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Market Outlook

India Research
September 1, 2010

Dealer's Diary

The market opened on a weak note, tracking lower Asian stocks and extended losses in mid-morning trade as RIL's stock fell on the news of its acquisition of stake in EIH Ltd. Further, weak global stocks offset data showing robust GDP growth of 8.8% in 1QFY2011. However, the market staged a mild recovery after sliding to a fresh intraday low in afternoon trade. The intraday recovery gathered steam in mid-afternoon trade as European stocks and US index futures came off initial lows. High volatility was witnessed in late trade. The Sensex and Nifty closed down by 0.3% and 0.2%, respectively. The BSE mid-cap and the small-cap indices closed lower by 0.6% and 1%, respectively. Among the front liners, M&M, ITC, Maruti Suzuki, Tata Motors and Bharti Airtel gained 1–3%, while RCOM, Jaiprakash Associates, RIL, Jindal Steel and DLF lost 2–4%. Among mid caps, United Breweries, Emami, Radico Khaitan, KGN Industries and Marico gained 4–9%, while EIH, State Bank of Mysore, Rajesh Exports, State Bank of Travancore and State Bank of Bikaner & Jaipur lost 5–7%.

Markets Today

The trend deciding level for the day is 17936 / 5388 levels. If NIFTY trades above this level during the first half-an-hour of trade then we may witness a further rally up to 18051 – 18131 / 5428 - 5453 levels. However, if NIFTY trades below 17936 / 5388 levels for the first half-an-hour of trade then it may correct up to 17856 – 17740 / 5363 - 5323 levels.

Indices	S2	S1	R1	R2
SENSEX	17,740	17,856	18,051	18,131
NIFTY	5,323	5,363	5,428	5,453

News Analysis

- 1QFY2011 GDP grows at 8.8%
- ABB Ltd – Analyst Meet and Facility Visit
- Nalco seeks stakes in Indonesian coal mines
- Sun Pharma receives US FDA warning letter

Refer detailed news analysis on the following page.

Net Inflows (August 30, 2010)

Rs cr	Purch	Sales	Net	MTD	YTD
FII	1,417	1,145	273	10,647	58,588
MFs	386	378	8	(2,817)	(15,440)

FII Derivatives (August 31, 2010)

Rs cr	Purch	Sales	Net	Open Interest
Index Futures	1,829	2,535	(706)	15,587
Stock Futures	1,104	1,347	(243)	34,146

Gainers / Losers

Gainers			Losers		
Company	Price (Rs)	*chg (%)*	Company	Price (Rs)	*chg (%)*
Adani Enter.	651	*4.0*	Indus Ind.	220	*(3.9)*
Colgate	825	*3.5*	Lanco Infra.	66	*(3.8)*
M&M	626	*2.9*	RCom	156	*(3.6)*
United Spirits	1,433	*2.7*	Jaiprakash Asso.	109	*(3.5)*
Ambuja Cem.	125	*2.5*	Pantaloon	452	*(3.5)*

Domestic Indices	Chg (%)	(Pts)	(Close)
BSE Sensex	-0.3%	(61.0)	17,971
Nifty	-0.2%	(13.1)	5,402
MID CAP	-0.6%	(44.1)	7,597
SMALL CAP	-1.0%	(95.9)	9,541
BSE HC	-0.1%	(5.7)	5,544
BSE PSU	-0.8%	(76.0)	9,641
BANKEX	-0.3%	(34.0)	12,191
AUTO	0.8%	72.3	8,814
METAL	-1.0%	(150.9)	14,978
OIL & GAS	-2.0%	(197.5)	9,921
BSE IT	0.0%	1.7	5,376
Global Indices	**Chg (%)**	**(Pts)**	**(Close)**
Dow Jones	0.0%	5.0	10,015
NASDAQ	-0.3%	(5.9)	2,114
FTSE	0.5%	23.7	5,225
Nikkei	-3.6%	(325.2)	8,824
Hang Seng	-1.0%	(200.7)	20,536
Straits Times	-0.2%	(6.7)	2,950
Shanghai Com	-0.5%	(13.9)	2,639

