Morning Buzz

INDIA

9 January 2017

Research Picks

- India Banks: Q3 Preview - Difficult to call; guidance keenly awaited
- India Consumer: Q3 Preview - Demonetization blues
- India Energy: Q3 Preview - A stellar quarter…yet again!
- India Economics: FY17 GVA Advance Estimate at 7% ex-demonetisation

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Sector Update
INDIA
BANKING

6 January 2017

India Banks

Q3 Preview: Difficult to call; guidance keenly awaited

Q3FY17 is proving difficult to predict as demonetisation has thrown up several moving parts. We expect a sharp drop in loan growth, but small-to-midsized banks (YES, IIB) should fare relatively better. Margins are likely to decline as benefits of the CASA influx will be offset by pressure on yields. The pace of slippages should reduce, but ageing NPAs would keep credit costs high. We expect fees and opex to take a hit while treasury gains should support profits.

- **Loan growth slowing, large banks to bear the brunt:** In the aftermath of demonetisation, we expect a significant decline in loan growth across banks. As per the latest RBI data, loan growth has slipped to 5% YoY as on 23 December. In our view, larger banks will be the hardest hit. In contrast, we expect small/midsized private banks like YES and IIB to grow faster than the system as well as their larger peers at ~25% YoY, given that their loan books are fairly diversified with a low base and working capital funding dominates their corporate books.

- **Margins likely to decline:** After the currency ban, banks have witnessed an influx of deposits in line with their market share, largely in the form of CASA deposits. Most banks will benefit from this windfall, especially the ones that are more reliant on high-cost/bulk deposits. However, the RBI's CRR hike and tepid loan growth in high yielding segments such as retail and SME will more than offset this benefit and compress margins. Flush with liquidity and facing a dearth of investment opportunities, banks have been compelled to park their incremental deposits with the RBI under low yielding repo which will put further pressure on yields.

- **Treasury gains to aid non-interest income:** Fee income will take a hit as retail loans slow. In addition, the waiver of merchant discount rates (MDR) on debit card transactions during Q3 will have some impact on fee income, albeit not overly so as credit cards are the bigger revenue drivers. On a positive note, surplus liquidity has prompted a 30-40bps decline in G-sec yields in Q3. This directly benefits most banks (especially public sector players) in terms of higher treasury/MTM gains, thus aiding profitability.

- **Credit costs to stay elevated:** Management commentary on retail/ SME asset quality will be a key parameter to watch for. In our view, NPAs in these segments may remain stable in Q3 due to the RBI's 90-day grace period for NPA recognition on outstanding accounts less than Rs 10mn. Ageing of NPAs will keep credit costs elevated in Q3. The pace of incremental slippages is likely to be lower, especially for public sector banks, while the asset quality of banks such as YES and IIB is expected to remain stable.

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Recommendation snapshot

Ticker	CMP (Rs)	TP (Rs)	Rating
Pvt. Banks			
AXSB	458	465	SELL
HDFCB	1,186	1,465	BUY
ICICIBC	260	240	HOLD
IIB	1,128	1,350	BUY
YES	1,210	1,600	BUY
KMB	699	940	BUY
PSU Banks			
BOB	151	125	SELL
BOI	110	80	SELL
CBK	266	200	SELL
PNB	118	75	SELL
SBIN	245	235	SELL
UNBK	128	110	SELL

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6 January 2017

India Consumer

Q3 Preview: Demonetization blues

Most companies in the RCML consumer universe saw tepid demand growth in Q3FY17 due to weak consumer offtake, further hit post demonetisation. We expect aggregate sales/adj. PAT to decline 0.9%/3.7% YoY in Q3, along with a 75bps EBITDA margin contraction. Emerging headwinds from input cost inflation could weigh down earnings growth further. We reiterate our negative stance on the sector.

