

# GOOD SHOW CONTINUES

Monsoon, Pay Commission and government spending to aid corporate growth in next three quarters

**KRISHNA KANT, RAM PRASAD SAHU, SHEETAL AGARWAL & UJVAL JAUHARI**

Corporate earnings improved during the April-June 2016 quarter, driven by higher volumes in manufacturing sectors and continued gains from lower prices of raw materials and energy. Combined net sales for around 1,600 companies, excluding the financial and oil & gas sectors, was up 6.4 per cent year-on-year (y-o-y), during the first quarter of FY17, growing at the fastest pace in the last six quarters. The combined net profit for the sample was up 11.7 per cent y-o-y during the quarter, down from 79 per cent y-o-y growth in the preceding quarter, but it kept the hopes of bulls on Dalal Street alive. Lower input prices resulted in a further decline in corporate India's input costs while core-operating margin (excluding other income) at 19.8 per cent of net sales was at a four-year high. Every ₹100 worth of net sales cost ₹39.7 worth of raw materials in the quarter ended June, down from a high of ₹46.7 in the quarter ended December 2012. Corporate India, however, continues to feel the effect of higher consumer inflation through a creeping rise in employee costs.

CORPORATE EARNINGS IMPROVE			
y-o-y growth (%)	Net sales	Net profit	
Sep '14	8.2	29.5	
Dec '14	8.0	11.2	
Mar '15	3.2	-50.3	
Jun '15	0.9	3.0	
Sep '15	3.4	13.0	
Dec '15	1.3	-0.6	
Mar '16	4.5	79.1	
Jun '16	6.4	11.7	

Every ₹100 worth of net sales cost ₹14.9 worth of salaries, nearly 50 per cent higher than four-year low of ₹9.5 per cent in the December 2012 quarter. This wage inflation could start biting once gains from lower input costs start to fade later this year. For the software sector, this is already an issue. Banks, on the other hand, continue to battle bad loans and slow credit growth, but

the intensity of the problem seems to have softened. The sector's combined net profit was down for the third consecutive quarter, but the worst seems to be behind. Consumer demand from good monsoon, Pay Commission awards and government spending will drive corporate growth for the next three quarters. The bull run on Dalal Street may last for a while.

## CEMENT

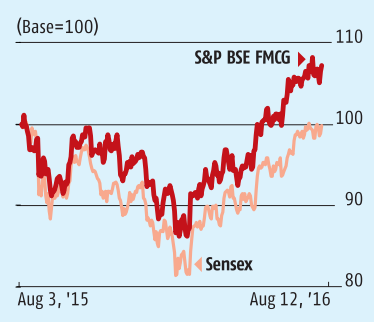
June 2016 quarter (% change y-o-y)	Net sales	PBIDT	Net profit	Operating margin (bps)	CMP
UltraTech Cement	4.1	25.0	29.2	416	33.3
ACC	-3.1	34.3	79.2	465	21.5
Ambuja Cements	1.9	46.7	76.5	862	29.8
Ramco Cements	4.3	19.8	57.1	419	36.9
Birla Corp	16.6	112.6	278.1	911	41.0

- Cement makers' profitability got a boost during the quarter
- Demand was flat and volume growth was muted in most regional markets and cement

- prices were flat on all-India basis
- Lower fuel costs aided by increased pet coke usage and lower freight costs helped margins, and hence higher Ebitda, per tonne
- September quarter may be subdued as monsoons hit construction activities and prices
- Analysts remain positive given demand triggers from rural India and infrastructure spend

## FMCG

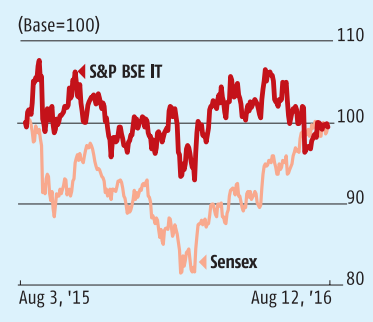
June 2016 quarter (% change y-o-y)	Net sales	Raw material	Net profit	Operating margin (bps)	CMP
ITC	9.7	12.1	10.1	-12	16.09
Hindustan Unilever	3.6	3.0	9.8	139	7.92
Asian Paints	9.0	12.2	18.5	239	28.75
Godrej Consumer	6.8	21.0	109.3	626	17.38
Britannia	8.5	12.4	13.2	80	11.05



