

Q4FY22 REVIEW

06 June 2022

Heightened cost pressures

- Nifty 200 companies largely met consensus estimates at the aggregate level, with only 38% of them managing to beat earnings forecasts
- Operating expenses at 78% of sales are now close to levels seen prior to the global financial crisis
- We believe moderation in consensus earnings estimates through the results season largely captures the higher operating costs

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Nifty 200 revenue and earnings broadly in line: Nifty 200 companies largely met consensus expectations at the aggregate level in Q4FY22, posting only a modest revenue and PAT beat of 1.8% and 0.2% respectively. Out of 198 companies that reported results, just 31% outperformed consensus on revenue (41% in Q3FY22) and 38% on PAT (43% in Q3FY22).

Sector summary: Financials, industrials and real estate led the beat on revenue while IT and energy had subpar numbers. None of the IT companies beat revenue expectations. The profit beat was led by real estate and utilities, while the healthcare, consumer discretionary and energy sectors posted below-consensus results.

Inflation continues to deplete profits: The **banking** sector clocked above-expected asset quality and strong loan growth in Q4, but saw stiff pricing and margin pressures. Cost ratios inched up for **insurers**. The **cement** sector posted lower EBITDA as fuel and logistics costs spiralled. Margin gains proved elusive for **consumer durables** as the sector was buffeted by Covid-19 headwinds in H1FY22 and cost inflation in the second half.

Demand momentum across the **building materials** space remained robust with healthy recovery for most companies in Q4. **Auto** players posted positive results on the back of calibrated price hikes. In **OMCs**, RIL, GAIL and upstream players benefitted from commodity price increases, and **CGDs** recovered from margin pressure. OMCs need a pullback in crude to return to a healthy profit zone.

IT sector growth was tepid due to weakness in the BSFI vertical and rising wages. However, underlying demand remains robust. **Steel** majors were able to tide over rising costs with better throughput. **Pharmaceutical** companies continued to see the impact of price erosion in US formulations coupled with increasing raw material cost pressures. Logistics costs, too, remained elevated.

Investment view: As noted in our recent report entitled [Mixed outlook](#), we continue to favour sectors linked to domestic as opposed to export demand. Recent trends in earnings and subsequent revisions reaffirm our thesis.

Reporting season trends

India Q4FY22	QoQ (%)	YoY (%)
Net Sales	9.0	22.8
Raw materials	12.0	35.3
Salaries and wages	2.8	12.2
Interest expenses	1.4	1.6
Net Profit (after tax)	6.6	25.0
Q4 surprise	Revenue (%)	Income (%)
Weighted	1.8	0.2
Average	4.9	29.6

Source: Bloomberg, BOBCAPS Research



Q4FY22: Sector-wise review

Automobiles

Q4FY22 results for the auto sector were quite positive owing to calibrated pricing actions, stabilisation of raw material prices and cost-saving initiatives by major OEMs. This helped auto companies post above-consensus net income. Further, company managements indicated optimism on raw material inflation as prices have largely stabilised, which will help them improve margins going forward. Additionally, most OEMs pointed to the better availability of chips. Demand for PVs, CVs, three-wheelers and tractors remained buoyant, though two-wheeler demand continues to be weak despite a lower base, primarily due to weak rural sentiments.

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Banking and Insurance

The quarter was marked by a healthy performance among large private sector banks, barring some pressure on margins. Asset quality has held up better than expected. Loan growth was strong, particularly underlined by market share gains in the commercial banking space. Growth in unsecured retail loans was also encouraging and reflects the confidence in a quality franchise that large banks enjoy. However, the sector saw pressure on pricing and margins. We believe large private banks with legroom to grow in unsecured retail are better placed to counter the impact of competitive stress.

For the insurance sector, Q4FY22 saw Covid-19 cases increasing in the first half of the quarter although the mortality claims normalised. Overall, it was business as usual towards the end of Q4, as reflected in the new business premium of major players such as HDFCLIFE, IPRU and SBILIFE, all of which reported decent numbers. Cost ratios increased as well, with a surge in both commission and opex ratios.

