Research

CRISIL
An S&P Global Company

CRISIL Q2 FY18 Results Outlook

October 2017

Industry summary

Results review, April-June 2017

Slower export and consumption-linked sectors a drag

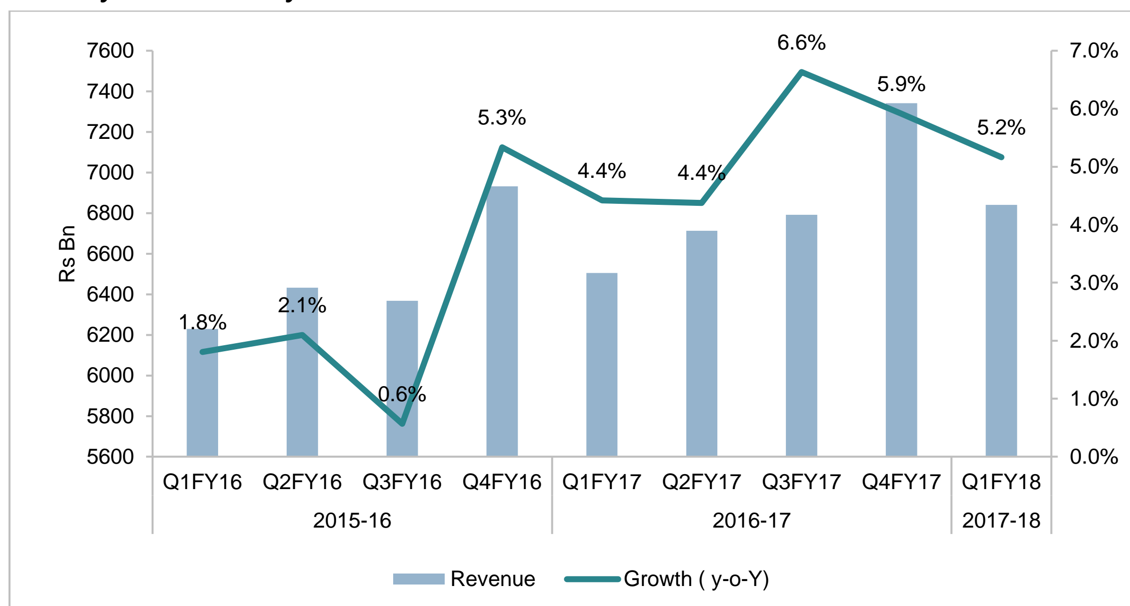
Corporate revenue grew at a moderate pace in the first quarter, mainly due to slower growth in export and consumption sectors.

Export-based sectors such as information technology (IT) services and pharma were impacted amid pricing pressure in global markets and a stronger rupee as compared to last year.

Among the consumption-linked sectors, telecom services suffered because larger incumbents saw an erosion in their pricing power due to rising competitive intensity. Fast-moving consumer goods (FMCG) and automobiles grew slower because of destocking ahead of the Goods and Services Tax (GST) rollout. The destocking hurt manufacturer volume growth. The analysis is corroborated from the performance of 422 companies across 50 sectors (excluding financial services and oil).

Revenue of commodity-linked sectors expanded by a robust 27% as the realisations on key commodities such as steel, crude oil and aluminium rose 24%, 12% and 6.9%, respectively. The natural gas and cement industries also benefitted from higher realisations in garnering double-digit revenue growth.

Industry revenue, on-year basis



Source: CRISIL Research

Snapshot of key sectors

Revenue growth	Q1FY16	Q2FY16	Q3FY16	Q4FY16	Q1FY17	Q2FY17	Q3FY17	Q4FY17	Q1FY18
Overall	1.8%	2.1%	0.6%	5.3%	4.4%	4.4%	6.6%	5.9%	5.2%
Key industries	1.3%	3.0%	0.7%	8.4%	6.8%	6.5%	7.4%	6.0%	5.4%
Automobiles	11.2%	10.6%	12.5%	16.1%	9.6%	11.0%	2.7%	6.8%	4.7%
FMCG	0.8%	-2.5%	-2.0%	1.3%	5.7%	7.1%	2.3%	5.7%	0.6%
IT services	14.7%	15.3%	13.2%	18.5%	13.9%	9.7%	9.6%	4.6%	2.6%
Pharmaceuticals	22.8%	8.8%	6.9%	15.6%	8.9%	8.2%	10.3%	0.4%	-8.3%
Power	2.8%	13.9%	3.7%	11.6%	4.5%	0.8%	0.6%	-0.2%	5.0%
Steel products	-14.5%	-18.5%	-21.4%	-8.3%	-1.7%	9.7%	28.4%	25.7%	23.9%
Telecom services	9.7%	9.2%	7.4%	9.2%	6.5%	6.6%	-2.7%	-14.1%	-16.0%

