Research

CRISIL
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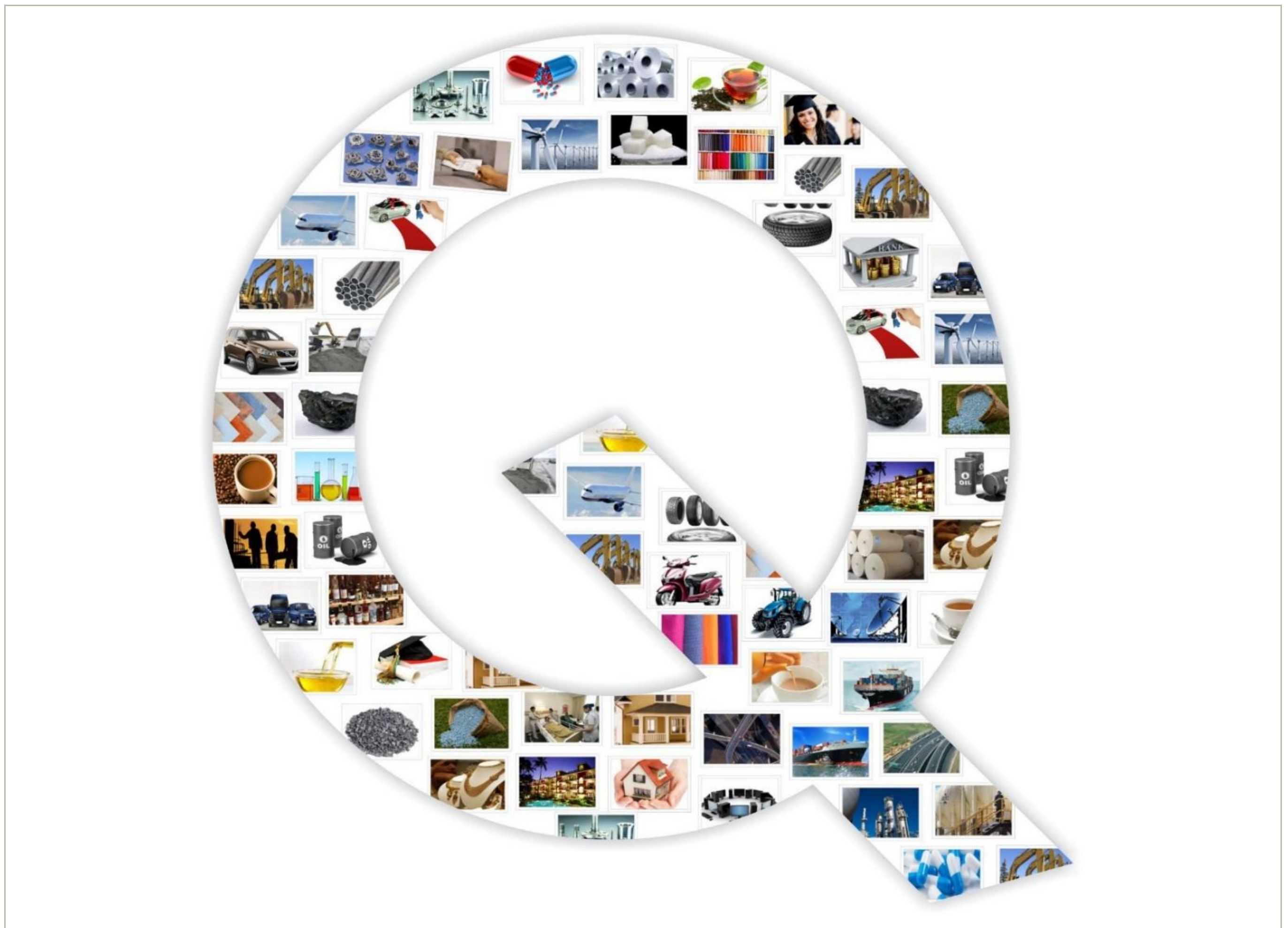
CRISIL Q1 FY18 Results Outlook

July 2017



Industry summary

Results review (January – March 2017)