In FY22, private life insurers reported a better YoY margin performance supported by a product mix focused on profitable products such as term insurance and non-par savings. Persistency across 13th-month and 61st-month cohorts improved for major life insurers in FY22 vs. FY21. Their solvency ratios remained adequate and above the minimum regulatory requirement of 150%. Media reports of higher premium in term products in FY22 stemmed from increased rates from reinsurers considering the tall claims coming from Covid fatalities.

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Cement

The sector earnings performance had declined with EBITDA/EBITDA Margins and EBITDA/tn softening in the range of 20%/600-800bps. Sector performance was affected by the fuel cost spiral (imported coal/pet coke) and logistics cost inflation due to the hike in diesel prices. Volume growth was tepid in the range of 0-5% due to a higher base and focus on maintaining realisations. YoY realisation growth was between 3% and 6% to partially pass through the cost inflation. We expect sector headwinds to continue due to sustained higher fuel cost for the next 2-3 quarters at least.

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Consumer Durables

FY22 will be remembered as a year when margin gains proved elusive for the consumer durables sector. If the first half of the year was marred by Covid-related stress, the second half saw raw material headwinds. The Russia-Ukraine conflict, supply shortages, logistical issues and the shutdown of key business and transportation hubs in China due to the Omicron wave all contributed to higher input costs for companies. Inflation, which has a direct impact on discretionary spending, topped this heady cocktail.

Pricing power and cost management are crucial in a high-inflation environment as these factors will determine cash flow yields. We prefer leaders that have a demonstrable track record, viz. VOLT (BUY, TP Rs 1,250) and HAVL (BUY, TP Rs 1,500) among the durable names. POLYCAB (BUY, TP Rs 3,000) is our pick among cables and wires where pass-through is easier. In the contract manufacturing business, we like DIXON (BUY, Rs 4,600) for its business model.

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IT Services

Q4 was a mixed bag for the sector. Growth was tepid due to seasonality and weakness in the BFSI vertical. While players such as TECHM, PSYS and MTCL delivered QoQ USD growth in line with expectations, INFO and HCLT disappointed with a sluggish performance. The BFSI vertical registered slow growth across large players but momentum is expected to pick up next quarter. The communications, manufacturing and life sciences verticals stood out for most players. Retail also did well for a few.

Overall demand remains robust as deduced by the positive management commentary. Despite macro concerns looming large, companies have reported record TCV numbers and their FY23 growth guidance appears cautious with a positive bias. TCV was a mix of large- and medium-sized deals. Conversations around higher deal pricing in line with increasing inflation have gathered momentum. Cloud remains the largest growth driver followed by 5G, cybersecurity, customer experience and artificial intelligence/machine learning. Companies continue to expand capabilities in metaverse and blockchain.

Supply-side pressures still plagued the sector with a majority of companies reporting another quarter of higher QoQ attrition. Margins declined by an average of ~34bps QoQ bogged down by the headwinds of (1) high onsite costs, (2) multiple wage hike cycles, (3) retention costs, (4) utilisation declines due to fresher hiring, and (5) increased travel, marketing and visa costs. This was offset partially by sequential tailwinds from (1) better deal pricing, (2) rupee depreciation, and (3) lower subcontracting expenses.

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Metals & Mining

- **Steel majors:** In Q4, steel majors were able to arrest their EBITDA decline with sequential volume growth. Looking to Q1FY23, a sequential EBITDA and margin decline looks inevitable given higher coking coal and lower steel prices driven by a global pullback and compounded by the surprise export duty levy, with only a part-offset from lower iron ore prices. Medium-term, we expect earnings to be supported by volume growth and healthy mid-cycle level margins.
- **Base metal players:** Aluminium and zinc players reported a strong Q4. While base metal prices remain supported by supply disruptions, margins are likely to ease sequentially due to the impact of higher raw material costs. Medium-term earnings should be supported by the restart of investments and healthy prices.

