012 and FY2013 to factor in a higher rupee-dollar rate; consequently we have increased our target price to Rs1,250 from Rs1,201 earlier. At our target price the stock would be valued at 20x FY2013E earnings; we maintain our Buy rating on the stock.

- **Strong volume growth continues:** TCS has continued to show strong volume growth. For Q2FY2012 blended volumes grew by 6.3% QoQ, marginally above our expectations of a 6.1% volume growth. In the last four preceding quarters TCS has reported a 5.6% average blended sequential volume growth.

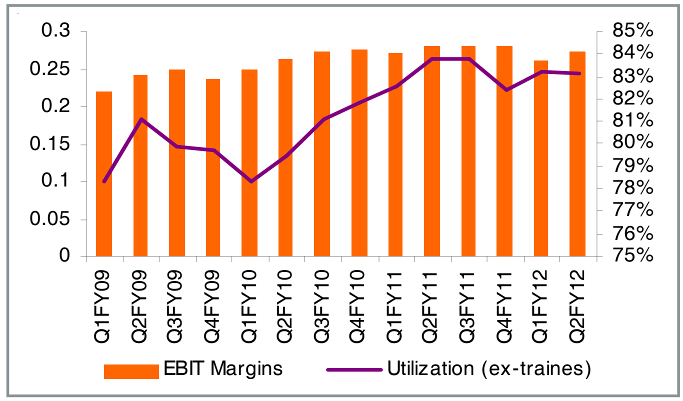
Volume trend



Source: Company and Sharekhan Research

- **Margins ahead of expectations:** The margin performance for the quarter was ahead of expectations. The earnings before interest and tax (EBIT) margin has improved by 90bps QoQ to 27.1%, ahead of our expectations of a 50bps decline. The improvement in margin was primarily aided by a favourable currency movement. The management remains confident of maintaining margins at 27%; if currency movement continues to be favourable then the same would further aid in margin improvement. We have modeled 27.7% and 26.7% EBIT margins for FY2012 and FY2013 estimates respectively.

EBIT margins and utilisation trend



Source: Company and Sharekhan Research

All round growth: TCS reported a strong growth across industry verticals, geographies and service lines except for telecom which saw a dip of 4.3% and India which saw a dip of 6.6%.

The banking, financial services & insurance (BFSI) vertical grew 5.2%, manufacturing (7.4%), hi-tech (6.5%), retail and distribution (9.2%), energy and utilities (18.5%) and life science and healthcare grew 6.7% in revenues.

Among the geographies, Asia Pacific led the growth with a 7.6% sequential growth, North America grew 5.7%, Continental Europe 6.8%, UK grew 6.1%, Middle East and Africa 4.7% and Latin America 1.3%.

Among the service lines, the growth was led by consulting (23.7%), asset leveraging (16.3%), engineering & industrial solutions (9.2%), assurance services (9.0%) and enterprise solutions (7.6%). Whereas application development and maintenance grew 1.3%, infrastructure management services (5.8%), business process outsourcing (BPO; 4.7%) and business intelligence grew 0.4%.

Operating matrix

Particulars	Q2 FY12	Q2 FY11	Q1 FY12	% YoY	% QoQ
Geographic mix (%)					
Americas	53.4	53.7	52.9	25.3	5.7
Latin America	3.0	3.9	3.1	-3.1	1.3
UK	15.5	15.3	15.3	27.6	6.1
C Europe	10.1	9.1	9.9	39.8	6.8
India	8.3	9.9	9.3	5.6	-6.6
APAC	7.5	6.2	7.3	52.4	7.6
MEA	2.2	1.9	2.2	45.9	4.7
Service offering (%)					
ADM	44.7	46.8	46.2	20.3	1.3
BI	4.7	5.6	4.9	5.7	0.4
Ent Soln	11.1	10.3	10.8	35.8	7.6
Assurance services	7.6	6.6	7.3	45.1	9.0
Engg & Ind services	4.8	4.9	4.6	23.4	9.2
IMS	9.6	9.4	9.5	28.7	5.8
Consulting	2.6	2.1	2.2	56.0	23.7
Asset leveraging	4.0	3.4	3.6	48.2	16.3
BPO	10.9	10.9	10.9	26.0	4.7
Industry verticals (%)					
BFSI	43.5	44.0	43.3	24.6	5.2
Telecom	10.7	12.8	11.7	5.3	-4.3
Retail & Dist	12.1	10.9	11.6	39.9	9.2
Manufacturing	7.8	7.4	7.6	32.8	7.4
Hi-tech	5.9	4.6	5.8	61.6	6.5
Life Sciences	5.3	5.1	5.2	30.9	6.7
Transportation	3.8	3.2	3.7	49.6	7.5
Energy & utilities	4.3	4.3	3.8	26.0	18.5
Media & entertainment	2.1	2.0	2.2	32.3	-0.1
Others	4.5	5.7	5.1	-0.5	-7.6
Client contribution (%)					
Top client	6.9	8.0	7.1	8.7	1.7
Top 5 clients	20.0	22.1	20.7	14.0	1.1
Top 10 clients	28.3	30.1	28.9	18.5	2.5
Others	71.7	69.9	71.1	29.2	5.6

