

5 February 2009 | 16 pages

India Equity Strategy

Earnings Tracker 2: Falling and Flailing

- We are there – India’s earnings growth is negative** — India’s earnings have been falling and flailing (all over the place); for the first time in 6 years, Sensex earnings growth (ex-Oil) is -4.5%, wider CIR universe is -10% (includes oil down 58%), and the wider BSE500 index is down 16%. So, the wider the set, the deeper the pain. India’s nadir on earnings growth was -14% in 2001 (full year) – but the next year saw a 7% bounce-back. Currently, we are clearly not as optimistic – forecast -1% earnings growth in FY10.
- Sales Slump, while margins fare a tad better** — Sales finally take a hit – while the headlines suggest a crush (32%yoy down to 7%yoy) – even excluding oils/metals (commodity price impact), sales momentum falls off from 24% to 16%yoy. Margins are not as bad a story; down 219bps yoy, but actually up 1bps qoq – suggesting some benefits coming through on costs. We see further sales growth pressures ahead, on demand, and the now deflationary environment.
- The broader market hurts more** — Earnings and growth pressures significantly higher at the broader level. Sales for BSE-500 cos are up + 9% yoy (+38%, Sep08), margins are down 430bps yoy (though up 63bps qoq), and profits are down 16% (10%, ex-oils). Bottom-line - earnings/growth pressures are far deeper in the broader economy, than Sensex/CIR universe.
- Leaders and Laggards** — Banks (bond gains, and questions on quality), utilities and Pharma have done better than expected; but it’s a long tail of disappointments led by Capital goods, Real estate, Metals, Auto and energy. The quarter has been impacted by sharply falling Oil and Metal prices, FX losses (5-7% of Ebidta), and macro/funding volatility (globally); but a weak demand/economic environment, should keep us braced for more.

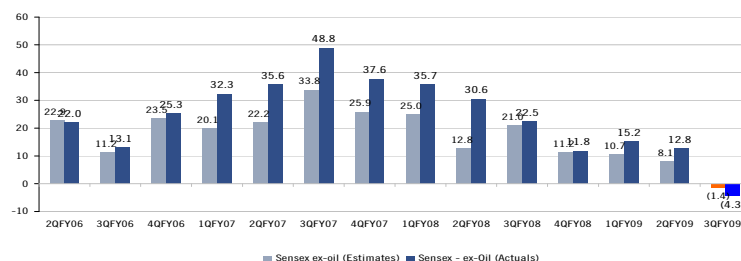
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Figure 1. Sensex ex-oil Earnings Trend: Estimates vs. Actuals



Source: Citi Investment Research

See Appendix A-1 for Analyst Certification and important disclosures.

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India Equity Strategy

Falling and Flailing

Earnings growth a little weaker than expected (-4% vis -1% expectation)....and in negative territory, for the first time since 2001...oil and metals major contributors, but even excluding them, there is de-growth

Figure 2. CIR Universe 3QFY09 Results (Growth in Percent YoY)

Sector	Sales		EBITDA		PAT		Est. vs. Act.
	Expected	Actual	Expected	Actual	Expected	Actual	
Sensex (29/29)	14.0%	4.4%	4.2%	-5.8%	1.0%	-10.0%	↓
Sensex ex-oil (28/29)	14.1%	6.8%	3.0%	0.8%	-0.9%	-4.3%	↔
Citi Universe	25.7%	7.3%	5.2%	-10.0%	-11.0%	-10.0%	↔
Citi Universe Ex-oil	11.8%	13.2%	2.6%	3.5%	0.0%	-4.5%	↔

Source: Citi Investment Research

Figure 3. CIR Universe 3QFY09 Results in Detail (Growth in Percent YoY)

Sector	Sales		EBITDA		PAT		Est. vs. Act.
	Expected	Actual	Expected	Actual	Expected	Actual	
Citi Universe ex-fin	25.4%	5.8%	1.6%	-21.5%	-18.7%	-19.2%	↔
Sensex ex-Energy	14.0%	12.0%	4.4%	2.4%	1.9%	-3.3%	↓
Sensex ex-fin	13.1%	3.1%	1.6%	-11.2%	-2.1%	-14.6%	↓
Sensex ex-oil, ex-fin	13.2%	5.5%	-0.6%	-4.2%	-5.0%	-8.8%	↔
Citi Univ. ex-Real Estate	26.5%	8.6%	7.5%	-6.3%	-9.1%	-5.4%	↔
Citi Univ. ex-oil, Real Estate	13.2%	16.2%	5.4%	9.3%	3.7%	2.5%	↔
Citi Univ. ex-Metals	27.5%	8.1%	7.8%	-7.3%	-10.1%	-7.4%	↔
Citi Univ. ex-oil, Metals	14.1%	15.8%	5.7%	8.8%	2.7%	-0.1%	↔
Citi Univ. ex-oil, Metals, Real Estate	15.7%	19.4%	9.2%	16.0%	7.2%	8.5%	↔