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Oil & Gas

- **RIL – Margin uptick in cyclicals; consumer business to drive growth:** RIL is likely to benefit from a sharp margin uptick in refining near-term. We believe medium-term earnings growth would be supported by an estimated 28% EBITDA CAGR for consumer businesses over FY22-FY25.
- **OMCs – Near-term pressure; return to healthy profit needs pullback in crude price:** OMCs have underperformed consensus in Q4 as losses on marketing outweighed the gains on refining. Near-term, the best-case scenario for OMCs will be to cover high costs on account of high oil price and refining margins. Medium-term, we expect margins to return to the healthy zone as consumer acceptance of current high petrol/diesel prices allows OMCs to remain profitable even around US\$ 100/bbl of oil price.
- **CGD – Returning to healthy mid-cycle margins; volume growth to be supported by CNG:** Margins recovered in Q4 as city gas distribution companies were able to pass on the increase in natural gas prices. We expect margins to remain in a healthy mid-cycle zone in FY23 as the increase in retail prices has already offset higher gas procurement costs so far. Further, there is a possibility that the increase in domestic gas prices from Oct'22 may partly be countered by substitution of spot LNG with a relatively cheaper oil-linked LNG for the shortfall component. Volume growth for the key CNG segment will be supported by pick-up in momentum in commercial segments and the launch of new CNG models by OEMs.

- **Upstream – Earnings supported by high oil and gas prices:** Q4 earnings were backed by a surge in oil and gas prices and will see a further boost from the likely increase in domestic gas prices in FY23.

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Pharmaceuticals

Our pharma coverage reported 10% YoY revenue growth (-1% QoQ) in Q4FY22 led by a recovery in acute therapies. EBITDA for the quarter declined 5% YoY and 15% QoQ with margin contraction of ~300bps YoY and QoQ. Pharma companies continued to see the impact of price erosion in US formulations coupled with rising raw material cost pressure. Logistics costs also remained elevated which resulted in a PAT decline of 16% YoY and 34% QoQ. As per management commentaries, the older portfolios of Indian generic companies would continue to face near-term challenges in the US market. A few companies are also looking to rationalise their portfolios to improve profitability.

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Mid-caps

Demand momentum across building material products remained healthy in Q4, with Mar'22 especially marking a recovery for most companies. This was spurred by a combination of good underlying demand and some preponement of stocking ahead of price hike expectations from Apr'22 onwards. We note that construction and renovation activities were affected in certain parts of India in the first half of Jan'22 due to the Omicron-related case surge and in Feb'22 due to the impact of state elections.

In the **pipes** segment, destocking by dealers amid price volatility had led to lower volumes in Q3FY22. PVC prices started increasing from the middle of February, which led to dealers stocking up again, but not fully given the current volatile situation. The pipes industry saw higher sequential volume offtake in Q4 led by demand from the residential segment, whereas the agri segment remained subdued due to the volatile PVC prices.

Sales volume showed sequential as well as yearly growth as the volume opportunity lost in Q3FY22 was recouped in Q4, in addition to the existing demand. CPVC demand held up in Q4 and the industry took ~3-5% price hikes in the product. Players with a higher focus on CPVC performed better given the sustained increase in CPVC prices.

Tile players reported high-single-digit volume growth during Q4FY22 (off a high base). March was a strong month as on-ground demand showed resilience and dealers had stocked up inventory in anticipation of price hikes from April. Exports continued to be sluggish due to high freight costs; this along with increased gas costs led to many Morbi-based players shutting down operations, thus easing some competition from the domestic market.