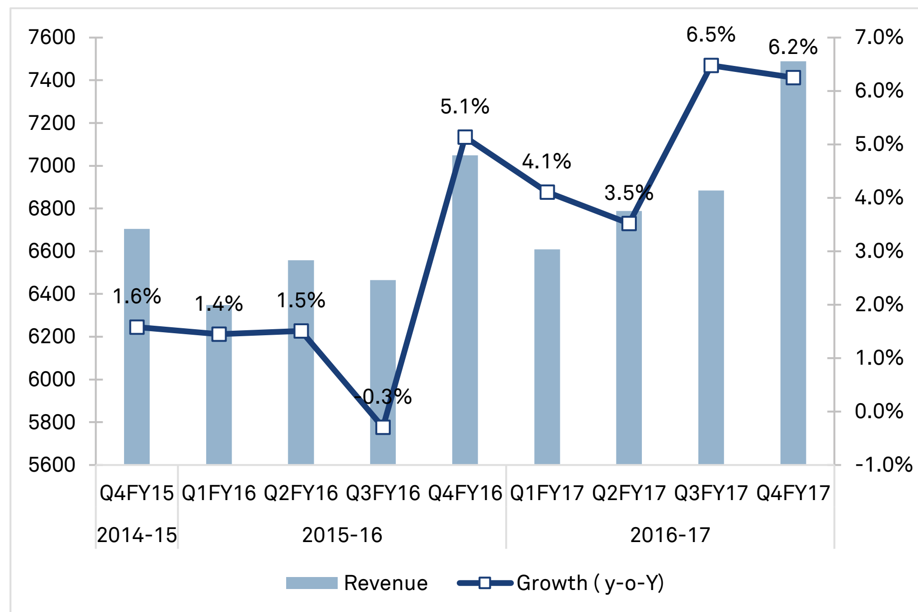
Revival in demand led by consumer sectors

Revenue continued to grow at a moderate pace in the final quarter, led by commodity-linked sectors, such as steel, aluminium and cement, on the back of robust realisation improvement. An analysis of the performance of 423 companies across 50 sectors (excluding financial services and oil) reflects the same.

A rise in realisations of key commodities such as steel, crude oil and aluminium by 29%, 70% and 22%, respectively, led to a robust revenue growth of 22% for commodity-linked sectors. Natural Gas and cement industries also benefitted from higher realisations.

On the other hand, export-driven sectors – IT services and pharmaceuticals – recorded slowest growth in the past five years at 4.3%, due to pricing pressure and rupee appreciation. Consumer-driven sectors, such as auto, retail and airline services, grew by a moderate pace of 7.5%, as the impact of demonetisation spilled over to this quarter.

Industry revenue, year-on-year basis



Source: CRISIL Research

A snapshot of key sectors

Revenue Growth	Q4FY15	Q1FY16	Q2FY16	Q3FY16	Q4FY16	Q1FY17	Q2FY17	Q3FY17	Q4FY17
Overall	1.6%	1.4%	1.5%	-0.3%	5.1%	4.1%	3.5%	6.5%	6.2%
Key Industries	0.6%	1.0%	2.4%	-0.3%	8.1%	6.3%	5.5%	7.2%	6.4%
Automobiles	8.6%	11.2%	10.6%	12.5%	16.1%	9.6%	11.0%	2.7%	6.7%
FMCG	8.0%	0.8%	-2.5%	-2.0%	2.5%	6.3%	7.0%	4.7%	6.5%
IT services	9.4%	14.7%	15.3%	13.2%	18.5%	15.1%	9.7%	9.6%	5.9%
Pharmaceuticals	21.0%	30.6%	9.1%	5.8%	15.6%	8.9%	8.2%	10.3%	0.7%
Power	-2.8%	2.8%	13.9%	3.7%	11.6%	4.5%	0.8%	0.6%	2.2%
Steel products	-8.9%	-13.5%	-17.2%	-20.4%	-6.5%	-1.5%	8.2%	29.6%	26.5%
Telecom services	7.1%	5.8%	6.0%	4.9%	8.7%	6.0%	3.1%	-4.2%	-14.4%

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, Textiles 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

Source: CRISIL Research

Key segments that supported revenue growth in Q4 2016-17:

- **Steel products:** In Q4 2016-17, revenue of companies in this sector grew 26.5% on-year, driven by moderate growth in domestic steel demand (7%) and robust exports, which grew 69% on-year. The revenue growth was also driven by a 29% y-o-y rise in steel prices in the domestic market.
- **IT services:** The sector witnessed moderate growth of 5.9%, driven by volume growth. Rupee appreciation of 0.7% y-o-y against USD during the quarter limited revenue growth. Moreover, billing rates continued to decline in traditional IT services, because of their increased commoditisation.
- **FMCG:** The sector revived in Q4 2016-17, brushing aside the impact of demonetisation to record a healthy growth of 6.5%, driven by volume growth. A rise in revenue was also aided by higher realisations and exports.
- **Power:** The sector recorded lower growth than the industry average for the fourth quarter in a row. Revenue of the power generation segment remained tepid at 1.4%, due to tepid demand. However, transmission segments witnessed a robust growth of 17.9% on-year on account of strong asset capitalisation by Power Grid Corporation. Thus, the power sector witnessed a 2.2% rise in revenue in Q4 2016-17.
- **Automobile:** The automobile sector posted 6.7% on-year growth, mainly because of a surge in sales of cars and utility vehicles (UV) (20.3% on-year growth) on the back of new model launches. Revenue of domestic commercial vehicle (CV) manufacturers rose 7.7% on-year, mainly due to a 3.5% rise in realisation and 4.2% growth in sales volume. However, two-wheelers' net revenue dropped 7% on-year, mainly due to a 5% decline in total sales.