- FMCG companies witnessed flattish volume growth
- The hair oil, oral care and health food drinks categories remained under pressure
- Colgate and Emami outperformed as new launches and acquisitions improved their volumes and realisations
- Most players took select price hikes even as operating margin continue to be robust
- Rural growth continued to lag urban growth but could improve in coming quarters on good monsoon, higher rural income from pay hikes and OROP trigger among others

## INFORMATION TECHNOLOGY

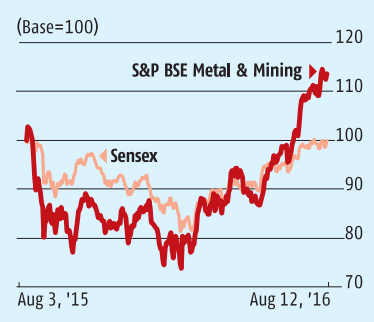
June 2016 quarter (% change y-o-y)	Net sales	Employee cost	Net profit	Operating margin (bps)	CMP
TCS	14.2	15.7	9.4	-102	12.0
Infosys	16.9	15.3	13.5	-48	-3.7
Wipro	10.7	11.8	-6.4	-254	-2.9
HCL Technologies	20.4	-	11.3	25	-5.0
Tech Mahindra	10.0	8.1	28.0	206	-5.6



- Most companies witnessed a slowdown in revenue growth in an otherwise seasonally strong quarter
- Cut in revenue guidance by Infosys was a key dampener
- Like Infosys, TCS too reported weak growth in the BFSI vertical
- HCL Technologies started providing full year guidance and expects to post industry leading growth this fiscal
- Wipro's struggle continues; it will have to improve meaningfully to restore investor confidence
- Brexit could impact companies' revenue growth and lead to forex losses in the near term

## METALS & MINING

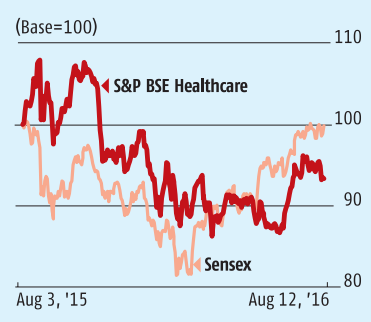
June 2016 quarter (% change y-o-y)	Net sales	PBIDT	Net profit	Operating margin (bps)	CMP
Vedanta	-15.2	-9.4	-27.0	204	83.8
JSW Steel	2.4	89.6	5,133.6	1,317	67.0
Hindustan Zinc	-30.4	-22.4	-46.6	719	49.2
Jindal Stainless	28.2	96.4	-	441	-10.6
Hindalco	-11.90	34.50	381.30	621	72.51



- With base metal prices rebounding from lows, most companies reported sequential improvement in performance
- Steel players saw full benefits of better prices in June quarter as minimum import price on imports was imposed in February
- Hindalco and Vedanta witnessed improvement in profitability with aluminium being the third-best performing base metal
- Zinc and nickel prices have rallied most benefiting Hindustan Zinc. Lower coal and ore prices improved operating show of all players

## PHARMACEUTICALS

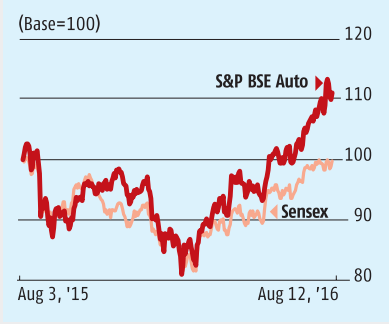
June 2016 quarter (% change y-o-y)	Net sales	Raw Material	Net profit	Operating margin (bps)	CMP
Sun Pharma	22.7	10.2	265.8	1,934	-2.21
Lupin	40.0	12.1	55.1	301	-14.09
Cipla	-6.9	-21.8	-43.7	-1,120	-20.45
Dr Reddy's Labs	-14.0	-9.3	-76.3	-1,420	-3.16
Cadila Healthcare	-2.2	-12.8	-22.6	-213	12.61