Source: Citi Investment Research

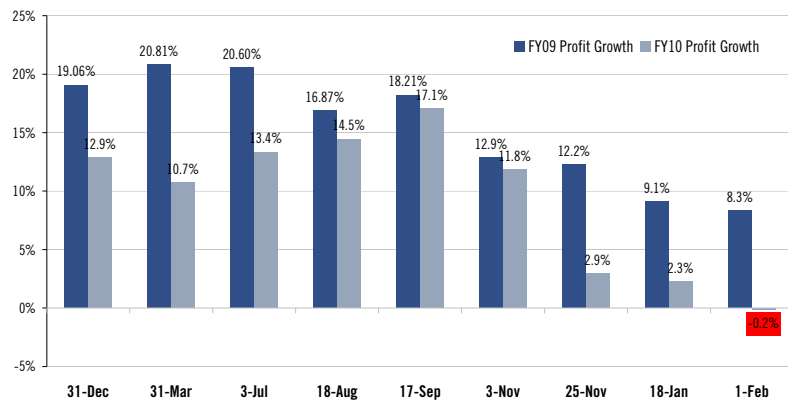
Dec-08 was decisively worse than Sep-08, on sales, EBIDTA and profits

Figure 4. CIR Universe 3QFY09 Profits (Growth in Percent QoQ)

Sector	Sales		EBITDA		PAT	
	Expected	Actual	Expected	Actual	Expected	Actual
Sensex (29/29)	-4.8%	-12.8%	-3.3%	-12.6%	-5.3%	-15.5%
Sensex ex-oil (28/29)	-5.2%	-11.2%	-5.0%	-7.0%	-6.5%	-9.7%
Citi Universe	3.1%	-12.0%	40.9%	20.6%	29.9%	31.2%
Citi Universe Ex-oil	-2.4%	-1.3%	-3.4%	-2.5%	-1.7%	-6.2%

Source: Citi Investment Research

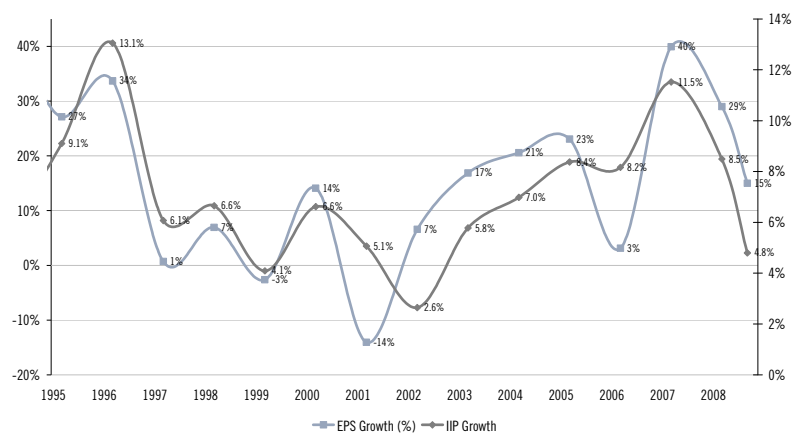
Figure 5. Revisions in Sensex FY09E, FY10E Earnings Growth Since 31-Dec-2007



Source: Citi Investment Research

It looks only a tad better ahead....we forecast a -1% earnings growth into the next year....the last time earnings fell (2001, full year), they bounced back sharply in the next year...our numbers suggest it will be different this time (though we expect +8% growth in the current full year)

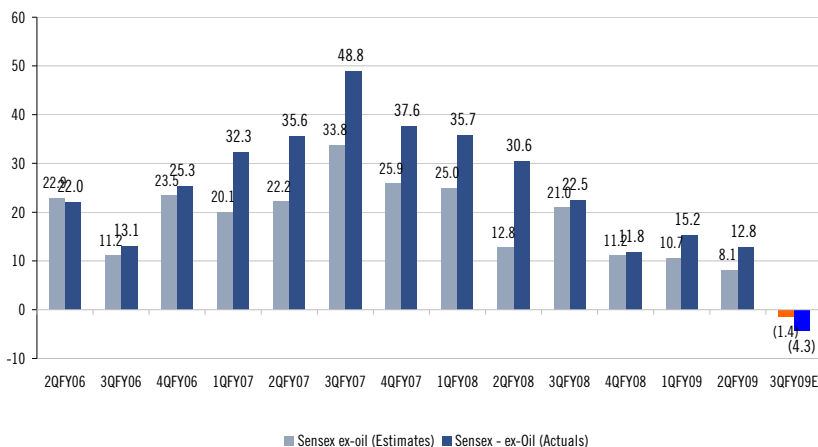
Figure 6. Sensex EPS Growth and IIP Growth



Source: Citi Investment Research

Earnings have fallen off-sharply....from +12% in 2Q08, to -4.3%...scale of the fall the highest in the recent past too

