Date : 03-Aug-2009 Edition : National Page No.: 24 Page Name: The Last Word Size: 480.45 sq. cm

Sector: Banking and Finance Circulation: 105000 AVE: Rs.0.00 Frequency: Daily

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EXCLUSIVE PARTNER
THE WALL STREET JOURNAL.

Sensex, Nifty earnings at a four-quarter high

▶ FROM FRONT PAGE

raising hopes of higher sales in the coming quarters, rising commodity prices could cause margins to shrink.

The sales of both the Sensex and Nifty samples analysed by *Mint* were also dragged down by oil companies, which posted a steep decline in revenue because of a fall in crude oil prices.

Excluding **Reliance Industries Ltd**, the country's most valuable company, and **Oil and Natural Gas Corp. Ltd**, the biggest explorer, the Sensex group posted sales growth of 12%, better than the 10.8% sales growth they recorded in the March quarter. Profits for the non-oil pack of companies grew 22.8%, the highest in seven quarters.

The Nifty group of non-oil firms, which consisted of 39 companies, also posted the sharpest rise in profits in seven quarters at 18%, though sales grew at a more modest 6.7%.

Cairn India Ltd, an arm of UK-based oil explorer **Cairn Plc**, **DLF Ltd**, India's biggest realty firm by market value, mobile phone operators **Idea Cellular Ltd** and **Reliance Communications Ltd**, electricity transmitter **Power Grid Corp. of India Ltd**, and energy firm **Reliance Power Ltd** did not have comparable numbers going back 12 quarters.

Computer services provider **HCL Technologies Ltd** has not yet declared its June quarter numbers.

According to Morgan Stanley India Co. Pvt. Ltd analysts Ridham Desai and Sheela Rathi, earnings for the quarter ended June—the first of fiscal 2010—have exceeded analysts' expectations.

However, they say that the broader market has outperformed the Sensex companies in earnings growth.

According to data available with *Mint*, 1,974 firms have until now announced their June quarter results.

On an aggregate, their net profit has grown by 19.64%, while sales fell 7.5%.

"At the sector level, consumer discretionary (spending) and energy are the key positive surprises while healthcare is the key negative surprise. So far, the best performing sector in terms of profit growth is financials, followed by energy, while materials is the worst performing sector," Desai and Rathi wrote in a 30 July strategy report.

"The risk is in execution. The challenge is how we grow profitability from now on," said Kenneth Andrade, vice-president, equity, **IDFC Asset Management Co. Ltd**. "We have done well this quarter. But what is absent is sales growth."

Experts say the earnings story will be even better if demand picks up and results in higher sales growth for companies.

"While there is likely a commodity price component to modest demand, we believe this is a worrying trend (of poor sales but good profits). Businesses have clearly taken advantage of raw material costs (50% of expenses), but also appear to have cut other operating costs, collectively driving up margins. We believe rising margin is good, but rising demand/sales would probably be better," **Citigroup Global Markets India Ltd** analysts Aditya Narain and Tirthankar Patnaik wrote in a report last week.

Andrade also says sales growth will be key going ahead. "We saw one of the weakest top line growth (rates). We need to see how top line behaves going ahead," he said.

Signals from the economy have been positive, economists say. The Index of Industrial Production numbers, a key measure of productivity, saw 2.7% growth in May. This was the second consecutive month the index registered growth after a 1.2% increase in April.

"Economic growth outlook is likely to improve, although there continue to be near-term concerns over the impact of the shortfall in monsoon season rainfall," Rajeev Malik, head of India and Asean (Association of Southeast Asian Nations) Economics at **Macquarie Securities Ltd**, said in a 28 July report.

Macquarie is maintaining its gross domestic product growth forecast of 7% for the current fiscal and 7.5% for the next.

Malik added that the rate easing cycle was over, and that the Reserve Bank of India appeared to have signalled a shift to a neutral stance. "We believe liquidity will be easy and policy rates will remain at their current low levels for several months," he added.

While easy and cheap credit is good news for companies, it also could mean higher raw material prices due to commodity price inflation, some analysts warn.

"With the stimulus from governments across the world, things are looking better for the economy. While there is hope for revival in revenue growth, there is a concern about rising commodity prices," said Dipen Shah, vice-president (private client group research) at **Kotak Securities Ltd**. "Hopefully, revenue growth exceeds the rise in commodity prices so that we can see margins expand in coming quarters."

Analysts say that without further earnings growth, valuations will become a cause for concern.

Consensus estimates by analysts, said Shah, put earnings per share of Sensex companies at Rs875 for fiscal 2010.

At Friday's Sensex close of 15,670 points, the price-earnings, or P-E, multiples work out to 17.9 times, significantly higher than the long-term mean P-E of 15 times.

"We look fully priced at current levels. We need to look at FY11 earnings and possible upgrades. Only if that happens can the market move up on a substantial basis," said Shah of Kotak Securities.

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REVIVING HOPE

Data for 43 Nifty firms show that profits went up in the June quarter despite a decline in sales.

Quarter	Net sales (Rs cr)	% change (y-o-y)	Operating profit (Rs cr)	% change (y-o-y)	Net profit (Rs cr)	% change (y-o-y)
September 2006	1,74,940.62	32.37	41,938.00	31.62	26,654.31	29.90
December 2006	1,80,865.86	29.75	46,254.71	45.38	28,642.03	48.63
March 2007	1,91,748.07	18.67	45,623.19	14.82	29,558.49	21.12
June 2007	1,81,636.55	15.25	44,723.85	18.29	30,522.91	34.05
September 2007	1,95,284.73	11.63	49,531.63	18.11	32,949.90	23.62
December 2007	2,10,301.05	16.27	52,207.63	12.87	36,893.24	28.81
March 2008	2,37,090.06	23.65	52,710.79	15.54	32,781.06	10.90
June 2008	2,43,175.34	33.88	54,892.59	22.74	33,595.42	10.07
September 2008	2,54,825.39	30.49	53,333.02	7.67	31,977.89	-2.95
December 2008	2,24,012.61	6.52	48,102.62	-7.86	29,217.21	-20.81
March 2009	2,31,693.63	-2.28	54,181.01	2.79	35,567.57	8.50
June 2009	2,23,808.93	-7.76	54,564.79	3.21	36,919.66	9.89

Comparable data were available for 43 of the 50 Nifty firms Y-o-y: Year-on-year Source: Capitaline; Mint research