Source: Company and Sharekhan Research

Other highlights

- The company added 20,349 employees on a gross basis (including 10,192 campus recruits, 8,125 laterals and 2,032 overseas employees) and 12,580 employees on a net basis, taking the total headcount to 2,14,770 employees at the end of Q2FY2012. The attrition on a last twelve month (LTM) basis was seen trending down to 13.7% from 14.8% in the sequential previous quarter.

- The utilisation rates improved during the quarter - utilisation rate including trainees improved by 20 basis points to 76.4% and that excluding trainees was down 10 basis points to 83.1%.

- TCS' cash and cash equivalents at the end of Q2FY2012 stood at about Rs9,500 crore down from Rs10,520 crore as at the end of the sequential previous quarter. The investible balance is lower due to a dividend payout and on account of acquisition of additional stake in Diligenta.

- *Client additions:* The company added 35 new clients in the quarter taking the total number of active clients at the end of the quarter to 1010, down from 959 clients in the sequential previous quarter. The number of $100 million clients increased to twelve from ten in the sequential previous quarter and the number of $50 million clients increased to 36 from 33 in the sequential previous quarter.

- *Large deals won:* The company signed atleast ten key deals during the quarter including a large deal worth more than $100 million in the telecom vertical from a large broadband and telecommunication player in Europe and Latin America. The company won atleast three deals in TCS BaNCS (banking solution). Other deals include wins from a large US based insurance company; a US Fortune 500 medical devices company; a large US based cable operator and home internet service provider, a global brewing and bottling company and a leading generator and marketer of electricity in North America among others.

Reason for change in estimates and target price: We have increased the rupee-dollar estimates for FY2012 and FY2013 to Rs46.5 and Rs46 respectively from Rs45.5 and Rs44 earlier. Consequently, we have increased our earnings estimates by 2.6% and 4% for FY2012 and FY2013 respectively. We have kept our volumes and pricing assumptions intact for FY2012 and FY2013, however we have marginally increased our margin estimates on account of higher rupee-dollar rate estimates. In view of higher earning per share (EPS) estimates, we have increased our target price to Rs1,250 from Rs1,201 earlier.

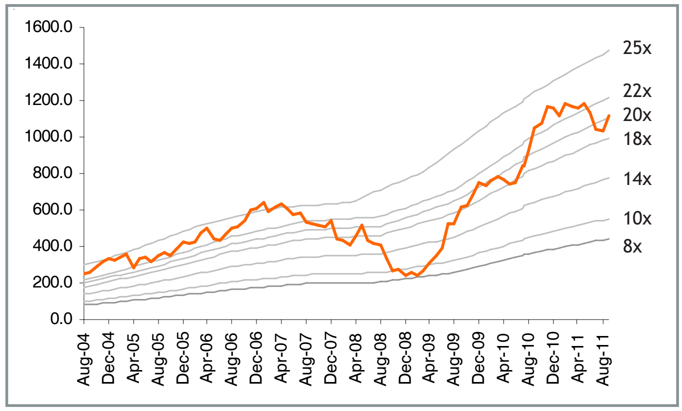
Valuation and view

TCS' performance for the quarter under review was broadly in line with expectations and the management commentary continues to remain optimistic on growth outlook, despite macro uncertainties. We continue to remain positive on TCS and expect it to continue with its strong growth momentum. We have increased our earnings estimates for FY2012 and FY2013 to factor in a higher rupee-dollar rate; consequently we have increased our target price to Rs1,250 from Rs1,201 earlier. At our target price the stock would be valued at 20x FY2013E earnings; we maintain our Buy rating on the stock.