Other key sectors

- **Pharma:** The sector recorded a tepid revenue growth of 0.7% on-year, due to lukewarm sales growth by large formulation players. Revenue of large formulation players fell 1% on-year, as moderate sales growth by Glenmark Pharmaceuticals, Lupin and Cipla in the non-US markets was offset by continued pricing pressure

in the US market. However, domestic market growth continued to be healthy, with major players such as Lupin and Sun Pharma posting double-digit growth.

- **Telecom:** The sector witnessed a drastic fall of 14.4% on-year in total revenue, due to a decline in the revenues of all the players. The entry of Reliance JIO exerted pricing pressure on players across the board, leading to a decline in the blended realisation, which, at Rs 0.407 per minute, was the lowest level since Q4 2010-11, as well as ARPU (Rs 157), which was at a four-year low.

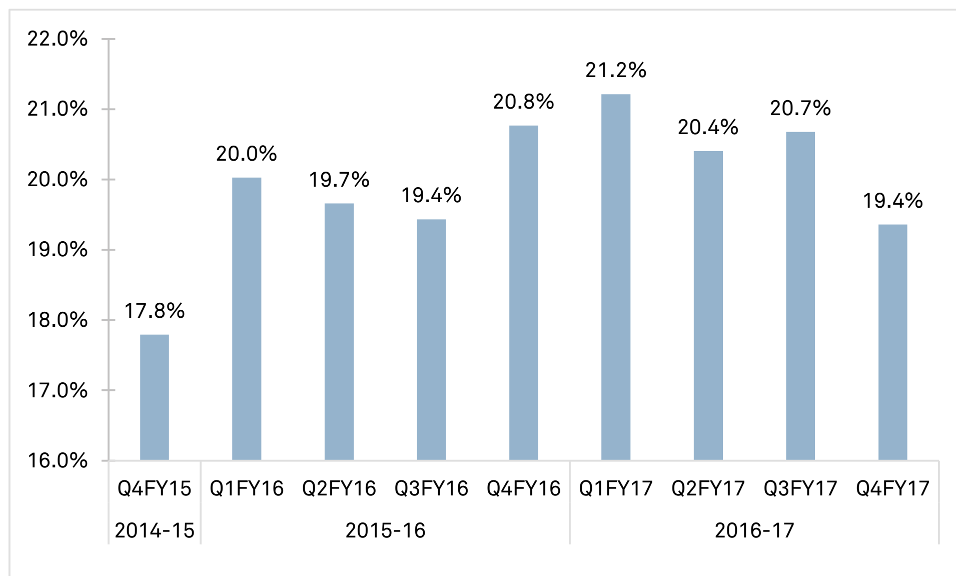
Higher input costs and pricing pressure lead to margin contraction in Q4 2016-17

A rise in input cost and pricing pressure dented the overall profitability of Indian industries; EBITDA margin contracted 129 bps to 19.4% in Q4 2016-17. Pricing pressure led to a fall in realisation across key sectors such as telecom, airline services, pharma and IT services. While telecom services witnessed pricing pressure due to intense competition in the domestic market, pharmaceuticals and IT services witnessed pricing pressure in the global markets.

Several sectors, such as automobiles, textiles, tyres, chemicals, airline services and construction, witnessed falling margins due to a rise in input cost. Key inputs, steel and crude oil, witnessed an increase in prices by 29% and 70% y-o-y, respectively, leading to a contraction in margins for these sectors.

However, commodity-linked sectors – steel products, natural gas and aluminium –drove profitability, as rising metal prices along with volume growth expanded the operating margin by 527 bps on-year to 16.2 %. In fact, excluding these sectors, the operating margin would have declined 193 bps on-year.

Industry's EBITDA margin



Source: CRISIL Research

A snapshot of key sectors

EBITDA	Q4FY15	Q1FY16	Q2FY16	Q3FY16	Q4FY16	Q1FY17	Q2FY17	Q3FY17	Q4FY17
Overall	17.8%	20.0%	19.7%	19.4%	20.8%	21.2%	20.4%	20.7%	19.4%
Key Industries	18.0%	19.8%	20.0%	19.8%	21.3%	21.6%	21.1%	20.9%	19.9%
Automobiles	10.5%	12.9%	13.4%	12.2%	13.7%	12.7%	13.2%	11.9%	11.1%
FMCG	21.9%	22.3%	22.9%	24.0%	24.8%	23.0%	23.4%	25.6%	25.1%
IT services	20.3%	23.7%	25.4%	24.9%	25.0%	23.8%	24.3%	24.7%	24.5%
Pharmaceuticals	17.7%	25.2%	24.9%	23.7%	22.4%	24.5%	24.4%	24.0%	18.4%
Power	30.6%	31.1%	32.9%	34.0%	36.8%	33.3%	33.5%	32.8%	33.6%
Steel products	11.3%	11.7%	9.8%	5.7%	10.0%	16.8%	13.0%	15.7%	15.9%
Telecom services	35.1%	34.3%	33.7%	34.3%	35.6%	34.9%	35.1%	32.1%	32.0%

