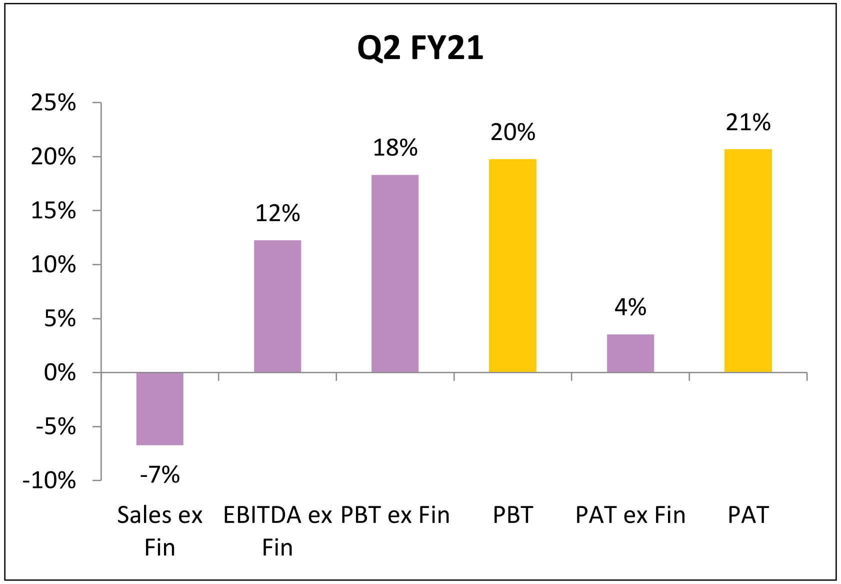
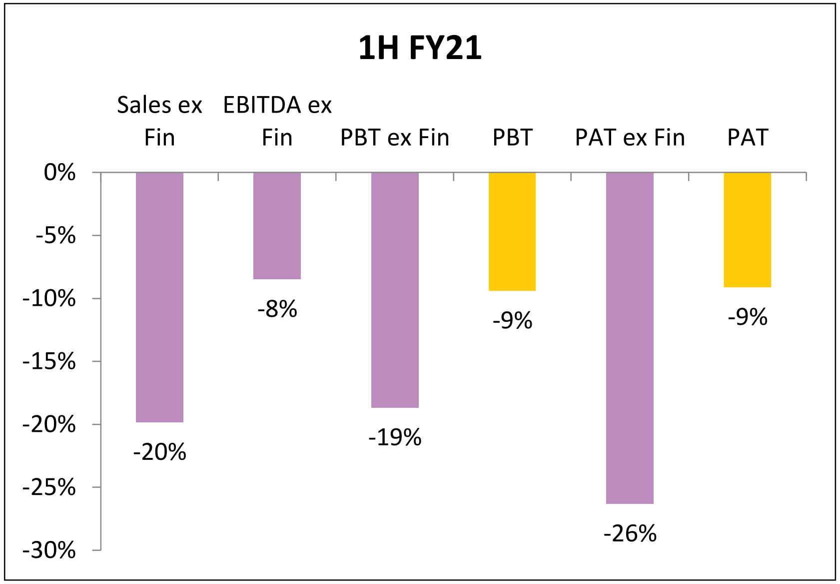
EARNINGS, MARKETS AND PERSPECTIVES

DECEMBER 2020

IDFC MUTUAL FUND

Q2 FY21 Earnings: Sales de-growth, operating profits significantly better than expected





Source: Bloomberg

- Q2 FY21 was one of the best quarters in the last many years in terms of ratio of positive to negative surprises on earnings, though earnings estimates were significantly lowered after the last 2 quarters.
- Ex Financials, Sales saw degrowth of 7%, slightly above estimates. Margins beat even most optimistic estimates with EBITDA growing 12%.
- Including Financials, PBT grew 20% and PAT grew 21%. PAT YoY is not exactly comparable as base had many one-offs due to the changes in tax rate in the base quarter.
- For 1H, Financials have supported profits with PAT falling 9% overall but down 26% ex Financials. On all accounts even Sales (-20% YoY) were much better than initial estimates when the lockdown started.
- **While sales growth was in-line: (1) better-than-expected demand recovery, (2) continued cost control measures, and (3) lower-than-expected provisioning costs for the BFSI segment drove a spectacular profit beat**

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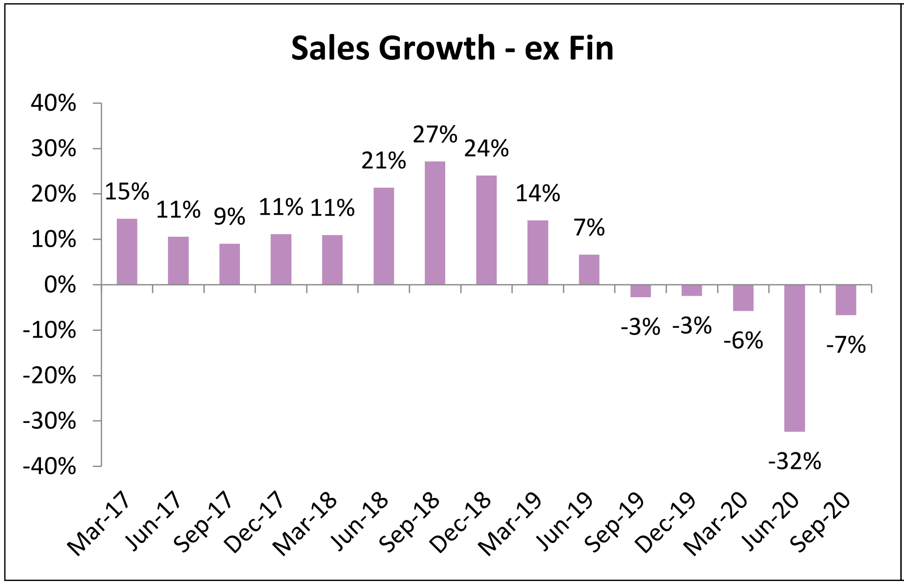
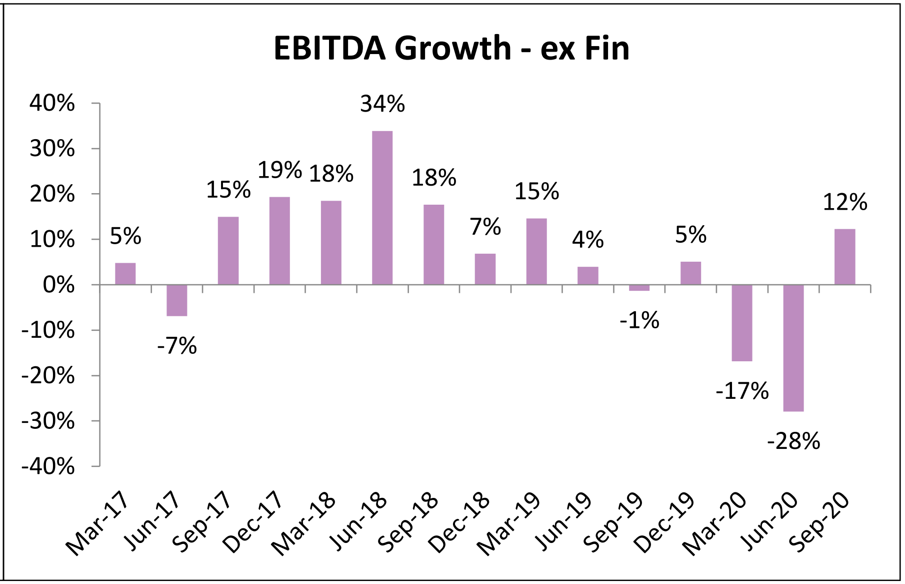
Q2 FY21 Earnings : EBITDA growth despite Sales degrowth





Source: Bloomberg

- Sales have seen degrowth for five consecutive quarters, including a 32% degrowth in Q1 of this year. This sets a very low base of sales for the next five quarters.
- Even in Q1, EBITDA fell lower than Sales. Four of the last five quarters, EBITDA has done better than Sales.

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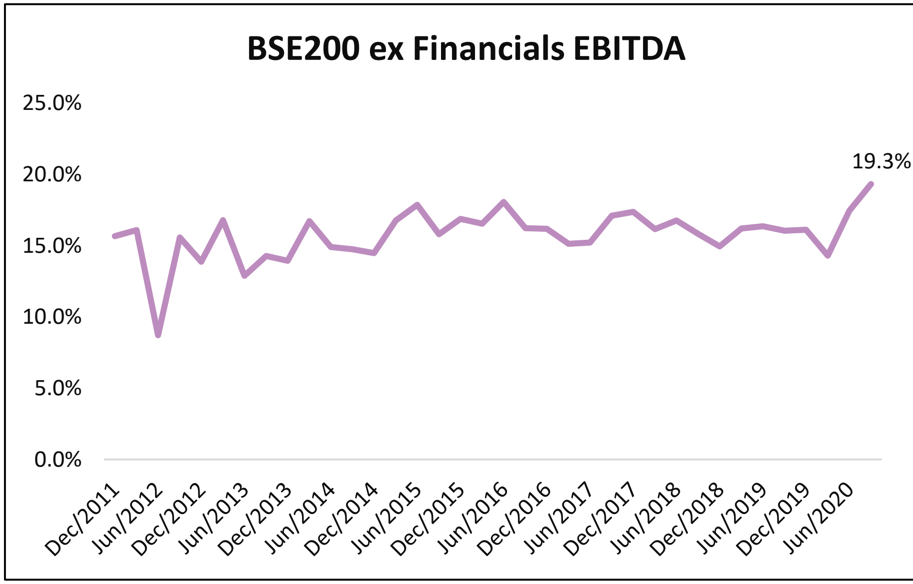
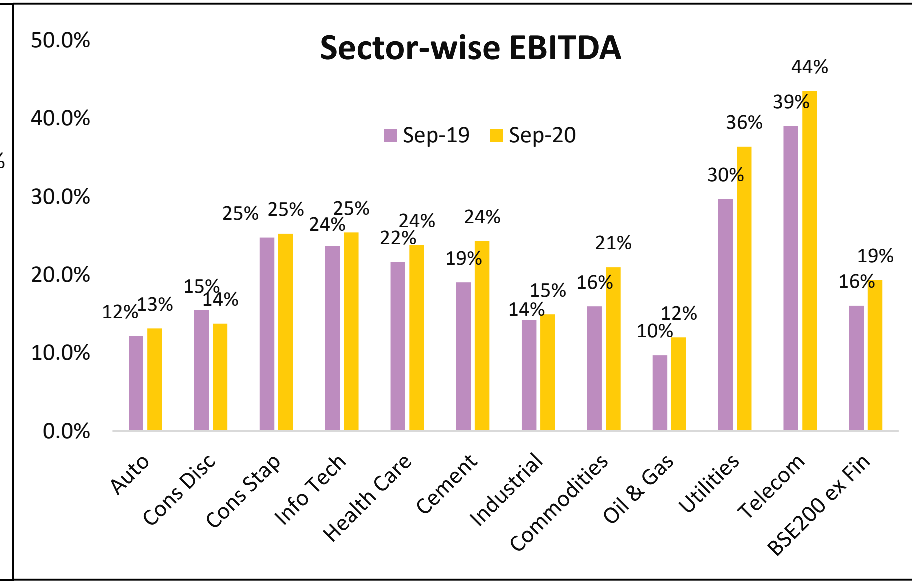
Q2 FY21 Earnings: EBITDA Margins at a decadal high