Valuation table

Particulars	FY2010	FY2011	FY2012	FY2013
Total revenue (Rs cr)	30028.9	37324.5	47855.9	56035.6
EBIT margin (%)	26.5	27.8	27.7	26.7
Net profit (Rs cr)	6889.5	8682.9	10537.6	12229.6
EPS (Rs)	35.2	44.4	53.8	62.5
EV/EBITDA	24.3	18.8	14.5	12.4
RoE (%)	40.8	42.0	39.8	36.4
RoCE (%)	46.4	51.5	51.6	46.2
P/E (x)	31.8	25.2	20.8	17.9
Market cap/sales (x)	7.3	5.9	4.6	3.9
Dividend yield (%)	1.8	1.3	1.5	1.8

One-year forward PE band



Source: Bloomberg

The author doesn't hold any investment in any of the companies mentioned in the article.

Housing Development Finance Corporation

Evergreen

Stock Update

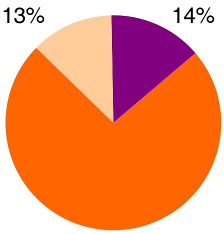
Steady earnings growth

Hold; CMP: Rs673

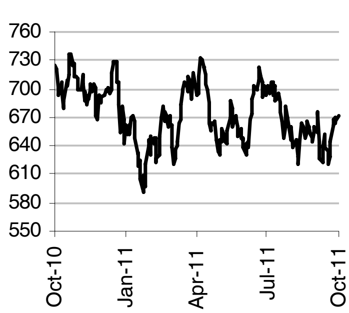
Company details

Price target:	Rs730
Market cap:	Rs98,818 cr
52 week high/low:	Rs750/582
NSE volume: (No of shares)	24.6 lakh
BSE code:	500010
NSE code:	HDFC
Sharekhan code:	HDFC
Free float: (No of shares)	147.2 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	2.7	-4.3	-6.2	-9.0
Relative to Sensex	0.2	5.1	8.2	9.9

Result highlights

- HDFC Ltd reported its results in line with our estimates as the earnings of the company grew by 20.2% year on year (YoY) and 14.9% quarter on quarter (QoQ) to Rs970.7 crore. The net interest income (NII) grew by 15% YoY while the operating profit increased by 18% YoY due to a higher treasury and fee income. The advances of the company grew by 25% YoY (including the loans sold). The reported spread declined sequentially to 2.28% from 2.30% due to rising interest expenses. During the quarter the company provided Rs255 crore from the reserves toward provisions and contingencies due to an increase in the provisioning requirements by National Housing Bank (NHB). The asset quality remained stable as gross non performing assets (NPAs) were at 0.82%. Since the approvals and disbursements are growing at sub 20% levels, the business growth is witnessing some pressure due to rising rates. We expect the company's earnings to grow at a compounded annual growth rate (CAGR) of 17% over FY2011-13. Currently, the stock is trading at 4x FY2013E book value (stand-alone) which is at a significant premium to other players. We maintain our Hold rating on the stock with our sum of the parts (SOTP) based target price of Rs730.

- **Steady growth in NII:** The NII of the company reported a healthy growth of 14.7% YoY and 13.6% QoQ to Rs1,244 crore. This was majorly led by steady net interest margins (NIMs) and a strong growth in advances of the company. During Q2FY2012 the advances of the company grew by 25% YoY including the loans sold (19.5% excluding the loans sold). The individual home loans which comprise 66% of the book also grew 25% (18% excluding loans sold). The approvals and disbursements grew 18% YoY and 19% YoY respectively and are witnessing pressure due to a sharp rise in interest rates. The management expects to grow its book in the range of 18-20%.

