FMCG

The FMCG sector is the fifth largest sector in the Indian economy with a total market size in excess of US$ 13.1 billion. The sector has a strong MNC existence and is also characterised by a well established distribution network, intense competition between the organised and unorganised segments and low operational cost. Due to the availability of key raw materials, cheaper the costs and existence across the complete value chain India has a competitive advantage.

The FMCG market is expected to grow from US$ 11.6 billion in 2003 to US$ 33.4 billion in 2015. In India most of the products categories like jams, toothpaste, skin care, hair wash etc have the low penetration level as well as per capita consumption which indicate the untapped market potential. Rapidly increasing Indian population, mainly the middle class and the rural segments, presents an opportunity to makers of branded products to convert consumers of branded products.

During the first Quarter of FY 10 FMCG Sector observed a 9.8% YOY growth in revenues. Some of the Mid-cap companies like, Marico, Nestle, Dabur and GCPL also showed a strong revenue growth in the range of 15-24% YOY. However the lower revenue growth has been witnessed by big players of the industry like HUL and ITC.

The main highlight of the quarter was the return of strong volume growth across segments.

Some of the reasons of the signs of healthy growth of the sector are:

- **Players increase their ad spend to support volume growth**

Most of the players in the first quarter of FY10 have increase the ads spend. The players have strategically increased the ad spends for driving volume growth and also of the introduction of new products. HUL incurred its highest quarterly ad spend at 12.5% of net sales. Almost all the companies have shown the increase in the ad expenditure except Colgate which showed a drop in 16% YOY basis. With the strong leadership position in the oral care sector, Colgate has been able to easily gain market share despite rising competition.

- **Expansion of Healthy margin due to raw material cost savings**

Companies have also shown an increment in operating margin mainly due to lower raw material cost except Britannia which witnessed ~100-600 bps YOY. Prices of key raw materials like LAB, palm oil, crude oil and HDPE (packing material) remained low during the previous quarter. GCPL (decline in input cost + low base last year) and Colgate (reduction in food companies like Nestle, GSK Consumer and Britannia will not have a major impact given ad spend and input cost) reported highest expansion in margin at 598bps and 557bps respectively. Despite firm prices of key agro commodities like milk, sugar and wheat, Nestle and GSK Consumers witnessed 280bps and 140bps margin expansion led by their strong pricing power. With the expectations of below-normal monsoon, the agro commodity prices are expected to remain firm in the coming quarters. However, we believe their strong leadership position in the respective categories.

- **Net profit growth matches expectations**

Aggregate sector net profit growth (16% YOY – Rs20.1bn) for the quarter was in-line with the expectations (17% YOY – Rs20.3bn). Healthy topline growth, significant expansion in margin and higher other income were the key drivers of earnings growth. The growth could have surpassed the estimates but for the poor performance of HUL, which reported a ~1% YOY decline in net profit due to higher tax

Out go and lower other income. After adjusting for forex MTM loss (which was included in other income), HUL has registered 6.7% YOY growth in net profit. GCPL reported the highest bottomline growth of 78% YOY during the quarter followed by Colgate at 43% YOY. Nestle recorded strong a ~34% YOY growth in net (robust 20% YOY growth in domestic business). ITC registered a 19% YOY growth led by the robust performance of the core cigarette segment (revenues up 23%, EBIT up 17%).

Q1 FY10 Results

(Rs mn)	Revenues	YOY growth (%)	OPM (%)	YOY Change (bps)	PAT#	YOY growth (%)
Britannia	7,312	5.5	8.2	-12	544	18.5
Colgate	4,680	14.8	22.5	557	1,028	42.9
Dabur	7,427	23	15.9	149	910	28.7
GSK Cons*	4,687	24.5	15.9	141	552	19.6
GCPL	4,389	21.4	19.7	598	697	78.2
HUL	44,757	7.8	15.4	209	5,367	-0.6
ITC	40,827	4.7	32.8	385	8,787	17.4
Marico	6,967	16.8	13.8	116	600	29.6
Nestle*	12,095	16.8	21.6	281	1,620	33.8
Total	**133,141**	**9.8**	**21.2**	**254**	**20,104**	**16.2**

Source: Company, India Infoline Research, *# Pre exceptional PAT; * Year end December*

Oil and Gas

Major boost to the domestic oil and gas sector in India have been provided by the two major events of this year i.e. the initiation of production of natural gas from Reliance Industries Ltd's (RIL) Krishna Godavari (KG) fields and the scheduled commencement of production of crude oil from Cairn India Ltd's fields later this year and also the upstream activities that have received major attention over the past years.