Source: Bloomberg

- EBITDA Margin for BSE200 ex Financials came at 19.3%, highest since 2011 atleast.
- EBITDA grew 12% YoY led by broad-based margin expansion across sectors
- Margin expansion was broad-based across sectors except in Consumer Discretionary.
- Margins expanded on the back of:
  - Lower discounts across sectors like Auto, Cement etc
  - Significant curtailment in discretionary spends like ad spends, travel etc
  - Temporary salary cuts in and temporary reduction in rents in sectors with higher impact like Retail, Industrials etc
  - Reversal of inventory losses in sectors like Oil & Gas, Metals etc

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Q2 FY21 Earnings: Sectoral Trends

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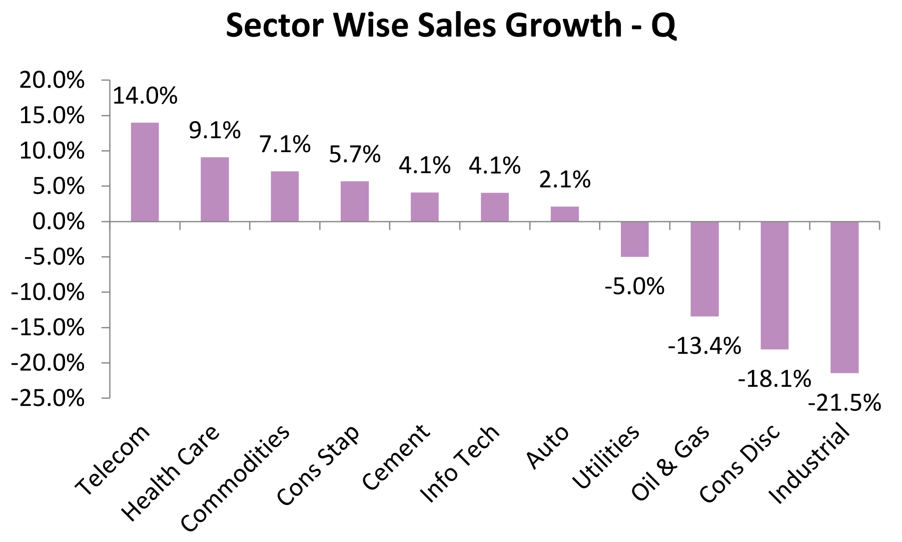
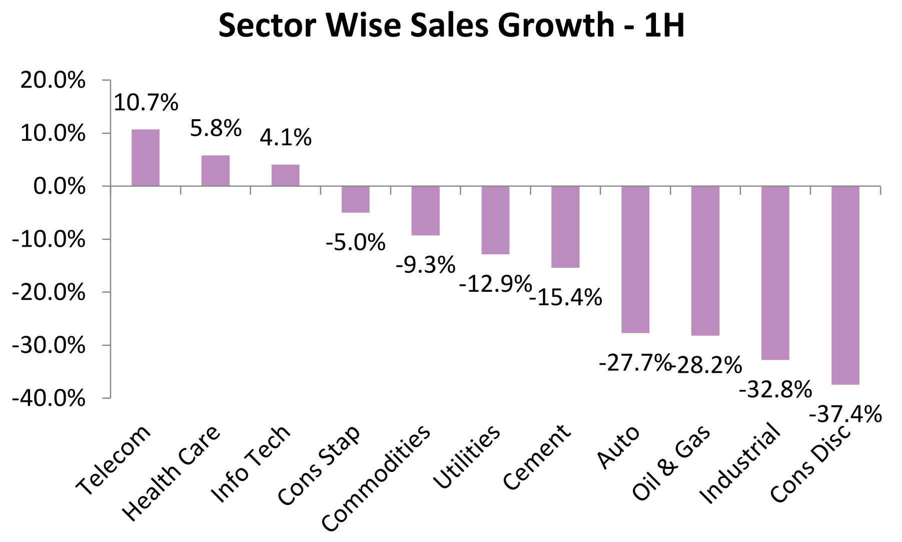
Q2 FY21 Earnings: All sectors report single digit sales growth



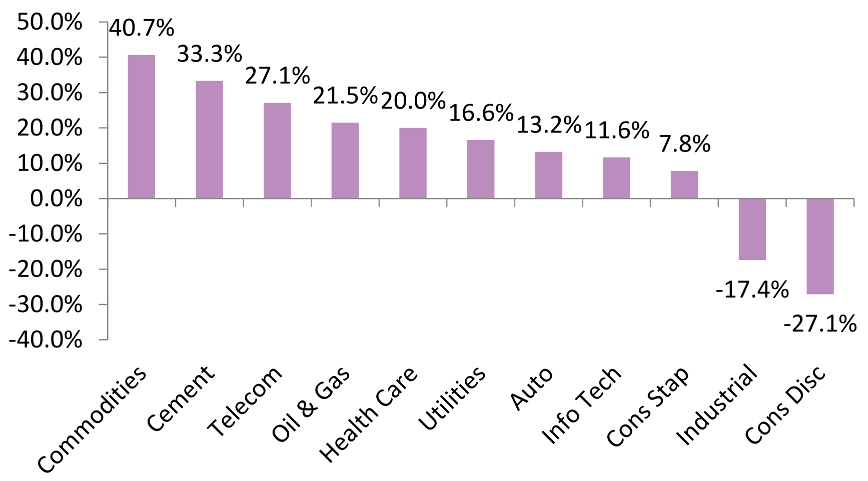


Source: Bloomberg

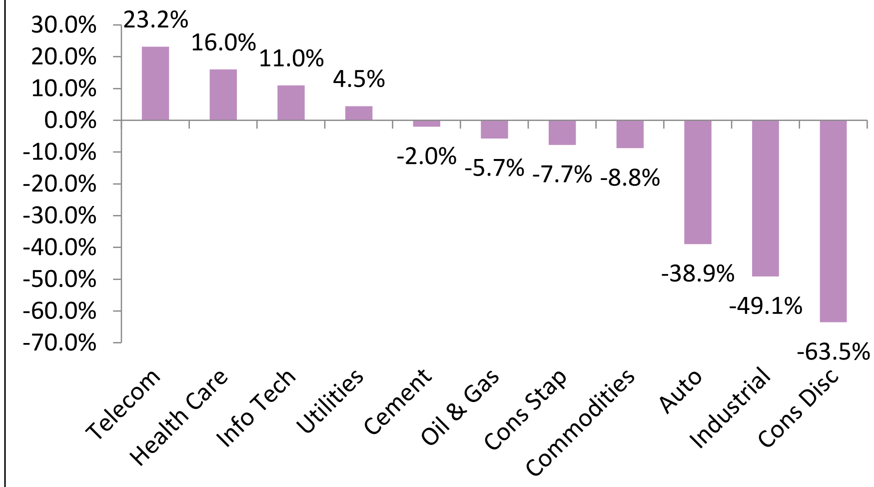
- In the above table, 7 of the 11 sectors reported positive Sales Growth in Q2 led by Telecom and HealthCare.
- For the first half, only 3 sectors Telecom, HealthCare and IT reported positive Sales Growth
- Discretionary demand is the most impacted with Consumer Discretionary down 18.1% in Q2 and 37.4% in 1H. Autos, which is another discretionary category, also witnessed sales degrowth of 27.7% for 1H.

Q2 FY21 Earnings: EBITDA beat across sectors

Sector Wise EBITDA Growth - Q



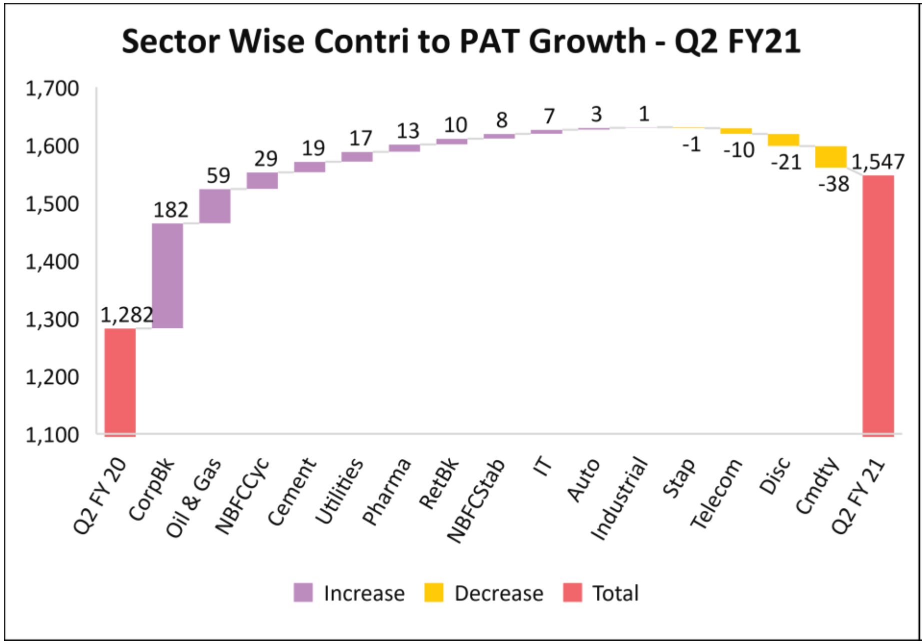
Sector Wise EBITDA Growth - 1H

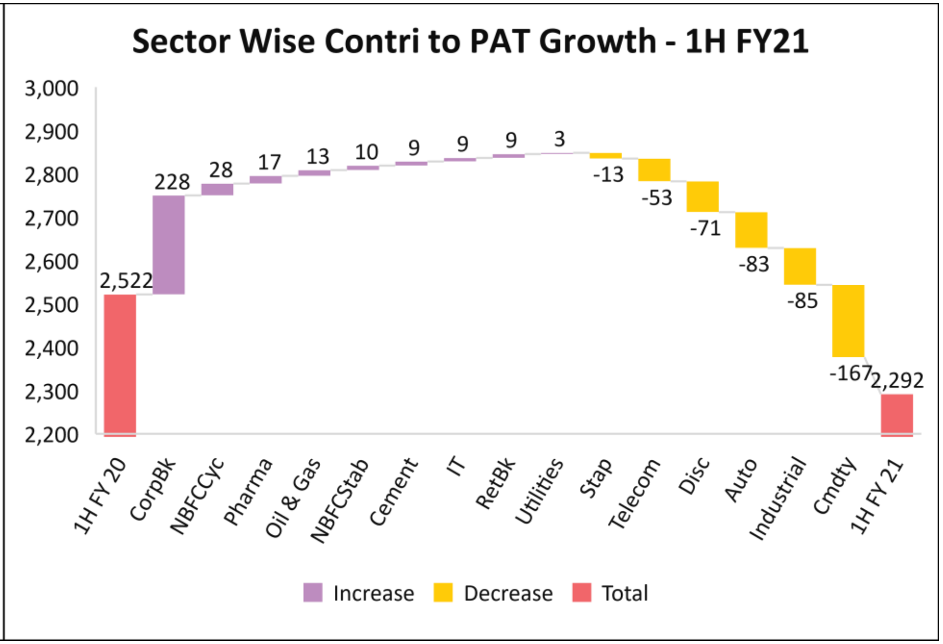


Source: Bloomberg

- All sectors except Industrials and Discretionary reported EBITDA growth in Q2.
- Discretionary, Industrials and Auto have seen a significant impact on EBITDA in the first half

Q2 FY21 Earnings : Corp Banks and Oil & Gas drive PAT





Source: Bloomberg

- Absolute PAT for BSE 200 increased from Rs 1,282 bn in Q2 FY20 to Rs 1,547 bn in Q2 FY21.
- Corp Banks and Oil were the key contributors whereas Discretionary and Commodity were laggards
- Commodity PBT grew in Q2 FY21. The degrowth seen here is mainly of a large tax write back in the base quarter which optically boosted profits.