Note: key sectors include airline services, aluminium, automobiles, auto components, capital goods, cement, chemicals, construction, FMCG, housing, IT services, media & entertainment, natural gas, pharmaceuticals, power, retail, steel products, sugar, telecom services, cotton yarn and tyres; overall industry covers key sectors and other sectors (automotive castings, ceramic tiles, chlor alkalies, coal, coffee, distillers and breweries, edible oil, educational services, ferro alloys, fertilisers, gems and jewellery, hotels, hospitals, ites, material handling, oilfield equipment, paper, ports, power cables and conductors, power transformers, roads and highway, shipping, steel intermediates, steel pipes, tea, transmission towers and telecom towers)

Segments that supported revenue growth in the first quarter:

- **Steel products:** Aggregate revenue increased 24% on the back of improved realisation and healthy demand growth. Domestic flat and long steel prices rose 13% and 22% on-year, respectively, in line with higher global prices amid strong demand in China. Increase in domestic demand by 3.1% on-year coupled with sharp export growth of 65% on-year supported the top-line growth of domestic steelmakers.
- **Petrochemicals:** The aggregate revenue increased 19.9% on-year led by a rise in volume and product prices. Prices of butadiene increased due to planned and unplanned turnarounds. Consequently, synthetic rubber prices also rose. Ramp-up of RIL's PX plant of 2.2 MMTPA capacity at Jamnagar supported volume growth. Thus, RIL's revenue (accounting for ~75% of the sample set's total revenue) increased by ~25% on-year.
- **Sugar**: The revenue of North-based sugar mills increased by a significant 50% on-year as sugar prices (Delhi M-30) rose 31% on-year to ~Rs.40 per kg. Volumes also rose due to increased crushing as sugarcane production in North India saw a healthy expansion. On the other hand, the revenue of South-based mills

declined 8.3% on-year despite a 22% on-year increase in sugar prices (Mumbai S-30) to Rs 39 per kg. The slide in revenue was because of the sales volume falling by almost 20 per cent) due to lower sugarcane production in the South, especially Maharashtra and Karnataka.

- **Airline services**: The aggregate revenue increased 18% on account of a steep growth in passenger traffic. Despite a marginal rise in fares, total passenger traffic grew 20% on year for these airlines during the period.
- **Cement**: Aggregate revenue grew at a healthy 13.2% on-year, largely driven by an approximately 8% increase in realisation supported by a 5.1% increase in sales volumes. The revenue of UltraTech, the largest contributor to the set, grew 9%, entirely on the back of a similar increase in realisation.
- **Power**: The sector grew 5%, with the transmission segment expanding a robust 17.3% on-year on account of strong asset capitalisation by Power Grid Corporation. The power distribution segment grew 9.7% on account of rising power demand and tariff revision.

Other key sectors

- **Aluminium:** Aggregate revenue for companies in the sample set rose 11.5% on-year on the back of production growth and improved realisations. Domestic aluminium prices improved 6.9 % on-year in line with elevated London Metal Exchange prices.
- **FMCG:** The aggregate revenue of FMCG companies grew 1% on-year with the sector witnessing de-stocking issues before the implementation of GST.
- **Telecom**: Aggregate gross revenue slipped ~16% on-year owing to pressure on realisation due to pricing disruption led by Reliance Jio. Smaller players were affected more than larger operators. Incumbents devised new and innovative data plans to counter Reliance Jio and retain subscribers. This put pressure on their data tariffs and realisations (both data and voice) leading to decrease in the gross revenues. However, increase in volumes offset the revenue decline to some extent.
- **IT services:** The rupee revenue of Tier-1 IT services companies stayed flat, expanding ~2% on-year in the first quarter, mostly due to the strong rupee. The rupee gained significantly by ~4% on-year against the dollar, affecting the rupee revenue of players in general. Billing rates continued to decline in traditional IT services owing to their increased commoditisation. On the other hand, the rupee revenue for mid-tier companies rose 6% on-year, driven by an increase in volume.