Indian ADRs	Chg (%)	(Pts)	(Close)
Infosys	-0.1%	(0.0)	$57.3
Wipro	-0.9%	(0.1)	$12.8
Satyam	0.2%	0.0	$4.5
ICICI Bank	1.0%	0.4	$41.3
HDFC Bank	0.3%	0.5	$159.8

Advances / Declines	BSE	NSE
Advances	867	356
Declines	2,112	1,021
Unchanged	54	27

Volumes (Rs cr)	
BSE	4,677
NSE	14,102

 Sebi Registration No: INB 010996539

1QFY2011 GDP grows at 8.8%

For 1QFY2011, India's GDP growth came in at 8.8%, broadly in line with expectations and ahead of the 8.6% GDP growth posted during 4QFY2010. Growth was mainly driven by the agriculture sector, which posted 2.8% growth, and the services sector, which posted 9.4% yoy growth. The industry sector posted growth of 11.4%, mainly aided by the manufacturing segment, which grew by 12.4%.

Going forward, the Indian economy is expected to deliver 8.5% GDP growth in FY2011, driven by agriculture growth accelerating on the back of good monsoons and robust growth in the manufacturing and services sectors. With economic growth well on track, the RBI's prime focus in FY2011 would be on controlling inflation, which is becoming more broad based. Thus, the RBI is expected to continue its policy of hardening interest rates, in order to anchor inflationary pressures, though most of these hikes would be front ended, as inflationary pressures would ease during 2HFY2011 on the back of the high base effect of the last corresponding period and the moderation of food inflation on the back of normal monsoons.

ABB Ltd – Analyst Meet and Facility Visit

We attended the analyst meet and facility visit hosted by ABB India Ltd. at its Neelamangala facility near Bangalore on August 25, 2010. We understand that demand for automation technologies has commenced from the cement and steel sectors, while other process industries such as pulp and paper, chemicals and pharma are expected to place orders in the near future. While the order accretion rate for power technologies has been low during the past quarters, the company expects order inflows from PGCIL to gather pace from 2HCY2010. ABB continues to be adversely impacted by the exits costs on the orders acquired under the Rural Electrification (RE) projects. Also, the increasing competition from both domestic and international players has been exerting downward pressure on equipment prices. Though the management does not expect equipment prices to rise in the near future, it believes the same to stabilise nearer to the current levels. At the current price, the stock is trading at 34x and 25x CY2010E and CY2011E EPS, respectively. We maintain Neutral on the stock.

Key Takeaways

Rural electrification projects dents profits: ABB has been facing diverse set of challenges in the timely execution of the rural electrification (RE) projects resulting in perennial delays and poor payment cycle. As most of the RE projects were facing cost and schedule overruns, ABB decided to exit from these projects and had initiated settlement negotiations with the State Electricity Boards (SEB). While few SEBs acquiesced and concluded the remainder portion through other contractors, some of the SEBs obligated ABB to complete the projects. In one particular RE project, there were differences in the interpretation of the scope of work between the client and ABB. The resultant foreclosure costs and cost overruns attributable to these RE projects have adversely impacted profitability in the power systems segment. Management informs that ~Rs2bn worth of RE projects are yet to be executed and expects to completely exit from RE projects by 1QCY2011.

Growing competition impacts pricing: Increasing competition, both domestic and international, has been exerting downward pressure on equipment prices. Though the management does not expect equipment prices to rise in the near future, it believes the same to stabilise nearer to the current levels. In response to a query related to the lower cost of equipment sourced from Chinese and Korean vendors, management was of the view that the serviceability and life cycle costs of ABB's equipments outweigh its initial price disadvantages and the same can be vouched by the increasing number of repeat customers for ABB's products. While the transmission equipment segment is relatively disciplined, the distribution segment is characterised by over 1,000 players offering inferior quality products at lower costs.