- **Spreads remain stable:** HDFC reported spreads at 2.28% for Q2FY2012 (2.29% for H1FY2012) compared to 2.30% in Q1FY2012. The NIMs also remained stable at 4.3% during H1FY2012 similar to that of the corresponding quarter of the previous year. The management aims to maintain spreads at 2.3% levels in

Result table (Rs cr)

Particulars	Q2FY12	Q2FY11	% YoY	Q1FY12	% QoQ
Interest earned	3,934.0	2802.0	40.4	3,609.8	9.0
Interest expense	2,690.5	1717.6	56.6	2,514.9	7.0
Net interest income	**1,243.5**	**1084.5**	**14.7**	**1,094.8**	**13.6**
Other income	235.1	159.4	47.5	211.8	11.0
Net operating income (NOI)	1,478.6	1252.7	18.0	1,306.7	13.2
Operating expenses	123.9	104.1	19.0	113.2	9.5
Operating profit	**1,354.7**	**1148.5**	**17.9**	**1,193.5**	**13.5**
PBT	1,337.7	1133.5	18.0	1,175.5	13.8
TAX	367.0	326.0	12.6	331.0	10.9
PAT	**970.7**	**807.5**	**20.2**	**844.5**	**14.9**

FY2012 and expects the same to remain in the range of 2.15-2.35% in the medium term.

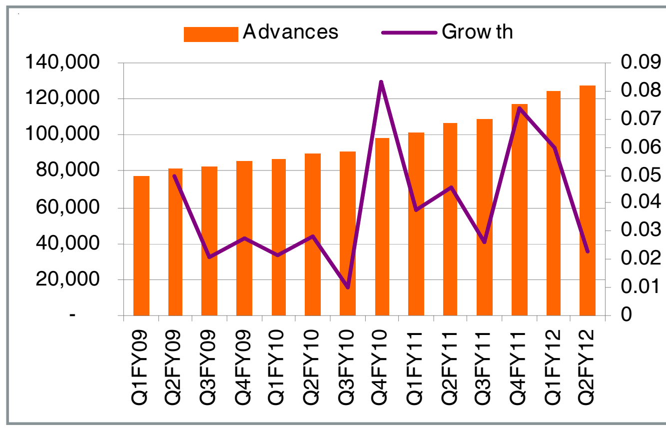
- **Non-interest income shines:** The non interest income of the company grew by 39.8% YoY and 11% QoQ to Rs235 crore. This was on account of a strong growth in the dividend income which grew by 175% YoY to Rs62.9 crore followed by a 47.4% Y-o-Y increase in the profit from sale of investments to Rs86.9 crore (Rs50 crore from realisation of Intelenet). The fee income also showed a healthy growth of 15.9% YoY and 37.7% QoQ to Rs78.9 crore.

- **Asset quality stays healthy:** The asset quality of the company remained healthy with the gross NPA (more than 180 days) at 0.53% as compared to 0.55% in the previous quarter. The gross NPA (comprising more than 90 days) stood at 0.82%, in line with that of the previous quarter. During the quarter the company provided Rs255 crore towards increase in provision requirements for standard advances (to 0.40% from 0.25%) stipulated by the NHB and towards provision on dual rate home loans. As on Q2FY2012 the company had a balance of Rs1,525 crore against the NHB's requirement of Rs1,196 crore (Rs455 crore for increased provision on standard advances and dual rate home loans).

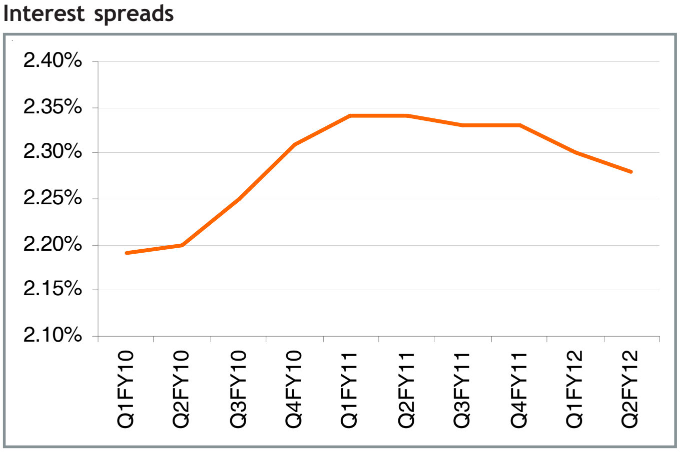
- **Capital adequacy ratio at 13.8%:** The capital adequacy ratio (CAR) stood at 13.8% as against the minimum requirement of 12% whereas the tier 1 capital adequacy was 11.7% as against a minimum requirement of 6%.