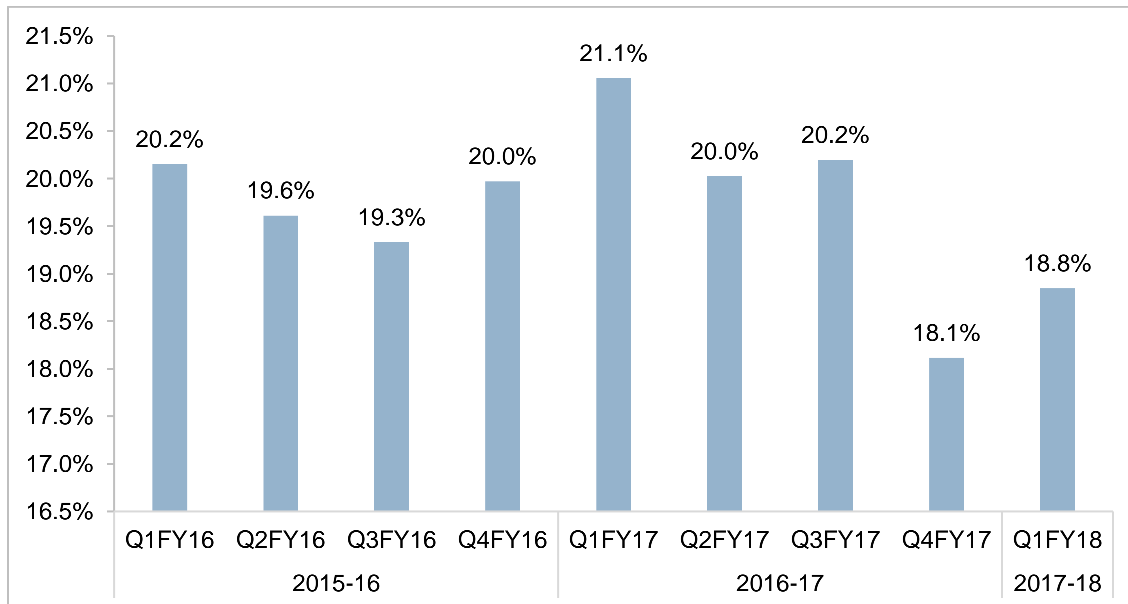
Pricing pressure, higher input cost dent EBIDTA margins

A rise in input cost and pricing pressure dented the overall profitability of Indian industries. The EBITDA (earnings before interest, tax, depreciation, and amortisation) margin contracted 220 basis points (bps) to 18.8% in the first quarter of this fiscal. Pricing pressure led to a fall in realisation across key sectors such as telecom, pharma, IT services. While telecom services witnessed pricing pressure due to intense competition in the domestic market, pharmaceuticals and IT services faced pricing pressure in the global market.

Several other sectors, such as automobiles, textiles, tyres, construction, and sugar witnessed falling margins due to a rise in input cost. The prices of key inputs – steel and crude oil – rose 24% and 12% on-year, respectively, leading to a contraction in margins for these sectors.

In fact, even absolute EBIDTA profits were down by ~7% with the sharp drop in revenue as well as margins for pharma, telecom and IT services contributing the bulk.

Industry's EBITDA margin



Source: CRISIL Research

A snapshot of key sectors

EBITDA margin	Q1FY16	Q2FY16	Q3FY16	Q4FY16	Q1FY17	Q2FY17	Q3FY17	Q4FY17	Q1FY18
Overall	20.2%	19.6%	19.3%	20.0%	21.1%	20.0%	20.2%	18.1%	18.8%
Key Industries	19.8%	19.9%	19.5%	20.9%	21.3%	20.6%	20.4%	19.1%	18.9%
Automobiles	15.4%	13.4%	12.2%	13.7%	12.7%	13.2%	11.9%	11.1%	10.5%
FMCG	22.3%	23.0%	24.0%	23.9%	23.3%	23.5%	24.0%	24.2%	23.5%
IT services	23.7%	25.4%	24.9%	25.0%	24.1%	24.3%	24.7%	24.8%	22.1%
Pharmaceuticals	25.2%	25.0%	23.8%	22.4%	24.6%	24.5%	24.1%	18.5%	17.5%
Power	31.1%	32.9%	34.0%	36.8%	33.7%	33.5%	32.8%	32.2%	34.2%
Steel products	11.3%	9.3%	5.2%	9.1%	16.0%	12.7%	15.2%	14.9%	13.5%
Telecom services	35.1%	34.7%	35.0%	36.1%	35.7%	35.3%	31.2%	29.6%	27.5%

Note: key sectors include airline services, aluminium, automobiles, auto components, capital goods, cement, chemicals, construction, FMCG, housing, IT services, media & entertainment, natural gas, pharmaceuticals, power, retail, steel products, sugar, telecom services, cotton yarn and tyres; overall industry covers key sectors and other sectors (automotive castings, ceramic tiles, chlor alkalies, coal, coffee, distillers and breweries, edible oil, educational services, ferro alloys, fertilisers, gems and jewellery, hotels, hospitals, ites, material handling, oilfield equipment, paper, ports, power cables and conductors, power transformers, roads and highway, shipping, steel intermediates, steel pipes, tea, transmission towers and telecom towers)

On-year EBIDTA margins were supported by:

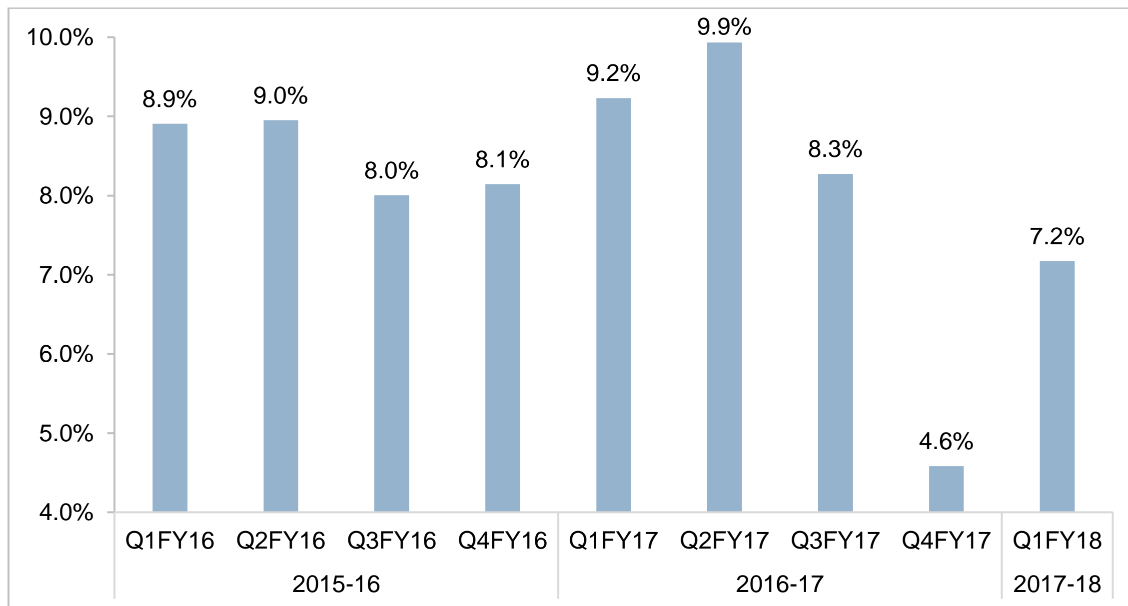
- **Power:** EBITDA margins of the companies expanded 46 bps on-year supported by the distribution segment where margins expanded 285 bps on-year on account of lower power purchase cost.
- **Retail:** Aggregate EBIDTA margins expanded ~138 bps to 4.9% mainly due to the improved operating leverage of Future Retail and Trent. This outweighed the contraction in the margins of Shoppers Stop owing to higher employee and other expenses.
- Other than these key segments, a decline in the operating margin was witnessed in sectors such as tyres, automobiles, cotton yarn (increase in the raw material cost), construction (cost overruns in some projects), pharma (pricing pressure in the US market), sugar (lower volumes and higher cane cost coupled with contraction in the margins of byproducts) and telecom services (competitive pressures rise).

Poor operating performance continue to impact net margins on-year

Falling operating profitability drove the net profit margin of Indian industries down by 200 bps on-year to 7.2%. Sequentially, the net margins showed a significant improvement, thanks to lower extraordinary expenses. The margin drop was similar to the drop at the operating level. However, for sectors such as pharma and telecom a worsening debt structure led to a sharper fall at the net level.

The net profit margin of the consumer discretionary sector narrowed significantly (370 bps), because of a decline in the profitability of telecom, retail and automobile sectors. Even export-oriented sectors and utilities felt the pinch in net margins.

