Equities

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India Equity Strategy

2QFY12 Earnings Tracker 1: Holding Up Well

- **Just a little ahead** — Top down and bottom up downside risks were expected to show up this quarter; but so far; a little over halfway through the earnings season, actuals are a little ahead of expectations. Sensex ex –energy (14/28) profits are up 12% (vs. 10.5% expectations) while CIRA ex-Energy (53/122) up 13% (vs. 10% expectations). The upside/downside ratio 26/14 (18 in-line), also suggests corporate profitability is a little better than what the market has been extrapolating, albeit not by too much.
- **It is still a sales show, with margin pressure easing, but still there** — Corporate India continues to be able to sell; 21% growth for CIRA Univ ex-fin, energy (16% expectations, 22% last quarter); a mix of still decent demand, and some pricing power. Margin pressures however remain, down qoq, although the pace of this pressure has eased (with management commentaries now less downbeat on margins). We believe the worst on margins is now over with pressure likely to start shifting to the top line.
- **Most In line, with a few outliers** —The cement and metal sectors have surprised meaningfully on the upside, raising the overall averages, while most other sectors have stayed in line. The outliers this time around have been more company than sector specific, with a few positive (HUL, Jindal Steel & Power, Infosys, ICICI) and some negative (Maruti, Union Bank, PNB) surprises, and some guidance revisions (and cautious but steady commentary), but at aggregate, with a 26/14 upside/downside ratio, more positively than negatively biased.
- **Does it change things?** — We don't believe the results – so far - are decisive enough to change earnings or expectations meaningfully. The quarter does however challenge the top down expectation that there is still a long way for earnings to go down for FY12 – which we believe is not the case (only some modest revisions ahead). FY13 – which the market has not looked at yet, could however come under a little more scrutiny. Let's watch the rest of the season.

Figure 1. Sensex and CIRA Universe 2QFY12 Results (Growth in percent YoY)

	Sales		EBITDA		PAT		
Aggregate	Expected	Actual	Expected	Actual	Expected	Actual	Act. Vs. Est.
Sensex (15/30)	18.2%	26.3%	8.1%	9.3%	11.7%	13.2%	⇔
Citi Universe	21.4%	23.9%	-6.2%	-7.1%	-14.9%	-16.7%	⇔
Citi Univ ex-Fin	22.1%	24.4%	-9.4%	-12.4%	-20.8%	-23.2%	⇔
Citi Univ Ex-Energy	15.2%	20.0%	11.4%	14.3%	9.9%	13.2%	⇔
Citi Univ ex-Fin, Energy	15.8%	20.7%	13.0%	14.2%	8.6%	12.5%	⇔
Sensex ex-Energy	15.7%	19.5%	11.1%	11.2%	10.5%	12.3%	⇔
Citi Universe ex-Metals	21.1%	22.8%	-8.4%	-10.1%	-16.4%	-20.0%	⇔

Source: Company data, CIRA

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India Equity Strategy

2QFY12 Earnings: Holding up well

Ex – Energy, we are expecting high single digit growth for the market

Figure 2. Sensex and CIRA Universe 2QFY12 Estimates - Aggregates

	QoQ Growth—Expected			YoY Growth—Expected		
Sector	**Sales**	**EBITDA**	**PAT**	**Sales**	**EBITDA**	**PAT**
Sensex (30/30)	-1.3%	4.7%	8.0%	16.0%	13.2%	12.8%
Sensex ex-Oil (29/30)	-3.3%	-2.3%	-0.2%	15.5%	10.0%	8.6%
Citi Universe	-0.1%	3.3%	3.7%	20.0%	-2.9%	-17.2%
Citi Univ ex-Fin	-0.3%	2.9%	0.7%	20.4%	-6.1%	-22.3%
Citi Univ Ex-Energy	0.7%	-1.7%	-2.7%	14.1%	11.3%	5.8%
Citi Univ ex-Fin, Energy	0.3%	-4.0%	-7.8%	14.2%	11.4%	5.0%
Sensex ex-Energy	0.0%	-1.9%	-0.3%	13.8%	11.6%	7.4%
Sensex ex-fin	-1.6%	4.6%	5.5%	15.9%	12.7%	12.7%
Sensex ex-fin, energy	-0.3%	-3.9%	-5.2%	13.5%	10.3%	6.2%
Citi Universe ex-Metals	1.5%	9.9%	13.6%	21.7%	-4.7%	-20.5%
Citi Univ ex-Energy, ex-Metals	4.1%	5.0%	6.2%	15.4%	11.3%	5.1%