- **What has changed from Q2FY17:**
  - (a) **Volume growth** for the RCML consumer universe remained tepid, and was further hit by the Govt.'s demonetisation drive. Rural growth would lag urban growth in Q3 despite a good monsoon due to salience of the wholesale channel. We build in a volume decline of 3%/1% for ITC/HUVR in Q3. A good winter season could offset muted volume growth for HMN and HUVR.
  - (b) Q3 saw **inflation in inputs** such as palm oil (+9.5% QoQ), crude (+7.3% QoQ), wheat (+15% QoQ) and copra (+9.4% QoQ). While companies in our coverage have initiated price hikes and/or rolled back promotions, gross margin gains in H1FY17 could evaporate as tepid sales growth limits pricing power in the current inflation upcycle (contrary to previous cycles).
  - (c) **Ad spend moderation** could be the only margin cushion in Q3, even as it may not be sustainable in a weak macro environment.

- **Q3 likely to be a tough quarter:** Amid the current volatility, we feel forecasting the Q3 performance is difficult given the sudden disruption in value chains and sharp cuts in A&P spends. We build in -0.9%/-3.7% aggregate revenue/adj. PAT growth YoY for Q3 along with 75bps EBITDA margin contraction. We expect YoY gross margin contraction for most consumer companies under our coverage given the high base and input cost inflation.

- **Key things to watch out for:** Any commentary on (1) sales recovery trends post demonetisation across channels and geographies, and expectations of normalcy, and (ii) ad spends intensity/moderation.

- **View: Stay cautious, be selective**
  1. Poor demand has weighed on the Indian consumer sector over the last two years. Additional headwinds from demonetisation and GST (in FY18) could have a lasting disruptive impact on the indirect distribution value chain, pushing back recovery to H2FY18.
  2. In the interim, players with an urban focus, direct-to-consumer reach or retail franchise would be less affected; retail players could benefit from a shift in trade from unorganised to formal channels.
  3. We continue to have an underweight position on the consumer sector, with ITC as our only BUY due to its favourable risk-reward profile.

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Recommendation snapshot

Company	Ticker	CMP (Rs)	TP (Rs)	REC
Asian Paints	APNT IN	909	850	SELL
Britannia Industries	BRIT IN	2,865	2,950	HOLD
Colgate India	CLGT IN	900	920	SELL
Dabur India	DABUR IN	278	285	SELL
Emami	HMN IN	1,033	1,000	SELL
Godrej Consumer	GCPL IN	1,522	1,330	SELL
Hindustan Unilever	HUVR IN	828	825	HOLD
ITC	ITC IN	245	270	BUY
Marico	MRCO IN	260	230	SELL
Nestle India	NEST IN	5,900	5,500	SELL
Jubilant Foodworks	JUBI IN	859	930	HOLD
Titan	TTAN IN	359	350	HOLD
United Spirits	UNSP IN	1,953	1,875	SELL
Arvind	ARVIND IN	365	380	HOLD
ABFRL	ABFRL IN	141	175	BUY

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Sector Update
INDIA
ENERGY

7 January 2017

India Energy

Q3 Preview: A stellar quarter…yet again!

Q3FY17 could prove to be another stellar quarter for oil & gas companies, given the improvement in macro parameters (higher oil prices, benchmark GRMs). OMCs could see significant inventory gains, resulting in GRM outperformance. RIL's earnings are likely to surprise yet again, driven by improving petchem spreads and GRMs. Among gas utilities, GAIL should see the highest improvement on petchem earnings. CGDs, especially IGL and MAHGL, are likely to deliver a robust earnings performance. Top picks: GAIL, IOCL, RIL and IGL.