Source: CRISIL Research

On-year increase in EBITDA margin was driven by:

- **Steel products:** EBIDTA margins of these companies improved 589 bps on-year, leading to an improved realisation (because of the imposition of safeguards by the government). Even though realisations improved by 29% on-year, high international coking coal and domestic iron ore prices limited margin expansion.
- **FMCG:** The sector witnessed a tepid margin expansion of 30 bps, at 25.1%, driven by higher top line growth and lower employee and advertisement expenses.
- Other than these key segments, a decline in the operating margin was witnessed in sectors such as **automobiles** (due to an increase in the raw material cost), **power** (higher fuel cost), **IT services** and **pharmaceuticals** (due to rupee appreciation and pressure on billing rates), and **construction** (fall in input cost and demand**).**

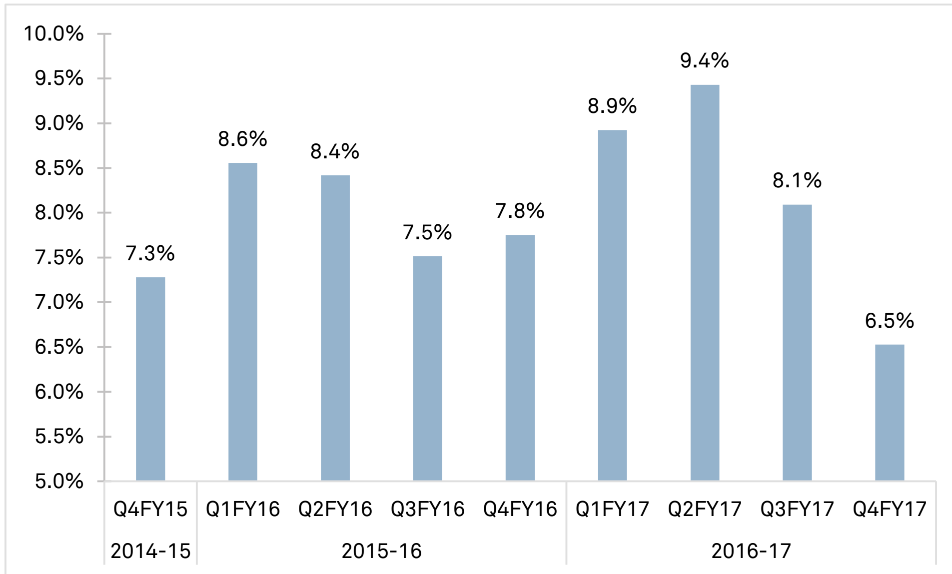
Poor operating performance and extraordinary losses lead to worst net margins in four years

Falling operating profitability, coupled with extraordinary losses, drove the net profit margin of Indian industries to a 16-quarter low at 6.5%, a fall of 122 bps on-year. In fact, margin pressure at the net level was witnessed across the industry, with 50% of the sectors (accounting for 68% of total net profit) witnessing margin contraction.

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.

A write-off of Mundra plant by Adani Power to the tune of Rs 36.2 billion and provisioning by Oil India for the royalty payment to the Assam government led to extraordinary losses, thus dragging down the overall net profitability of India Inc.