Industry's net margin



Source: CRISIL Research

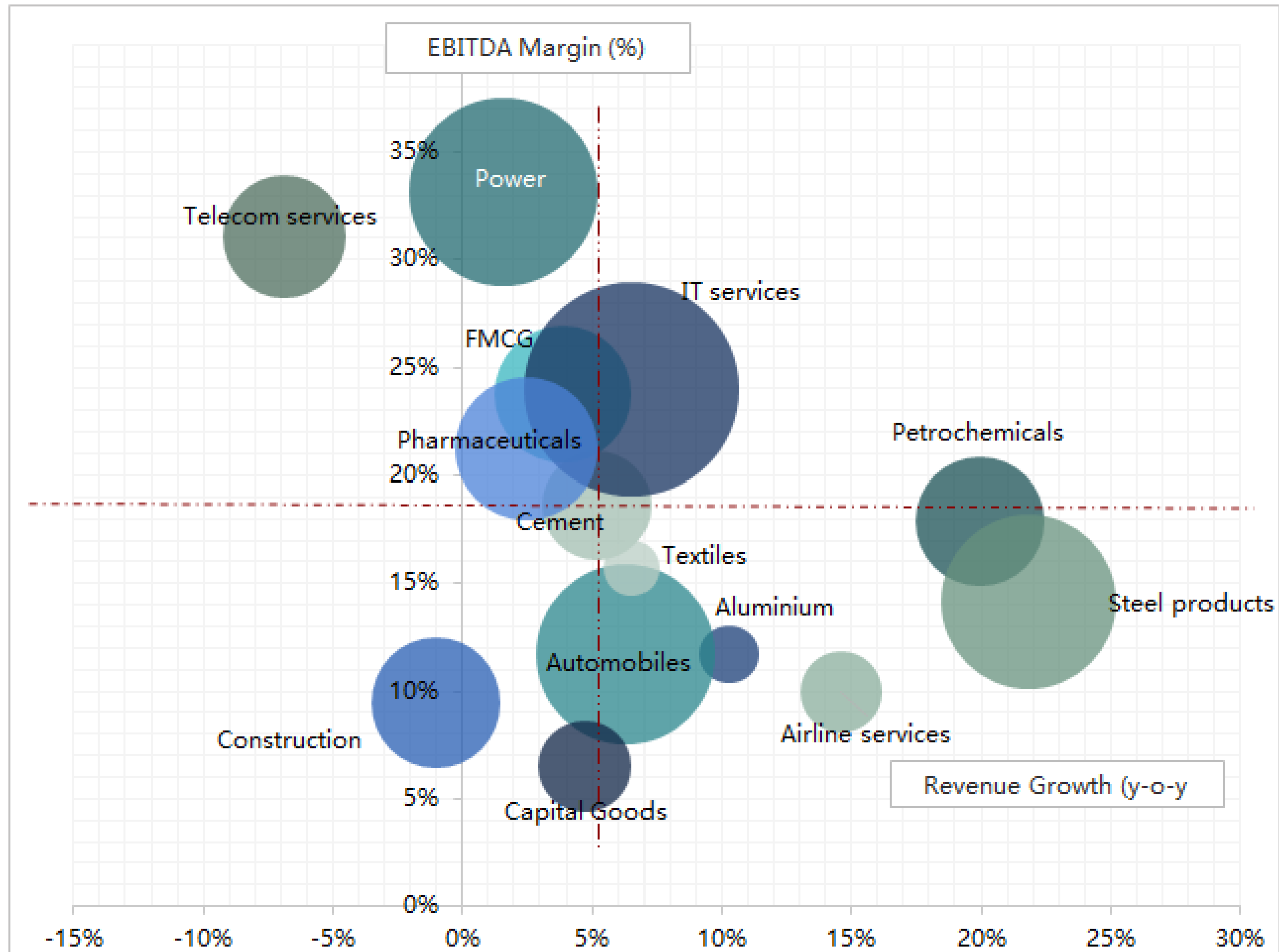
A snapshot of key sectors

Net Margins	Q1FY16	Q2FY16	Q3FY16	Q4FY16	Q1FY17	Q2FY17	Q3FY17	Q4FY17	Q1FY18
Overall	8.9%	9.0%	8.0%	8.1%	9.2%	9.9%	8.3%	4.6%	7.2%
Key Industries	8.5%	8.8%	8.2%	8.0%	9.1%	10.1%	8.1%	3.7%	6.9%
Automobiles	8.4%	7.8%	7.1%	7.0%	8.4%	9.1%	6.6%	5.7%	6.6%
FMCG	14.4%	15.5%	16.8%	15.4%	15.8%	16.5%	17.0%	16.9%	15.9%
IT services	19.0%	19.1%	19.0%	18.8%	18.2%	18.1%	18.6%	18.3%	17.6%
Pharmaceuticals	15.2%	16.4%	16.2%	13.6%	16.3%	16.0%	14.9%	10.9%	5.5%
Power	8.8%	10.6%	9.1%	6.5%	8.4%	10.2%	7.4%	-3.9%	7.9%
Steel products	-3.5%	-7.7%	-11.5%	-6.5%	-3.3%	-4.4%	-2.1%	0.0%	-3.1%
Telecom services	9.6%	10.3%	8.9%	6.9%	5.1%	9.5%	-2.9%	-64.9%	-8.3%

Note: Key sectors include Airline services, Aluminium, Automobiles, Auto components, Capital Goods, Cement, Chemicals, Construction, FMCG, Housing, IT services, Media & Entertainment, Natural gas, Pharmaceuticals, Power, Retail, Steel products, Sugar, Telecom services, Cotton yarn and Tyres; Overall industry covers key sectors and other sectors (Automotive castings, Ceramic Tiles, Chlor Alkalies, Coal, Coffee, Distillers and breweries, Edible oil, Educational services, Ferro Alloys, Fertilisers, Gems and jewellery, Hotels, Hospitals, ITeS, Material handling, Oilfield equipment, Paper, Ports, Power cables and conductors, Power transformers, Roads and highway, Shipping, Steel Intermediates, Steel pipes, Tea, Transmission towers and Telecom towers)

Performance metrics of major sectors

Revenue growth versus EBITDA margin across key sectors (past four quarters)



Source: CRISIL Research

Note: Data represents aggregate performance of the mentioned sectors for the *past four quarters (Q2 2016-17 to Q1 2017-18)*; size of the bubble indicates sector's share in overall industry's revenue