Q2 FY21 Earnings: Sectoral Trends

Financials, Domestic Consumption and Exports

- **Financials – Banks:** The asset quality outlook appears to be better than was initially feared as collection efficiency improved sharply in 2Q and most banks guided for low restructuring levels. We also saw an uptick in NII growth, aided by improved cost of funds and recovery in retail disbursements, with certain segments reaching pre-COVID levels.

- **NBFCs:** Contrary to initial expectations, 2QFY21 surprised positively on both growth and asset quality (collections). A supportive liquidity environment helped companies reduce their incremental cost of funds and aided margins. Disbursements picked up meaningfully across segments: housing finance, vehicle finance and gold finance.

- **Consumer:** Sales growth was largely in line with expectations for most consumer companies. This was enabled by buoyancy in rural sales growth, healthy growth in in-home consumption, herbal products (to boost immunity), and hygiene products. While the sales growth trend was in-line for most players, EBITDA performance was above expectations.

- **Retail:** Revenues of apparel retailers' were hit on account of the COVID-19 crisis as retail stores remained partially closed during 2QFY21, with much lesser footfalls and only need based shopping across the country. Gradual lifting of lockdown restrictions and pick-up in economic activity was accompanied by rising footfalls and a demand uptick with the onset of pre-festive shopping in September. Grocery retailing witnessed a limited impact as demand for essentials and groceries recovered quickly

Q2 FY21 Earnings: Sectoral Trends

Financials, Domestic Consumption and Exports

- **Auto:** After a washed-out 1QFY21 due to strict lockdown restrictions, 2Q witnessed a good recovery across segments in varying proportions. While Tractors (+41% YoY) and PV (+3%) have been positive on a YoY basis, 2W (-2%) volumes are marginally lower. The commercial segment was weak, but recovering, with LCV (-12%) faring better than M&HCV (-50%) and 3W (-53%). With a reasonable start to the festive season and expected strong Diwali, 3QFY21 is expected to gain on the momentum seen in 2Q.

- **HealthCare:** 2QFY21 aggregate earnings of pharma companies handsomely beat estimates for the second quarter running. Key themes during the quarter were: a) Gradual improvement in Domestic Formulation (DF) sales, b) Steady US sales, c) Continued benefit of lower opex, d) Favorable demand for APIs, which led to strong YoY earnings growth.

- **IT Services:** IT services companies delivered sequential growth of 1–10% (USD) in 2QFY21, aided by broad-based growth across geographies and verticals. This was meaningfully ahead of expectation, indicating faster-than-expected recovery in technology spends by corporates. While supply-side issues were largely contained in 1QFY21, demand normalization was seen across segments in 2QFY21. Companies have seen the deal pipeline improve further (v/s 1QFY21), with the pipeline now at pre-COVID levels

Q2 FY21 Earnings: Sectoral Trends

Domestic Investment and Commodities

- **Telecom:** With the lifting of COVID-related restrictions, businesses resumed operations and migrant workers started to return to work. Telcos witnessed earnings improvement due to resumption of physical recharges, halted due to unavailability or economic challenges. While the industry awaits a tariff hike, 2QFY21 saw ARPU (average revenue per user) improvement across telcos, without any price increase, with different levers at play. The improvement in ARPU came from a) recovery of revenue lost in 1QFY21 due to delayed recharges, b) favorable mix from the shift of 2G subscribers to higher ARPU 4G, and c) lingering benefits of price hikes in FY20

- **Utilities:** Power demand for the quarter ended flat on a YoY basis, thereby showing a marked improvement over demand decline of ~16% YoY in 1QFY21. Generation from coal-based plants also improved, declining just 5% YoY (v/s 25% YoY decline seen in 1QFY21). India's power demand has continued to recover in the first half of 3Q as well. Based on initial data from POSOCO (Power System Operation Corporation Limited), power demand for Oct and Nov is trending up 12% YoY.

- **Cap Goods:** Recovery seen quicker in products business, projects limping back. Within the capital goods universe, product-led businesses outperformed while project-led businesses are inching towards pre-COVID levels. While order inflow declined 44% YoY, it increased 20% sequentially as most of the ordering, which was disrupted owing to COVID-led lockdown in 1QFY21, got finalized in 2Q. Most project sites are operating ~80-90% occupancy levels, with a number of migrants slowly returning to work. However, execution is yet to go full throttle as various COVID-led precautions have impacted efficiency across project sites, even with full labor strength.

Q2 FY21 Earnings: Sectoral Trends

Domestic Investment and Commodities

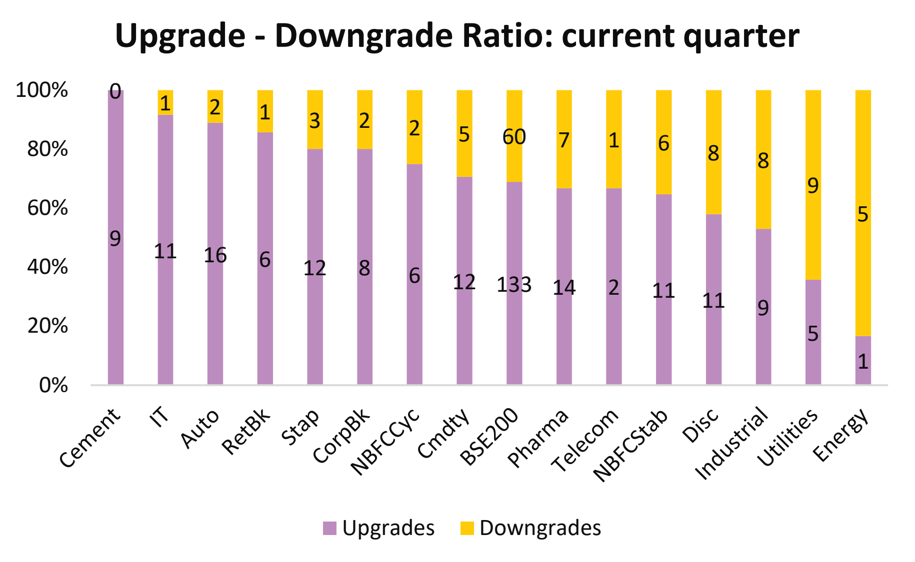
- **Cement:** 2QFY21 volumes for cement companies were up 5% YoY (v/s est. of a 3% increase) led by strong demand in North and East regions. This was attributable to strong rural and semi urban demand and pick-up in government infra and road projects from September. Most companies continued with margin expansion, supported by better fixed cost absorption (from higher volumes), but was partially offset by higher raw material cost.

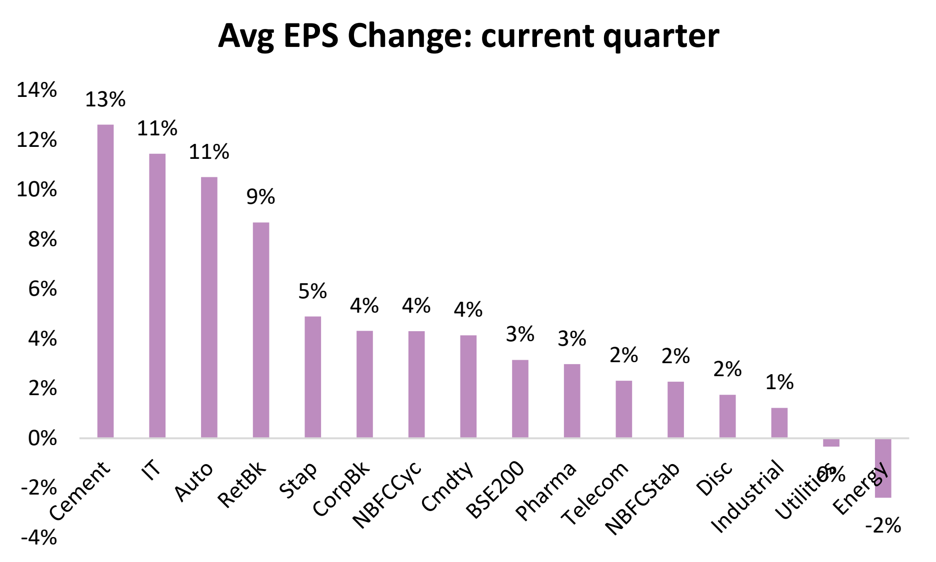
- **Metals:** Profitability of domestic steel companies rebounded during 2QFY21 on strong volume growth and improvement in pricing. Strong Chinese demand during the quarter led to improved steel prices in the region, thus improving average realization by 5% QoQ. Domestic demand improved gradually during the quarter (down just 4% in Sep'20), which coupled with higher export orders, led to liquidation of steel inventories

- **Oil and Gas:** Indian refineries' reported GRM stood at USD5.1-8.6/bbl. OMCs clocked huge inventory gains (USD2.4-9.6/bbl) during the quarter owing to benefits of lower priced crude oil stored in previous quarter, resulting in core GRM of –USD1-2.7/bb

FY22 Estimates

FY22 Estimates: Broad based Upgrades during Q2





Source: Bloomberg

- Q2 FY21 saw broad-based upgrades to year forward (FY22) estimates. EPS for 133 companies was upgraded as compared to 60 downgrades
- Cement saw upgrades in earnings of all 9 companies, whereas IT and Auto saw upgrades in 11 of 12 and 16 of 18 companies respectively
- Average EPS for BSE200 was up 3% in the quarter led by Cement (+13%), IT (+11%) and Auto (+11%)

