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12 July 2024

RESEARCH

BOB ECONOMICS RESEARCH | CPI INDEX

Impact of commodities with high inflationary potential

TATA CONSULTANCY SERVICES | NOT RATED

Modest growth improvement in FY25 over FY24 likely

CEMENT | Q1FY25 PREVIEW

Headed for a relatively slow start

CONSUMER STAPLES | Q1FY25 PREVIEW

FMCG 1QFY25 earnings preview

SUMMARY

INDIA ECONOMICS: CPI INDEX

India's inflation has witnessed considerable volatility in the last few years. From episodes of low inflation, it overshot RBI's 4+/-2% bandwidth. However, a statistical evaluation of the entire disaggregated series of CPI shows that volatility is concentrated in few food items. At times, fuel products have also exhibited high annualized average monthly volatility which was mainly due to changes in retail prices at certain points of time. The distribution of inflation also witnessed positive skewness in the past two years and higher kurtosis (>3), which indicates that due to certain specific items, inflation is ruling higher.

Click here for the full report.

TATA CONSULTANCY SERVICES

- Results were better than expected, more so on margins. Broad-based growth seen. However, international growth was much weaker
- While TCS reiterated that FY25 growth is going be better, it refused to say that the quarter's momentum would sustain on customer behaviour
- A mid-single digit EPS upgrade for FY25 is likely because of a margin upgrade. Will be initiating coverage on the sector and TCS shortly

Click here for the full report.

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CEMENT: Q1FY25 PREVIEW

- Q1FY25 demand likely to be weak due to limited infrastructure demand, extreme summer and lull in new real estate project announcements
- Weak pricing is reflected in our coverage companies as realisations dropped on average by ~7%/3% YoY/QoQ
- EBITDA margin of our cement coverage estimated on average at ~18% vs ~17% YoY. We expect EBITDA/t to be flat at ~Rs 960 YoY

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CONSUMER STAPLES: Q1FY25 PREVIEW

- We expect marginal sequential improvement in sales growth for most FMCG companies in our coverage due to slight pickup in rural
- Gross margin expansion trend to slow sequentially. EBITDA likely to grow slightly ahead of sales on increased business reinvestments
- Key focus areas – (1) recent trends in rural demand; and (2) market share performance given some rollback of pricing actions

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CPI INDEX

11 July 2024

Impact of commodities with high inflationary potential

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India's inflation has witnessed considerable volatility in the last few years. From episodes of low inflation, it overshot RBI's 4+/-2% bandwidth. However, a statistical evaluation of the entire disaggregated series of CPI shows that volatility is concentrated in few food items. At times, fuel products have also exhibited high annualized average monthly volatility which was mainly due to changes in retail prices at certain points of time. The distribution of inflation also witnessed positive skewness in the past two years and higher kurtosis (>3), which indicates that due to certain specific items, inflation is ruling higher.

The analysis here looks at commodities in the CPI basket which have witnessed high inflation and volatility in the last few years relative to the headline numbers and examines their price movements as represented by a combined index called 'CPI-volatile Index'. The CPI-volatile series indicates that most of the overshooting of CPI beyond its 6% level is attributable to higher inflation in these few items. In May'24, these volatile items pushed up CPI by 1.5%. Historically as well, in most of the periods, these volatile items have been responsible for higher inflation.

Background:

Inflation trajectory has evolved interestingly since FY19. We witnessed episodes of low inflation just prior to the pandemic period (FY18 and FY19), supported by benign food inflation. The pandemic witnessed a slack in demand conditions and core inflation softened. However, with resumption of economic activity, inflation numbers witnessed an upturn with normalization in core inflation and food prices spiraling on account of a variety of factors. This can be attributed to both domestic factors (crop failures) as well as global factors (disruptions due to wars).

Table 1: Trend of inflation and its components

Inflation (% YoY)	Headline CPI	Food inflation	Core (excl. food and fuel)
FY19	3.4	0.2	5.8
FY20	4.8	6.7	4.0
FY21	6.2	7.8	5.7
FY22	5.5	3.8	6.1
FY23	6.7	6.6	6.1
FY24	5.4	7.5	4.3

Source: CMIE, Bank of Baroda Research

NOT RATED

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Modest growth improvement in FY25 over FY24 likely

- **Results were better than expected, more so on margins. Broad-based growth seen. However, international growth was much weaker**
- **While TCS reiterated that FY25 growth is going be better, it refused to say that the quarter's momentum would sustain on customer behaviour**
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Client behavior has not seen change: TCS refuses to say that a sustained uptick is on the cards, though it insists that FY25 is going to be a better year. A mid-single digit EPS upgrade is likely for FY25 largely due to better margins. TCS is uncertain whether the 2.2% CC QoQ growth (better than our estimate of 1.5%) seen in 1QFY25 will sustain. This is due to clients who take decisions at short notice based on the evolving macro environment. Even in 1QFY25 TCS saw clients ramping down programmes or re-evaluating programmes at very short notice where the ROI did not meet expectations. It stated that customer sentiment remains like what it was in past quarters.

Growth in line with company expectations: The 2.2% growth number was in line with internal expectations at the beginning of the quarter. The lack of confidence in growth probably also stems from the fact that international business (ex India) revenue growth in USD terms on a QoQ basis fell to 1%. India growth we believe was largely driven by the BSNL order. While BFSI in North America has picked up, TCS refused to conclusively state that a bottom had been reached. Growth in the quarter was quite broad-based with only the communications and media sector not participating.

