ING INVESTMENT MANAGEMENT HOUSEVIEW

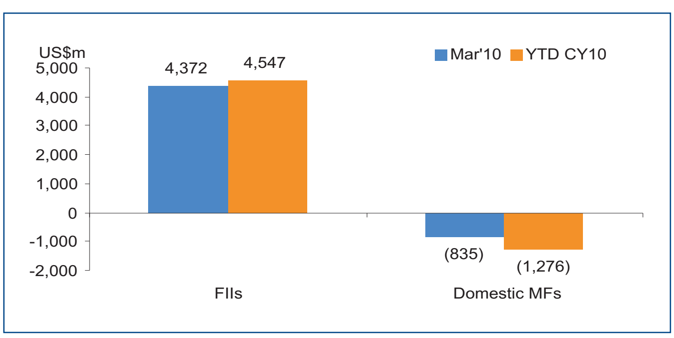
Indian Economic Outlook

- The Reserve Bank of India raised the policy rates (repo and reverse repo) by 25bp joining Malaysia as the second Asian central bank to hike rates.
- The repo and the reverse repo rate stand at 5.0% and 3.5%, respectively. The cash reserve ratio (CRR) was left unchanged at 5.75%.
- S&P raised the outlook on India's long term sovereign credit rating to stable from negative. The ratings for the long-term sovereign (BBB-) and short-term (A-3) bonds were maintained.
- Index of Industrial Production (IIP) for January grew by 16.7%, pretty much in line with the expectations. On M-o-M seasonally adjusted basis, IIP grew ~1% in January against ~4.6% in the previous month.
- India's Balance of Payment registered a small surplus of US$1.8bn in 3QFY10 compared to a surplus of US$9.4bn in previous quarter. Both export and import continue to show improvement sequentially as global economy recovers from the shocks of previous year.

Indian Equity Market Insights

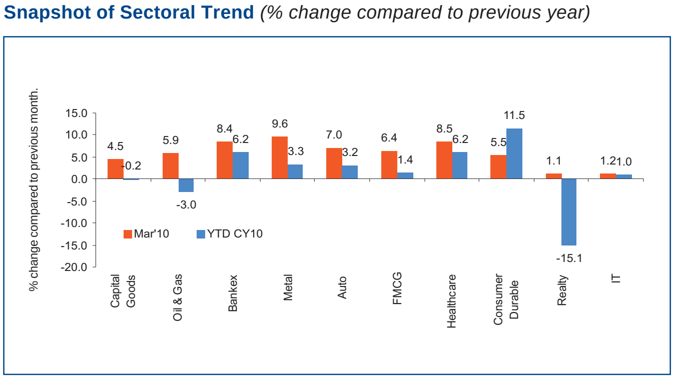
- Most global markets registered a good month with all key indices ending the month with gains of 5-6%. Japan was the best performing market amongst developed economies with gains of 9.5%.
- Indian markets also performed in line with its global peers and registered gains of ~7%. Mid cap indices were up by 7.5% and outperformed the large cap indices Sensex which ended the month with gains of 6.7%.
- After a lacklustre two months, FII turned aggressive on Indian market and invested US$4372m in Indian equities. Domestic MFs, however, did not share the sentiments and sold US$835m worth of equities.
- Metals and Healthcare were the two best performing sectors registering returns of 9.6% and 8.5%, respectively. Realty continues to be a laggard and has fallen by 15% since beginning of the year.

FII and MF Trend



Source: SEBI

Snapshot of Sectoral Trend *(% change compared to previous year)*



Source: Bloomberg

ING OVERVIEW OF SECTORAL TREND

INDUSTRIAL MANUFACTURING AND CONSTRUCTION

Financial closures of road BOTs have started to happen at accelerated pace, following NHAI's new norms that require developers to limit the number of projects that are pending financial closures. The opportunity in the sector is huge with execution being the only key challenge. We remain positive on the sector due to strong growth potential in the sector.

INFORMATION TECHNOLOGY

With US recovering, we expect strong volume growth for IT services companies in FY2011. However, pricing is likely to remain flat, coupled with wage inflation which can impact the margins negatively. Currency remains another key risk. Rupee has appreciated quite significantly over the last quarter against all major currencies and is likely to have a huge impact on profitability going forward. We have turned cautious on the sector with valuations of large cap IT player at almost 30% premium to broader market.