- **GRMs to surprise; watch out for inventory gains:** In a reversal of trends, Singapore complex GRMs have recovered to US$ 7/bbl levels in Q3FY17, driven by an improvement in light distillate spreads. Add to this a 10% surge in oil prices over Q3FY17, GRMs for OMCs such as IOCL and HPCL could throw up a major surprise. RIL's GRM improvement is expected to outperform benchmark Singapore GRMs, at US$ 11.5/bbl (+US$ 1.4/bbl QoQ).
- **Petrochem – Cracks robust; demonetisation to impact volumes:** The uptrend in polymer spreads continued, trending close to five-year average levels. Polyester spreads have been flattish, even as PX declined 40% QoQ while remaining at five-year average levels. While petchem margins for RIL and IOCL should marginally improve, sales volumes would be hit due to lower offtake post demonetisation.
- **Gains for utilities as LNG consumption surges:** We expect overall gas consumption to improve 5.5% YoY (or 7.2mmscmd) to ~140mmscmd in Q3, driven by an increase in PLNG's incremental 5mmtpa Dahej capacity, and resumption of operations at the Dabhol terminal. LNG consumption is expected to improve by ~13% YoY to 6.5 mmt in Q3FY17E. Spot LNG prices have crossed US$ 9/mmbtu levels in December, which could impact LNG demand for the short term.
- **Oil production growth to revive for ONGC/OINL:** ONGC's production growth is expected to improve to 12.7mmtoe (+3.1% YoY), with a 2.1%/4% YoY increase in oil/gas production to 6.7mmt/6bcm. OINL's production should continue to improve in Q3FY17 (+3.7% YoY to 1.64mmtoe) driven by higher oil production (+12.2% YoY), while gas production may decline by 5% during the quarter.

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RCML Energy universe

Company	Ticker	REC
Reliance Industries	RIL IN	BUY
Indian Oil Corp	IOCL IN	BUY
Bharat Petroleum Corp	BPCL IN	SELL
Hindustan Petroleum Corp	HPCL IN	HOLD
Oil & Natural Gas Corp	ONGC IN	HOLD
Oil India	OINL IN	BUY
GAIL (India)	GAIL IN	BUY
Petronet LNG	PLNG IN	BUY
Indraprastha Gas	IGL IN	BUY
Gujarat State Petronet	GUJS IN	BUY
Gujarat Gas	GUJGA IN	HOLD

Fig 1 - RCML Energy universe: Q3FY17 preview

(Rs mn)	Net Sales			EBITDA			PAT		
Company	Q3FY17E	YoY (%)	QoQ (%)	Q3FY17E	YoY (%)	QoQ (%)	Q3FY17E	YoY (%)	QoQ (%)
Reliance Industries	6,79,543	20.1	14.1	1,16,499	13.4	10.4	80,497	11.5	4.5
Indian Oil Corp	10,05,933	20.9	25.7	82,006	65.4	50.6	44,265	61.6	41.8
Bharat Petroleum Corp	5,54,345	18.9	24.2	24,946	5.6	86.9	15,184	2.0	16.3
Hindustan Petroleum Corp	5,19,810	19.7	23.7	19,007	(12.5)	59.9	10,964	(5.2)	56.3
Oil & Natural Gas Corp	2,03,506	10.6	11.3	1,07,482	24.4	12.7	50,916	28.5	2.3
Oil India	25,253	13.8	12.6	10,432	65.8	39.5	7,546	83.8	30.0
GAIL (India)	1,45,716	8.3	22.7	21,396	85.0	39.4	12,192	83.5	31.9
Indraprastha Gas	9,473	2.2	(1.6)	2,389	29.1	(0.8)	1,354	28.8	(6.1)
Petronet LNG	76,105	47.9	15.1	7,698	143.7	6.0	4,649	160.6	1.2
Gujarat State Petronet	2,699	9.1	5.3	2,312	10.8	3.0	1,360	10.1	4.7
Gujarat Gas	12,800	(13.0)	4.3	2,039	42.4	0.5	673	234.6	(6.2)

Source: RCML Research

Click here for the full report.

6 January 2017

India Economics

FY17 GVA Advance Estimate at 7% ex-demonetisation

- As per Central Statistics Office's (CSO) First Advance Estimates of GDP, **GVA is set to rise by 7% in FY17**. Note that this number is based on data extrapolated for various indicators for the fiscal's first 7-8 months and doesn't factor in the impact of demonetisation. First Advance Estimates, used in budget assumptions, are typically released in February every year; the early release this year is due to an advanced Union Budget (to 1 Feb'17 from the usual February-end). However, an early release means that the estimates will not capture a significant chunk of economic activity in Q3.