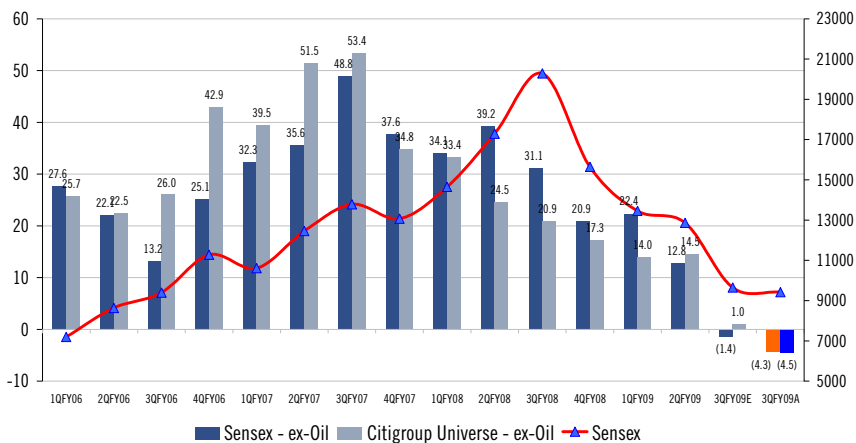
Figure 7. Sensex ex-oil Quarterly Earnings Growth vs. Estimates Trend (Percent YoY)



Source: Citi Investment Research

Earnings growth is falling off more rapidly than it went up..... we don't call an early bounce, and expect marginally negative growth in the next full year

Figure 8. Sensex and CIR Universe ex-oil Earnings Growth Trend

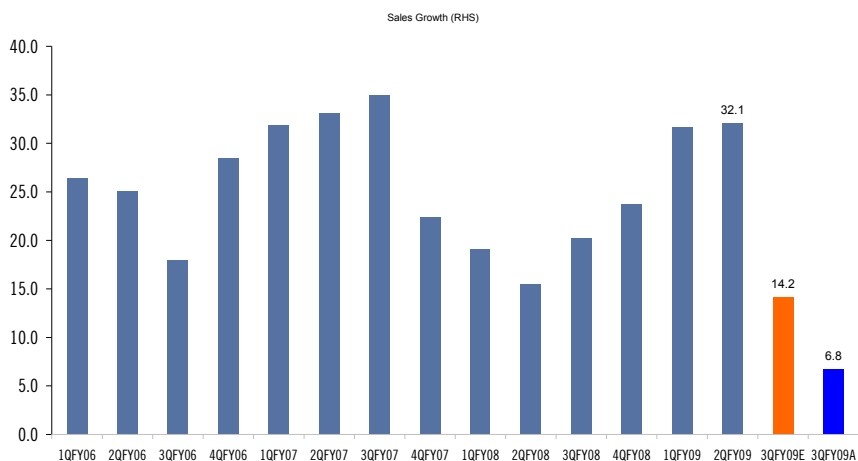


Source: Citi Investment Research

Sales Slump

Sales slump well beyond expectations...while pressured by falling oil and commodity prices, even excluding them, sales growth is down from 24% to 16%, suggesting falling domestic demand and a deflationary environment are showing

Figure 9. Sensex ex-oil Quarterly Sales Growth Trend

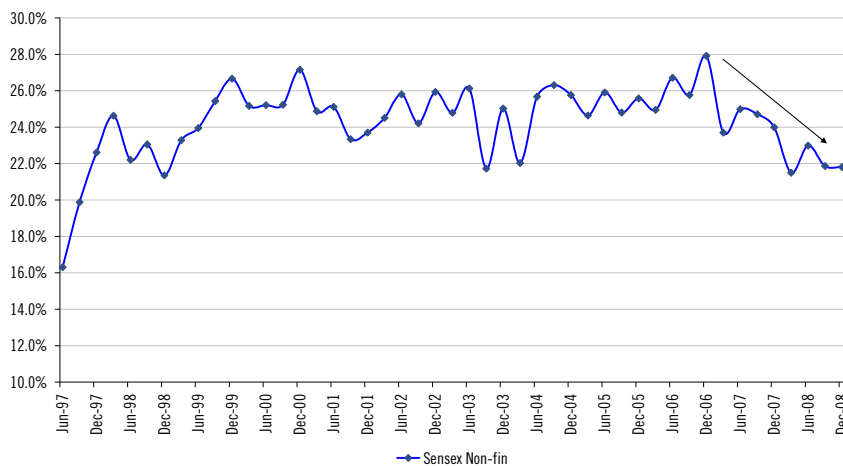


Source: Citi Investment Research

Margins are near a 10 year low

Margins have fallen precipitously over the year, and now appear at a near 10 year low...but they are up qoq, in spite of a significant sales slide, suggesting some cushion from falling costs

Figure 10. Sensex Long-term EBITDA Margin Trend

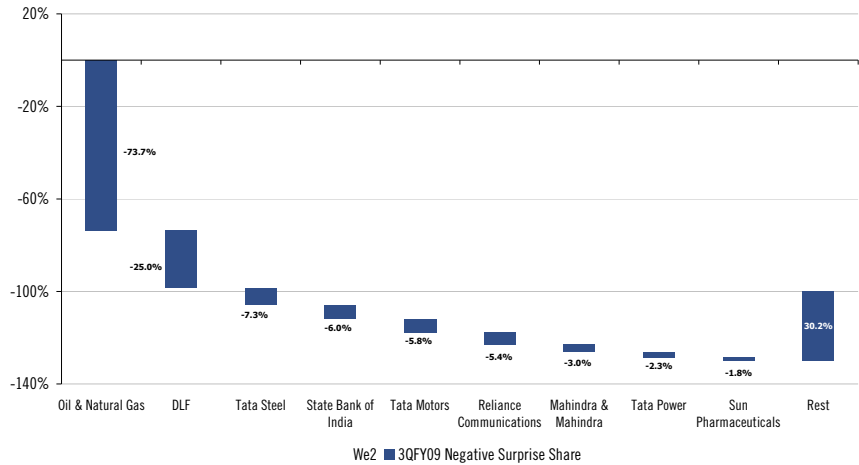


Source: Citi Investment Research

Some major players disappointed..... almost 75% of the negative surprise was due to ONGC, DLF and Tata Steel.