Given the country's targeted GDP growth, India's fuel needs are likely to expand at a substantial rate. Also India's per-capita consumption of energy and electricity is much less than that of industrialized nations and the word average which indicates that there is a huge scope for rapid expansion in the country. At the same time, India already imports over 70 percent of its crude oil requirements, with its oil import bill being close to USD 90 billion in 2008-09. In addition, some of the existing oil and gas fields were experiencing a decline in their production since they had already been in production for several years and were past their plateau phase. Given this context, particularly the high import dependence, the New Exploration Licensing Policy (NELP) was envisaged in 1997 (and operationalized in 1999) by the MoPNG, as part of its Hydrocarbon Vision 2025, a landmark 25- year planning document. These factors also meant that the issue of energy security was brought to the forefront of strategic decision making and an urgent need was felt to augment the domestic supplies of oil and gas .In addition to NELP, other efforts were made to address the need for achieving energy security such as:

- Acquisition of Oil and Gas assets abroad, the latest being ONGC Videsh's acquisition of Imperial Energy
- Developing strategic storage facilities at identified locations
- Exploring alternate sources of Energy, including Coal Bed Methane, gas hydrates, etc
- Improving the recovery of oil and gas from existing fields through methods such as Enhanced Oil Recovery (EOR) and Increased Oil Recovery (IOR).

The main issues that affected the performance of the Indian oil and gas sector were

1) Decrease in crude prices by 52% YOY,
2) Reduction in GRMs,
3) Lesser inventory gains,
4) Sharp decline in gross under recoveries
5) Modification in subsidy sharing pattern.

As announced by the government, upstream companies bore the burden of under recoveries on HSD and SKO. However, under recoveries on SKO and LPG were borne by oil marketing companies.

ONGC had to bear Rs4.3bn (down 95.6% YOY) worth of under recoveries resulting in US$2.3/bbl worth of discounts. For GAIL, huge jump in dry well expenses and lower petrochemical segment EBIT margins acted as a dampener for earnings. Impact of lower gross under recoveries for oil marketing companies' was offset by sharp fall in GRMs on a YOY basis and complete burden of LPG and SKO under recoveries. For Reliance Industries, lower refining segment EBIT margins were more than offset by a surprise jump of 733bps YOY in petrochemicals EBIT margins. Cairn's earnings were impacted due to lower production and realizations. CPCL earnings were lower on account of a YOY fall in GRMs.

Subsidy sharing pattern different yet again
Crude oil prices recovered from the sharp fall witnessed during Q4 FY09 as they increased 25% QOQ but were lower 52% YOY. During Q1 FY10, revenue for OMCs was down both on QOQ and YOY basis driven by lower realizations. Fall in crude prices resulted in fall in gross under recoveries for OMCs but the burden was shared by the upstream companies only on MS and HSD. There was no correspondence from the government with respect to sharing of under recoveries on SKO and LPG. Lower GRMs on a YOY basis on account of fall in inventory gains was more than negated by decline in net under recoveries. Profitability was better on a YOY basis but sequentially performance deteriorated on account of absence of bond provisioning.

Lower volumes and realization impact upstream performance ONGC and Cairn witnessed a double whammy of falling production (natural decline in mature fields) and plummeting crude prices. However, the impact was partially offset by 25% YOY depreciation in rupee against the US dollar. For ONGC, despite 95.6% YOY fall in subsidy burden, realizations were down 16% YOY. Furthermore, its earnings were impacted on account of jump in dry well expenditure. For Cairn, sharp jump in other income was offset by increased exploration write offs and one off provision of Rs1.6bn

Lower refining margins on a YOY basis translates into lower earning for RIL and CPCL Reliance Industries registered a GRM of US$7.5/bbl; lower than the expectations of US$8.7/bbl. Other refineries including that of OMCs and Chennai Petroleum reported YOY fall in GRMs. Fall in GRMs for these companies was in line with decline in benchmark Singapore GRMs as spreads for middle distillates witnessed a steep fall. With inventory losses significantly lower in comparison to Q1 FY09, OMCs witnessed a sharper fall in GRMs. Chennai Petroleum reported robust growth of 12% sequentially in profits owing to higher GRMs QOQ (from US$6.6/bbl to US$6.9/bbl). For Reliance Industries, weaker refining segment profitability was more than offset by a surprise 741bps YOY jump in petrochemical segment EBIT margins. Further, RIL also witnessed commencement of gas production from KG-D6 leading to 14ppts increase in EBIT contribution of the oil and gas segment.