- **Outlook:** HDFC continues to deliver strong earnings growth aided by a healthy growth in disbursements and stable margins. However a high interest rate has begun impacting the business as approvals and disbursements are seeing some moderation. This could lead to a lower growth in the loans book and may even impact spreads. We expect the company's earnings to grow at a CAGR of 17% over FY2011-13. Currently, the stock is trading at 4.0x FY2013E book value (stand-alone) which is at a significant premium to other players. We have valued the mortgage business at Rs537 (3.2xFY13E BV) and hence maintain our SOTP based price target of Rs730. We maintain our Hold rating on the stock.

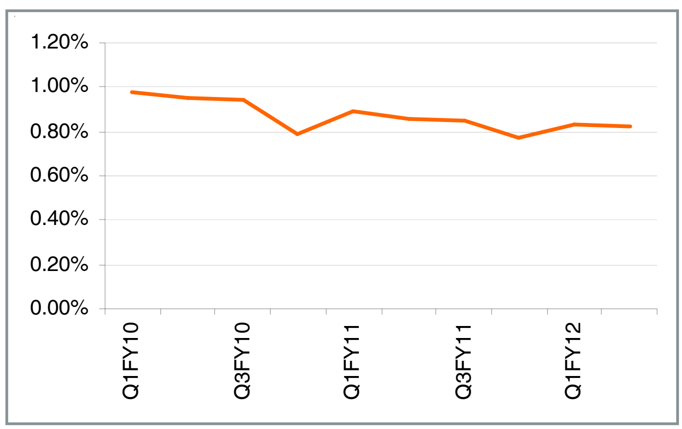
Loan growth



Interest spreads



Gross NPAs



The author doesn't hold any investment in any of the companies mentioned in the article.

Financials

Profit & Loss statement (Rs cr)

Particulars	FY09	FY10	FY11	FY12E	FY13E
Net interest income	3,054	3,388	4,247	5,064	6,005
Other Income	531	910	1,072	1,214	1,373
Operating expenses	299	306	362	431	500
Operating Profit	3,287	3,992	4,957	5,847	6,879
Depreciation & Provision	67	76	89	114	138
PBT	3,219	3,916	4,868	5,733	6,741
Tax	937	1,090	1,332	1,605	1,887
PAT	2,283	2,826	3,536	4,128	4,853

Balance sheet (Rs cr)

Particulars	FY09	FY10	FY11	FY12E	FY13E
Liabilities					
Equity capital	284	287	293	293	303
Reserves & surplus	12,853	14,911	17,023	19,460	25,126
Networth	13,137	15,198	17,317	19,754	25,429
Borrowings	83,856	96,565	115,410	138,004	164,005
Term loans	25,372	32,137	42,490	53,112	66,125
Bonds, debentures	39,110	41,347	48,296	53,125	58,172
Deposits	19,375	23,081	24,625	31,766	39,708
Current liabilities & provisions	4,663	4,878	6,775	7,182	7,397
Total liabilities	101,657	116,641	139,502	164,939	196,831
Assets					
Loans	85198	97967	117127	140552	168662
Investments	10469	10727	11832	12424	13915
Deferred tax asset	216	286	448	515	593
Current assets, loans and advances	5571	7439	9861	11217	13460
Net block	203	222	234	231	201
Total assets	101657	116641	139502	164939	196831

Key ratios

Particulars	FY09	FY10	FY11	FY12E	FY13E
Per share data					
EPS	16.0	19.7	24.1	28.1	32.0
BV	92.4	105.9	118.1	134.7	167.9
Spreads (%)					
Yield on funds	11.0	9.6	9.2	9.8	9.8
Cost of funds	9.7	7.8	7.1	7.8	7.9
Net interest margins	3.3	3.1	3.3	3.3	3.3
Operating ratios (%)					
Interest expended/ Interest earned	70.9	67.6	64.0	66.2	66.4
Cost to income	8.3	7.1	6.8	6.9	6.8
Non interest income/ Total income	4.8	8.0	8.3	7.5	7.1
Return ratios (%)					
RoE	17.4	18.6	20.4	20.9	19.1
RoA	2.5	2.6	2.8	2.7	2.7
Assets/Equity	7.7	7.7	8.1	8.3	7.7
Growth ratios (%)					
Net interest income	15.6	10.9	25.4	19.2	18.6
PPP	18.0	21.5	24.2	18.0	17.6
PAT	(6.3)	23.8	25.1	16.7	17.6
Advances	16.2	15.0	19.6	20.0	20.0
Deposits	21.3	15.2	19.5	19.6	18.8
Valuation ratios (%)					
P/E	44.1	36.0	29.4	25.2	22.1
P/BV	7.7	6.7	6.0	5.3	4.2

The author doesn't hold any investment in any of the companies mentioned in the article.