Some big disappointments

Figure 11. 3QFY09 Profits: Share of Negative Surprise in Sensex Companies

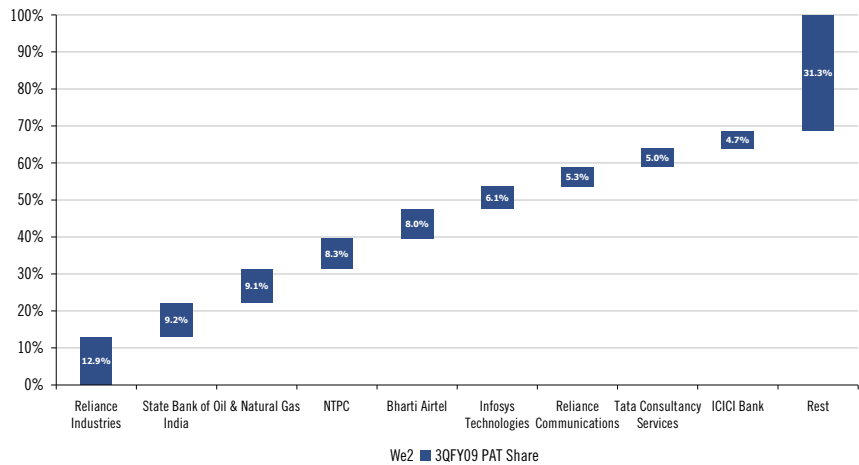


Source: Citi Investment Research

Profit share though is a little more democratic....with the Oil majors hurting, the top 5 companies now account for about 50% of sensex profits, against 80%+ in the previous quarter

Profit concentration is falling

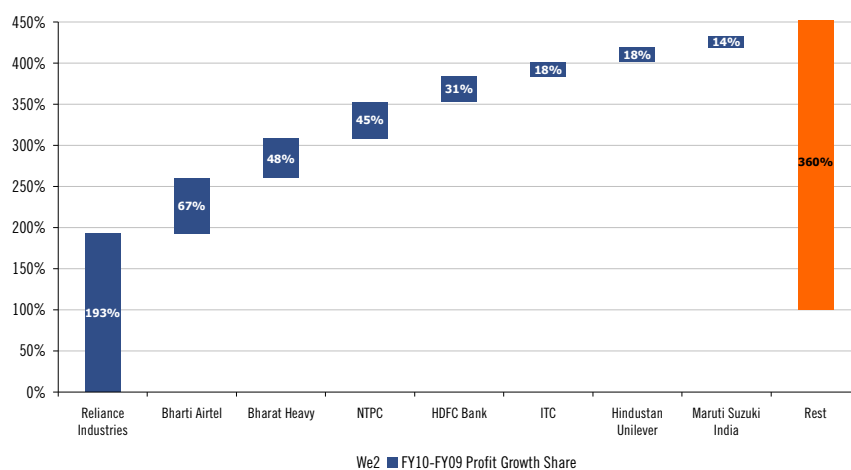
Figure 12. Actual 3QFY09 Profit Share of Sensex Companies



Source: Citi Investment Research

Into the next year, we expect a lot of companies to de-grow.....and overall earnings growth concentration in a few companies should be very high

Figure 13. Sensex FY10E Profit Growth Share



Source: Citi Investment Research

Sharp sector divergence,

More disappointments than surprises

Figure 14. CIR Universe 3QFY09 Results by Sector (Growth in Percent YoY)