Dry well expenditure impacts GAIL's performance Gail (India) Ltd reported net sales of Rs60.4bn, an increase of 5.4% YOY but decline of 3.1% QOQ. YOY growth was driven by stronger than expected transmission volumes and better realizations for natural gas transmission (driven by KG-D6 volumes) and gas trading segments. However, OPM fell by 645bps YOY despite 84% lower subsidy burden due to

1) Jump in dry well expenditure from Rs33mn in Q1 FY09 to Rs701mn in Q1 FY10 leading to sharp jump in overheads

2) Increase in purchases as percentage of sales and

3) 12ppts and 18ppts YOY fall in EBIT margins of petrochemicals (lower spreads on gas prices) and LPG and liquid hydrocarbon respectively.

Uncertainties continue to impact sentiment for the sector. Most of the companies in the sector are witnessing a high degree of uncertainty with respect to their future earnings. For ONGC, GAIL and OMCs, opaqueness about future subsidy sharing pattern continue to cloud earning estimates. ONGC earnings get further pressurized on account of a constant decline in production from their matured fields, while APM gas prices have dampened profitability. For Cairn, although some clarity has emerged over pricing of the Rajasthan crude oil but issues pertaining to cess would hamper sentiment for the stock. Even in terms of valuations, we believe Cairn is currently discounting a long-term average crude oil price realization of more than US$70/bbl, which we feel expensive. For Reliance, pending case on RIL-RNRL dispute along with litigations with NTPC and tax tribunal (KG-D6 tax free status) will keep the sentiment weak. Overall, we maintain the negative stance on the sector and are positive only on GAIL on account of strong increase in its core business of natural gas transmission. Further, with exposure to lucrative city gas projects and E&P business, the earnings base would be considerably diversified in the years to come.

Q1 FY10 Results

		(%) growth			Change (bps)			(%) growth	
(Rs mn)	Revenue	YOY	QOQ	OPM (%)	YOY	QOQ	PAT	YOY	QOQ
Reliance	320,550	-22.9	13	18.5	375 bps	(70) bps	36,360	-11.5	-6.1
ONGC	149,453	-25.5	8	64	539 bps	2,130 bps	48,478	-26.5	119.7

Q1 FY10 Results									
		(%) growth			Change (bps)			(%) growth	
(Rs mn)	Revenue	YOY	QOQ	OPM (%)	YOY	QOQ	PAT	YOY	QOQ
GAIL	60,413	5.4	-3.1	18	(645) bps	53 bps	6,558	-26.9	4.1
Cairn	2,050	-49.2	12.8	64.5	(296) bps	1,674 bps	454	-67.2	143.3
CPCL	56,604	-49.7	17.7	8.3	(212) bps	(253) bps	3,047	-56.7	12.1
HPCL	244,362	-29.7	-3.7	5.4	661 bps	(1,684) bps	6,491	NA	-87.3
BPCL	255,144	-34.6	-3.8	3	498 bps	(1,273) bps	6,141	NA	-83.1
IOC	591,796	-33.1	-1.3	8.4	736 bps	(650) bps	36,828	787.2	-44.4

Source: Company, India Infoline Research

Bank

During the first quarter of FY '10 Indian retail banking sector which primarily depends upon the transactions directly with consumers savings and lending, registered a decline in share of 5.02 per cent as compared to the corresponding period last year as per analyses of thirty public and private Indian banks by the ASSOCHAM Financial Pulse (AFP).

The Study elaborated that the private banks are performing better than the public banks in terms of their revenue from retail segment. The private and public banks have registered about 54.27 per cent and 35.47 per cent share in retail banking during Q1 FY '10 respectively.

Due to the global meltdown, Indian government took major steps in Monitory policy and made changes like cut in banking interest rate for lending housing and auto loans which impacted the revenue of Indian retail banking segment. Other reason behind the decline in retail revenue may be due to higher collateral charged by the banks for retail loans which impacted the demand for credit adversely.

In the context of banking sector revenues, the public sector banks registered a growth of 28.96 per cent in total income while their income from the retail segment grew only 9.92 per cent during the first quarter of FY '10. On the other hand the share of retail banking for public banks declined 6.14 percentage points during the period from 41.61 per cent in Q1 FY '09 to 35.47 per cent in Q1 FY '10.

However the private banks registered only 13.52 per cent growth in total income during the period but their income from retail segment registered a minimal decline of 0.16 per cent. The share of retail banking for private banks declined by 7.44 percentage points during the period from 61.71 per cent in Q1 FY '09 to 54.27 per cent in Q1 FY '10.