Reliance Industries

Evergreen

Stock Update

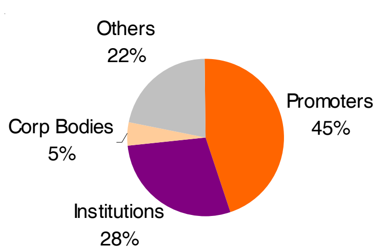
Q2 results in line with estimates though GRMs disappoint

Buy; CMP: Rs833

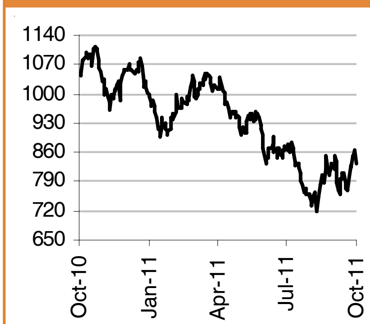
Company details

Price target:	Rs1,040
Market cap:	Rs273,744 cr
52 week high/low:	Rs1187/714
NSE volume: (No of shares)	42.4 lakh
BSE code:	500325
NSE code:	RELIANCE
Sharekhan code:	RELIANCE
Free float: (No of shares)	181.7 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	4.5	-2.1	-16.4	-20.4
Relative to Sensex	1.9	7.4	-3.6	-3.9

Result highlights

- **PAT in line with estimate, but operational matrices show concern:** Reliance Industries Ltd (RIL)'s earnings and sales are in line with our estimate. The refining segment witnessed a gross refining margin (GRM) of $10.1 per barrel which implies a premium of only $1 per barrel (the lowest in the last four years) over the Singapore GRM. The production of oil and gas from the Krishna-Godavari (KG) D6 field remains low and would not see any ramp-up in the near future. On the brighter side, the petrochemical (petrochem) segment recorded a decent volume and is operating at high utilisation levels.

- **Sales grew in line with estimate, however GRM disappointed:** RIL reported net sales of Rs78,569 crore, in line with our estimate. This reflects a year-on-year (Y-o-Y) growth of 36.7% but a 3% decline sequentially. The Y-o-Y sales growth was driven by both the petrochem (40%) and refining (37%) businesses. However, the revenue of the exploration & production (E&P) segment declined by 17% year on year (YoY) due to lower production from the KG D6 basin and natural decline in Tapti. Sequentially, the sales dropped by 3% mainly on account of lower sales from the refining business, which would be attributed to the lower GRM of $10.1 per barrel against $10.3 per barrel in Q1FY2012 which effectively overshadowed the sequential growth of the petrochem segment.

- **OPM slipped YoY as expected due to hit in petrochem margin:** The operating profit margin (OPM) slipped 382 basis points YoY and remained almost flat sequentially. This would be attributed to the 305-basis-point decline in the petrochem (PBIT) margin over the last year to 11.5%, due to high prices. Even sequentially, there was a decline of 56 basis points. The profit before interest

Result table (Rs cr)

Particulars	Q2FY12	Q2FY11	% YoY	Q1FY12	% QoQ
Net sales	**78569**	**57479**	**36.7**	**81018**	**-3.0**
Total expenditure	68725	48083	42.9	71092	-3.3
Operating profit	**9844**	**9396**	**4.8**	**9926**	**-0.8**
Other income	1102	672	64.0	1078	2.2
EBITDA	10946	10068	8.7	11004	-0.5
Interest	660	542	21.8	545	21.1
Depreciation	2969	3377	-12.1	3195	-7.1
PBT	7317	6149	19.0	7264	0.7
Tax	1614	1226	31.6	1603	0.7
PAT	5703	4923	15.8	5661	0.7
Reported PAT	5703	4923	15.8	5661	0.7
EPS	17.4	15.1	15.7	17.30	0.7
Margins (%)					
OPM	12.53	16.35		12.25	
PATM	7.26	8.56		6.99	
Tax rate	22.06	19.94		22.07	

and tax (PBIT) margin of the refining segment remained stable at 4.5% but that of the E&P segment expanded to 43% against 36-38% in the comparable quarter. The operating profit of RIL in Q2FY2012 remained flat sequentially but grew by 5% to Rs9,844 crore, primarily on account of higher revenue traction. The operating profit reported by the company was 8% lower than our estimate.

