FIRST LIGHT

11 July 2024

RESEARCH

BANKING | Q1FY25 PREVIEW

Margin under pressure; lower provision to support PAT

CONSUMER DURABLES | Q1FY25 PREVIEW

Moderate quarter; room AC outshines

IT SERVICES | Q1FY25 PREVIEW

Earnings cycle to turn up? Too early to call, in our view

METALS & MINING | Q1FY25 PREVIEW

Soft volumes in Q1 to offset benefit of lower coking coal costs

SUMMARY

BANKING: Q1FY25 PREVIEW

- Credit growth remains healthy with broad-based growth supported by wholesale segment, while some moderation in retail book is expected
- Sequential moderation in deposit mobilisation to keep CD ratio elevated, while higher CoF continues to put pressure on margins
- Asset quality concerns continue to ebb; HDFCB, KMB, IIB, SBIN and RBK are our top picks

Click here for the full report.

CONSUMER DURABLES: Q1FY25 PREVIEW

- Q1FY25E to be strong given the severe heat wave across the country; cooling products to outperform
- Despite increased A&P spends and elevated raw material prices, companies will maintain healthy EBITDA margins
- Expect revenue/EBIDTA/PAT growth of 26%/28%/29% YoY for our coverage universe

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IT SERVICES: Q1FY25 PREVIEW

- After multiple quarters of earnings downgrades, 1QFY25 will likely see a pause. We think it is too early to call if the cycle has turned up for good
- Commentary from players indicates growth upturn is unlikely in FY25. Consensus assumes it will happen in FY26. We think the odds are even.
- We expect better QoQ growth on an aggregate basis, which we believe is in the price. We will be reinitiating coverage on the sector soon.

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METALS & MINING: Q1FY25 PREVIEW

- We expect aggregate EBITDA to decline by 13% sequentially for the four steel majors on seasonal pullback in volume and margin contraction
- We believe ferrous majors are largely pricing in volume growth, and we see lower possibility of margin surprise during the early recovery phase
- Retain HOLD on TATA, JSTL and JSP and SELL on SAIL; structural resolution of China’s surplus capacity is a key upside trigger

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BANKING | Q1FY25 Preview | 10 July 2024

Margin under pressure; lower provision to support PAT

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Healthy business growth continued: According to RBI data, system credit grew 15.6% YoY for the fortnight ended 14 Jun 2024. Growth during the quarter was broad based with support from wholesale book. Although retail continued to outpace wholesale, we expect some moderation in unsecured retail loans like personal and in the credit card segment. Given the ongoing system dynamics and liquidity situation, we expect system credit growth of 14-15% for FY25 vs. 16.3% in FY24 excluding the HDFC merger and 20.2% including the same.

Sequential moderation in deposit mobilisation likely to lift CD ratio: Though deposit mobilisation recovered from a lower base, sequential moderation in deposit mobilisation (12.6% YoY vs. 13.5% in Q4) is likely to keep the CD ratio up. Further, continued higher deposit rates made it competitive for incremental deposits mobilisation and banks are betting big on liquidity utilisation and borrowing programmes like infrastructure bonds to fund asset. Term deposits (TD) spurred growth, where banks kept increasing rates leading to a continued subdued CASA.

Margins under strain from rising deposit costs: The continued rise of TD rates and tight liquidity environment likely will keep cost of funds elevated and put pressure on margin. But, banks' core focus on high yield retail loans could alleviate some of the stress. We expect a further 4-5bps QoQ decline in aggregate margin for our coverage, similar to Q4. However, management outlook on margin would be key to watch. Q1 being seasonally weak, we expect topline growth to stay muted.

Slippages to remain in check: We expect incremental stress from agriculture (seasonality) and some increase in stress from the unsecured portfolio to increase/ stablise GNPA and NNPA with stable PCR. Credit cost normalisation will continue to drag bottomline. We don't see any major challenges towards restructured/SMA books which are expected to improve. In our view, topline growth will remain muted on higher CoF, while opex will remain elevated as banks strive for higher deposit mobilisation. Sequential rise in provisions is likely to drag PAT. We continue to prefer HDFCB (BUY, TP Rs 1,872), KMB (BUY, TP Rs 2,000), IIB (BUY, TP Rs 1,881), SBIN (BUY, TP Rs 969) and RBK (BUY, TP Rs 309) in the sector.

Recommendation snapshot

Ticker	Price	Target	Rating
AXSB IN	1,292	1,252	HOLD
BANDHAN IN	192	222	BUY
CBK IN	115	140	BUY
DCBB IN	132	172	BUY
FB IN	189	207	BUY
HDFCB IN	1,626	1,872	BUY
ICICIBC IN	1,243	1,272	HOLD
IDFCBK IN	78	96	BUY
IIB IN	1,426	1,881	BUY
KMB IN	1,830	2,000	BUY
RBK IN	244	309	BUY
SBIN IN	849	969	BUY

Price & Target in Rupees | Price as of 10 Jul 2024

CONSUMER DURABLES

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10 July 2024

Moderate quarter; room AC outshines

- **Q1FY25E to be strong given the severe heat wave across the country; cooling products to outperform**
- **Despite increased A&P spends and elevated raw material prices, companies will maintain healthy EBITDA margins**
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Expect 1QFY25 revenue/PAT growth of 26%/29%: On a consolidated basis, we expect a robust 26% YoY revenue growth across our coverage universe for 1QFY25. This upward trend in revenue and profitability is fueled primarily by heightened demand due to rising temperatures and buoyant real estate transactions. Also, increased consumer spending and infrastructure development have contributed to positive outlooks for these companies. Leading this trend are DIXON (55% YoY) followed by VOLT (35% YoY) and BLSTR (30% YoY). We believe this growth is underpinned by strong increases in EBITDA of 28% and PAT 29%.