Quarter wise growth of banking sector in India

	Total Income Growth	Retail Income Growth	% change in share of retail banking
Private Bank	13.52	-0.16	-7.44
Public Bank	28.96	9.92	-6.14
All Bank	24.3	6.03	-5.02

Source: ASSOCHAM Financial Pulse

The analyses of fifteen public sector banks shows that State Bank of Hyderabad had the maximum share of retail banking segment contributing about 81.84 per cent to its total income followed by Andhra Bank with 42.14 per cent, State Bank of India with 39.81 per cent and Indian Bank with 38.01 per cent.

Other public sector banks which present major share of retail banking segment in their total income were Andhra Bank (42.17 per cent), Indian Bank (38.01 per cent), Punjab National Bank (35.14 per cent), UCO Bank (37.42 per cent), Central Bank of India (34.45 per cent), Canara Bank (33.42 per cent) and Union bank of India (31.36 per cent).

The banks which registered decline in share of retail banking during Q1 FY '10 as compared to the same period last year were Oriental Bank of commerce (by 33.96 per cent), Allahabad Bank (10.54 per cent), Corporation Bank (7.81 per cent), Bank of India (7.71 per cent), Indian Overseas Bank (6.64 per cent) and Bank of Baroda (5.88 per cent).

In the context of fifteen private banks, Ing Vysya Bank Limited recorded the maximum share of retail banking in its total income contributing nearly 80.20 per cent, followed by Kotak Mahindra Bank Limited (75.36 per cent), HDFC Bank of India (74.82 per cent) and ICICI Bank Limited (53.52 per cent).

Other private sector banks which recorded major share in retail banking segment from their total income were Axis Bank (47.16 per cent), South Indian Bank (46.92 per cent), J&K Bank (45.90 per cent), IDBI Bank (43.45 per cent) and The Bank of Rajasthan Limited (22.91 per cent).

The banks which registered decline in share of retail banking during Q1 FY '10 as compared to the same period last year were The Federal Bank Limited (by 20.07 per cent), IndusInd Bank (16.22 per cent), Dhanalakshmi Bank (15.89 per cent) and Karnataka Bank (13.29 per cent).

Metal

Adjusted earnings of the Q1 of FY10 for the sector were much greater than the estimate due to the stupendous performance by the nonferrous space. After showing a 10.8% QOQ growth in bottomline during the Q4 FY09, the growth momentum sustained in Q1 FY10, with the sector witnessing an increase of 19.7% QOQ. Due to lower sales volume of SAIL and TISCO the revenues declined by 8% QOQ.

Throughout the quarter OPM expanded to 627bps QOQ because of the lower raw material prices and elevated operational efficiencies. For all the steel companies EBIDTA/ton increased on a QOQ basis. The non-ferrous space recovered strongly guided by revitalization in commodity prices and a decline in crude oil linked input costs. Hindalco's numbers were the best among the sector, registering a bottomline that was twice of the estimate. Metal stocks have rallied sharply over the last one month as base metals are currently trading at their 2009 high. We believe that base metal prices will not be able to sustain at the current high levels and will slide as idle capacities continue to remain an overhang. Sterlite and JSPL are the preferred bets among the metals space due to the earnings visibility provided by their power subsidiaries over the next two years.

EBIDTA/ton increases of ferrous companies on a QOQ basis

Topline in Q1 FY10 declined 13.2% QOQ for the ferrous universe companies on account of a decline in sales volume for SAIL and Tata Steel. Volumes for all the companies were higher on a YOY basis, with the sector registering a growth of 16.9% YOY. Tata Steel managed a 9.2% QOQ increase in its realisations compared to a mere 3.7% QOQ rise for SAIL and a 2.6% decline for JSW. EBIDTA/ton for all the companies increased as coking coal prices declined.

Earnings of Non-ferrous space was above estimate

The non-ferrous space reported strong numbers during the quarter. The revival in investor sentiment and firm base metals prices led to a rebound in the sector. The sector outperformed the expectations led by lower raw material costs and operational efficiencies. Hindalco's numbers surprised the street on the positive side. Led by a robust performance by the zinc business, HZL and Sterlite reported a strong growth in earnings on a QOQ basis. NALCO underperformed the sector and reported lower than expected earnings.

Decline in ferrous sector topline brings down overall sector topline by 8.3% QOQ Revenues for the metal universe declined 8% QOQ mainly due to a decline in revenue from the ferrous sector. The impact of a 3.2% QOQ increase in revenue from the non-ferrous space was offset by a 13.2% QOQ decline in the ferrous space.