Source: Company data, CIRA

And so far – a little past midway, aggregates are 1-4% ahead of most groupings …the driver – sales growth – running a good 2-7% ahead, like in previous quarters

Figure 3. Sensex and CIRA Universe 2QFY12 Results (Growth in percent YoY)

	Sales		EBITDA		PAT		
Aggregate	**Expected**	**Actual**	**Expected**	**Actual**	**Expected**	**Actual**	**Act. Vs. Est.**
Sensex (15/30)	18.2%	26.3%	8.1%	9.3%	11.7%	13.2%	⇔
Citi Universe	21.4%	23.9%	-6.2%	-7.1%	-14.9%	-16.7%	⇔
Citi Univ ex-Fin	22.1%	24.4%	-9.4%	-12.4%	-20.8%	-23.2%	⇔
Citi Univ Ex-Energy	15.2%	20.0%	11.4%	14.3%	9.9%	13.2%	⇔
Citi Univ ex-Fin, Energy	15.8%	20.7%	13.0%	14.2%	8.6%	12.5%	⇔
Sensex ex-Energy	15.7%	19.5%	11.1%	11.2%	10.5%	12.3%	⇔
Sensex ex-fin	18.4%	26.7%	7.8%	8.9%	10.3%	11.7%	⇔
Citi Universe ex-Metals	21.1%	22.8%	-8.4%	-10.1%	-16.4%	-20.0%	⇔
Citi Univ ex-Energy, ex-Metals	13.8%	17.5%	10.0%	12.1%	10.6%	11.8%	⇔

Source: Company data, CIRA

Margins are down, and a little short of our expectations…we had thought they could surprise on the upside…not so far

Figure 4. Sensex and CIRA Universe 2QFY12 Margins (Growth in percent, Chg in bps)

	EBITDA Margin		PAT Margin		EBITDAM% Change		PATM% Change	
Aggregate	**Expected**	**Actual**	**Expected**	**Actual**	**Last Qtr**	**Last Year**	**Last Qtr**	**Last Year**
Sensex (15/30)	20.0%	18.9%	13.2%	12.5%	(4)	(295)	(4)	(145)
Citi Universe	16.0%	15.5%	9.2%	8.8%	(69)	(518)	(77)	(428)
Citi Univ ex-Fin	13.0%	12.4%	7.4%	7.1%	(109)	(519)	(96)	(439)
Citi Univ Ex-Energy	26.7%	26.3%	16.4%	16.2%	(163)	(132)	(149)	(98)
Citi Univ ex-Fin, Energy	21.6%	20.9%	13.5%	13.5%	(221)	(119)	(178)	(98)
Sensex ex-Energy	24.5%	23.7%	16.7%	16.4%	(72)	(177)	(63)	(104)
Sensex ex-fin	18.0%	17.0%	12.0%	11.4%	(12)	(276)	(17)	(152)
Citi Univ. ex-Metals	15.5%	15.0%	8.8%	8.3%	(25)	(548)	(45)	(446)
Citi Univ ex-Energy, ex-Metals	26.9%	26.5%	16.6%	16.3%	(84)	(128)	(94)	(84)

Source: Company data, CIRA

Cement and Metals margins bring up averages, with significant beats

Figure 5. CIRA Universe 2QFY12 Results by Sector (Growth in percent YoY)

Sector	Sales Expected	Sales Actual	EBITDA Expected	EBITDA Actual	PAT Expected	PAT Actual	Act. Vs. Est.
Auto & Components	3.2%	4.5%	-6.7%	-11.3%	-5.2%	-8.5%	⇔
Banks	9.7%	14.5%	6.8%	15.2%	14.5%	16.4%	⇔
Capital Goods	18.2%	21.2%	12.1%	23.5%	12.5%	14.9%	⇔
Div. Financials	9.7%	9.6%	8.7%	6.0%	7.5%	7.6%	⇔
Energy	28.5%	28.3%	-49.1%	-59.4%	-72.8%	-86.3%	⇩
Food, Bev, Tobacco	14.9%	18.0%	17.0%	17.8%	20.3%	21.5%	⇔
Hhold, Personal Prods	20.1%	20.9%	12.9%	15.7%	10.3%	12.2%	⇔
Metals	27.9%	42.7%	25.0%	35.6%	3.7%	25.7%	⇧
Cement	16.7%	24.9%	24.6%	30.1%	31.8%	48.3%	⇧
Media	19.4%	15.7%	23.9%	20.4%	30.8%	13.0%	⇩
Pharma	8.7%	16.8%	19.9%	24.8%	-2.8%	14.0%	⇧
Real Estate	-13.4%	17.5%	-29.3%	20.0%	-32.5%	2.7%	⇧
IT Services	22.2%	20.6%	15.9%	15.7%	12.7%	12.4%	⇔
Telecom	26.8%	26.2%	42.8%	37.0%	-20.0%	-51.3%	⇩
Utilities	8.2%	18.1%	4.1%	0.4%	7.4%	7.1%	⇔