- **PAT in line, other income supported:** The profit after tax (PAT) was 7% higher than our estimate despite a lower than expected operating profit as it was supported by a higher other income as a result of higher liquid investment. The PAT grew by 16% YoY on a 5% growth in the operating profit in Q2FY2012 due to a significant (64%) improvement in the other income and a lower depreciation cost (12%). On a sequential basis, the PAT remained flat. The earnings per share (EPS) for the quarter stood at Rs17.4.

- **Negatives factored in, maintain Buy:** Though the operational matrices are showing signs of concern, we believe most of the negatives are factored in the current valuation of the RIL stock. Currently, the stock is trading at 12x and 11x of FY2012 and FY2013 estimated earnings. We retain our Buy rating and sum-of-the-parts based price target of Rs1,040 for RIL.

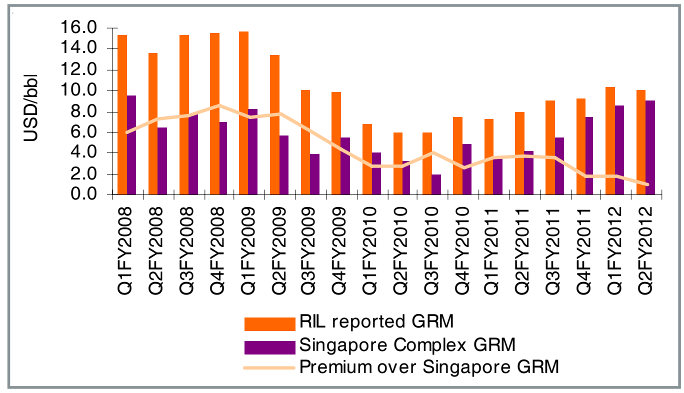
Key highlights

Refining segment: GRMs lower than expected

- RIL refined 17.1 million tonne of crude oil during Q2FY2012 against 17 million tonne in Q1FY2012. However, the GRM for Q2FY2012 was at $10.1 per barrel against $7.9 per barrel in Q2FY2011 and $7.9 per barrel in Q1FY2012. In the meanwhile, the Singapore GRM grew to $9.1 per barrel over $4.2 per barrel in Q2FY2011 and $8.6 per barrel in Q1FY2012. Hence, the spread between RIL's GRM and the Singapore GRM narrowed down to $1 per barrel in Q2FY2012 from $3.7 per barrel in Q2FY2011 and $1.7 per barrel in Q1FY2012. This would be attributed to the falling Arab Light-Heavy differential to $3.8 per barrel from $5.1 per barrel in the previous quarters.

- The refining segment's earnings before interest and tax (EBIT) grew by 40% YoY on a sales growth of 37% as the EBIT margin stood at 4.5%, up by 10.3 basis points YoY. Sequentially, the EBIT declined by 4% on a sales decline of 8% as the EBIT margin improved by 20 basis points.

GRM spread



E&P segment: Development of CBM and some other blocks picks up

- In Q2FY2012, the production from the KG-D6 basin dropped both YoY and quarter on quarter (QoQ) as a result of both lower production and lower share post-sharing 30% with British Petroleum (BP) from August 2011. The Y-o-Y production would have been driven by a decline in production while the sequential decline would have been largely due to the lowering share after the BP deal.

- In case of Panna-Mukta oilfield, the Y-o-Y volume growth appeared high due to a plant shutdown during the same period of the previous year. However, the production from Tapti was lower due to a natural decline.

- However, new developments in three coal bed methane (CBM) blocks are positive with RIL drilling 12 incremental development wells and taking the total number of development wells drilled to 26. We learned that a proposal for the gas pricing from these blocks has been submitted to the petroleum and natural gas ministry.

- The average crude oil price realisation was $114 per barrel for the KG-D6 basin and $116 per barrel for the PMT (vis-à-vis $77 per barrel and $79 per barrel YoY respectively).