Topline of the steel universe (Jindal Steel and Power Ltd -JSPL, JSW Steel - JSW, Steel Authority of India - SAIL and Tata Steel) declined due to lower sales by Tata Steel and SAIL on a QOQ basis. Total steel sales volume declined 14.1% QOQ to 6.1mn tons. The decline in sales volume was led by Tata Steel and SAIL as its Q4 FY09 sales volume were boosted by liquidation of finished goods inventory it carried forward from Q3 FY09. As a result, sales volume declined sharply on a QOQ basis, as against a 5% and a 10% fall in production volumes for SAIL and Tata Steel respectively. JSW's steel sales soared 24.4% QOQ to 1.3mn tons outperforming its peers. Tata Steel managed a 9.2% QOQ increase in its realisations compared to a mere 3.7% QOQ rise for SAIL and a 2.6% decline for JSW. JSPL's topline fell the most (15.2% QOQ) on account of inferior product mix.

The total revenue for the non-ferrous pack (Hindustan Zinc Ltd - HZL, Hindalco Industries Ltd -Hindalco, National Aluminum Company – NALCO, Sterlite Industries - Sterlite) increased 3.2% QOQ as LME prices remained firm on a QOQ basis. During the quarter, average LME prices for copper and zinc increased 36% and 27.6% QOQ. Average aluminum prices rose the least among the base metals pack rising 12.1% QOQ. HZL registered an 18.4% QOQ increase in topline, significantly higher than the estimates. Hindalco and NALCO's topline were lower than the estimate due to lower sales volume. Lower raw material costs lead to a 627 bps expansion in OPM. All metal companies in the coverage managed to register an expansion in OPM on a QOQ basis against a contraction on a YOY basis. Operating profit for all the companies, except JSPL, witnessed a growth on a QOQ basis. Firm realisations coupled with a correction in input costs led to an expansion in OPM. Steel companies' operating profit grew by 17% QOQ as coking coal prices declined and companies managed to reduce their other expenditure. Steel companies' OPM in Q4 FY09 was impacted by high cost inventory it carried forward from Q3 FY09. Tata Steel's

EBIDTA/ton in Q1 FY10 rose to US$250/ton, whereas those of JSW and SAIL stood at US$140 and $112, respectively.

Firm base metal prices and a correction in crude oil linked input costs led to an increase in OPM for the non-ferrous space. After an awful performance in Q4 FY09, non-ferrous companies posted a 41.2% QOQ growth in operating profit. Hindalco's operating profit during the quarter almost doubled to Rs3.4bn on a QOQ basis. This was due to higher sales of value added products and better operating efficiencies.

HZL's performance for the second consecutive quarter was above the estimate, boosted by concentrate sales. NALCO's higher than expected operating performance was due to a write back of provision for employee cost under the Sixth Pay Commission.

In Q1 FY10 PAT growth doubles at 19.7% QOQ from 10.8% QOQ in Q4 FY09.PAT was higher than the expectations mainly due to the outperformance shown by the non-ferrous space. Steel sector numbers were 8.7% below than the estimate, whereas that of the non-ferrous space was 30% higher than estimate. Steel sector PAT was lower due to a sharp correction in JSW's other income and an increase in the interest expense of Tata Steel. Among the steel sector, SAIL was the only company, which reported PAT higher than the estimate. Among the non-ferrous space, except NALCO all the companies reported earnings higher than the estimate. Higher other income reported by Sterlite and HZL added on the outperformance of the companies.

Q1 FY10 Results

		(%) growth			Change (bps)			(%) growth	
(Rs mn)	Revenue	YOY	QOQ	OPM (%)	YOY	QOQ	PAT**	YOY	QOQ
JSPL*	15,761	-16.8	-10.5	35.4	-178	361	3,001	-25.4	-38.6
JSW*	39,168	6	17.7	19.1	-849	686	1,001	-82.8	218.8
SAIL	91,528	-15.5	-22	20.5	-511	521	13,261	-27.7	14.8
Tata Steel*	56,156	-8.7	-13.6	31	-1,813	874	7,898	-46.9	15.5
Steel	202,613	-10.3	-13.2	24.3	-902	626	25,161	-41.6	6.7
Hindalco *	38,905	-16.3	3.1	15.8	-462	747	3,376	-51.5	25.6
HZL	15,266	-8.8	18.4	51.2	-899	614	7,188	-15.2	30.3
NALCO	9,353	-37.6	-16.9	17.9	-3,331	941	1,265	-75.9	52.4
Sterlite	45,789	-20.6	3.9	22.3	-1,813	874	6,727	-41.6	72.2
Non-Ferrous	109,313	-19.6	3.2	23.7	-984	637	18,556	-42.4	43.4
Total	**311,926**	**-13.8**	**-8**	**24.1**	**-931**	**627**	**43,717**	**-41.9**	**19.7**

Source: Company, India Infoline Research, ***Pre-exceptional PAT; *Standalone; NA-negative base period numbers*

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