Margins expected to normalize: The growing competition has also hindered ABB's ability to pass on cost increases resulting from rising commodity prices. To counter the same, the company has embarked on increasing productivity and supply chain management to control cost and improve margins. Though the management does not expect EBITDA margins to return to the CY2007 levels of 12.3%, it expects to achieve normal margins of ~10% in the near future as compared to 8.5% for CY2009 and 3.5% for 2QCY2010.

Improving outlook: Order inflows for the past few quarters were impacted by delays in conclusion of few large orders and prevailing pricing pressures. While the order accretion rate has been low during the past quarters, the company expects order inflows from PGCIL to gather pace from 2HCY2010. Management informs that the base orders from the process automation and discrete automation segments have picked up on the back of the revival of industrial activities. Pickup in demand was seen from the cement and steel sectors and management expects other process industries such as pulp and paper, chemicals and pharma to place orders the near future. Order backlog at the end of 1HCY2010 was at Rs8,531cr.

Outlook and valuation: ABB has reported dismal performance during the past several quarters amidst heightened competitive pressures and the exit costs from RE projects. Although the economic scenario has been improving, we believe that current valuations factor in the same. At the current price, the stock is trading at 34x and 25x CY2010E and CY2011E EPS, respectively. **We maintain Neutral on the stock.**

Nalco seeks stakes in Indonesian coal mines

As per media reports, National Aluminium (Nalco) is looking to buy stakes in Indonesian coal mines to secure supplies for its aluminium project in East Kalimantan (Indonesia). The coal mine is estimated to have 500mn tonnes of coal reserves and annual production capacity of 10mn tonnes from 2014E. Nalco has entered into a joint venture with RAK Minerals & Metals Investments (which holds a 24% stake) to build a 0.5mn tonne aluminum smelter and a 1,250MW coal-based power plant in East Kalimantan (Indonesia) with an estimated investment of US $4bn.

Nalco continues to trade at rich valuations of 14.4x FY2011E and 11.3x FY2012E EV/EBITDA, as compared to its peers Hindalco and Sterlite. **We maintain our Sell rating on the stock with a Target Price of Rs316.**

Sun Pharma receives US FDA warning letter

Sun Pharma has announced that its wholly owned subsidiary Sun Pharmaceutical Industries (SPI) has received warning letter from US FDA for its manufacturing facility in Cranbury, New Jersey, with respect to violation of cGMP regulations. The warning letter was issued as a follow up of the inspection initiated in February 2010 of the aforesaid manufacturing facility. SPI intends to respond promptly and timely within 15 working days to the regulator. The facility is used for the manufacturing of controlled substances and was part of the acquisition of Able Labs done in CY2005 by Sun Pharma. However, the company has maintained its FY2011 top-line guidance of 18–20% growth.

Though the financial impact seems to be minimal, this could adversely impact the sentiments given the fact that this is the second facility of the company to have come under US FDA scan (earlier US FDA in June 2009 had seized drugs manufactured at Caraco's Michigan facility). The stock is currently trading at 24.7x FY2011E and 20.9x FY2011E earnings. **We recommend Neutral on the stock.**

Economic and Political News

- Government expects GDP growth to be more than the projected 8.5% in FY2011
- Mines Ministry seeks cabinet nod for BGML revival through Nalco
- Maharashtra ethanol makers to keep 50% alcohol for petrol blending
- Cement firms cut prices by Rs2–4/bag

Corporate News

- M&M terminates contract with US distributor for pick-ups
- Royal Orchid to increase room tariff from October 2010
- Tata Communications signs two-year deal with Malaysia-based Axiata

Source: Economic Times, Business Standard, Business Line, Financial Express, Mint

Events for the day	
Aegis Logistics	Stock Split
Ankur Drugs	Dividends, Results
Shiv Vani Oil	Dividends, Results
Surabhi Chem	Dividends, Results

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Ratings (Returns) :	Buy (> 15%)	Accumulate (5% to 15%)	Neutral (-5 to 5%)
	Reduce (-5% to -15%)	Sell (< -15%)	

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