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Another soft quarter on weak demand & intense competition

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Demand slump in the wet season; greenshoots for 2H

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Seasonal strength? Selectively.

OIL & GAS | Q2FY25 PREVIEW

Q2FY25 to reflect impact of normalisation of margins

SUMMARY

INDIA ECONOMICS: RBI MONETARY POLICY

The monetary policy committee of the RBI voted by a 5-1 vote to keep the policy rate unchanged at 6.5%. The stance was changed to "neutral" from "withdrawal of accommodation". The MPC remained confident on domestic growth and inflation trajectory. While acknowledging the recent dip in inflation, the MPC noted that there are risks to the inflation trajectory and aligning inflation to the RBI's target remains a key priority for the RBI. Hence, the change in stance gives RBI the space to monitor the trajectory of inflation in the face of growing risks from geo-political tensions, adverse weather shocks and uptick in a few global prices. Given the volatility in food prices, especially for horticulture products, the need for caution is warranted. With inflation in Q3 FY25 projected higher, we now expect a rate cut in Feb'25.

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BUILDING MATERIALS: Q2FY25 PREVIEW

- Our building materials universe's revenue likely to grow at a muted pace for the seventh consecutive quarter due to weak demand
- Our BM universe's EBITDA margin to contract by 67bps YoY to 13.2% in Q2FY25 due to intense competition in a weak demand environment
- On a relative basis, plastic pipe to perform the best and wood panel the worst in Q2FY25

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- Q2FY25 demand to be weak owing to monsoon seasonality (lull in new real estate projects) and limited infrastructure demand announcements
- Weak demand translates into soft pricing as reflected in our coverage companies, with realisations dropping on average by ~8%/2% YoY/QoQ
- EBITDA margin of our cement coverage estimated on average at ~15% vs ~16% YoY/MoM. We expect EBITDA/t at ~Rs 814, down 11% YoY

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- EMS companies poised for continued growth, fueled by strong order book, PLI boost, Make-in-India initiatives
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RBI MONETARY POLICY

09 October 2024

Cautious yet dovish

Aditi Gupta
Economist

The monetary policy committee of the RBI voted by a 5-1 vote to keep the policy rate unchanged at 6.5%. The stance was changed to "neutral" from "withdrawal of accommodation". The MPC remained confident on domestic growth and inflation trajectory. While acknowledging the recent dip in inflation, the MPC noted that there are risks to the inflation trajectory and aligning inflation to the RBI's target remains a key priority for the RBI. Hence, the change in stance gives RBI the space to monitor the trajectory of inflation in the face of growing risks from geo-political tensions, adverse weather shocks and uptick in a few global prices. Given the volatility in food prices, especially for horticulture products, the need for caution is warranted. With inflation in Q3 FY25 projected higher, we now expect a rate cut in Feb'25.

Key rates: The newly constituted MPC decide to keep the repo rate unchanged at 6.5%, with a 5-1 vote. The dissenting vote was cast by Dr. Nagesh Kumar, who voted for a 25bps cut in policy rate. The stance of the monetary policy was changed to "neutral" from "withdrawal of accommodation" by a unanimous vote. Notably the stance of monetary policy was last changed in Apr'22. The MPC noted that inflation and growth dynamics remain well balanced. The statement also reiterated the need for aligning inflation to the target on a durable basis, while also supporting growth. The change in stance gives the MPC room to monitor the evolving risks to inflation and can be viewed as a prelude to monetary easing.

Growth projections: The RBI remained positive on the growth outlook and kept its projection for GDP growth unchanged at 7.2% for FY25. It must be noted that real GDP growth for Q1 FY25 at 6.7%, undershot RBI's projection by 40bps. Significantly, growth forecast for Q2 FY25 has been lowered by 20bps. High frequency indicators also pointed to a loss in momentum in economic activity in the Sep'24 due to seasonal effects. However, growth is likely to pick up in H2 FY25. RBI's estimates for other subsequent quarters have been revised up by 10-20bps. This will be supported by a pickup in consumption demand due to the festive season as well as a good monsoon. Government expenditure is also likely to be scaled up in line with budget estimates. Overall, we continue to expect FY25 GDP growth in the range of 7.3-7.4%, which is marginally higher than RBI estimates.

Inflation projections: The RBI also retained its FY25 inflation projections unchanged at 4.5%. Inflation forecast for the current quarter was revised lower by 30bps to 4.1%, to account for the sharp moderation in inflation in Jul and Aug'24.

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BUILDING MATERIALS

| Q2FY25 Preview | 09 October 2024

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Building materials (BM): We expect our BM universe revenue to grow at a muted pace (+6.3% YoY in Q2FY25) for the seventh consecutive quarter due to weak demand on account of heavy monsoon and slowdown in pace of construction of the individual home building (IHB) segment. Furthermore, our BM universe EBITDA margin is projected to contract by 67bps YoY to 13.2% in Q2FY25 due to the rise of competitive intensity across segments in a weak demand environment. On a relative basis, plastic pipe is likely to perform the best and wood panel the worst in Q2FY25.