Rising gas costs remain a challenge for the entire ceramics industry though the Morbi cluster eschewed price hikes due to internal competitive pressures from new capacities

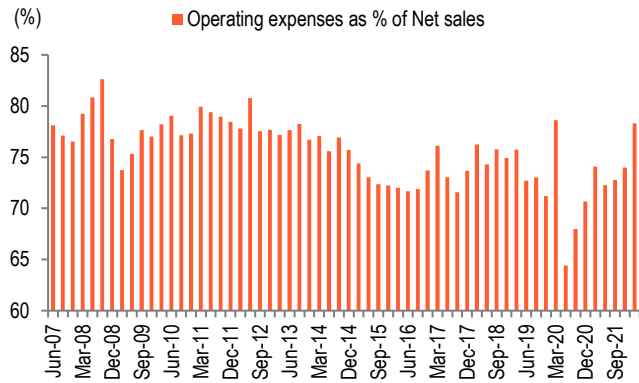
commercialised in the last 4-5 months. Ceramic tile players (organised) have been consistently hiking prices for the last six months, including ~5-10% hikes in Q4FY22 to pass on the cost inflation. This bodes well for sequential improvement in profitability next quarter. Similar trends were witnessed for players focused on the **sanitaryware** and **faucets** business.

The **wood panel** space witnessed continued price hikes in plywood, laminates and MDF (the latter saw the most aggressive hikes due to favourable demand-supply) – this was to cover the increase in cost of chemicals, Kraft & Décor paper and imports (due to higher freight/shipping cost). Demand traction in MDF continued to rise in Q4 on the back of growth in ready-made furniture, both domestically and in export markets, and also expectations of higher MDF exports on the back of a vacuum created in international markets by the fall in supply from countries like Vietnam and Indonesia.

The **adhesives** segment witnessed price hikes which led to strong Q4 topline growth despite muted volumes. Gross margins were significantly compressed due to the relentless upsurge in crude-derived raw material costs.

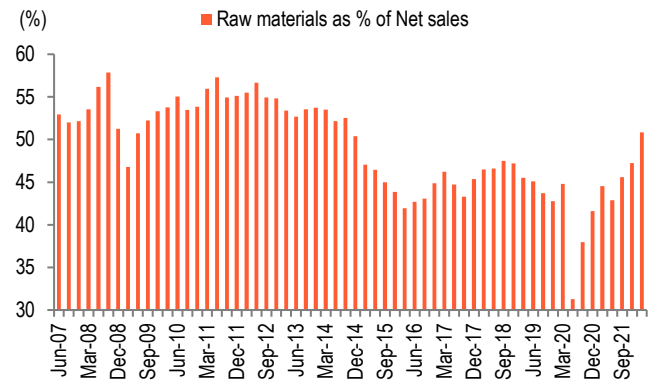
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Fig 1 – Operating expenses are close to pre-GFC level



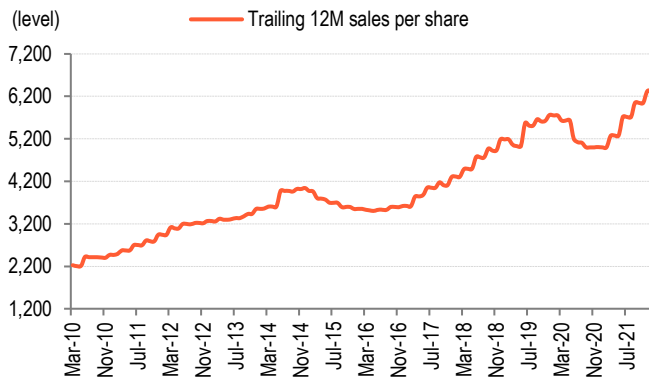
Source: CMIE, BOBCAPS Research | EN = Energy, UT= Utilities, MT=Materials

Fig 2 – Raw material cost is now 50% of net sales



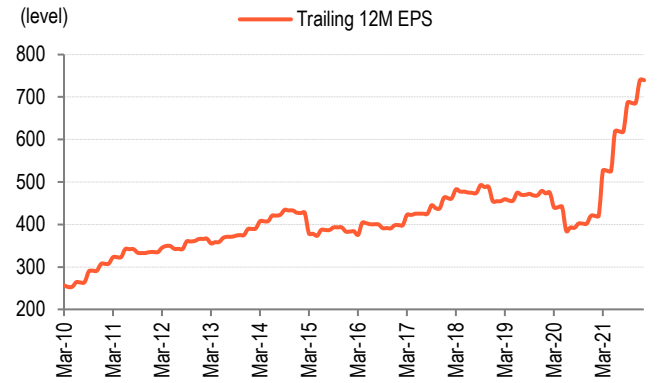
Source: CMIE, BOBCAPS Research | ID=Industrials, IT= Information Technology, RE= Real Estate