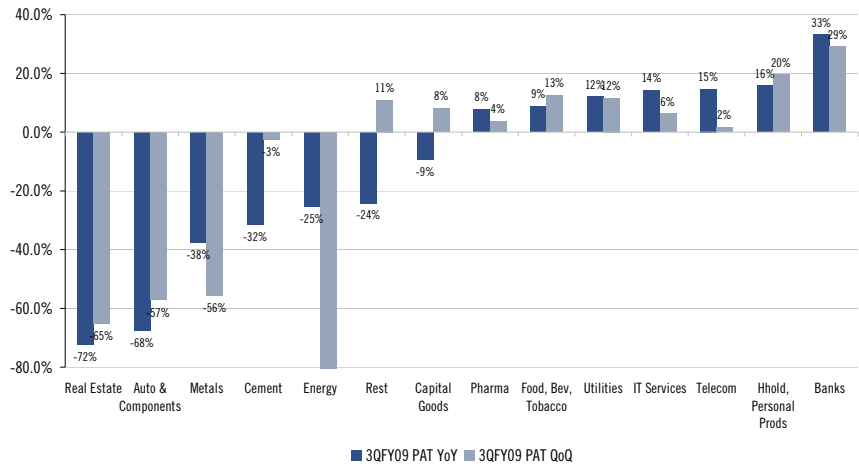
Company	Sales		EBITDA		PAT		Est. vs. Act.
	Expected	Actual	Expected	Actual	Expected	Actual	
Auto & Components	-17.6%	-17.9%	-48.4%	-54.5%	-53.9%	-67.6%	↓
Banks	28.1%	31.3%	15.4%	30.8%	22.2%	33.2%	↑
Capital Goods	9.3%	27.8%	0.4%	-3.4%	-1.2%	-9.4%	↓
Hotels	-27.5%	-14.3%	-58.5%	-32.7%	-66.2%	-39.8%	↑
Div. Financials	58.9%	66.9%	63.4%	14.7%	66.7%	15.3%	↓
Energy	38.1%	2.1%	14.5%	-58.5%	-41.5%	-25.3%	↑
Food, Bev, Tobacco	16.5%	10.9%	4.1%	12.8%	7.5%	8.7%	↔
Hhold, Personal Prods	25.2%	19.0%	12.6%	10.6%	19.7%	15.8%	↔
Metals	-4.9%	-6.2%	-20.8%	-35.9%	-19.7%	-37.6%	↓
Cement	6.1%	7.6%	-29.6%	-27.0%	-36.9%	-31.5%	↑
Media	21.5%	10.7%	9.2%	-12.8%	5.6%	-6.4%	↓
Pharma	20.5%	20.8%	9.7%	25.6%	1.0%	7.7%	↑
Real Estate	-20.4%	-61.5%	-33.0%	-70.0%	-35.6%	-72.5%	↓
Retailing	33.0%	20.9%	43.3%	40.7%	21.8%	-60.6%	↓
IT Services	30.5%	28.3%	27.7%	34.6%	12.8%	14.3%	↔
Tech Hardware	16.9%	24.9%	21.7%	38.4%	-100.0%	25.1%	↑
Telecom	34.2%	33.0%	25.8%	23.6%	20.2%	14.7%	↓
Transportation	13.8%	24.6%	-52.0%	25.2%	170.0%	135.0%	↓
Utilities	19.3%	27.9%	4.7%	16.8%	6.4%	12.0%	↑

Source: Citi Investment Research

Wide divergence in performance...banks and consumer take the lead, Real estate and Auto make up the rear

The sharp slowdown in consumption is reflected in the performance of Auto, Real Estate, Media, and Retailing sectors

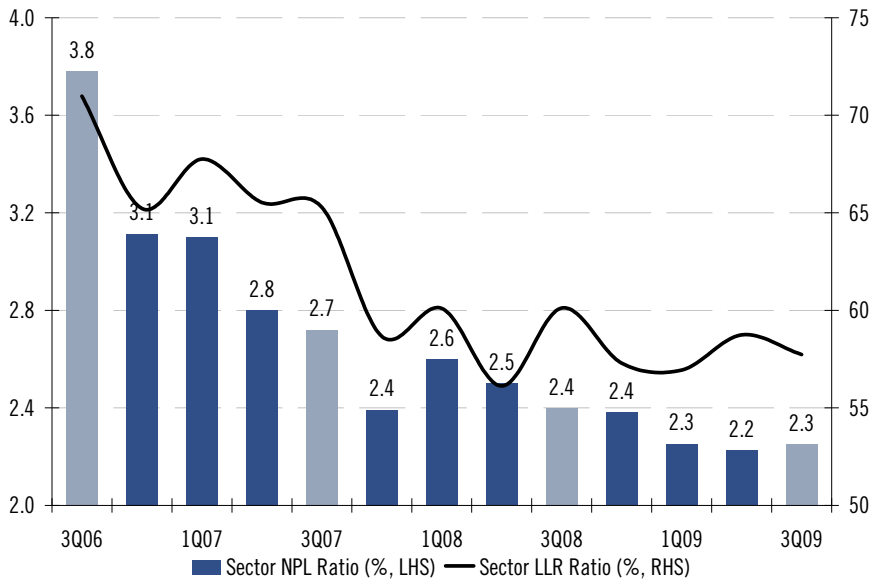
Figure 15. CIR Universe 3QFY09 Profits by Sector (Percent YoY & QoQ)



Source: Citi Investment Research

The banks do well on profitability, but asset quality shows signs of strains, with suspicions of yet unrecognized pressures