Source: Company data, CIRA

But margins continue to drift lower qoq, although inconsistently so

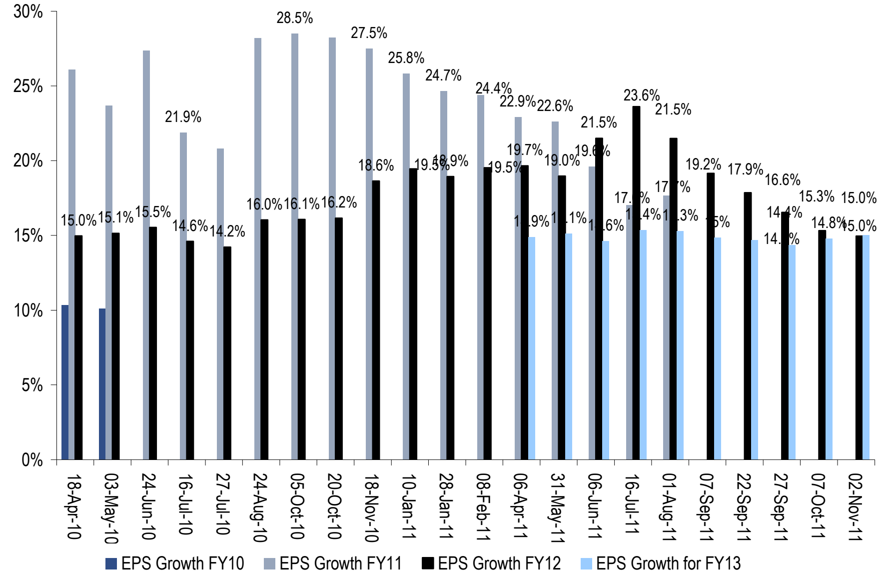
Figure 6. CIRA Universe 2QFY12 Margins by Sector (Growth in percent, Chg in bps)

Sector	EBITDA Margin Expected	EBITDA Margin Actual	PAT Margin Expected	PAT Margin Actual	EBITDAM% Change Last Qtr	EBITDAM% Change Last Year	PATM% Change Last Qtr	PATM% Change Last Year
Auto & Components	11.6%	10.9%	9.2%	8.8%	(81)	(194)	(90)	(124)
Banks	79.7%	82.4%	45.6%	44.3%	246	56	23	73
Capital Goods	9.7%	10.5%	7.2%	7.2%	(80)	20	(72)	(40)
Div. Financials	54.4%	53.1%	33.6%	33.6%	133	(181)	132	(62)
Energy	5.1%	4.1%	1.8%	0.9%	(85)	(880)	(81)	(751)
Food, Bev, Tobacco	36.0%	35.3%	25.8%	25.3%	263	(6)	224	71
Hhold, Pers. Prods	15.3%	15.6%	11.7%	11.8%	49	(70)	54	(91)
Metals	25.0%	24.3%	14.4%	15.7%	(712)	(127)	(535)	(212)
Cement	16.1%	15.7%	7.1%	7.4%	(1092)	62	(682)	117
Media	25.6%	25.7%	11.0%	9.8%	159	100	(166)	(24)
Pharma	19.7%	19.1%	11.0%	12.0%	105	124	65	(29)
Real Estate	31.6%	39.5%	24.2%	27.1%	951	83	(2469)	(390)
IT Services	24.5%	24.8%	17.8%	17.9%	82	(106)	(43)	(131)
Telecom	23.2%	22.4%	2.8%	1.7%	(99)	177	(168)	(272)
Utilities	28.2%	25.0%	16.4%	15.0%	(213)	(440)	(106)	(154)

Source: Company data, CIRA

Earnings expectations continue to hold relatively steady….we believe most of the earnings downgrades for FY12 are done…not necessarily so for FY13