Fig 3 – Nifty 50: Sales per share



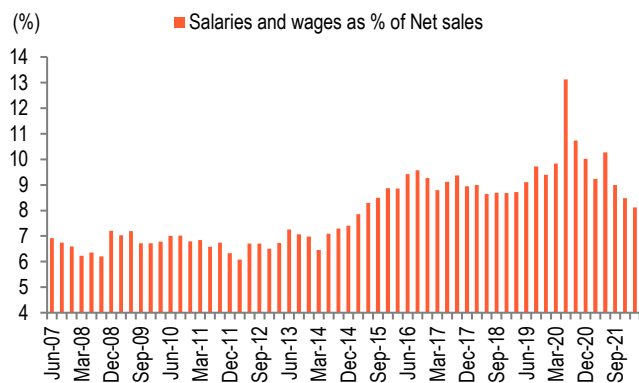
Source: Bloomberg, BOBCAPS Research

Fig 4 – Nifty 50: Earnings per share



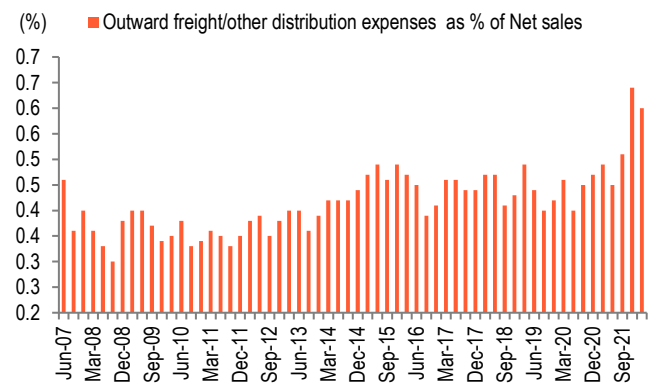
Source: Bloomberg, BOBCAPS Research

Fig 5 – Salary and wage cost continues to decline



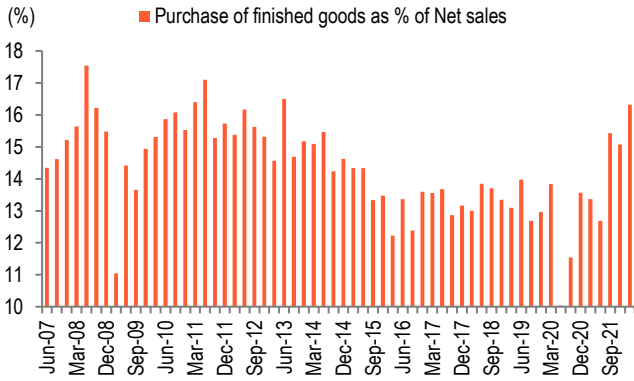
Source: BOBCAPS Research, CMIE

Fig 6 – Freight charges are the highest in history



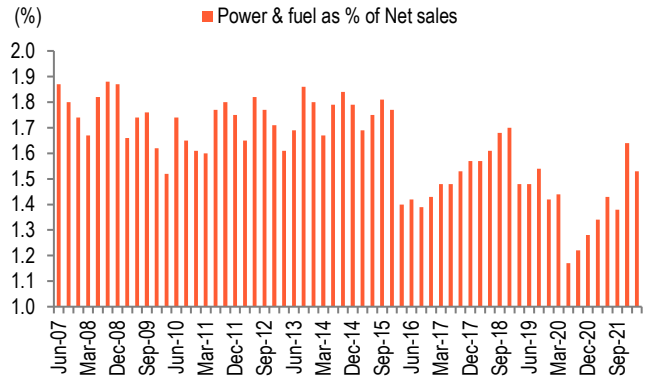
Source: BOBCAPS Research, Bloomberg

Fig 7 – Purchase of finished goods also remains elevated



Source: CMIE, BOBCAPS Research

Fig 8 – Power and fuel cost, although up, remains lower than historical standards



