Q3 Earnings Preview

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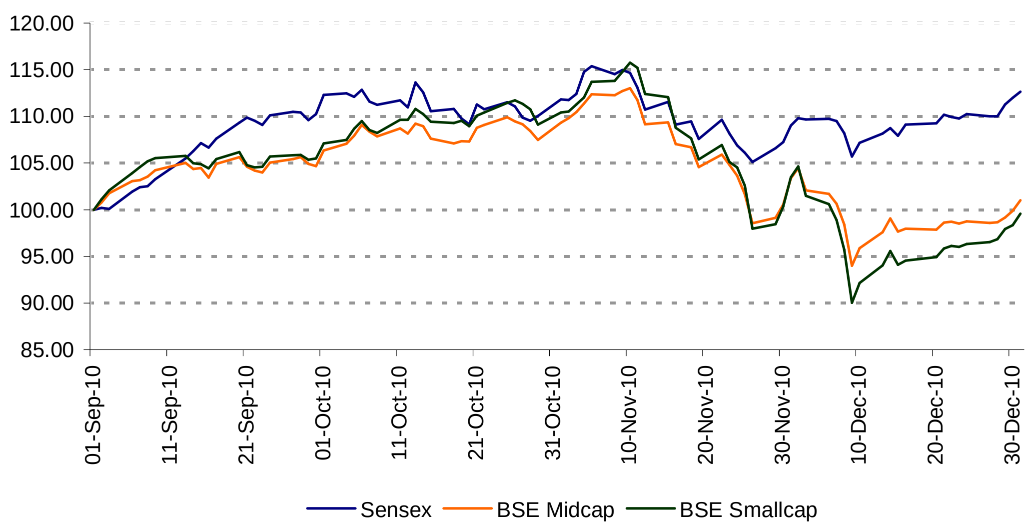
MPA FINSECURITIES PRIVATE LIMITED

During the third quarter (December) ending FY11 the benchmark Nifty index moved up by only 1.73% compared to over 5-6% rise in most of the developed markets like US and Japan. The key reasons behind this underperformance were on account of:

- Widespread scams like the 2G telecom license scam, housing loan scam involving LIC Housing finance and many nationalized PSU banks
- Price rigging allegations by SEBI on several companies like Welspun, Brushman, Murli which spread across majority of mid/small cap companies leading to a sell of by foreign and domestic institutions
- Higher Crude Prices which for major par of the quarter remained above the comfort zone of over $90/barrel
- Rising food price inflation and other metal prices which kept on increasing the threat of higher interest rates

Exhibit: RELATIVE PERFORMANCE OF INDICES



Source: BSE

We believe that in Q4 FY11 the markets will remain quite volatile and the upside potential remains highly capped beyond last Bull Run's high of around 6350 for Nifty index. The only ray of hope could be around the **union budget** where the street is already started to build up expectations of a consumer friendly budget with focus on further infrastructure spending and reduced deficit. The several risks that could lead to a negative performance of Indian markets compared to global peers are:

- A lack lustre earnings performance by India Inc. in the third quarter,
- Highly probably rate hike by RBI in its Q3 monetary Policy review on 25th of January
- Too much expectation from the Union Budget which as always could lead to disappointed markets
- Further rise in crude oil prices increasing the current account deficits and a weakening of rupee

The possible earnings and the markets performance of some of the key sectors:

Sector	Earnings View	Earnings Preview	Market Outlook	Market Outlook Rationale
Banking	Neutral	• Banking Sector to post good YoY profit as well as net interest income growth on account of a lower base effect and a higher advances growth • However compared to Q2FY11 the net interest margins are expected to decline marginally on account of a higher deposit rates and inability to increase their lending rates • Treasury gains are also expected to remain muted on account of a upward tending bond yields in Q3 • One of the key metrics that the street would be watching in Q3 would be the NPA numbers and especially that of the PSU Banks	Negative	Banking sector is likely to underperform on account of a expected RBI interest rate hike, higher inflation and a falling margins on account of a higher deposit rates.
Auto	Positive	• Auto sector to post good Q3 numbers on account of strong volume growth of over 24% in Two Wheelers & Passenger Car sales and 17% in Commercial Vehicles segment • The margins might see slight contraction on account of a higher steel and other key raw material pries in Q3	Negative	Auto sector is likely to see profit booking on account of being a highly rate sensitive sector and moreover higher fuel prices coupled with rising input prices could also add to negative sentiments
FMCG	Neutral	FMCG sector is likely to post a strong volume growth in Q3 on account of a high rural demand because of good monsoons however will see a margin contraction because of rising crude and prices of other inputs like palm oil, etc.	Positive	FMCG sector should witness higher fun flows in Q4 on account of a possible correction in rate sensitive space and its position as a defensive play and rising consumer spending
Oil & Gas	Neutral	• The Oil and Gas Marketing Space is likely to see high losses on account of crude prices above \$90/barrel and huge under recoveries. • The refining space is likely to post good set of results on account of improved GMRs because of over \$11/barrel rise in the crude prices in Q3	Neutral	OMCs stocks like HP, BP and IOC to underperform on account of higher crude prices and refinery ones like RIL to benefit on account of same

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Metal & Mining	Positive	Metal and Mining space including steel, copper, aluminium producers are likely to post good Q3 numbers on account of a higher volume growth because of an increased demand from automobile and infrastructure sector	Negative	Metal and Steel Space is likely to underperform on account of rising input prices like of coal and iron ore and also on account of profit booking. Companies like JSPL which are integrated steel players with captive raw material sources are likely to outperform others
Information Technology	Positive	• IT sector in expected to post better Q3 numbers in dollar terms on account of higher increase in volumes because of stronger economic growth in US and EU region • However in rupee terms the performance could be lower on account of average rupee appreciation of around 2.3% against dollar for the quarter	Positive	IT Space is likely to outperform the overall markets in Q4 on account of a strong recovery across US and EU region and a possible depreciation on rupee because of a higher inflation. Moreover, it will also attract fund flows as it's a non rate sensitive sector.
Capital Goods	Negative	Capital goods sector is likely to post poor Q3 numbers on account of sluggish order intake and higher raw materials cost of steel, aluminium and copper	Negative	Capital Goods space is likely to underperform in Q4 on account of being rate sensitive, higher raw material prices, government's non imposition of any duty on imported capital goods and stretched valuations of major players like L&T, BHEL, etc.
Cement	Negative	• Cement space is likely to post sluggish Q3 performance on account of poor cement dispatch numbers during the quarter and higher raw material prices • The volume growth is also expected to be muted on a YoY basis on account of a prolonged monsoon this fiscal compared to a bad season a year before	Neutral	Going further the Cement space is likely to remain neutral and the upside potential could be there if the demand recovery across infrastructure space picks up.
Pharmaceutical	Positive	• Pharma sector is likely to post strong growth in Q3 driven by product introductions and higher penetration in the domestic market and regulated markets • However, slight rupee appreciation in the current quarter could lead to a small correction in the margin	Positive	Being a non-rate sensitive sector, non-cyclic and a defensive play Pharma sector is likely to attract strong fund flows during the quarter and stocks like Cipla, Dishman, Bliss GVK Pharma and Novartis appears to be good investment opportunities

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