Plastic pipes: The sector witnessed weak demand in the month of Jul-Aug'24 due to destocking of inventories in the channel on account of falling PVC resin prices. Overall, we believe our pipe universe volume will grow at 11.4% YoY in Q2FY25 (5Y CAGR: +9.7%). However, our pipe universe EBITDA per unit is projected to decline by 11.0% YoY to Rs 19.7/kg in Q2FY25 due to continued aggressive pricing strategy by SI and mark-to-market inventory loss. On a relative basis, SI is likely to post superior volume growth (+15% YoY) for the 11th straight quarter.

Bathware: We believe our bathware universe revenue will grow at 5.7% YoY, but EBITDA decline by 5.3% YoY in Q2FY25 due to higher discounts offered on slow-moving products and intense competition in a weak demand environment.

Tiles: We forecast our tiles universe EBITDA to be relatively flat (-0.2% YoY) in Q2FY25 as the impact of higher volume (+8.0%) is likely to be offset by margin pressure on account of intense competition from Morbi players.

Wood panels: Our wood panels universe EBITDA is likely to contract on a YoY basis for the ninth consecutive quarter (-0.3% YoY in Q2FY25) due to margin pressure on account of unfavourable supply-demand fundamentals in MDF & particleboard, and high timber prices. On a relative basis, MTLM is likely to post sharp growth in its operating profit (+32.3% YoY) due to the fast ramp up of its new MDF unit.

CEMENT | Q2FY25 Preview | 09 October 2024

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Lacklustre demand keeps volume growth muted: Cement demand was weak in Q2FY25 owing to monsoon seasonality that particularly hit the real estate segment. Infrastructure demand too was listless due to delayed budgetary allocations. The higher base (FY24 was below normal monsoon) additionally aided weak demand growth of 2% YoY for our coverage companies. QoQ growth fell sharply by 13% despite a lull in 1Q. Volume growth was particularly muted for companies with limited capacity expansion, including Orient Cement and JK Lakshmi Cement.

Pricing pressure across regions owing to supply glut, demand weakness: Supply excesses and limited demand kept pricing under pressure in addition to the traditional seasonality weakness. Pan-India cement prices weakened by ~+8% YoY and 3% QoQ (otherwise flat although driven by 8% fall in South India) in Q2FY25. Most of the impact was felt in the eastern and southern regions of India as prices fell by ~12% each YoY, followed by the western region with 8%. Central and North India fared better with 4-5% YoY fall in prices.

Effective realisations remain weak: Realisations of our coverage companies dropped on average by ~8%/2% YoY/QoQ. However, with no major negative cost headwinds the margins drop was limited or even better for more efficiently-driven companies. Manufacturers in southern and eastern India, including JK Lakshmi and Dalmia Bharat, were hit harder (~300bps YoY impact) compared to Shree Cement and UltraTech Cement which have a presence in remunerative regions.

EBITDA/t and margins flat YoY, slip QoQ: We estimate EBITDAM of our cement coverage on average at ~15% in Q2FY25 vs ~16% in Q2FY24/Q1FY25, aided by cost relief driven by lower energy and logistics expenses. We expect EBITDA/t at ~Rs 814/t a drop of ~11%/7% YoY/QoQ with SRCM and UTCEM the exceptions as they maintained the previous year's performance.

Supply flow from new M&A yet to impact industry: Adani Cement's/Ultratech Cement's acquisition of Penna Cement/India Cement respectively is yet to be reflected in the incremental cement supply but expected to add from H2FY24.

CONSUMER DURABLES | Q2FY25 Preview | 09 October 2024

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Expect 2QFY25 revenue/PAT growth of 27%/33%: We expect strong 27% YoY revenue growth for 2QFY25 across our coverage universe. We expect this revenue growth to be driven mainly by the wires and cables segment, which has rebounded as demand recovers from the raw material cost volatility seen between May and July 2024, supported by higher government spending and an uptick in real estate investments. The EMS sector also shows continued strength, with a growing order book and healthy customer additions across segments. Leading this growth are Dixon (70% YoY), followed by SYRMA (35% YoY) and AMBER (25% YoY) in EMS, and POLYCAB (19% YoY) and KEII (17% YoY) in wires and cables. This overall growth is underpinned by a 24% increase in EBITDA and a 33% rise in PAT.

Segment-wise outlook: The C&W segment is expected to maintain strong growth; with improved sales in September. However, kitchen appliances sales are likely to be lower due to weak consumer sentiment, while fan growth will be limited to the high single digit after a strong summer season. The lighting segment will see limited performance due to ongoing price erosion. Refrigerator and room air conditioners (RAC) are expected to see softer demand as the summer season fades. After a slow start, washing machines rebounded with customers showing a preference for premium products, according to our discussions with dealers. High-value electronics, including laptops and mobile phones, gained traction in Q2, showing strong performance.