Figure 7. Evolution of Sensex Earnings Growth Estimates



Source: Citi Investment Research and Analysis

Figure 8. Sector-wise trends in results

Sector	Comment
Real Estate	For the reported companies, topline is better than expectations as execution is largely on track. Margins pressures remain and interest expense has gone up. Operationally, sales momentum remains muted on the back of high prices and rate hikes. Commercial segment is beginning to see some demand slowdown.
Metals	Companies with US denomiated debt have been impacted due to the weakening of the rupee. Steel companies have been adversely hit on their coking coal imports due to the movement of the currency. While the companies consider this a notional loss - unless the rupee recovers, the impact on raw material costs will be negative. The weak rupee is however positive for domestic steel/non-ferrous metal prices. Non-ferrous metal companies that have reported benefited from stronger LME prices, volumes.
Financials	Key trends this quarter are: Overall profit growth has been slightly higher than estimated, on the back of: a) Loan growth remains healthy (over 20% yoy), b) Net interest margins well supported and has seen mildly positive trends across banks; c) asset quality and credit costs have largely been stable, though public sector banks have seen relatively high deterioration, but this has been largely from migration to automated NPL recognition, and has not been environment related.
IT Services	Inline quarter but muted given the historic seasonality associated with September quarter. TCS/HCLT disappointed with inline results. Infosys result was inline but a good Q3 guidance surprised investors. Wipro result suggested first signs of recovery - volume growth and lower attrition was encouraging. Overall, no big surprises on large caps.
Oil and Gas	Gas companies have reported strong results, led by stable volumes and margins. Refiners have been impacted owing to forex losses due to sharp rupee depreciation. OMCs (oil marketing companies) have been impacted by heavy losses owing to nil Gov't compensation and low GRMs. Petchem producers (RIL, GAIL) have benefited on account of strong margins and volumes.
Industrials	Although the results have been inline/ahead of our expectations this quarter, there has been a deterioration in the outlook for new order inflows. Companies mentioned that coupled with deferment of orders in several segments, competitive intensity remained high thus resulting in pricing pressures. However, there was one silver lining in that most companies have seen commodity prices cooling off towards the end of September which is expected to provide a cushion to margins going forward.
Utilities	The results in the generation segment continued to be weak with difficulties around coal availability leading to lower PLFs. Concerns remain on SEB finances, especially in light of recent media reports on payment defaults and banks restructuring power loans. We continue to prefer Powergrid, given its robust quarterly performance and relative insulation from the coal availability / SEB finances issues.
Pharmaceuticals	Results have been inline/ahead of our expectations for the companies that have reported led by the strong growth in US generics & benefits from operating leverage playing out. CRAMS space (Jubilant) did well with signs of improvement in the Services biz as well. Reported PAT for the quarter has been subdued due to foreign exchange related losses (rupee depreciation) given the significant US$ exposure. Companies have remained bullish and have guided for a strong 2H. If rupee/dollar remains at current levels for the coming quarters most companies are set to gain.
Consumer	Despite some sequential moderation, volume growth has been fairly healthy. While input costs remain high though within expectations. Gross margins have been supported to some extent by a bouyant pricing environment. Some HPC players (excluding Colgate) have tactically scaled back advertising spends to support profit growth.
Media	Slow visible - advertising growth has moderated in the backdrop of the current macro environment. Regional print has held up better than other sub-categories driven by strong local advertising. DTH subscription growth remains healthy albeit at a lower level now compared to the previous quarters.
Telecom	Idea's is the only key result that has been announced till now. Operationally, the quarter showed a surprise uptick in rev/ min (due to tariff hikes, increase in non-voice revenue and 3G roaming arrangements) which helped to offset decline in mins. However, EBITDA and PAT were hit by 3G roaming and forex respectively and were below our estimates.
Cement	Volume growth for the majors varied substantially with ACC reporting 18% growth, whereas UltraTech reported only 2% growth. EBITDA/PAT declined in all cases on a qoq basis as prices had declined 6-8% qoq and cost pressures persist (coal and freight). EBITDA/t ranged from Rs387 for ACC to Rs664 for Ambuja. The cement majors are likely to report better performance in the Oct-Dec quarter if cement prices (which have been hiked) stay at current levels. Overall industry growth is sluggish (3.1% in 1H FY12) and oversupply is around 15%, so we think there is downside risk to prices.

Source: Citi Investment Research and Analysis

Appendix A-1

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