Industry's net margin



Source: CRISIL Research

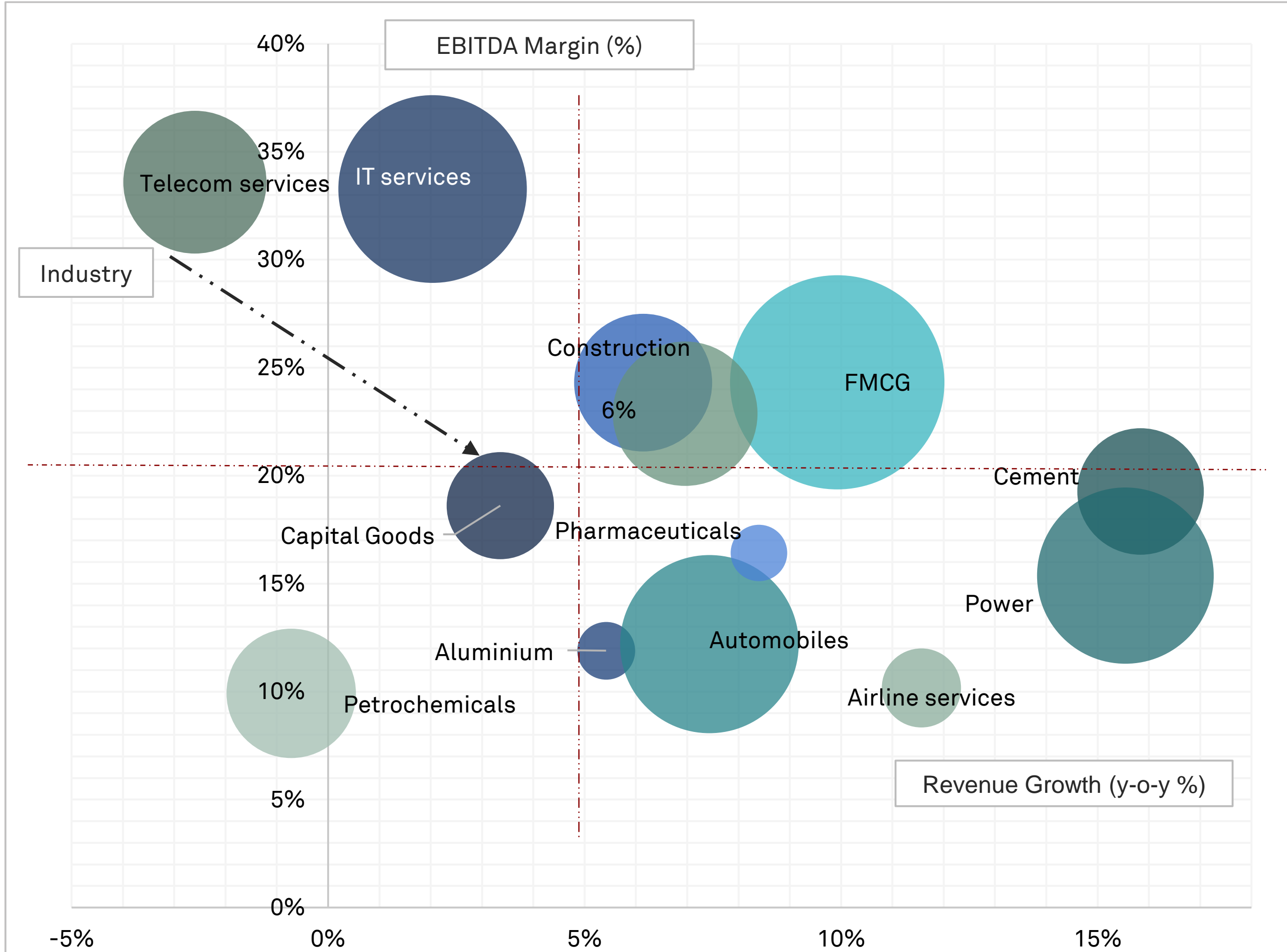
A snapshot of key sectors

Net margins	Q4FY15	Q1FY16	Q2FY16	Q3FY16	Q4FY16	Q1FY17	Q2FY17	Q3FY17	Q4FY17
Overall	7.3%	8.6%	8.4%	7.5%	7.8%	8.9%	9.4%	8.1%	6.5%
Key Industries	7.5%	8.3%	8.3%	7.8%	7.7%	8.9%	9.7%	8.1%	6.2%
Automobiles	4.0%	8.4%	7.8%	7.1%	6.9%	8.4%	9.1%	6.6%	5.7%
FMCG	15.6%	14.3%	15.4%	16.7%	15.1%	15.6%	16.4%	16.5%	16.5%
IT services	16.9%	19.0%	19.1%	19.0%	18.8%	18.0%	18.1%	18.6%	18.1%
Pharmaceuticals	12.5%	15.0%	16.2%	16.0%	13.5%	16.1%	15.8%	14.7%	10.7%
Power	11.1%	8.8%	10.6%	9.1%	6.5%	8.4%	10.2%	7.4%	-3.8%
Steel products	-2.2%	-4.7%	-8.6%	-12.4%	-7.3%	-4.4%	-6.0%	-3.2%	-1.1%
Telecom services	5.5%	8.5%	6.3%	5.5%	4.9%	4.1%	3.3%	-0.5%	-6.2%

Source: CRISIL Research

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 (Q1 2016-17 to Q4 2016-17)*; size of the bubble indicates sector's share in overall industry's revenue

Industry outlook

Revenue outlook (April – June 2017)

CRISIL Research expects the revenues of companies in key sectors – excluding banking, financial services and insurance and oil – to rise ~7 per cent on-year in the Q1 2017-18. Consumption-driven sectors, including automobiles, airlines, FMCG and retail, but excluding telecom, are estimated to grow at a healthy pace of 10-11%, after consecutive quarters of tepid growth post demonetisation. However, panic among sellers and distributors due to the rollout of Goods and Services Tax (GST) from Q2 FY18 is expected to limit revenue growth. On the other hand, appreciation of the rupee, along with pricing pressure, is expected to hit export-linked sectors, such as Pharma and IT services, thus leading to slowest growth in the past 16 quarters.

However, commodity-linked sectors are expected to do well, led by a robust increase in realisations in crude oil, steel and aluminium, and moderate growth in demand.