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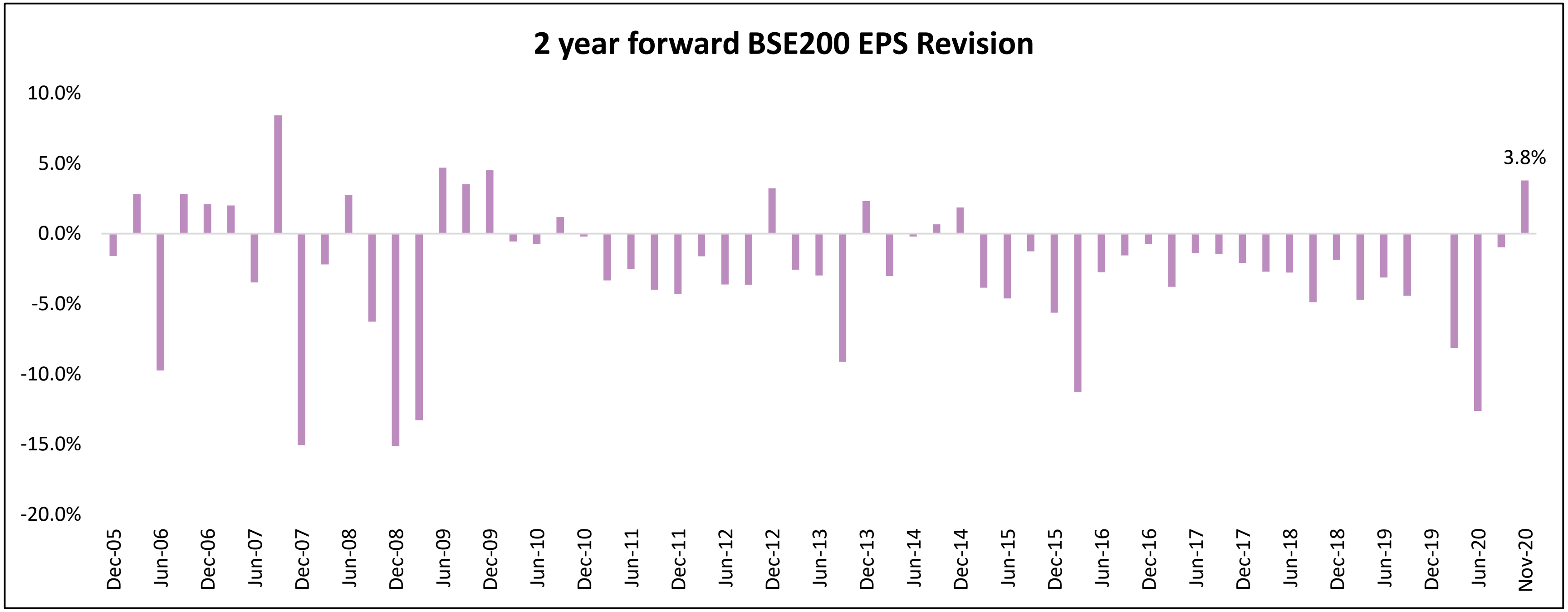
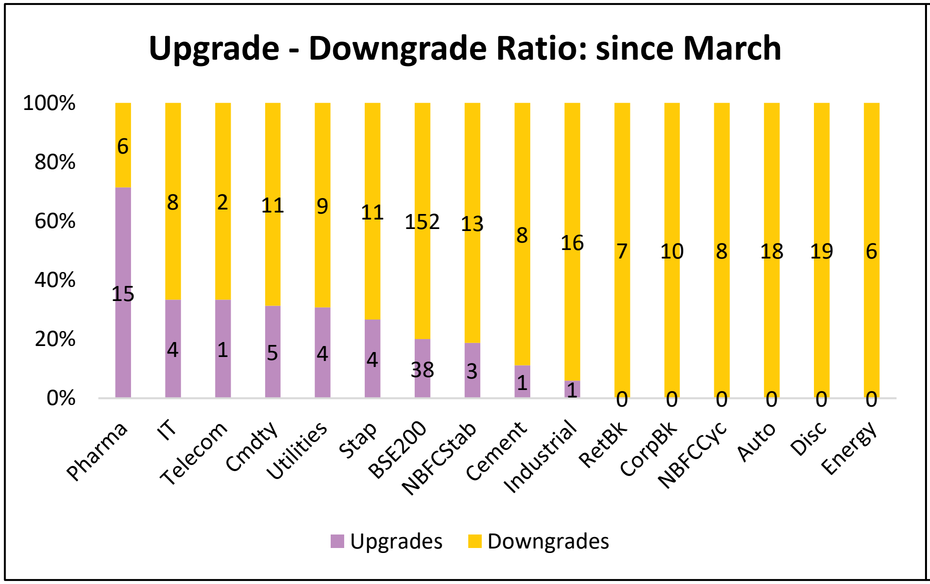
FY22 Estimates: Broad based Upgrades during Q2

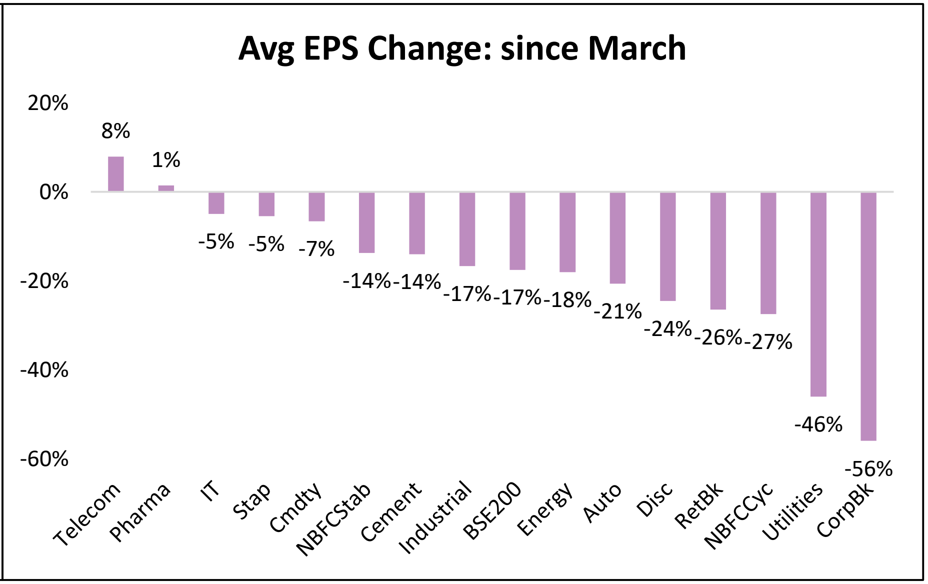


Source: Bloomberg

- After 23 quarters of continuous downgrades, this was the first reporting season when consensus lifted its BSE200 EPS.
- This has resulted in the first material earnings upgrade for EPS estimates in many years.
- More importantly, corporate commentaries across the sector suggest continued demand recovery in 3QFY21, underpinned by a healthy start to the festive season.

FY22 Estimates: Still significantly below March levels





Source: Bloomberg

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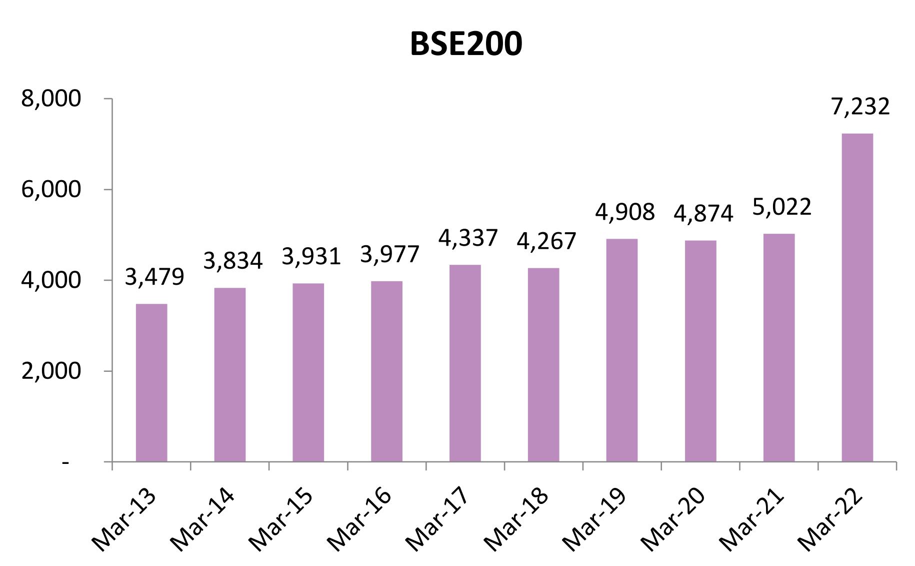
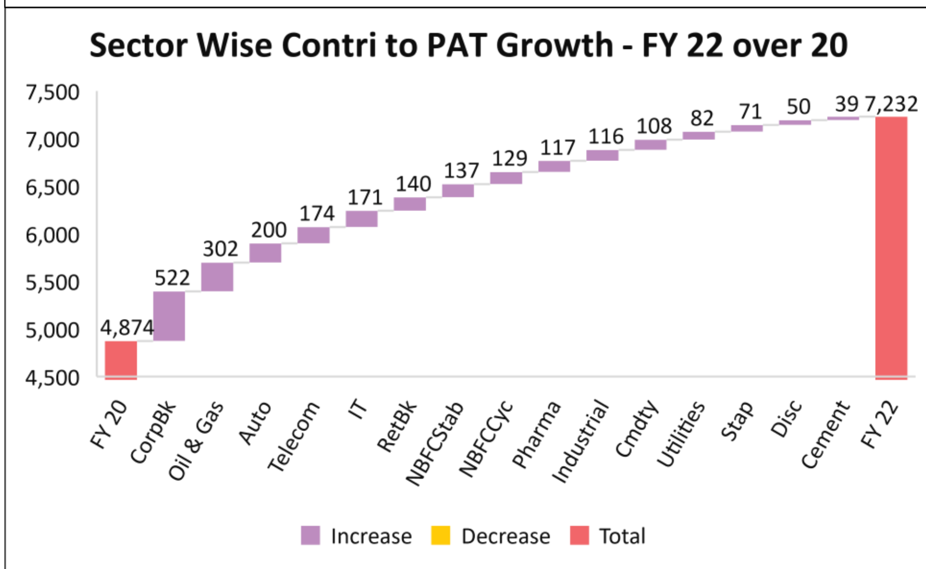
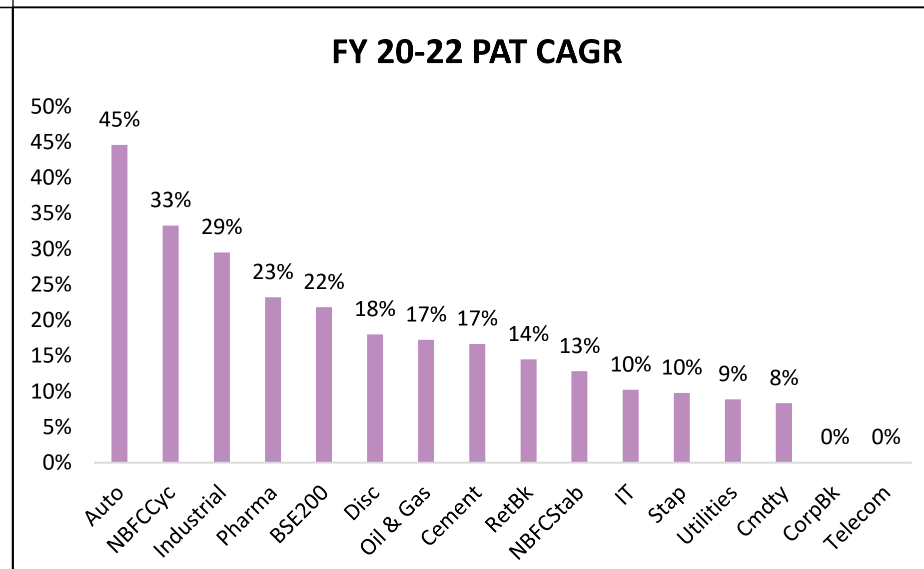
FY22 Estimates: Absolute PAT movement



- At Rs 7,232 bn, FY22 PAT estimates are significantly higher than FY20 reported PAT of Rs 4,874 bn
- Lower provisioning by Corporate Banks (+Rs 522 bn), Reliance + reversal of inventory losses in Oil & Gas (+Rs 302 bn), Auto (+200 bn) and Telecom (+174 bn) the key sectors driving the growth in PAT
- In CAGR terms, Auto (+45%), Industrials (+29%) and Pharma (+23%) are expected to lead the growth