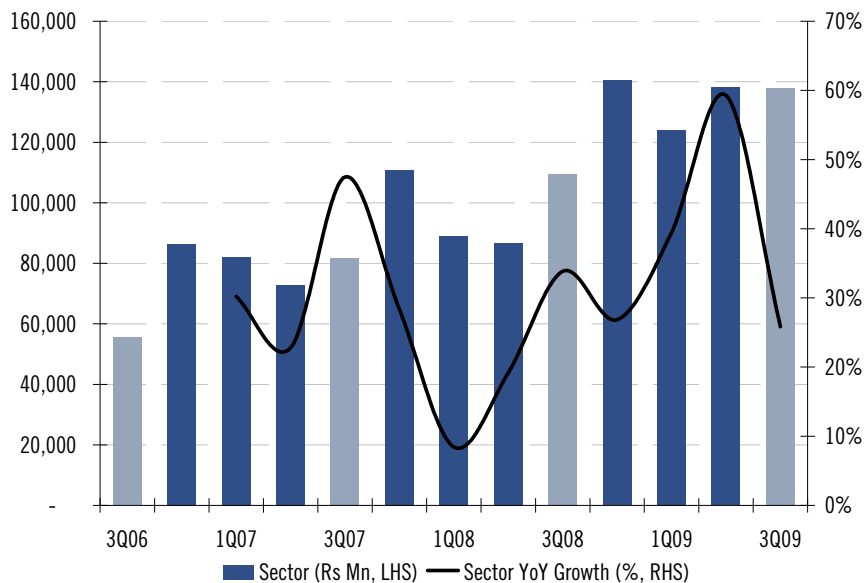
Figure 16. Banks: Gross Non-Performing Loans & Sector LLR



Source: Citi Investment Research

Strong banks profits have been boosted by trading gains...excluding them, profits are up 23% instead of headline 32%

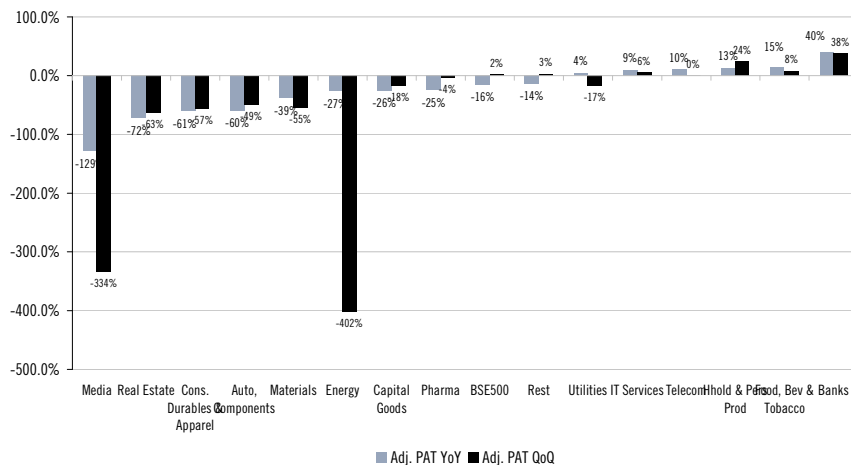
Figure 17. Banking Sector Pre-Provision Profits ex-Trading Gains



Source: Citi Investment Research

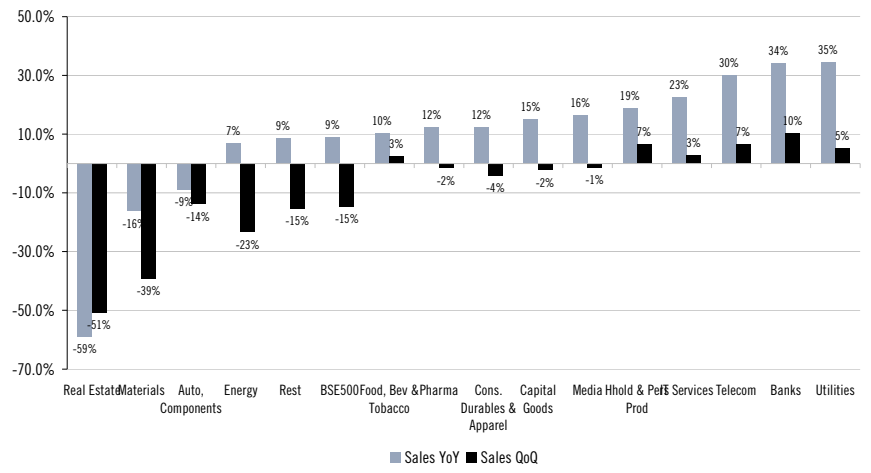
Broad market performance in the quarter shows the extent of the slowdown—Sales growth is sharply down to 9% (6.6% excl. financials), compared to 38% last quarter, key sectors are Real Estate, Hotels, and Commodities. Most other sectors are also feeling the pain on interest costs and tight liquidity.

Figure 18. BSE500 3QFY09 Profits by Sector



Source: Citi Investment Research

Figure 19. BSE500 3QFY09 Sales by Sector



Source: Citi Investment Research

Tables

Figure 20. CIR Universe 3QFY09 Results by Sector (Growth in Percent QoQ)