Snapshot of key sectors

Revenue Growth	Q1FY16	Q2FY16	Q3FY16	Q4FY16	Q1FY17	Q2FY17	Q3FY17	Q4FY17	Q1 FY18E
Key Sectors	1.0%	2.4%	-0.3%	8.1%	6.3%	5.5%	7.2%	6.4%	7.3%
Automobiles	11.2%	10.6%	12.5%	16.1%	9.6%	11.0%	2.7%	6.7%	3.8%
FMCG	0.8%	-2.5%	-2.0%	2.5%	6.3%	7.0%	4.7%	6.5%	8.1%
IT services	14.7%	15.3%	13.2%	18.5%	15.1%	9.7%	9.6%	5.9%	5.3%
Pharmaceuticals	30.6%	9.1%	5.8%	15.6%	8.9%	8.2%	10.3%	0.7%	-1.8%
Power	2.8%	13.9%	3.7%	11.6%	4.5%	0.8%	0.6%	2.2%	1.9%
Steel products	-13.5%	-17.2%	-20.4%	-6.5%	-1.5%	8.2%	29.6%	26.5%	29.1%
Telecom services	5.8%	6.0%	4.9%	8.7%	6.0%	3.1%	-4.2%	-14.4%	-14.7%

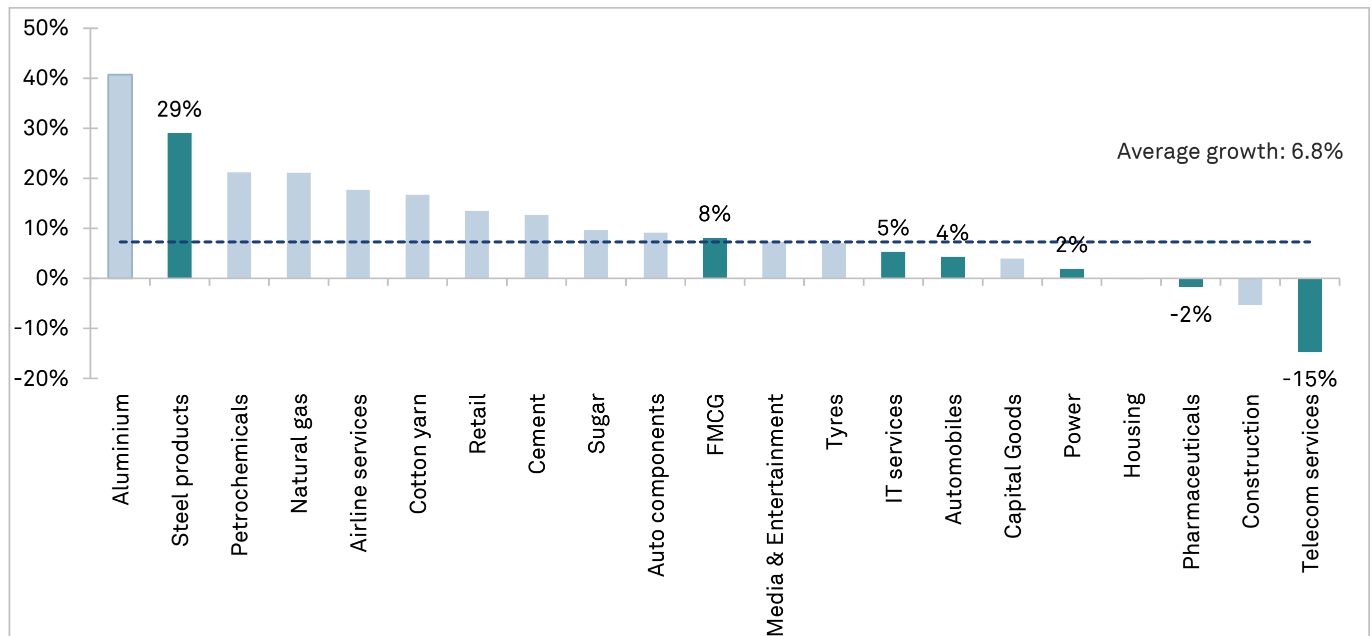
Source: CRISIL Research

- **Steel products:** Revenue is projected to increase 29.1% on-year, because of higher realisations, revival in domestic demand and a surge in exports. Overall sales volume is expected to grow 10-12% on-year, led by exports, which is expected to double on-year. Domestic demand, however, is expected to remain moderate at 4-5% on-year. Realisations are expected to witness strong growth to 22%, driven by a rise in demand as well as rise in raw material prices.
- **FMCG:** Aggregate revenue is expected to improve 7-9% on-year. Stable realisation and moderate volume growth will drive revenue. Further, increasing penetration, coupled with innovation and strengthening of product portfolio will also drive growth.
- **IT services:** Rupee revenue is projected to increase a slower 5-6% on-year versus 15-16% on-year in Q1 2017-18. Changes in technology and protectionist bent in key export destinations is buffeting the industry. The rupee's 3.5-4% on-year appreciation in Q1 2017-18 is also expected to play a significant part in limiting revenue growth.
- **Automobiles:** Revenue for the automobile industry is projected to post a meagre increase of 4% on-year, due to the weak performance of the commercial vehicles segment, whose revenue is expected to fall 16%

on-year, due to a 4% expected fall in volume and a 12% decline in the average realisation. On the other hand, net revenue of PVs is expected to increase 20-22% on-year, driven by a rise in the sales volume to 16-18%, as the industry bounces back post-demonetisation, with continued traction for popular models and successful model launches.