Industry outlook

Revenue outlook

Growth to improve as key consumption linked sectors recover

CRISIL Research expects corporate revenues – excluding the banking, financial services and insurance, and oil companies – to rise ~7% on-year in the second quarter ended September 30, 2018. Commodity-linked sectors such as steel products and petrochemicals would continue to grow amid firm prices. Consumption-linked sectors, with the exception of telecom, should grow at a healthy 12% with restocking taking place after the Goods and Services Tax (GST) regime kicked in. On the other hand, a strong rupee on year, along with pricing pressure, would hit export-linked sectors such as pharma and IT services. Telecom would as well continue to face pricing pressure because of white-hot competition and high network operating expenses.

Sectoral snapshot

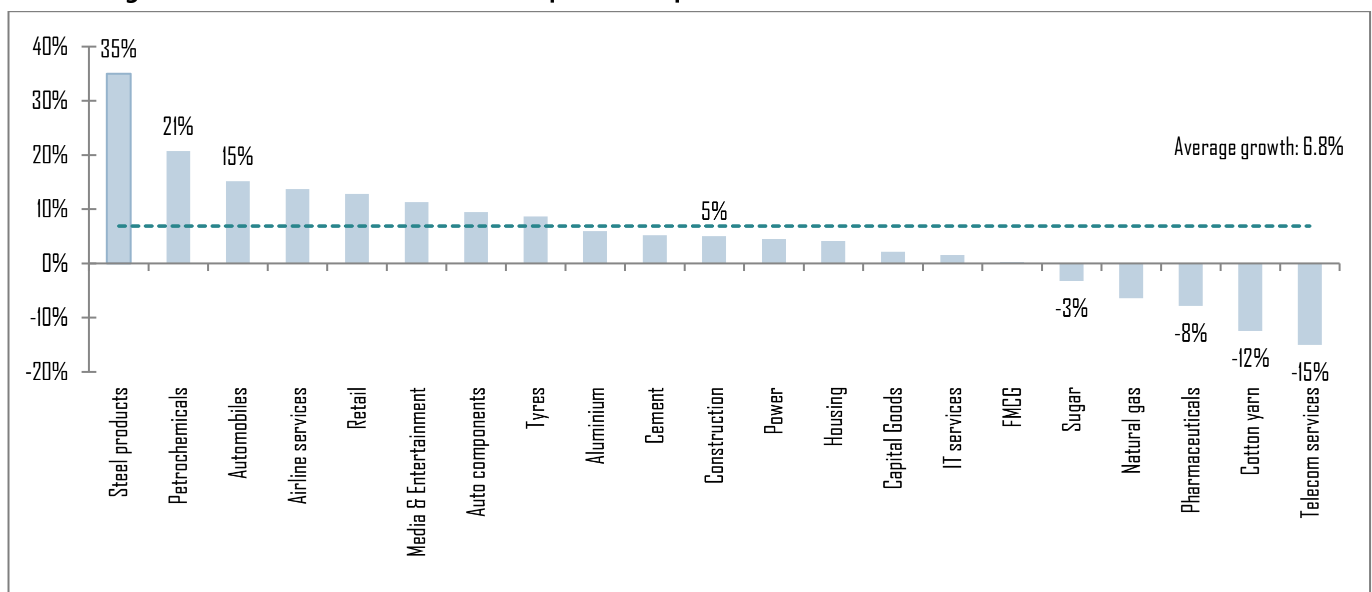
Revenue growth	Q2FY16	Q3FY16	Q4FY16	Q1FY17	Q2FY17	Q3FY17	Q4FY17	Q1FY18	Q2FY18E
Key sectors	3.0%	0.7%	8.4%	6.8%	6.5%	7.4%	6.0%	5.4%	6.9%
Automobiles	10.6%	12.5%	16.1%	9.6%	11.0%	2.7%	6.8%	4.7%	15.2%
FMCG	-2.5%	-2.0%	1.3%	5.7%	7.1%	2.3%	5.7%	0.6%	0.3%
IT services	15.3%	13.2%	18.5%	13.9%	9.7%	9.6%	4.6%	2.6%	1.6%
Pharmaceuticals	8.8%	6.9%	15.6%	8.9%	8.2%	10.3%	0.4%	-8.3%	-7.8%
Power	13.9%	3.7%	11.6%	4.5%	0.8%	0.6%	-0.2%	5.0%	4.5%
Steel products	-18.5%	-21.4%	-8.3%	-1.7%	9.7%	28.4%	25.7%	23.9%	35.0%
Telecom services	9.2%	7.4%	9.2%	6.5%	6.6%	-2.7%	-14.1%	-16.0%	-15.0%