Source: CMIE, BOBCAPS Research

Fig 9 – Q4FY22: Beats and misses – Aggregates

Sector	# Cos	Mkt Cap (Rs bn)	Reported	% Mcap reported	Reported (Rs bn)		Consensus Estimate (Rs bn)		Weighted Q4 Beat (%)		Average Q4 Beat (%)	
					Revenue	Income	Revenue	Income	Revenue	Income	Revenue	Income
Financials	44	28,173	43	99	2,376	579	2,193	562	8.3	3.1	8.8	28.4
Information Technology	14	11,337	14	100	1,518	259	1,525	260	(0.4)	(0.2)	(2.4)	(0.6)
Energy	8	9,161	8	100	6,689	449	6,870	494	(2.6)	(9.1)	(3.7)	(3.9)
Materials	27	8,503	27	100	2,690	396	2,609	393	3.1	0.8	1.5	17.0
Consumer Discretionary	27	7,391	27	100	2,025	66	1,956	70	3.6	(6.3)	4.6	(49.9)
Consumer Staples	15	7,759	15	100	657	103	649	102	1.3	1.2	1.1	12.8
Industrials	20	5,369	20	100	1,336	88	1,224	84	9.1	5.6	6.8	241.6
Health Care	22	4,367	21	99	510	56	501	70	1.7	(20.7)	1.4	(22.6)
Communication Services	7	2,573	7	100	496	(16)	498	(27)	(0.4)	39.1	1.8	4.4
Utilities	12	4,202	12	100	968	154	906	128	6.8	20.4	4.1	18.6
Real Estate	4	472	4	100	57	17	42	12	34.5	45.3	62.6	144.8
Total	200	89,306	198	100	19,324	2,152	18,974	2,148	1.8	0.2	4.9	29.6

Source: Bloomberg, BOBCAPS Research

Fig 10 – Q4FY22: Beats and misses – Numbers

Sector	Reported	Mcap reported (%)	Revenue				Income			
			Beat	Miss	In-line	No Data	Beat	Miss	In-line	No Data
Financials	43	99	14	6	11	12	19	11	6	12
Information Technology	14	100	0	2	10	2	4	2	6	2
Energy	8	100	1	5	2	0	2	6	0	0
Materials	27	100	10	5	9	3	10	11	4	3
Consumer Discretionary	27	100	10	9	7	1	12	12	2	1
Consumer Staples	15	100	2	0	12	1	4	6	4	1
Industrials	20	100	7	1	9	3	8	7	4	3
Health Care	21	99	8	3	8	2	4	14	1	2
Communication Services	7	100	2	0	4	1	3	3	1	1
Utilities	12	100	6	3	0	3	8	2	0	3
Real Estate	4	100	2	2	0	0	2	2	0	0
Total	198	100	62	36	72	28	76	76	28	28

Source: CMIE, BOBCAPS Research

Fig 11 – Earnings trends YoY (Q4FY21 – Q4FY22)