Scorching heat drives robust demand for cooling products: Room air conditioners (RAC) is poised for 40-45% YoY growth in Q1FY25, buoyed by high temperatures nationwide and benefitting from a favourable base effect. Similarly, most companies' electrical consumer durables (ECD) segments are likely to perform strongly, particularly the fan segment, although the lighting sector within ECD may experience subdued growth due to ongoing price erosions. We expect wires and cables segment, which performed well in 4QFY24, to face sequential declines, primarily due to increased commodity prices potentially dampening revenue growth. Air cooler segment saw 35-40% increase in sales in 1QFY25, according to dealers.

Healthy EBITDA margins to be maintained: On the margin front demand revival and price revisions taken after increase in raw material costs should help improve cost absorption and retain margins on YoY basis. To address escalating input costs, brands have implemented on average a 5% price hike in RAC segments, and prices in the air cooler category have risen up to 10%. We expect margins for wires and cables at 9.6% (+20bps YoY), durables at 7.8% (+50 bps YoY) and electronics manufacturing services companies to be about 6.4% (+50 bps YoY).

Management commentary critical: In our view, comprehensive management commentary on the demand outlook, price revisions resulting from raw material inflation, cost management strategies, and revised outlook on margin profile that account for high competition and cost inflation, will provide a clearer picture for the remainder of the year.

IT SERVICES

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Demand commentary: We expect the demand commentary to be largely like what we have heard in the last few quarters. Need to see if customers are becoming increasingly wary of changes in economic policies due to changes/likely changes in governments in various parts of the world – the US, the UK, France, etc. We do not expect any change in the guidance given by INFO and HCLT either on revenue or on margins post 1QFY25.

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 (2) a 'slower-for-much-longer' situation under a not-so-soft-landing. We think a new US presidency under Donald Trump (seems likely at this stage) could lead to greater uncertainty in 1HCY25.

US economy: The US economy has been very resilient thus far despite high interest rates, helped by excess household savings from the pandemic and a looser fiscal stance by the US government. But the latest economic data is pointing to weakness.

IT spends: IT spending has broadly held up in this environment and grown at a muted pace in 2022, 2023 and 1H2024. Growth has slowed materially for India's IT services sector compared to the pandemic frenzy, but it has not felt significant pain yet.

Gen AI and Productivity: There still is no sign that discretionary spending is making a decisive comeback. Enterprise Generative AI uptake has been slow. We will watch for commentary if that is eating into other IT services spend. It remains to be seen if the 'surround services' business needs to be compressed to generate savings for the Gen AI initiatives. Different players have given out different numbers regarding the extent of productivity increase due to Gen AI – from 10-15% to as much as 30-40%. The bigger question is how much is retained by the vendors and how much is passed on to customers.

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Q1 EBITDA to ease sequentially: We expect aggregate consolidated EBITDA for the four steel majors under our coverage to decline 13% QoQ and 1% YoY in Q1. The sequential decline is the result of a seasonal pullback in volumes as well as a modest margin contraction despite the benefit of reduction in coking coal prices. Among the four majors, we expect players with a focus on long products – JSP and SAIL – to post relatively resilient results this quarter.

Softer volumes: We expect sales volume to be up only 4% YoY for the four majors impacted by a slowdown in the election quarter despite apparent 12% YoY growth in steel consumption for the industry over Apr-May 2024. This translates to a 9% sequential decline in sales volume collectively for the four majors.

Decline in EBITDA margin: We forecast a Rs0.5k/t sequential decline in EBITDA margin to Rs9.9k/t collectively for the four majors. The benefit of reduction in coking coal costs is likely to be offset by the impact of softer volumes, leading to higher per unit overhead costs. While we expect JSP and SAIL to post a relatively resilient EBITDA margin of Rs13.k/t and Rs6.7k/t, benefitting from strength in long products pricing, we also expect TATA's EBITDA margin to be Rs13.5k/t from stable prices.

Key drivers for the sector: Near term, the monsoon is likely to keep steel volumes and margins in check in India. Similarly, continuing weakness in China's property sector as well as slower recovery in the western world has resulted in the softening of global steel prices. Key upside trigger for the sector includes (a) resumption of strong infrastructure investments in India, (b) arresting steel demand decline from China property sector and (c) structural resolution of surplus steel capacity in China.

India's steel sector pricing in volume growth: With the recent 40% rally since Nov'23 vs 26% in NIFTY 50, we believe the four ferrous majors in our coverage are now largely pricing in the benefits of expansion. We retain our HOLD ratings on TATA, JSTL and JSP, and SELL rating on SAIL. We see lower possibility of positive surprise on margin in this economic recovery cycle for the ferrous sector, until China addresses surplus steel capacity in a structured manner.

Recommendation snapshot

Ticker	Price	Target	Rating
JSP IN	1,008	1,055	HOLD
JSTL IN	925	940	HOLD
SAIL IN	151	110	SELL
TATA IN	168	175	HOLD

Price & Target in Rupees | Price as of 10 Jul 2024

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BUY – Expected return >+15%

HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

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