Sector	Sales		EBITDA		PAT	
	Expected	Actual	Expected	Actual	Expected	Actual
Auto & Components	-20.2%	-20.5%	-35.8%	-43.3%	-39.2%	-57.2%
Banks	4.7%	7.3%	7.4%	21.7%	18.5%	29.1%
Capital Goods	11.0%	29.8%	23.7%	18.9%	17.8%	8.0%
Hotels	-2.6%	15.0%	-10.2%	45.5%	-27.5%	29.2%
Div. Financials	4.3%	9.6%	11.5%	-21.8%	14.0%	-21.1%
Energy	7.4%	-20.6%	-395.2%	-207.0%	-351.0%	-420.3%
Food, Bev, Tobacco	7.0%	1.9%	11.9%	21.2%	11.2%	12.5%
Hhold, Personal Prods	8.9%	3.5%	20.0%	17.8%	23.6%	19.5%
Metals	-27.2%	-28.2%	-42.0%	-53.1%	-42.9%	-55.6%
Cement	4.0%	5.4%	4.7%	8.5%	-10.3%	-2.7%
Media	8.3%	-1.3%	27.7%	1.9%	5.0%	-6.9%
Pharma	0.7%	0.9%	-6.2%	7.3%	-2.9%	3.6%
Real Estate	-8.2%	-55.6%	-16.5%	-62.7%	-18.5%	-65.1%
Retailing	10.6%	0.6%	13.9%	11.9%	60.8%	-48.0%
IT Services	6.0%	4.2%	2.1%	7.6%	4.9%	6.3%
Tech Hardware	1.0%	7.9%	25.8%	43.0%	-100.0%	-38.7%
Telecom	7.5%	6.6%	7.2%	5.3%	6.6%	1.6%
Transportation	-11.6%	-3.2%	-139.3%	-202.5%	-36.0%	-44.3%
Utilities	2.0%	9.3%	-0.9%	10.5%	6.0%	11.6%

Source: Citi Investment Research

Margins erosion seems to have slowed down in this quarter, but the impact of falling input costs would take some time to take hold...

Margins continue to remain weak...across most sectors.

Figure 21. CIR Universe 3QFY09 Margins

Company	EBITDA Margin		PAT Margin		EBITDAM% Change		PATM% Change	
	Exp	Act	Exp	Act	Last Qtr	Last Year	Last Qtr	Last Year
Sensex (29/29)	27.9%	27.5%	17.4%	17.0%	7	(297)	(54)	(270)
Sensex ex-oil (28/29)	25.3%	26.4%	16.2%	16.7%	119	(156)	28	(193)
Citi Universe	16.1%	16.1%	9.3%	11.0%	435	(310)	361	(212)
Citi Universe Ex-oil	29.1%	29.0%	18.2%	17.1%	(36)	(271)	(89)	(317)
Citi Universe ex-fin	12.7%	11.7%	7.3%	8.6%	330	(407)	302	(268)
Sensex ex-Energy	29.0%	29.0%	18.9%	18.2%	(22)	(271)	(86)	(288)
Sensex ex-fin	24.1%	23.1%	15.5%	14.9%	(113)	(371)	(116)	(308)
Sensex ex-oil, ex-fin	20.8%	21.5%	14.0%	14.4%	1	(219)	(32)	(226)

Source: Citi Investment Research

Figure 22. CIR Universe 3QFY09 Margins by Sector

Company	EBITDA Margin		PAT Margin		EBITDAM% Change		PATM% Change	
	Exp.	Act.	Exp.	Act.	Last Qtr	Last Year	Last Qtr	Last Year
Auto & Components	8.0%	7.1%	4.8%	3.4%	(284)	(567)	(293)	(523)
Banks	80.3%	88.8%	45.8%	48.7%	1052	(34)	823	69
Capital Goods	12.1%	9.9%	7.6%	6.0%	(91)	(321)	(121)	(246)
Hotels	26.5%	36.3%	12.8%	19.3%	759	(993)	212	(817)
Div. Financials	32.9%	22.0%	23.9%	15.7%	(880)	(1002)	(614)	(706)
Energy	6.6%	3.2%	2.8%	4.8%	562	(471)	603	(177)
Food, Bev, Tobacco	31.0%	35.3%	22.2%	23.6%	563	59	223	(46)
Hhold, Personal Prods	14.3%	14.8%	12.7%	12.9%	179	(113)	172	(36)
Metals	26.6%	21.8%	17.0%	13.4%	(1158)	(1012)	(830)	(675)
Cement	21.9%	22.4%	12.3%	13.2%	64	(1062)	(109)	(751)
Media	36.8%	32.2%	24.2%	23.5%	101	(871)	(141)	(430)
Pharma	18.7%	21.4%	13.5%	14.3%	127	82	37	(174)
Real Estate	50.0%	46.3%	39.2%	34.7%	(873)	(1317)	(950)	(1382)
Retailing	8.7%	9.4%	2.0%	0.7%	96	133	(66)	(146)
IT Services	24.6%	26.4%	18.3%	18.8%	82	123	36	(231)
Tech Hardware	19.5%	20.7%	0.0%	-4.0%	508	201	305	(1)
Telecom	38.6%	38.3%	21.3%	20.5%	(45)	(291)	(100)	(328)
Transportation	2.7%	6.4%	-8.9%	-7.1%	1242	3	524	(333)
Utilities	27.2%	28.3%	17.5%	17.2%	30	(269)	35	(244)

Source: Citi Investment Research

Broad market performance in the quarter shows the extent of the slowdown—Sales growth is sharply down to 9% (6.6% excl. financials), compared to 38% last quarter, key sectors are Real Estate, Hotels, and Commodities. Most other sectors are also feeling the pain on interest costs and tight liquidity.