- **Power:** Revenue for the power sector is expected to grow at a tepid pace of 2%, led by the generation segment, which is expected to rise 3-4% on-year due to a steady rise in generation. The transmission segment, which accounts for 11% of the sector, will grow 18-20% on-year, because of the high transmission capacity addition during 2016-17, leading to higher capitalisation. On the other hand, a decline in revenue by 5-7% in the distribution business, because of lower realisation, will limit the overall growth of the power sector.
- **Telecom:** The industry's gross revenue is expected to decline 15% on-year, due to the on-going price wars since the entry of Reliance Jio. The lower tariffs offered by Reliance Jio have driven the incumbents to come out with offers to retain customers with high data usage; this will put more pressure on data tariffs and realisations. Smaller players are expected to be impacted more versus larger operators, and are expected to witness revenue and margin erosion.
- **Pharmaceuticals:** Aggregate revenue is expected to marginally drop in Q1 2017-18, because of pricing pressure in the US market and a drop in revenue for a key player, Sun Pharma. Pricing pressure in the US is expected to impact mid-sized players as well, resulting in a 11-13% drop in revenue. However, strong performance by two large players, Glenmark and Lupin, is expected to limit the fall in revenue to 1-2%.

Revenue growth outlook across key sectors in the June quarter on-year



Source: CRISIL Research

Other sectors that are expected to drive revenue growth are:

- **Airline services:** The aggregate revenue of the airlines industry is expected to increase 15-17% on-year, upon strong growth in passenger traffic, primarily in the domestic sector. Domestic passenger traffic is expected to increase 16-18% on-year in Q1 2017-18, despite a rise in fares by airlines.
- **Chemicals:** The aggregate revenue of companies in the petrochemical segment is slated to rise 20-22% on-year in Q1 2017-18, due to an improvement in petrochemical realisations, due to a rise in feedstock naphtha price, following higher crude oil prices, which are expected to rise 15% on-year in Q1. A ramp-up in the production of Reliance Industries' 2.2 MMTPA PX plant at Jamnagar should drive volume growth.
- **Cement:** Revenue is projected to rise 13-15% on-year, due to a 4-5% increase in sales volume and a healthy improvement in realisation, led by higher input prices.

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EBITDA margin outlook

Rising input costs put pressure on corporate profitability

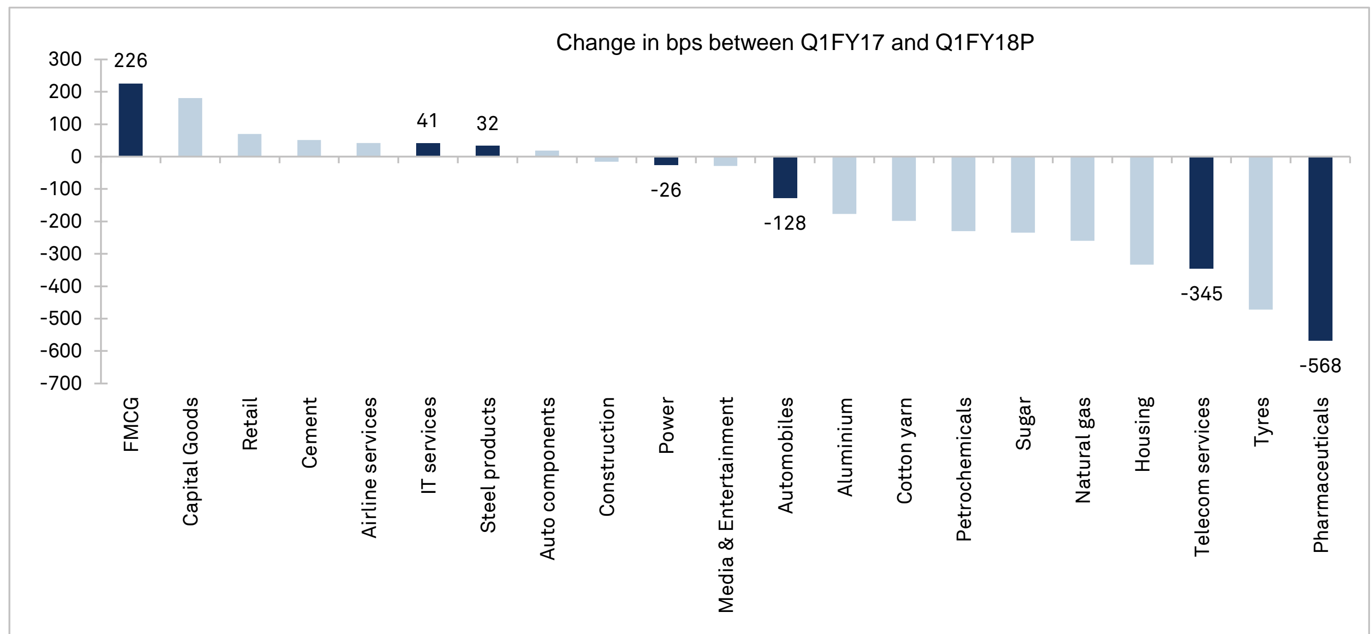
Revenue growth is not enough to improve the profitability, as India Inc faces an EBITDA margin contraction of 100-150 bps to 20.4% in Q1 FY18. Pricing pressure and high input costs will lead to margin erosion across sectors, with telecom, pharmaceuticals and chemicals being the key casualties. Higher raw material prices are expected to put downward pressure on automobiles, housing, textiles, sugar and tyres.