Production data—E&P segment

Particulars	Q2FY12	Q2FY11	YoY %	Q1FY12	QoQ %
Panna-Mukta					
Oil	333.3	93.3	257.1	360.0	-7.4
Gas	502.9	111.4	351.3	502.9	0.0
Tapti					
Oil	24.0	36.0	-33.3	36.0	-33.3
Gas	560.0	680.0	-17.7	577.1	-2.9
KG-D6					
Oil	173.3	293.3	-40.9	186.7	-7.1
Gas	4205.7	5391.4	-21.9	4462.9	-5.7
Condensate	24.0	24.0	0.0	24.0	0.0

Petrochem segment: Growth in demand

- The company reported polymer production of 1.1 million tonne, showing a 5.9% Y-o-Y growth and a 3.9% increase sequentially. The polyester volumes remained flat sequentially but declined by 3.5% over the last year. The management indicated the domestic demand for polymer products remained flat due to a lower demand in some of the key products and the uncertainty prevailing in the global market. However, PVC saw better demand due to a better than expected monsoon.
- The sales grew by 40% YoY and production grew by about 10% while the remaining growth could be attributed to the higher realistion. On a sequential basis also, a 15% improvement in the sales was driven by realisation.

Balance sheet update: debt grew despite significant cash on books

- The company's cash by the end of Q2FY2012 stood at Rs36,501 crore compared to Rs27,135 crore as on March 31, 2011. The debt stood at Rs71,399 crore in Q2FY2012 against Rs67,397 crore as on March 31, 2011. The net gearing as on June 30, 2011 was 11.4% as against 13.3% as on March 31, 2011. The net capital expenditure for H1FY2012 was at Rs6,691 crore ($ 1.1 billion) of which the cash outflow was Rs3,533 crore.

Other developments during the quarter

- The revised Production Sharing Contracts (PSCs) signed by RIL and BP (and Hardy & Niko, where applicable) were submitted to the government. RIL receives the full consideration as per the agreement and the company's management hinted that the key integration teams of the joint venture are in place and will review the strategy for developing resources, including exploration opportunities, transporting and marketing infrastructure, and maximising the production from the KG-D6 field.
- The last installment related to the BP deal is expected to come in Q3FY2012. We have not factored in yet the impact of the deal which will be reflected as an adjustment in the sales from the E&P business, assets, depreciation, cash and other income. We will factor the above in our estimates in our next update.
- RIL's three shale gas joint ventures have made significant progress in terms of execution. The exit gross production rate for the Pioneer and Chevron joint ventures was ~5.9mmscmd gas and ~24700bopd of condensate while the Carrizo joint venture is expected to start production by Q3FY2012.

Valuation

Though the operational matrices are showing signs of concern, we believe most of the negatives are factored in the current valuation of the stock. Currently, the RIL stock is trading at 12x and 11x of FY2012 and FY2013 estimated earnings. We retain our Buy rating and sum-of-the-parts based price target of Rs1,040 for the stock.

Valuation table (Rs cr)

Particulars	FY10	FY11	FY12E	FY13E
Net sales	203,739	265,810	269,086	292,945
EBITDA	41685	40586	45073	48903
Net profit (Adj)	15,897	19,293	21,559	24,480
Adj. EPS (Rs)	48.4	58.7	65.6	74.5
% Y-o-Y change	*-5.7*	*21.4*	*11.7*	*13.5*
PER (x)	17.2	14.2	12.7	11.2
EV/EBIDTA (x)	7.3	7.4	6.7	6.2

* Cash transfer of BP deal is not factored in yet, will be updated soon.

Evergreen

Housing Development Finance Corporation
HDFC Bank
Infosys
Larsen & Toubro
Reliance Industries
Tata Consultancy Services

Apple Green

Apollo Tyres
Bajaj Auto
Bajaj FinServ
Bajaj Holdings & Investment
Bank of Baroda
Bank of India
Bharat Electronics
Bharat Heavy Electricals
Bharti Airtel
Corporation Bank
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GAIL India
Glenmark Pharmaceuticals
Godrej Consumer Products
Grasim Industries
HCL Technologies
Hindustan Unilever
ICICI Bank
Indian Hotels Company
ITC
Mahindra & Mahindra
Marico
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