Source: Bloomberg

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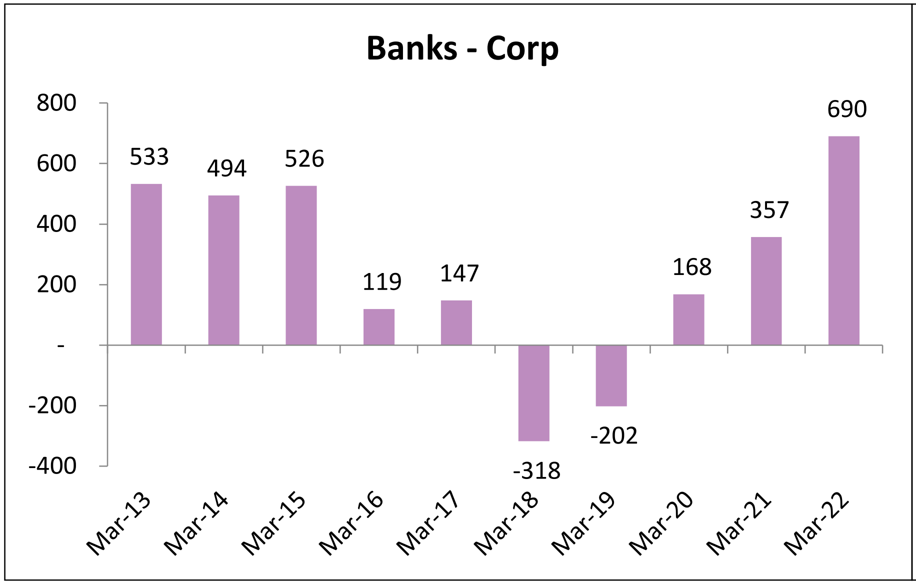
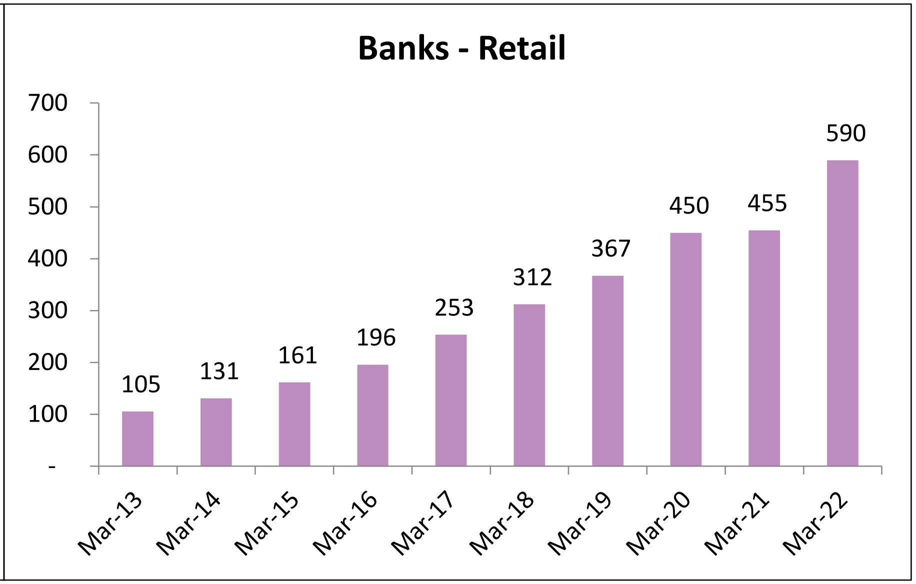
FY22 Estimates: Absolute PAT - Banks

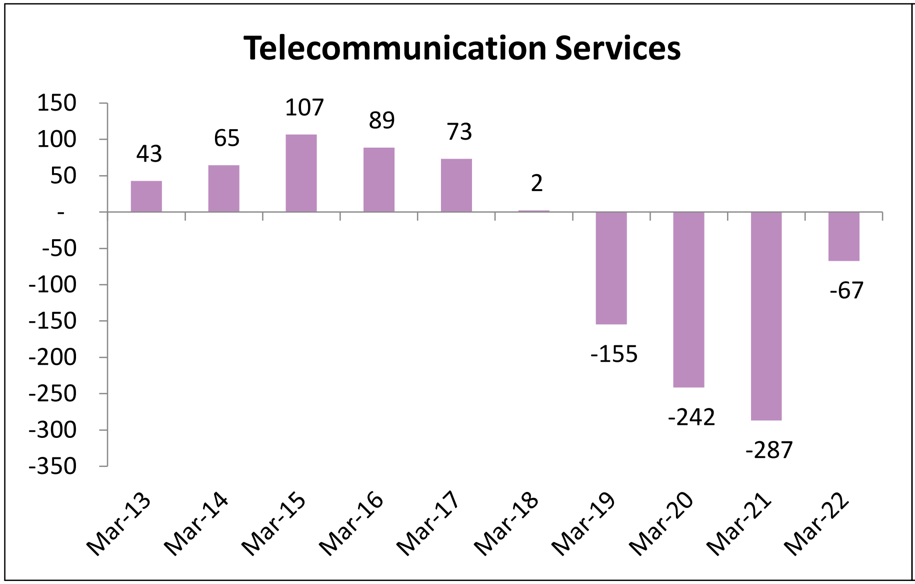


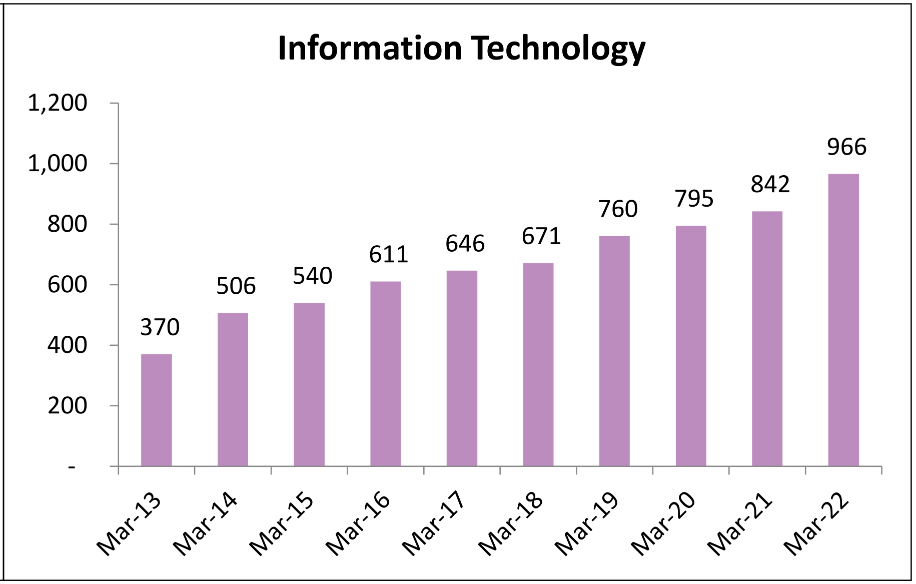


Source: Bloomberg

- Corporate Bank Profits are expected to normalize in FY22.
- From FY15 onwards, though pre-provisional profit for these banks has been increasing, higher provisioning has impacted reported PAT. Lower expected provisioning in FY22 will help restore PAT back to normalized levels
- Retail banks are expected to continue growth in FY22 after a blip in FY21

FY22 Estimates: Absolute PAT - Telecom

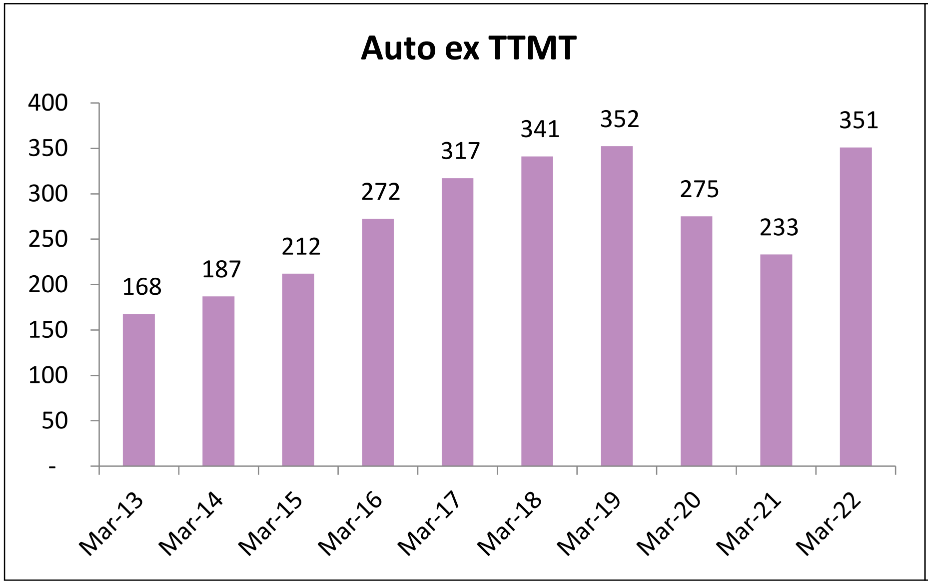


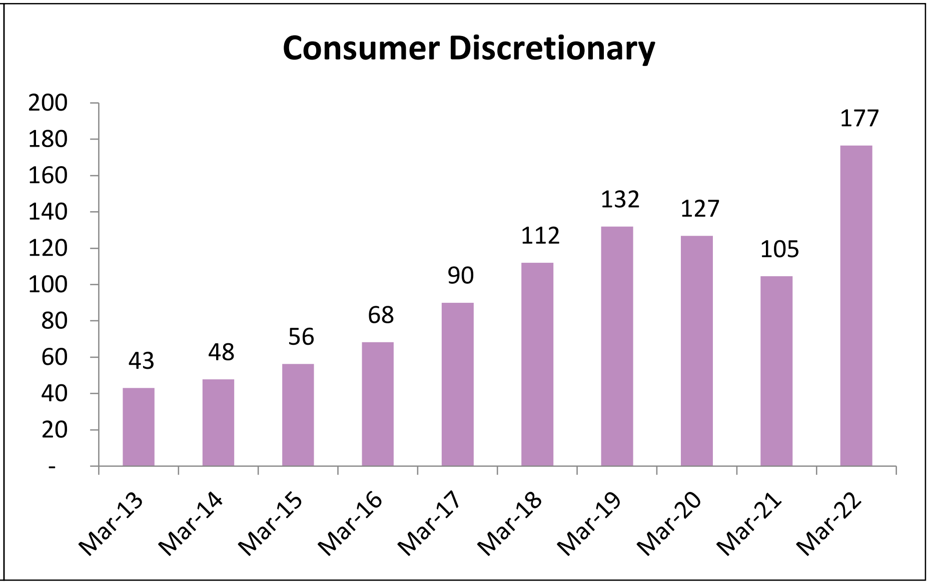


Source: Bloomberg

- Telecom losses are expected to reduce from a peak of Rs 287 bn in FY21 to Rs 67 bn in FY22.
- This is mainly on account of reduction in competitive intensity and ARPU increase.
- Info Tech Services has been one of the best performing sectors, other than Healthcare
- PAT is expected to increase from Rs 795 bn in FY20 to Rs 842 bn in FY21 and Rs 966 bn in FY22.