Snapshot of key sectors

Ebitda Margins	Q1FY16	Q2FY16	Q3FY16	Q4FY16	Q1FY17	Q2FY17	Q3FY17	Q4FY17	Q1 FY18E
Key Sectors	19.8%	20.0%	19.8%	21.3%	21.6%	21.1%	20.9%	19.9%	20.4%
Automobiles	12.9%	13.4%	12.2%	13.7%	12.7%	13.2%	11.9%	11.1%	11.4%
FMCG	22.3%	22.9%	24.0%	24.8%	23.0%	23.4%	25.6%	25.1%	25.3%
IT services	23.7%	25.4%	24.9%	25.0%	23.8%	24.3%	24.7%	24.5%	24.2%
Pharmaceuticals	25.2%	24.9%	23.7%	22.4%	24.5%	24.4%	24.0%	18.4%	18.8%
Pow er	31.1%	32.9%	34.0%	36.8%	33.3%	33.5%	32.8%	33.6%	33.0%
Steel products	11.7%	9.8%	5.7%	10.0%	16.8%	13.0%	15.7%	15.9%	17.1%
Telecom services	34.3%	33.7%	34.3%	35.6%	34.9%	35.1%	32.1%	32.0%	31.4%

Source: CRISIL Research

Change in EBITDA margin (outlook) across key sectors in the June quarter, on-year:



Source: CRISIL Research

- **FMCG:** Aggregate EBITDA margin is expected to expand 60-90 bps on-year on account of better realisation, optimisation efforts, a decline in the cost of raw materials, such as palm fatty acid distillate (PFAD). However, companies would continue with their aggressive marketing activities, as competition intensifies, which will increase marketing and selling expenses, thereby restricting margin expansion.
- **IT services:** EBITDA margin is forecast to expand 40-50 bps on-year, aided by a higher share of digital services of larger firms. However, the downward pressure on realisation and investments in digital technology will curtail further margin expansion. Limited scope for improvement in utilisation rates will also affect profitability.
- **Steel products**: EBITDA margin is expected to expand a mere 30-40 bps on-year, because of elevated raw material prices, especially that of coking coal. Also, arresting further widening of margin are higher on-year domestic iron ore prices.
- **Power:** Margins of power generation companies are expected to contract 200-250 bps on-year to 28-30%, due to higher imported coal prices. Although the increase in domestic coal availability would partially offset the rise in fuel cost, we expect the margin to be dragged down, since imported coal prices are still at an elevated level in contrast with on-year prices. However, steady margins in the transmission business and an increase in the margins of the distribution business, due to lower purchase costs, are expected to result in an overall margin contraction of 20-40 bps on-year.
- **Automobile sector:** EBITDA margin is expected to shrink 110-150 bps, as CV manufacturers' margins are expected to fall a sharp 470 bps, mainly due to higher raw material cost for BS-IV vehicles. Similarly, car makers' operating margin is likely to decline 60-80 basis points on-year, due to the expected sharp rise in raw material prices by 20-22%. However, tractor and two-wheelers segments are expected to witness stable margins, as higher raw material prices will be offset by higher utilisation.
- **Pharmaceuticals:** EBITDA margin is projected to drop 550-650 bps on-year to 19-20%, because of intense pricing pressure and the absence of exclusivity period for generic drugs of large formulation player, Sun Pharma, from which the company benefitted in the same quarter a year ago. Similarly, for mid-sized and small players, EBITDA margin is expected to drop 200-400 bps on-year, due to pricing pressure faced in Europe and the US as well as fewer new product launches.
- **Telecom services:** EBITDA margin is estimated to fall 350 bps in Q1, as the industry's revenue is expected to come under pressure (due to Reliance Jio). The launch of new networks on the spectrum acquired during the October 2016 auction will also add to the network operating expenses of the operators.

Other sectors that are expected to report an improvement in margins are:

- **Cement:** EBITDA margin is expected to expand 20-50 bps on-year for larger players on account of better realisations. However, elevated power, fuel and freight costs would restrict further expansion. Similarly, for mid-sized players, EBITDA margin is projected to expand 40-80 bps, due to lower costs and better economies of scale. Thus, the overall margin is expected to expand 40-60bps on-year in Q1.
- **Airline services:** EBITDA margin should rise a marginally 40-60 bps on-year to 12-13%, due to realisation growth in the domestic segment.

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Last updated: April 2016

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