- **Steel products:** Revenue is projected to increase 30-35%, with revival in domestic demand along with a surge in exports aiding healthy volume growth. Sales volume is projected to grow 10%, in line with the rise between July-August 2017 when domestic demand rose 7% and exports 48%. The surge in revenue would be driven by a sharp increase in prices. Domestic flat and long steel prices are expected to have risen ~21% and 25%, respectively, in line with global prices. The rise is partially speculative in nature, driven by robust demand anticipated in China and a ~100 million tonne capacity reduction of intermediate frequency furnace units in China.
- **Automobiles:** Growth should improve on lower taxes (for a short period after GST kicked in), restocking and supply constraints easing in the commercial vehicle space after the implementation of BS IV norms. We

believe because of faster sales of CVs (volume growth over 20%), average realisation would also improve, and support revenue growth.

- **Power:** Revenue growth would be supported by a rise in demand. PLFs should also rise on higher generation from coal-based plants. Further, a sharp rise in the exchange-traded prices of power in September would support revenue.
- **Telecom:** Gross revenue is expected to decline ~15% due to competitive pressures. In an effort to retain high data-using subscribers, incumbents are devising plans that are expected to increase pressure on data tariffs and realisations, including voice. Data volume growth will continue to be offset by sharp tariff drops.
- **Pharmaceuticals:** Aggregate revenue is expected to fall 7-9% following double-digit pricing erosion in the base business – or drugs that are not in the exclusivity period – will partially offset gains accruing from new product launches and two Para IV launches during the quarter. A strong Abbreviated New Drug Application pipeline and approvals from the US Food and Drug Administration to some major plants, which would prop exports, would prevent a further fall in revenue. Domestic revenue is expected to rise on restocking after GST.
- **IT services:** Rupee revenue is expected to grow in single digit amid a 4% currency appreciation on year and continuing billing pressure. Tier II companies would grow at a faster rate than Tier I counterparts.
- **FMCG:** Revenue is expected to be muted. Transition after GST as well as re-stocking are expected to take some time. However, demand is expected to normalise by September 2017. Hence, we expect a marginal growth in revenue.

Revenue growth outlook across for the September quarter



Source: CRISIL Research

Other sectors expected to drive revenue growth are:

- **Airline services:** Revenues should increase 13-15% on strong growth in passenger traffic, primarily domestic, which is seen up 13-15% despite a rise in fares. In the international segment, passenger traffic for the 3 listed carriers is expected to be up 13-14% mainly due to a decline in fares. Moreover, with bilateral seat restrictions limiting expansion of foreign carriers, domestic airlines are gaining market share abroad.
- **Cement:** Volume growth in cement to remain subdued amid prolonged rains. Overall revenue growth would be close to 5% on the back of improving realisations.
- **Chemicals:** Revenues in petchem are expected to grow sharply with a rise in the price of feedstock naphtha, tangoing higher crude oil prices. Ramp-up in production at Reliance Industries' PX plant at Jamnagar would drive sequential volume growth.

EBITDA margin outlook

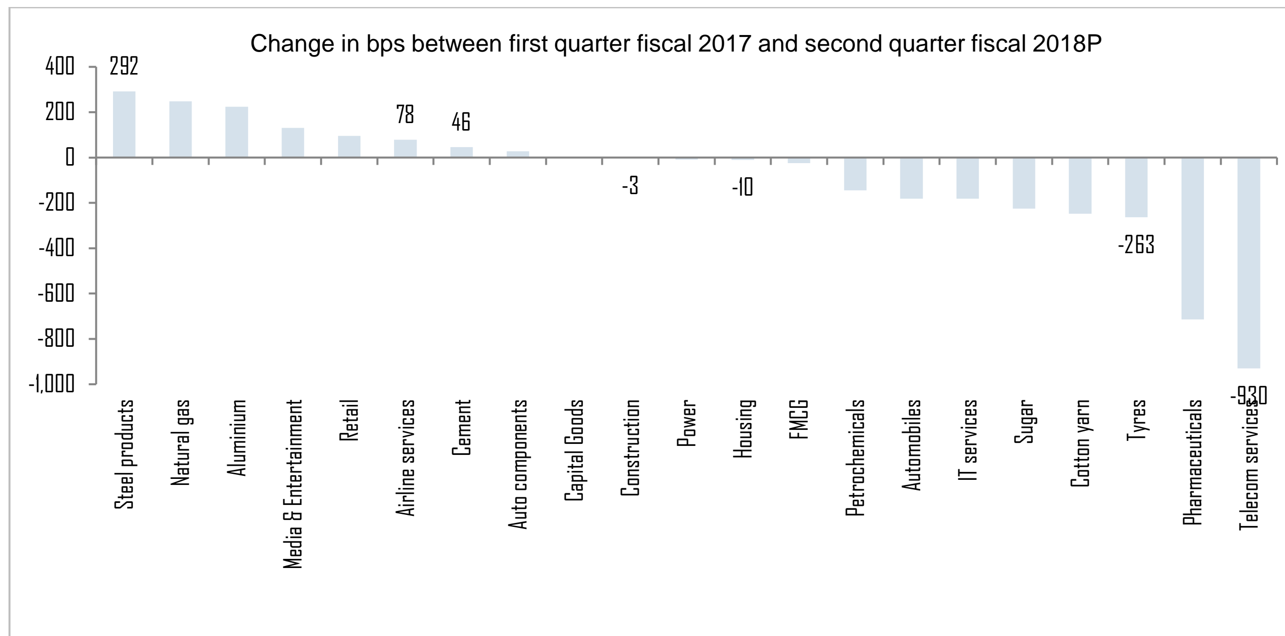
High input cost continues to exert pressure