MEDIA

Most industry participants seem to be more confident of growth going into FY11. Most surveys put the ad growth for the year 2010 at ~12-14% compared to almost zero growth in year 2009. While the growth in the sector is strong, valuations continue to remain a concern. We remain cautious on the sector.

TELECOM

After a long delay the 3G auction process started in the month of March. The actual auction will be held from 9th April. There is a serious risk of overbidding for the 3G auction which can impact the financial condition of many operators. We continue to remain negative on the sector.

UTILITIES

The high merchant power rates (MPR-The spot purchasing rate of power) currently prevailing are unsustainable. The frenzy over high merchant power prices will subside as factors such as long-term PPA (Power Purchase Agreement) capacity, the parlous finances of state utilities and regulatory bottlenecks come into play. In addition to power deficit, other factors such as fresh long-term PPA capacity, fragile state utilities reeling under losses and the willingness of state regulatory bodies to allow recovery of high power-purchase costs could play pivotal roles in governing merchant power rates. Merchant rates slid significantly in 2HFY10 which attributed to greater procurement in 1HFY10 and better grid discipline. The weighted exchange-traded price rose to Rs 5.5/kWh(Mar'10-mtd) from Rs. 3.20-3.40 (Jan-Feb '10). The addition of capacity against long-term-agreements (14 GW) and IPP (Independent Power Producer) capacity (2 GW) in the short-term market would benefit states such as Maharashtra, Punjab, Haryana and Uttar Pradesh, as also major buyers in the merchant market. PPA capacity is designed for base-load; so we expect the peak deficit to continue. We prefer Utilities with low exposure to the merchant market, keeping underweight on the sector.

FMCG

FMCG sector is reeling under price cuts especially in the non premium space. Competition in laundry space has intensified further with P&G announcing another round of price cuts (20-50%) recently for its Tide and Tide Naturals brand (powder and bars) in response to a 30% price cuts initiated by HUL for its Rin brand. The price reductions are being accompanied by higher trade promotions and brand investments which will keep A&P (Advertising and Promotional) spends at elevated levels. Battle for mind/wallet share will also intensify in potentially high growth categories like hair and skin care: Global home and personal care majors like L'Oreal, Beiersdorf and J&J are looking at innovative products, affordable price points and more distribution platforms to capture mind share from incumbents. They are fairly well capitalized and present a medium term risk of irrational competition rising in the market as new entrants will likely value market share gains over profitability. Input costs firming up. Palm Oil, HDPE and crude prices have risen by 20%, 7% and 12% respectively over past six months and pose further risk to margins for FY11E if the uptrend continues. Valuation is rich in light of the ongoing price sensitivities; hence we maintain an Underweight on FMCG.

METALS

The larger iron ore producers are moving towards shorter term iron ore contracts, of three months duration, rather than the yearly contracts earlier. The first contracts are likely to be signed at an 80% to 100% hike over the contract prices for last year. The domestic steel producers have already raised prices by Rs 2,000-2,500/tonne in the last three months for flat products in anticipation of raw material cost increases. They are likely to announce a further hike of Rs 2,000-3,000/tonne with effect from April. If raw materials remain strong and no further hikes are announced, domestic producers without integration for iron ore and coal would be adversely impacted.

CEMENT

Cement prices have recovered across the country, driven by strong demand and production cuts, especially in South India. While the March quarter tends to be the strongest quarter in terms of demand, demand momentum could ease with the onset of the monsoon season. Further, commissioning of 30 million tonnes of capacity will add to the annualized capacity of 250 million tonnes as at January 2010 which will worsen the oversupply situation. The combination of slowing demand and increased supply could result in cement prices correcting across the country during the monsoon months, with some pockets experiencing more severe fall in price.

AUTO

The increase in excise duty in the union budget and the rise in petrol and diesel prices have resulted in an increase in monthly running costs for automobiles by 3-4%. While we do not expect the increase in product prices to have a meaningful impact on demand, sector growth rates will moderate in FY2011 over the high base of FY2010. However, margins for most auto companies have peaked as companies will find it increasingly difficult to pass on higher input costs in the face of increasing competition.