Figure 23. BSE500 3QFY09 Results (Growth in Percent YoY)

Sector	Count	Sales YoY			Adj. PAT		
		Dec-07	Sep-08	Dec-08	Dec-07	Sep-08	Dec-08
Banks	33	33.9%	29.6%	34.2%	41.5%	18.8%	40.3%
Div. Financials	22	19.1%	27.5%	11.5%	54.2%	-12.2%	-41.8%
Insurance	1		9.8%	-18.1%		-135.3%	-115.2%
Real Estate	20	263.6%	-4.5%	-59.1%	451.9%	-7.4%	-72.4%
Financials	76	40.5%	26.4%	23.1%	74.6%	7.0%	1.3%
Auto, Components	17	31.0%	12.3%	-8.8%	39.7%	-20.1%	-60.0%
Capital Goods	81	21.3%	30.5%	15.1%	26.3%	-3.6%	-26.1%
Cons. Durables & Apparel	14	26.1%	27.0%	12.4%	13.7%	-14.7%	-60.7%
Consumer Services	7	31.7%	22.9%	-10.9%	39.4%	19.8%	-37.1%
Energy	20	16.8%	54.4%	7.1%	8.6%	-118.1%	-26.6%
Food, Bev & Tobacco	22	17.0%	25.2%	10.4%	18.5%	15.6%	14.9%
Healthcare	3	23.6%	40.0%	16.7%	355.3%	121.6%	87.9%
Household & Pers. Prod	8	15.5%	21.9%	18.8%	10.8%	12.8%	13.4%
Materials	79	50.0%	36.8%	-16.3%	6.6%	33.0%	-38.5%
Media	21	60.3%	43.2%	16.5%	-1.9%	-82.0%	-128.6%
Pharma	27	14.6%	20.5%	12.3%	24.3%	-8.3%	-24.7%
Retailing	3	91.5%	68.2%	20.9%	94.7%	12.8%	-27.6%
IT Services	38	24.1%	28.0%	22.7%	31.8%	15.5%	9.2%
Tech. Hardware	9	13.2%	27.2%	16.6%	-57.7%	-40.7%	-4.0%
Telecom	9	28.2%	31.1%	30.1%	35.7%	6.2%	10.3%
Transportation	13	30.4%	60.3%	32.0%	-35.0%	-678.7%	-102.0%
Utilities	18	8.1%	30.0%	34.6%	-2.9%	23.5%	4.0%
Non-Financials	389	24.5%	39.6%	6.6%	13.4%	-25.3%	-21.8%
BSE500	465	26.7%	37.7%	9.0%	24.6%	-18.1%	-15.9%
BSE500 ex-Energy	445	31.8%	30.2%	10.0%	28.7%	12.3%	-13.6%
BSE500 ex-Energy, ex-Fin	369	29.6%	31.2%	6.3%	15.0%	14.4%	-20.3%

Source: Citi Investment Research

Margins seem to be improving gradually, up 63bps for non-financials sequentially, but not yet for Autos, Real Estate and Commodities

Figure 24. BSE500 3QFY09 Margins

Sector	Dec-07	Sep-08	Dec-08	YoY (bps)	QoQ (bps)
Banks	68.1%	71.4%	74.3%	618	283
Div. Financials	56.2%	64.0%	62.3%	602	(178)
Insurance	-38.4%	6.8%	28.1%	6644	2131
Real Estate	55.9%	53.3%	40.1%	(1577)	(1325)
Financials	65.6%	69.4%	72.0%	645	259
Auto, Components	11.8%	8.5%	6.4%	(543)	(216)
Capital Goods	10.8%	8.2%	7.2%	(360)	(106)
Cons. Durables & Apparel	12.1%	11.4%	10.6%	(150)	(79)
Consumer Services	45.4%	28.1%	32.8%	(1253)	476
Energy	10.4%	2.3%	6.8%	(359)	450
Food, Bev & Tobacco	17.6%	16.7%	16.3%	(122)	(40)
Healthcare	15.6%	19.9%	18.0%	241	(182)
Household & Pers. Prod	16.6%	13.1%	14.8%	(188)	168
Materials	22.0%	19.0%	14.5%	(748)	(451)
Media	25.5%	9.6%	7.8%	(1774)	(182)
Pharma	20.3%	16.1%	8.0%	(1232)	(812)
Retailing	9.3%	9.7%	10.0%	69	28
IT Services	21.6%	22.5%	22.8%	121	33
Tech. Hardware	7.4%	5.9%	6.5%	(86)	55
Telecom	36.2%	34.1%	31.3%	(483)	(277)
Transportation	14.0%	1.6%	8.9%	(519)	723
Utilities	28.2%	25.3%	21.0%	(719)	(424)
Non-Financials	15.7%	10.7%	11.3%	(437)	63
BSE500	23.2%	18.7%	21.6%	(158)	287
BSE500 ex-Energy	29.1%	27.4%	28.3%	(83)	84
BSE500 ex-Energy, ex-Fin	18.9%	16.3%	14.0%	(482)	(230)

Source: Citi Investment Research

Appendix A-1

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