With revenue growth inadequate, India Inc faces an Ebidta margin contraction of 100-150 bps to 19% in the second quarter. Pricing pressure and high input costs will impact margins in telecom, pharmaceuticals and IT services sectors the most. Excluding pharma and telecom, India Inc's Ebidta margin would not dip more than 50 bps. Higher raw material prices would keep margins under check in the automobiles, chemicals, textiles, sugar and tyres sectors. Sequentially, however, better revenue growth would help sustain margins for key sectors.

Sectoral snapshot

Ebitda margins	Q2FY16	Q3FY16	Q4FY16	Q1FY17	Q2FY17	Q3FY17	Q4FY17	Q1FY18	Q2FY18E
Sectors	19.9%	19.5%	20.9%	21.3%	20.6%	20.4%	19.1%	18.9%	19.0%
Automobiles	13.4%	12.2%	13.7%	12.7%	13.2%	11.9%	11.1%	10.5%	11.4%
FMCG	23.0%	24.0%	23.9%	23.3%	23.5%	24.0%	24.2%	23.5%	23.2%
IT services	25.4%	24.9%	25.0%	24.1%	24.3%	24.7%	24.8%	22.1%	22.4%
Pharmaceuticals	25.0%	23.8%	22.4%	24.6%	24.5%	24.1%	18.5%	17.5%	17.3%
Power	32.9%	34.0%	36.8%	33.7%	33.5%	32.8%	32.2%	34.2%	33.4%
Steel products	9.3%	5.2%	9.1%	16.0%	12.7%	15.2%	14.9%	13.5%	15.6%
Telecom services	34.7%	35.0%	36.1%	35.7%	35.3%	31.2%	29.6%	27.5%	26.0%

Change in EBITDA margin outlook in the September quarter



Source: CRISIL Research

- **Steel products**: EBITDA margin is expected to expand ~250-300 bps on-year owing to healthy realisation. Higher cost of raw materials, especially coking coal, which rose from $104 to $181.5/tonne between July and August 2017 (1.7x on-year) because of re-stocking by Chinese steel makers in anticipation of domestic demand, will curb further expansion in margin. Domestic iron ore prices are expected to be ~20% higher.
- **IT services:** EBIDTA margin would remain stable sequentially, but contract on-year by nearly 200 bps because of the rupee's appreciation. And fewer H1B visas granted would mean more hiring's in the US and billing pressure, which will add to margin woes.
- **Power:** With prices of imported coal rising, EBITDA margin is expected to contract 150-200 bps to 28-30%. However, a fall in the landed cost of domestic coal after GST implementation would restrict further contraction.
- **Automobile sector:** Better capacity utilisation, improved product mix, and higher prices would mean a sharp margin expansion, with the commercial vehicles space outperforming.
- **Pharmaceuticals:** EBITDA margin is projected to contract 700-800 bps to 18-19%, on account of no Para IV launches and price erosion in the base business amid high competition. A further crimping of margins will be arrested by lower remediation expenses

- **Telecom services:** EBITDA margin is estimated to fall sharply by~930 bps as revenues drop. The launch of new networks on spectrum acquired during the October 2016 auctions will crank up network operating expenses, aggravating margin pressure.
- **FMCG:** EBITDA margin is expected to decline marginally by ~50 bps amid disruptions in the wholesale and stockists channel before GST, which will take time to stabilise. Companies would also continue with their aggressive marketing activities to increase sales, which will further increase marketing and selling expenses and curb margins.

The other sectors that are expected to report an improvement in margins are:

- **Airline services:** EBITDA margin would increase marginally to 6-6.5%, due to growth in realisations in the domestic segment, which would offset a drop in the international segment. Realisation on domestic routes is projected to increase 3-5% because of limited fleet expansion domestically, especially by IndiGo. We expect international realisations to decline ~4-5% due to competition between low-cost and full service carriers on short-haul routes.
- **Cement:** Rise in realisations to aid marginal improvement in EBIDTA margins. However, any sharp improvement to be contained amid rise in power and fuel cost.

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