FY22 Estimates: Absolute PAT – Auto & Discretionary

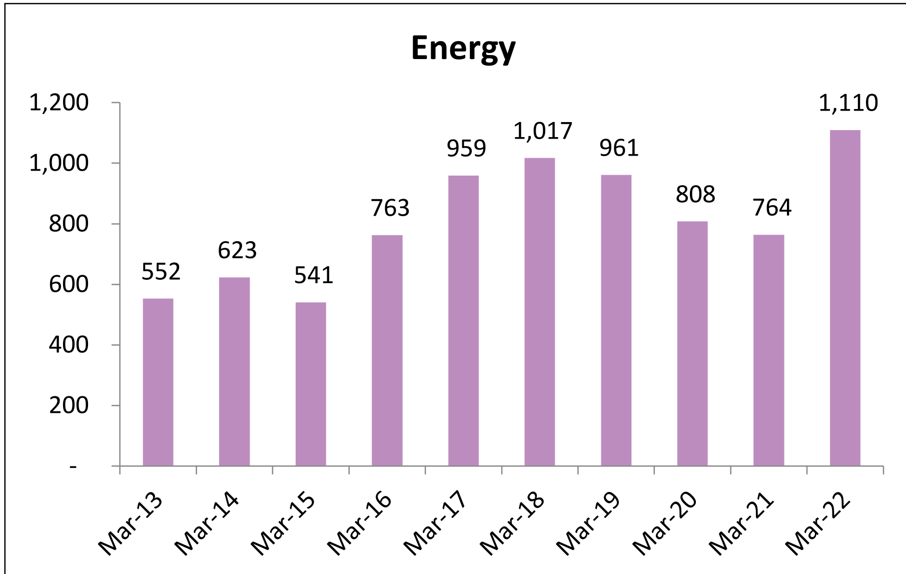


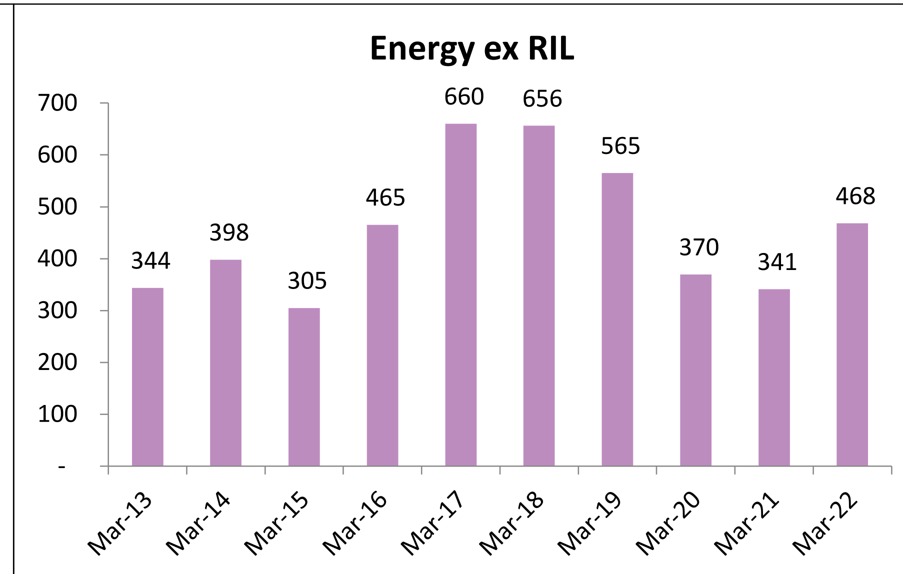


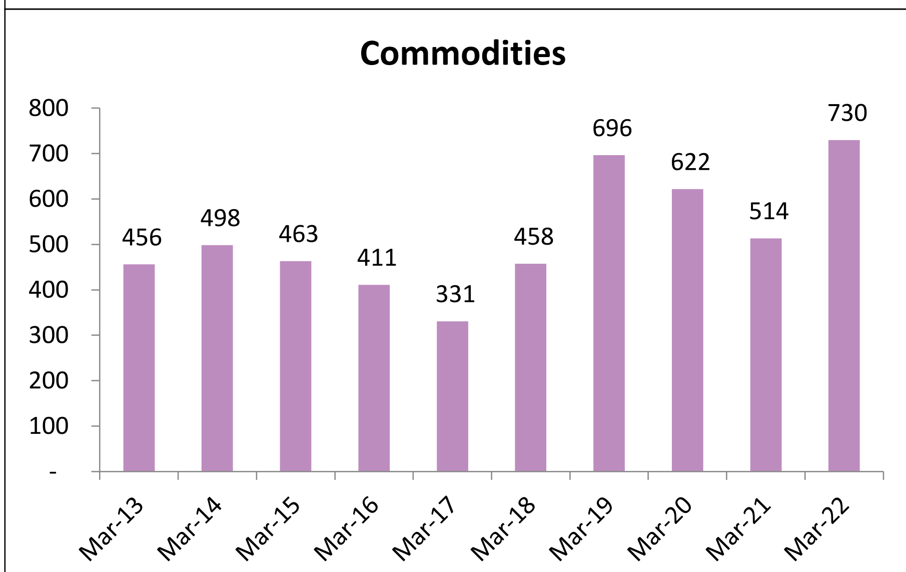
Source: Bloomberg

- In Autos, though FY20-22 growth looks very sharp, FY22 PAT is at the same level as of FY19 – implies no growth in absolute profitability for 3 years and hence reasonable.
- In case of Discretionary sector, FY22 PAT appears to be slightly aggressive, with 40% increase over FY20 levels

FY22 Estimates: Absolute PAT – Energy & Commodities







- PAT for Energy (Oil & Gas) is expected to increase from Rs 808 bn in FY20 to Rs 1,110 bn in FY22.
- Most of this is expected from one stock (RIL). Ex RIL, PAT is expected to rise from Rs 370 bn in FY20 to Rs 468 bn in FY22, mainly on account of inventory gains. This is still lower than previous peak profits seen in FY18.
- In case of Commodities, mainly metals, PAT is expected to be Rs 730 bn, which is higher than the FY19 peak of Rs 696 bn.
- This is building in assumption of robust commodity pricing in FY22.

Source: Bloomberg

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Equity Outlook

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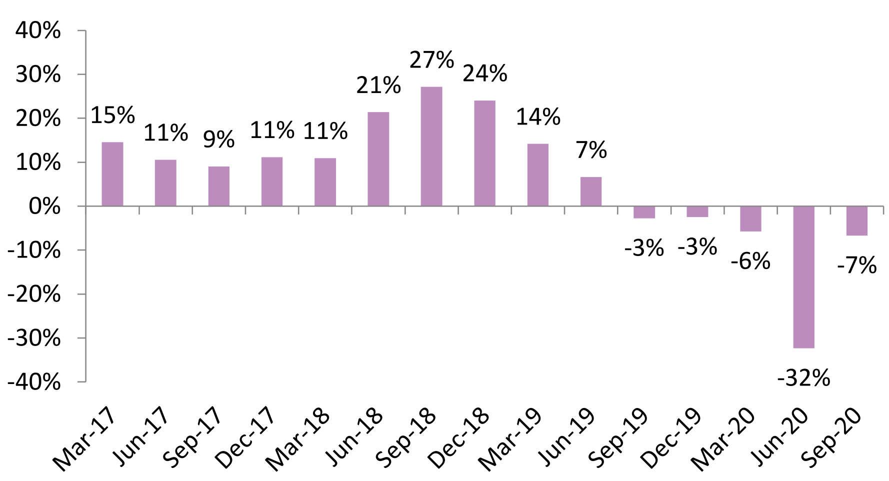
Key Takeaways and Outlook

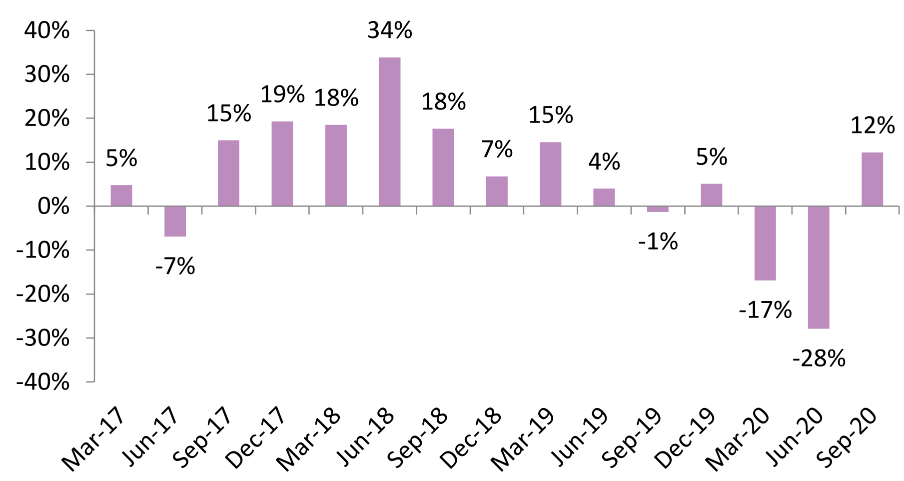
- The **2QFY21 corporate earnings season was a blockbuster** one, with big earnings beats and upgrades
- **Earnings upgrades were broad-based** in NIFTY as well as the Mid and Small cap space
- First quarter after 23 quarters which saw an upgrade in 2 year forward estimates for both NIFTY as well as BSE200
- **Demand recovery coupled with cost moderation** are the key themes of 2QFY21
- **Leverage and cash-flows** have also seen material improvement in 1HFY21 v/s 1HFY20
- **BFSI earnings were particularly strong**, with commentaries from large private sector banks indicating the stress on asset quality may not be as bad as initially feared. Although, banks continue to increase provisions for COVID-related stress.
- **Economic recovery continued**, with high-frequency data for October coming in fairly strong (GST collections, Manufacturing PMI, rail freight, power demand, and IIP)
- With active COVID cases down to 4,65,478 from the peak of 1.02m, the abatement of the spread of the virus has coincided **with an uptick in economic activity**
- Early trends from the festive season suggest **continued demand recovery**
- However, after the 70% rebound from Mar’20 lows**, Nifty valuations are no longer cheap**. At 19.6x FY22 EPS, it is already pricing in much of the positives and hereafter needs consistent support in terms of earnings delivery