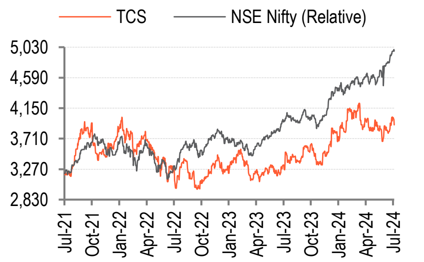
EBIT margin jumps: The biggest surprise was on the EBIT margin front where it came in at 24.7% (our estimate 24%), despite taking a hit of 170bps due to a compensation increase (QoQ) and higher pass-through costs QoQ (~90bps, again likely due to the BSNL order). The compensation hit was partly offset by better productivity and higher utilisation. Productivity could mean higher offshoring, span of control, and higher automation (including probable use of Gen AI).

Ambitious exit rate of margin unlikely: The CFO alluded to the 100bps/quarter clawback in FY24 from 1Q to 4Q and hinted at a similar trajectory in FY25. We think that may be ambitious in the context of the levers of Subcontracting being completely used up and utilisation being higher than it was in previous quarters. The bulk of the improvement will have to be driven by pyramid and higher automation. Consensus EBIT margin of 25.3% (BBG consensus) will likely move up.

Ticker/Price	TCS IN/Rs 3,902
Market cap	US$ 172.2bn
Free float	28%
3M ADV	US$ 112.0mn
52wk high/low	Rs 4,255/Rs 3,250
Promoter/FPI/DII	72%/17%/11%

Source: NSE | Price as of 11 Jul 2024

Stock performance



Source: NSE

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CEMENT | Q1FY25 Preview | 11 July 2024

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Volume growth driven by capacity addition due to higher demand: Cement demand momentum was weak in Q1FY25; however, our coverage universe delivered on average growth of 8%. This was driven by companies that added capacity in FY24, though volumes declined YoY for companies with limited capacity addition, including JK Lakshmi Cement and Orient Cement. QoQ growth fell by 5% following a lull in 1Q after busy period sales in Q4FY24. Q1FY25 demand remained weak due to various factors that include limited infrastructure demand owing to lack of clear policy framework in election phase, extreme summer climate in the northern and central India belt and lull in real estate demand with deferred real estate project announcements.

Enough supply across regions: Enough availability of headroom capacity following organic and inorganic capacity expansion by cement majors in FY24 implied strong supply. Adani Cement, UltraTech Cement, Dalmia Cement, Shree Cement and JK Cement added capacities in FY24, leading to a supply glut across regions in Q1FY25. With limited demand revival pressure on pricing imminent, Pan-India cement prices weakened by 6.7%/3.2 YoY/QoQ in Q1FY25. Most of the impact was felt in the eastern and southern regions as prices fell by 7-9% YoY and Central and West India fared better with limited fall in prices.

Effective realisations remain weak: Weak pricing is reflected in the coverage companies as realisations dropped on average by ~7%/3% YoY/QoQ. However, with no major negative cost headwinds the margins drop was to the extent of the fall in realisations only or relatively better in more efficiently driven companies.

EBITDA/t and margins flat YoY, slips QoQ: We estimate EBITDAM of our cement coverage on average at ~18% in 1QFY25 vs ~17% in Q1FY24/~19% in Q4FY24, aided by better-managed companies. We expect flat EBITDA/t at ~Rs 960 YoY.

Mergers & acquisitions activity picks up: Adani Cement through its major Ambuja Cement is acquiring Penna Cement, and UltraTech Cement is acquiring ~23% stake in India Cements apart from acquiring Kesoram Industries towards FY24-end.

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- **Gross margin expansion trend to slow sequentially. EBITDA likely to grow slightly ahead of sales on increased business reinvestments**
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Slightly improving sales trends: Overall, we expect mid to high single digit sales growth for most FMCG companies. Pricing will likely be stable to slightly weaker but volumes will improve on a sequential basis. Pricing trends reflect tactical rollbacks to regain market share from local/regional players who had passed through the lower cost benefit to consumers in FY24. Volume gains likely driven by the combination of pricing rollbacks and an improvement in rural demand.

Gross margin gains to slow but business reinvestment spending to continue: The combination of commodity deflation and pricing rollbacks in 2HFY24 will likely slow gross margin gains on a sequential basis. Also, we expect business reinvestments to continue and EBITDA to rise in line or only slightly ahead of sales growth on flattish margins.

No material changes to FY25E guidance: Recovery in rural demand is a key component of FY25E guidance across most FMCG companies. However, 3/4th of the Southwest monsoon is yet to complete and the quality of harvest is hard to predict at this stage. Rural bias appears positive as reflected in higher YoY sowings.

Key focus areas – market share performance; recent trends in rural demand: We expect the market to focus on FMCG market share performance which should improve given (1) pricing rollbacks, and (2) slight pickup in rural. Any weakness in market share performance or rural sales may not be well received by investors.

Name	BOBCAPS EBITDA YoY (%)	Consensus EBITDA YoY (%)	Date	Estimated / confirmed
HUVR	2	1	19-Jul-24	Estimated
NEST	18	21	25-Jul-24	Confirmed
TATACONS	13	10	26-Jul-24	Estimated
DABUR	12	9	01-Aug-24	Confirmed
BRIT	12	11	02-Aug-24	Estimated
MRCO	8	8	05-Aug-24	Confirmed
GCPL	15	12	07-Aug-24	Estimated
ITC	4	2	14-Aug-24	Estimated

Source: BOBCAPS Research, Bloomberg

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

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

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