- Most top companies saw weak domestic growth due to drug price control, fixed dose combination ban and supply issues
- Gains on exclusivity for Lupin, Sun Pharma but pricing pressures dented generic sales in the US for all companies
- Forex volatility, weak markets spoil emerging market performance
- US regulatory concerns continue to hamper sales with companies looking at transfer to other sites to overcome pressure
- Plant clearances, new launches and the US pipeline will be the key triggers for top companies

## AUTOMOBILES

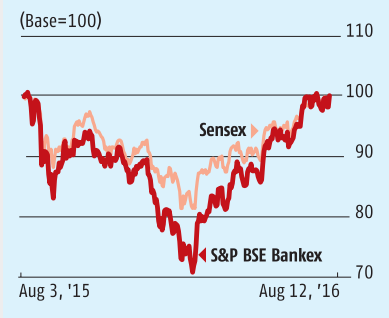
June 2016 quarter (% change y-o-y)	Net sales	Raw material	Net profit	Operating margin (bps)	CMP
Maruti Suzuki	12.1	10.9	23.0	27	6.1
Mahindra & Mahindra	12.3	-3.1	12.4	11	14.1
Hero Motocorp	7.1	3.4	18.1	168	22.9
Bajaj Auto	2.8	3.5	13.8	85	13.2
Motherson Sumi	16.1	13.8	15.8	7	8.7



- Two-wheeler revenue growth aided by strong domestic volumes for most companies
- Lower commodity costs and higher realisations aided margins. Royal Enfield continued to boost Eicher's margins, weak auto margins for M&M
- Muted export growth dented revenue and profit growth of Bajaj Auto and auto component makers
- Despite growth in volumes, discounts and price cuts continue to impact cars, utility and truck makers

## BANKS & FINANCE

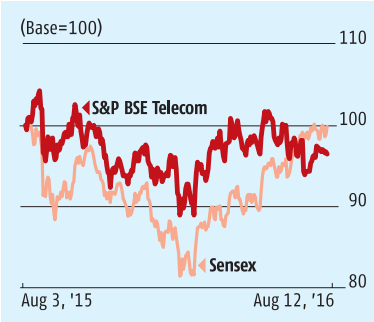
June 2016 quarter (% change y-o-y)	Net interest income	Provisions	Net profit	GNPA (bps)	CMP
State Bank of India	4.2	85.3	-31.7	265	8.4
HDFC Bank	21.8	19.1	20.2	9	13.4
ICICI Bank	0.8	163.2	-25.0	219	-5.9
Punjab National Bank	-9.8	51.2	-57.5	728	6.2
HDFC	48.4	-	37.5	6	9.2



- Even after stepping up provisions to meet the asset quality review needs, most banks continued to witness high slippages in the quarter
- The commentary around asset quality remained cautious
- Banks like Punjab National Bank and Bank of Baroda returned to profitability in the quarter
- Sharp improvement in PNB's recoveries was a key positive, likely to continue
- SBI outperformed peers with healthy reduction in bad loan additions in Q1

## TELECOM & MEDIA

June 2016 quarter (% change y-o-y)	Net sales	PBIDT	Net profit	Operating margin (bps)	CMP
Bharti Airtel	7.9	-11.1	-30.8	-773	2.3
Idea Cellular	7.9	1.4	-74.2	-212	-34.7
Tata Communications	-2.9	1.1	-3.5	65	10.2
Zee Entertainment	18.5	28.0	21.8	196	15.7
Bharti Infratel	5.9	5.9	70.9	-3	-14.4



- Led by highest voice growth in six quarters, Bharti Airtel's margins exceeded expectations
- Idea Cellular disappointed as the fall in voice volumes was higher than peers
- Though data volumes were strong, realisations continue to head south as companies invested in increasing data usage and expand customer base
- Sluggish tenancy additions dented the performance of Bharti Infratel
- Zee outperformed yet again on strong advertising and stable subscription revenue growth

Note: PBIDT is profit before interest, depreciation and tax; GNPA is gross non-performing assets as % of advances; positive number in basis points means that bad loans have increased; CMP is current market price as of Aug 12, 2016; All figures are y-o-y change in % for quarter ended June 2016; Price change is year-to-date change; change in operating profit and GNPA are in basis points

Source: Capitaline; Compiled by BS Research Bureau