Annexures

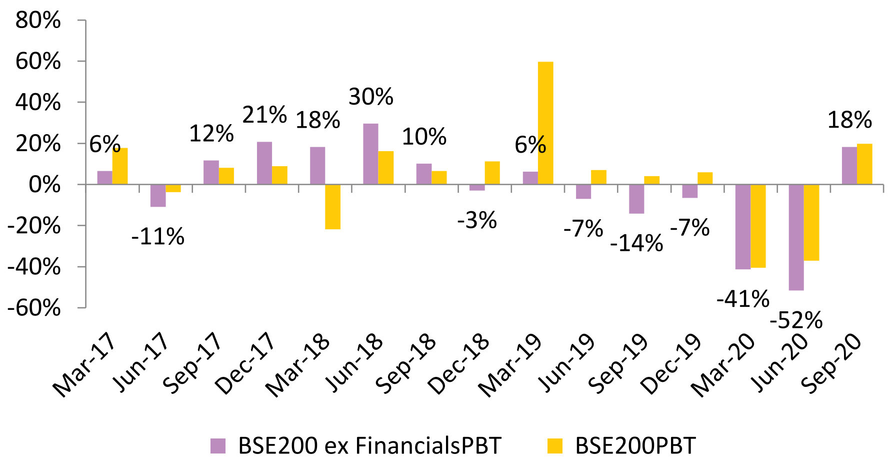
Sales Growth - ex Fin



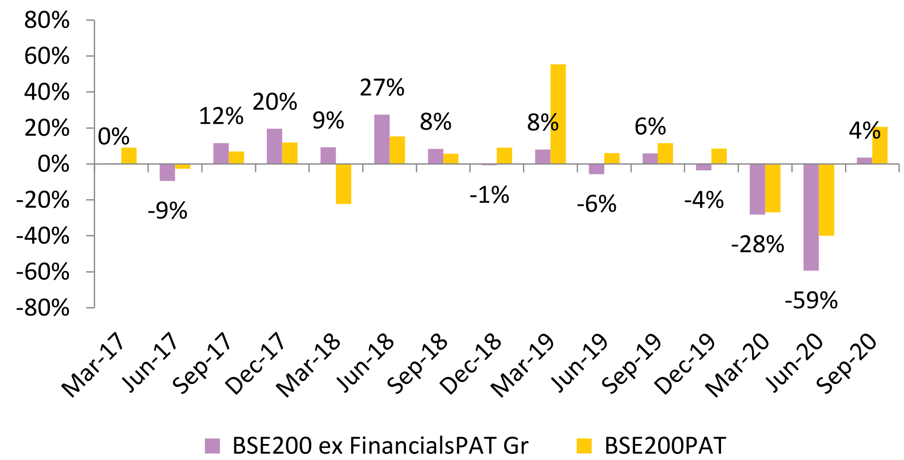
EBITDA Growth - ex Fin



PBT Growth

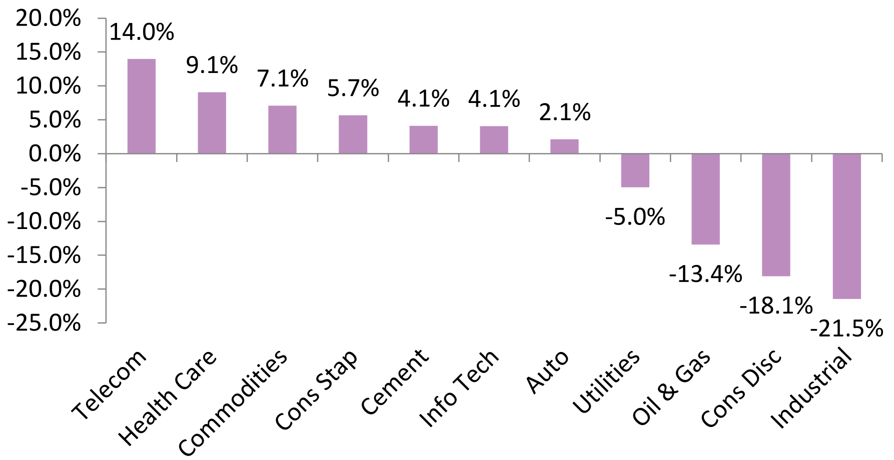


PAT Growth

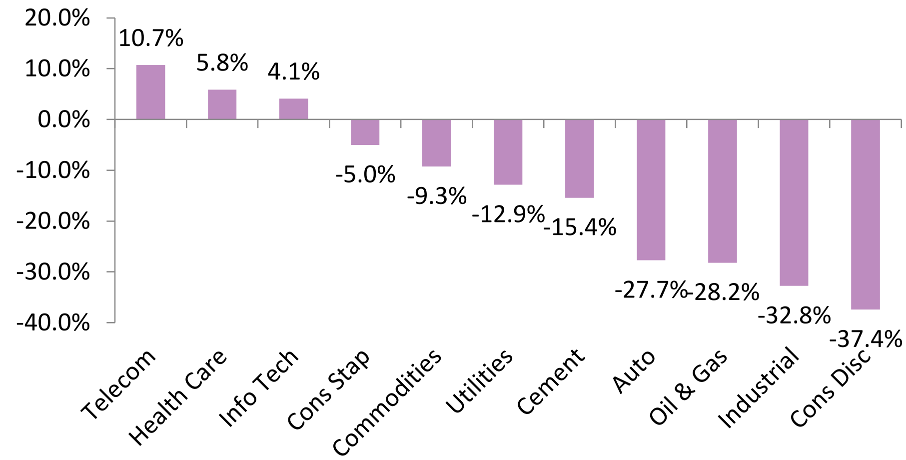


Source: Bloomberg

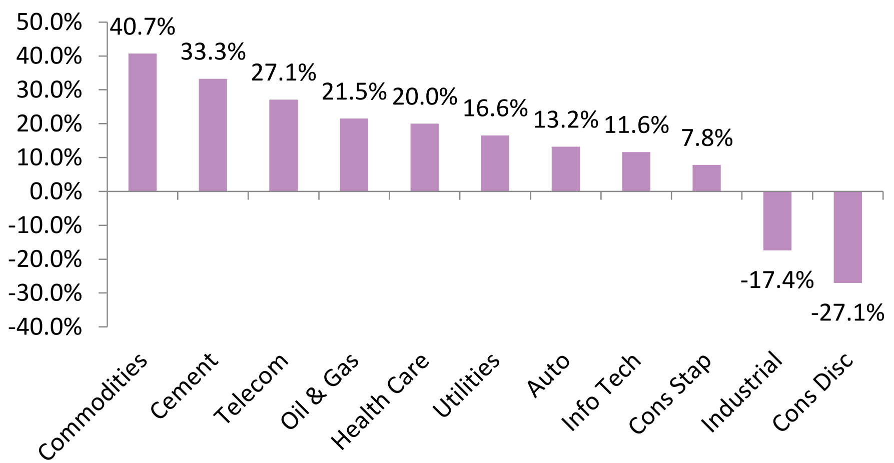
Sector Wise Sales Growth - Q



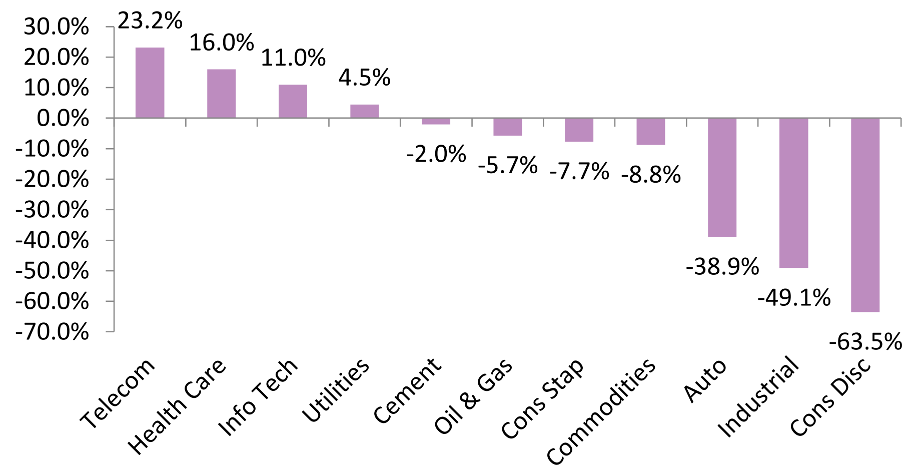
Sector Wise Sales Growth - 1H



Sector Wise EBITDA Growth - Q



Sector Wise EBITDA Growth - 1H



Source: Bloomberg

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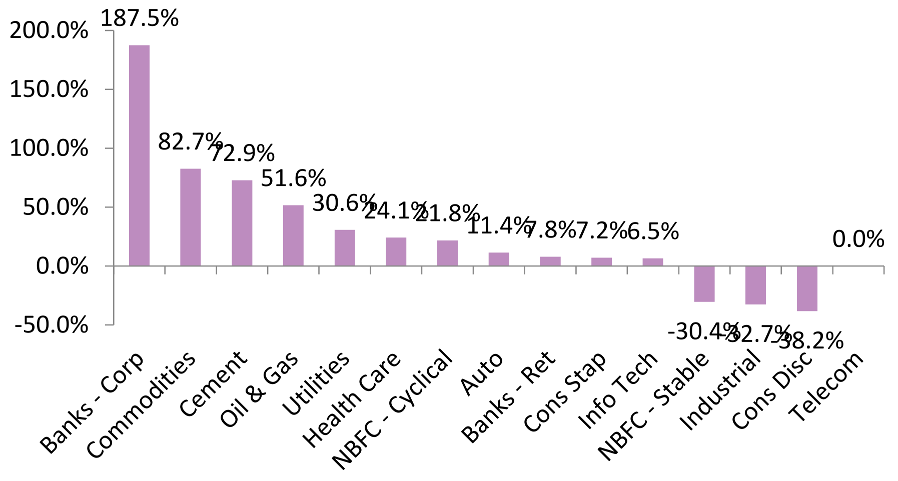
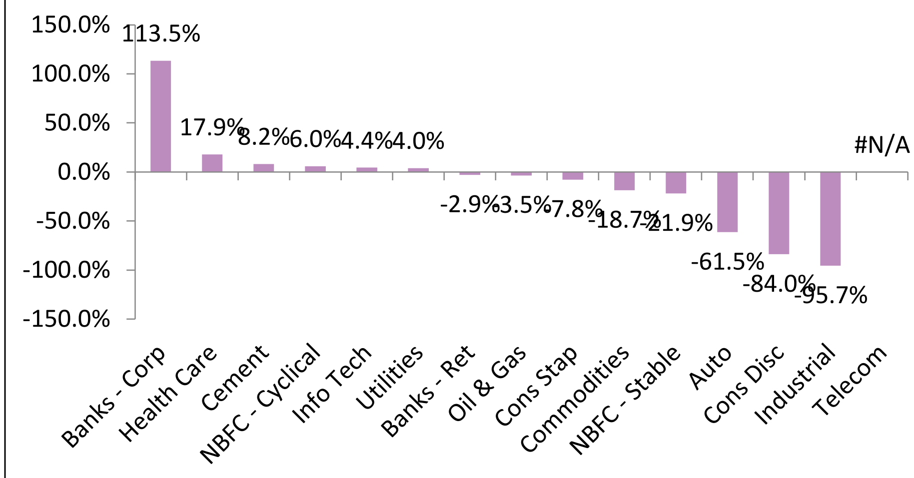
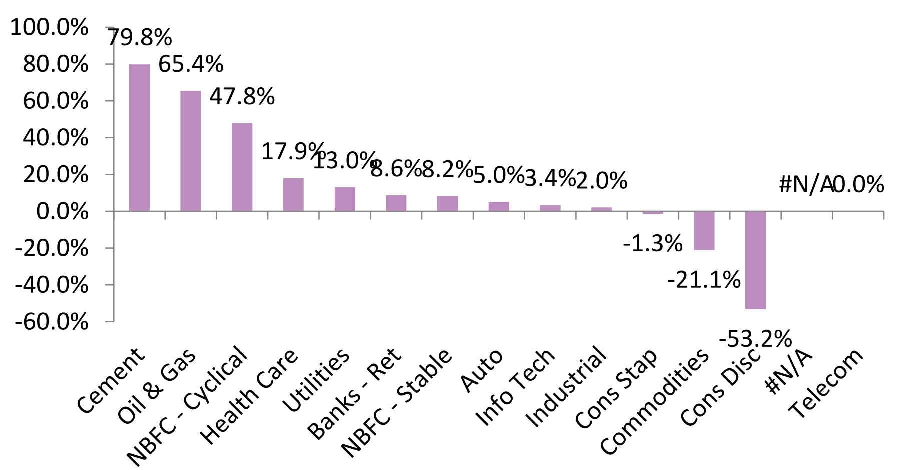
Sector Wise PBT Growth - Q