Challenging quarter for consumer durables: Q2 is typically seasonally weak for the consumer durables segment except for washing machines and kitchen appliances. We expect overall demand to remain subdued due to inflationary pressures on consumer spending, ongoing rural weakness, and the natural slowdown after the peak summer season in Q1FY25. Feedback from companies regarding demand during Onam was mixed. The trends during the upcoming festive season will be crucial to watch, as there is cautious optimism for a recovery in rural demand, along with potential shifts in raw material costs.

IT SERVICES | Q2FY25 Preview | 10 October 2024

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Unlikely to see incremental positivity: In QFY25 we saw both numbers and demand commentary turn modestly positive. While selective companies are expected to deliver better QoQ growth (Infosys, LTIM, Persistent) we believe that is now a consensus view. We expect Infosys to raise guidance on revenue growth by ~100bps. Expect 2H seasonal weakness to play out. Incrementally we do not expect companies to sound more bullish. Over the last 6 months, consensus earnings have been either flat or turned a tad negative.

BFSI upturn has more legs? One of the recurring features of 1QFY25 company commentary was the positivity around demand from US BFS clients. Need to see if that has further momentum in 2HFY25. Interestingly one of the largest players in the space – Accenture – has not made any positive noises on this front in the last two quarters. While there was an expectation that US interest rates were headed lower post the recent largish cut of 50bps (and spurring demand), recent macro data has pushed up US 10 year yield up to 4% + levels within a short period of time.

Contrasting narratives: The market is grappling with two contrasting narratives (1) a sharp demand upturn in FY26 (backed by a US soft-landing scenario) and Generative AI based pick up in discretionary spending (2) a 'slower-for-much-longer' situation under a not-so-soft-landing or a no landing scenario.

Discretionary spending and Gen AI: In our multiple conversations with companies in the last one month, there still is no sign that discretionary spending is making a broad-based comeback. Enterprise Generative AI uptake has been slow. Companies have stated that Gen AI is going to be net accretive with tailwinds from Legacy/Mainframe modernization outweighing the pass back to clients from productivity benefits. But the question is when that will start.

Cross currency tailwinds will support: Our analysis indicates that most companies will gain 15-95 bps from QoQ cross currency tailwind. But this is on paper, things could have turned out differently in reality. This will support both margins and revenue.

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OIL & GAS | Q2FY25 Preview | 10 October 2024

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- **OMC margins are cushioned by a sharp fall in crude price amid stable retail prices, retail CGD margins sustained with modest price increase**
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Sequential recovery in Q2FY25: We forecast a 29% YoY decline in EBITDA across our coverage universe, driven by 55% pullback in OMCs and 13% contraction in retail CGDs. However, we expect a sequential 6% recovery in EBITDA for our coverage universe supported by rise in petrol and diesel retail margins for OMCs, volume growth for retail CGDs and growth in Digital Services EBITDA for RIL

RIL to post modest YoY decline: We expect RIL to post 4% YoY EBITDA decline with a 2% decline in Retail business on rationalisation and a 15% decline in Energy business on lower O2C margins. However, RIL is likely to post a modest (2%) sequential recovery in EBITDA with pick-up in Digital Services from tariff increase. Commentary on momentum in 5G penetration, roll-out of Jio AirFiber, status of rationalisation in Retail and start-up of giga factories are key monitorables.

OMCs benefit from fall in crude: We expect a 15% QoQ recovery in OMCs EBITDA in Q2FY25E with pullback in crude prices. Higher retail margin on gasoline and diesel is likely to offset weakness in refining margin, under-recovery on LPG and inventory loss. Combined R&M EBITDA margin is likely to remain healthy at Rs4.2k/t or US$6.8/bbl of marketing volume. Progress on expansion projects and commentary on sustainability of marketing margin are key monitorables.

Retail CGDs to post healthy volume growth: Retail-focused CGDs are likely to report stable EBITDA sequentially as volume growth and price increase largely offsets pressure from higher LNG prices. We factor in an EBITDA margin of Rs11.2/scm for MAHGL and Rs7.2/scm for IGL in Q2FY25E. Commentary on the pace of CNG vehicle additions, additional success in the industrial segment, availability of APM gas and guidance on EBITDA margin are key monitorables.

Other gas utilities: Benefitting from redirected Dahej cargoes and growth in LNG consumption, PLNG is likely to clock 29% YoY growth in adj EBITDA ex provisions for TOP recovery. In contrast, GUJS is likely to post a sharp 52% YoY cut in EBITDA due to the **recent cut in HP Gas Grid's tariff**. Actual underlying tariff and volume outlook is key for GUJS; visibility on **timing for make-up cargos** is key for PLNG.

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