- GVA had risen by 7.2% YoY in H1FY16; this implies that **CSO has assumed growth to come in at 6.7% for H2,** given its full-year estimate of 7%. This we believe is on the higher side; **we expect growth to come in at ~5.5% in H2, implying full-year growth of 6.3% for FY17 (FY16: 7.2%).**

- The CSO expects growth in the construction sector to accelerate to 3.4% in H2 from 2.5% in H1FY17. Similarly, it expects growth in financial services, real estate and business services sector to pick up to 9.2% in H2 (H1FY17: 8.8%); note that estimates for this sector have been extrapolated from H1 corporate sector results and credit/deposit growth till Oc'16. **Acceleration in growth in both these aforesaid sectors (~30% of India's GDP) is highly unlikely as they are expected to be worst hit by demonetisation.** Trade, hotels & restaurants (~11% of GDP) and manufacturing (~17% of GDP) would also take a hit in H2 due to demonetisation.

- Gross Fixed Capital Formation (GFCF) had tanked by 4.4% YoY in H1FY17 due to a sustained downturn in private capex, which has been affected by low capacity utilisation and poor demand visibility. Survey-based CMIE data shows that the **number of new project announcements slumped to a 12-year low in the Dec'16 quarter** while the proposed cost of projects slid to Rs 1.3tn from average Rs 2.4tn in the last nine quarters. Demonetisation led-disruption and uncertainty is likely to hurt capex in H2. Thus, **assumption of a 4.2% growth in GFCF in H2 is unrealistic.**

- The CSO expects **Private Final Consumption expenditure (PFCE) growth to dip to 6% in H2 from 7.1% in H1.** However, it expects **Government Final Consumption Expenditure (GFCE) to rise by a sharp 32.4% YoY in H2** after clocking 16.9% growth in H1. Expectations of a sharp rise in GFCE largely reflect the implementation of the 7th CPC recommendations and should support growth in H2.

Fig 1 CSO expects H2FY17 GVA growth to come in at 6.7%

	% share	H1FY16	H2FY16	H1FY17	H2FY17*
GVA, of which	**100.0**	**7.2**	**7.1**	**7.2**	**6.7**
Manufacturing	17.5	8.2	10.3	8.1	6.7
Construction	8.5	3.3	4.5	2.5	3.4
Trade, hotels, transport, etc	19.2	8.3	9.5	7.6	4.5
Financial services, real estate, etc	21.6	10.7	9.8	8.8	9.2
GDP, of which	**100.0**	**7.5**	**7.6**	**7.2**	**7.0**
PFCE	55.5	6.6	8.2	7.1	6.0
GFCE	9.9	1.6	3.0	16.9	32.4
GFCF	31.2	8.4	-0.4	-4.4	4.2

Source: CSO, RCML Research *Growth is imputed from full year FY17 1st Advance Estimates

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CSO estimates FY17 GVA at 7%

	FY15	FY16	FY17*
GVA	7.1	7.2	7.0
Agriculture	(0.2)	1.2	4.1
Industry	5.9	7.4	5.2
Mining	10.8	7.4	(1.8)
Manufacturing	5.5	9.3	7.4
Electricity & utilities	8.0	6.6	6.5
Construction	4.4	3.9	2.9
Services	10.3	8.9	8.8
Trade, hotels, transport, etc	9.8	9.0	6.0
Financial services, real estate, etc	10.6	10.3	9.0
Community, social & personal services	10.7	6.6	12.8
GVA ex-agriculture	8.6	8.3	7.5

Source: CSO, RCML Research *1ST Advance Estimates

1st Advanced Estimates for GDP at 7.1% for FY17

	FY15	FY16	FY17*
GDP	7.2	7.6	7.1
PFCE	6.2	7.4	6.5
GFCE	12.8	2.2	23.8
GCF, of which	6.0	3.8	(1.4)
GFCF	4.9	3.9	(0.2)
Change in stocks	20.3	5.5	5.2
Valuables	15.4	0.3	(33.5)
Exports	1.7	(5.2)	2.2
Imports	0.8	(2.8)	(3.8)

Source: CSO, RCML Research *1ST Advance Estimates

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Hold	Between 15% and –5%
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