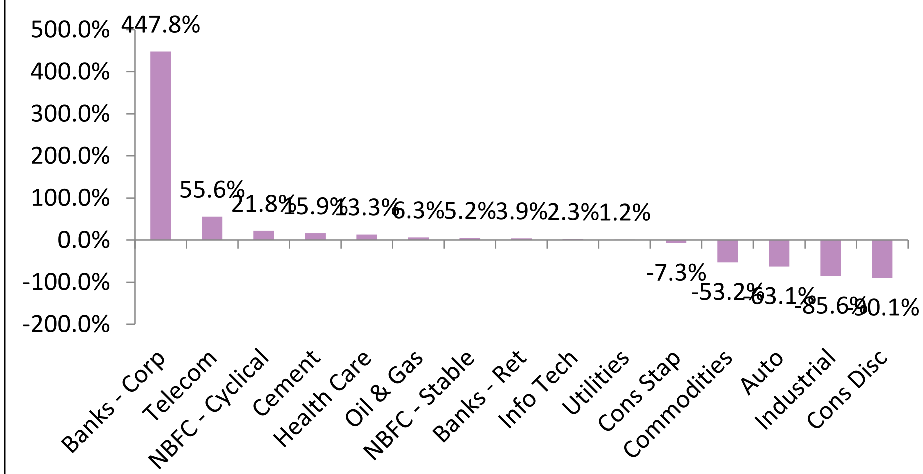
Sector Wise PBT Growth - 1H



Sector Wise PAT Growth - Q



Sector Wise PAT Growth - 1H



Source: Bloomberg

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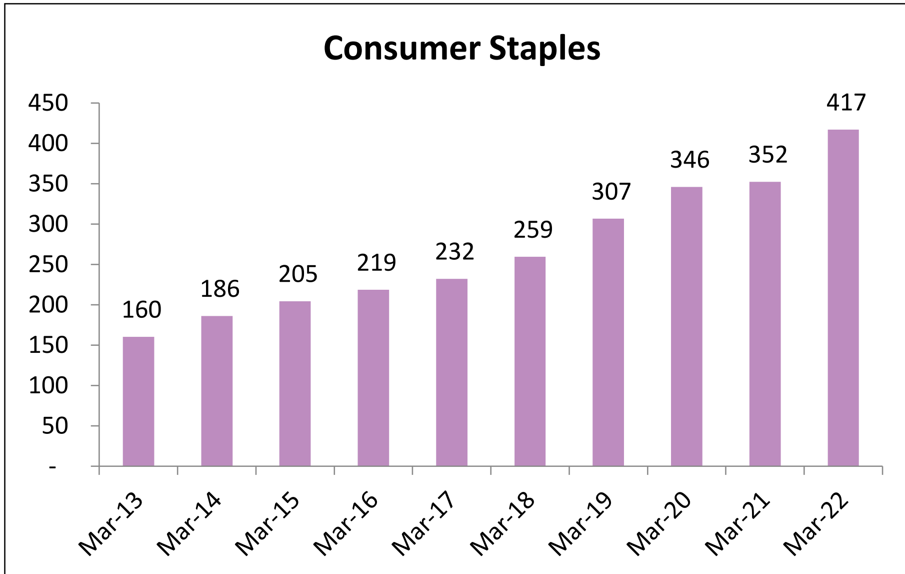
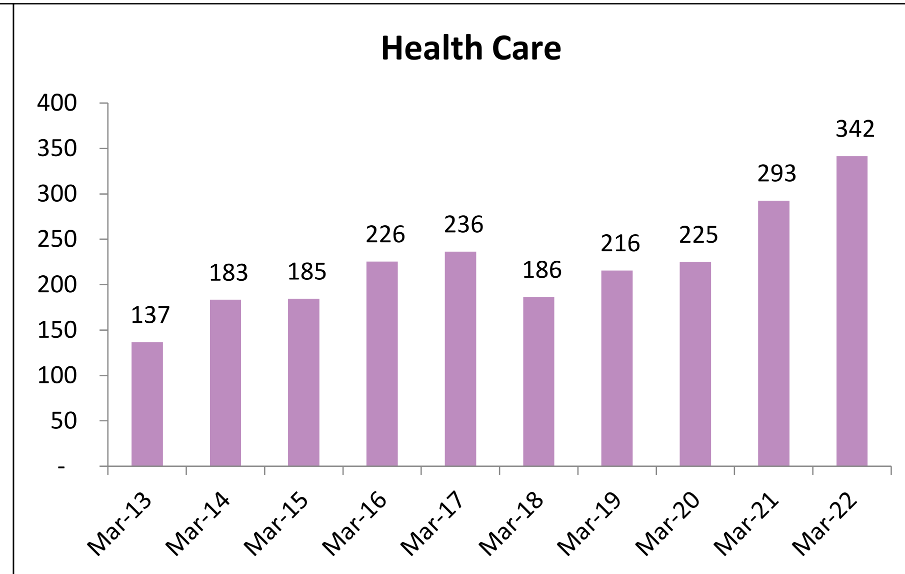
FY22 Estimates: Snapshot

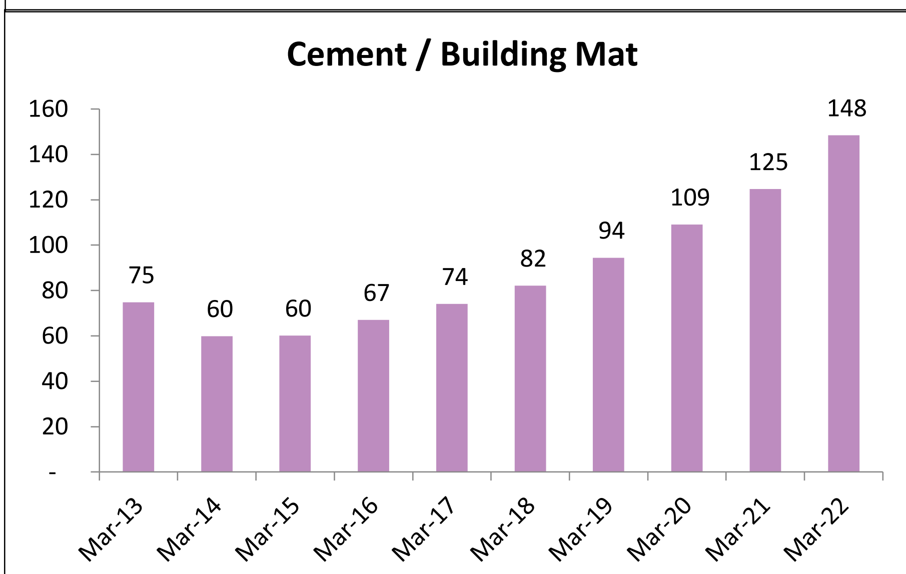
BSE200 - Abs Earnings	FY 20	FY 21 E	20-21 Growth	FY 22 E	21-22 Growth	20-22 CAGR	19-22 CAGR
Banks - Retail	450	455	1.1%	590	29.7%	14.5%	17.1%
NBFC - Stable	503	508	0.9%	641	26.1%	12.8%	11.6%
Auto	183	171	-6.7%	383	124.0%	44.6%	2.0%
Consumer Discretionary	127	105	-17.6%	177	68.9%	18.0%	10.2%
Consumer Staples	346	352	1.8%	417	18.3%	9.8%	10.8%
Information Technology	795	842	6.0%	966	14.7%	10.2%	8.3%
Health Care	225	293	30.0%	342	16.7%	23.2%	16.6%
Stable	**2,674**	**2,742**	**3%**	**3,394**	**24%**	**12.7%**	**10.9%**
Banks - Corp	168	357	112.1%	690	93.5%	102.6%	
NBFC - Cyclical	166	224	34.9%	295	31.6%	33.3%	2.6%
Cement / Building Mat	109	125	14.3%	148	19.0%	16.6%	16.2%
Industrials	171	158	-8.1%	287	82.3%	29.5%	8.9%
Commodities	622	514	-17.4%	730	42.1%	8.3%	1.6%
Energy	808	764	-5.4%	1,110	45.3%	17.2%	4.9%
Utilities	443	444	0.1%	525	18.4%	8.9%	8.2%
Telecommunication Services	-242	-287	Loss	-67	Loss		
Cyclical	**2,200**	**2,280**	**4%**	**3,838**	**68%**	**32.1%**	**16.7%**
Cyclical ex Corp Banks	**2,032**	**1,923**	**-5%**	**3,148**	**64%**	**24.5%**	**6.3%**
BSE200	**4,874**	**5,022**	**3.0%**	**7,232**	**44.0%**	**21.8%**	**13.8%**
BSE200 ex Corp Banks	**4,540**	**4,442**	**-2.2%**	**6,247**	**40.6%**	**17.3%**	**8.9%**

Source: Bloomberg

Sector Wise Absolute PAT

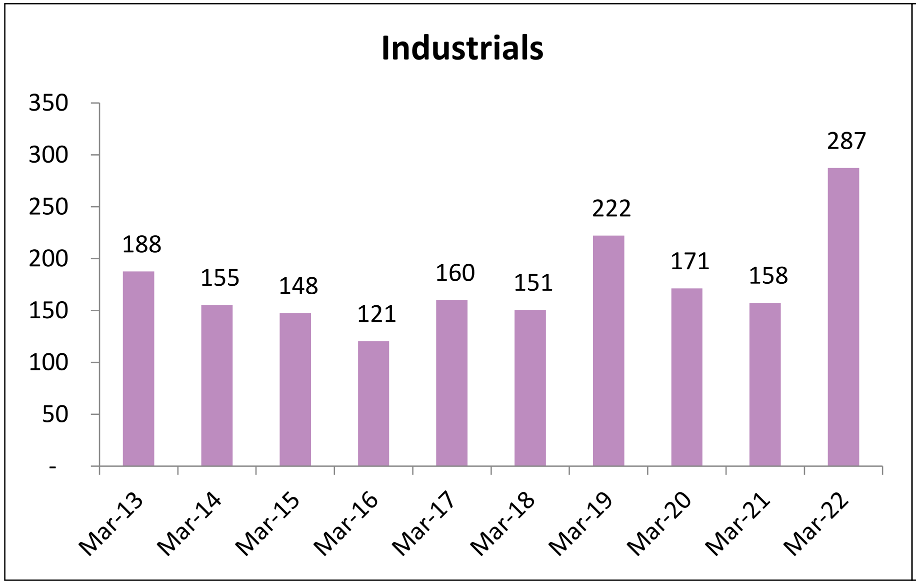


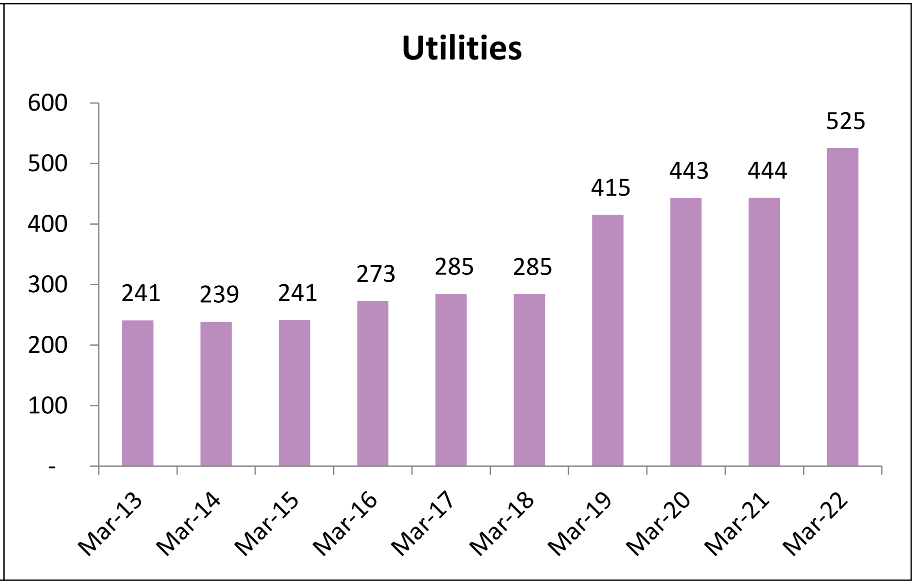




Source: Bloomberg

Sector Wise Absolute PAT





Source: Bloomberg

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