Sector	Net sales	Raw materials		Salaries and wages		Interest expenses		Net profit (after tax)	
	YoY (%)	YoY (%)	% of net sales	YoY (%)	% of net sales	YoY (%)	% of net sales	YoY (%)	% of net sales
NSE listed companies	22.8	35.3	48.0	12.2	9.6	1.6	8.7	25.0	9.3
Materials	36.0	46.1	71.4	10.3	2.8	5.0	1.4	1.1	8.0
Information Technology	22.4	33.0	4.8	22.8	50.7	16.9	0.5	23.0	16.1
Industrials	19.8	28.0	59.1	3.7	6.8	(0.2)	2.6	57.6	5.2
Financials	9.1	40.4	1.5	3.5	13.9	1.1	40.6	72.3	16.4
Communication Services	16.6	1.8	3.1	22.5	17.3	9.5	12.9	(66.6)	(1.5)
Consumer Discretionary	21.5	25.6	63.2	9.3	7.1	2.2	2.6	32.5	7.5
Consumer Staples	17.1	19.9	70.4	7.6	5.7	(1.8)	0.9	20.1	10.7
Health Care	10.9	15.8	35.2	12.3	16.3	(2.4)	2.1	(32.6)	7.5
Real Estate	4.4	4.2	24.1	15.7	5.0	(7.7)	7.1	(45.2)	10.3
Energy	27.0	37.8	51.9	19.2	5.8	(4.2)	2.4	(2.9)	6.4
Utilities	31.7	40.0	59.4	14.4	4.3	8.2	5.3	10.2	14.2

Source: CMIE, BOBCAPS Research

Fig 12 – Earnings trends QoQ (Q3FY22 – Q4FY22)

Sector	Net sales	Raw materials		Salaries and wages		Interest expenses		Net profit (after tax)	
	QoQ (%)	QoQ (%)	% of net sales	QoQ (%)	% of net sales	QoQ (%)	% of net sales	QoQ (%)	% of net sales
NSE listed companies	9.0	12.0	48.0	2.8	9.6	1.4	8.7	6.6	9.3
Materials	9.9	10.6	71.4	7.9	2.8	10.4	1.4	18.2	8.0
Information Technology	3.2	10.0	4.8	4.6	50.7	7.1	0.5	3.8	16.1
Industrials	16.2	18.1	59.1	0.6	6.8	2.1	2.6	(12.7)	5.2
Financials	4.2	45.5	1.5	(0.1)	13.9	0.5	40.7	6.6	16.4
Communication Services	5.3	64.6	3.1	2.6	17.3	(0.1)	12.9	69.4	(1.5)
Consumer Discretionary	10.1	12.2	63.2	2.5	7.1	1.7	2.6	30.8	7.5
Consumer Staples	0.5	10.0	70.4	(0.7)	5.7	(0.7)	0.9	5.1	10.7
Health Care	7.3	10.7	35.2	2.5	16.3	15.4	2.1	(38.6)	7.5
Real Estate	31.9	25.0	24.1	8.5	5.0	8.1	7.3	40.0	10.3
Energy	11.6	9.3	51.9	5.4	5.8	3.1	2.4	(0.5)	6.4
Utilities	31.7	40.0	59.4	14.4	4.3	8.2	5.3	10.2	14.2

Source: CMIE, BOBCAPS Research

Fig 13 – 3M change in consensus earnings estimates

(%)	1M	3M	6M
Nifty 50	(0.88)	17.87	17.74
Nifty 200	(2.38)	18.80	18.66
Nifty 500	(2.45)	20.09	17.81
NIFTY Midcap 100	(8.34)	59.08	56.62
NIFTY Smallcap 100	(5.67)	38.29	29.97
Nifty Bank	0.21	37.99	32.02
Nifty IT	(0.84)	12.14	12.29
Nifty Auto	2.73	102.33	60.52
Nifty Pharma	(5.80)	14.78	9.57
Nifty Metal	(9.20)	(22.85)	(20.93)
Nifty FMCG	0.18	10.65	5.39
Nifty PSU Bank	(5.26)	30.09	36.38
Nifty Realty	(1.90)	49.92	33.82
Nifty Financial Services	(2.70)	27.59	26.44
Nifty Infrastructure	(0.13)	21.64	26.86
Nifty Energy	(0.10)	16.91	26.91
Nifty CPSE	4.02	13.71	27.23
Nifty India Consumption	1.41	27.50	25.19
Nifty Media	(6.14)	101.46	88.67
Nifty PSE	(3.87)	5.14	12.34
Nifty Commodities	49.85	9.78	17.37

Source: Bloomberg, BOBCAPS Research

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Recommendation scale: Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

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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