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INDIA INC SEES ONLY TEMPORARY RELIEF IN COMMODITY PRICES

Most expect prices to soften further before firming up after mid-year

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The weekend saw commodity prices tumble the most since August, amid expectations that they will soften further. But, that may have been only temporary relief for India Inc, as the general expectation is also that prices will firm up again by the second half of this year.

Andrew Holland, Chief Executive Officer, Ambit Private Capital, expects commodity prices to soften further before firming up around the second half, once the global recovery strengthens. Ravi Sud, Chief Financial Officer, Hero Honda, says companies will still see some pressure in the next few quarters, but it won't be of the same kind we saw in the second quarter of 2008-09, when commodity prices had peaked. "Ultimately, economics will prevail."

Hitesh Agrawal, head of research at Angel Broking, said expansion of margins for companies from here onwards will be difficult, though an odd one may gain from some inventory or an ongoing contract where prices are still favourable. "Prices have also moved up in anticipation of contracts which are due for renewal," he said.

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fall much from these levels. Jignesh Shah, head of investment strategy at ABN Amro Private Banking, said the big improvement in this time's third quarter results were a function of the base effect, having been well down in the same period last year. "Margins were driven by cost-cutting efforts and efficiency improvements. Both these factors will reduce year-on-year growth," he said.

On the recent slump in commodities prices, Holland says, "Liquidity was driving prices. With easy liquidity going away, there's no real support for commodities... Commodities have run too high; the fundamentals don't justify the rise. There's no real demand."

This agrees with what Sud suspects, that the run in commodity prices was largely spec-

ulative, and not backed by physical demand. "When the futures start moving up, physical prices also start moving up after a lag effect," he says.

Dipen Shah, senior vice-president (private client group), Kotak Securities, doesn't expect commodities to rise much in the near term, as the global economy is still to recover as expected and there are concerns in Europe.

Pressure still there

Hero Honda's raw material bill (as a percentage of operating expenses) has risen from 67.95 per cent in the first quarter to 68.4 per cent in Q2 to 68.55 per cent in Q3. This will continue in Q4, but good (25 per cent growth) volumes have enabled it offset rising input costs.

Other companies have not been so lucky. Hit by sugar prices which have doubled over last year, Pepsi and Coke have increased prices by 9-20 per cent across packs; Britannia Industries saw net profits tumble 37 per cent in the December quarter and MD Vinita Bali has indicated it may be forced to increase product prices by 4-8 per cent.

Smaller biscuit makers like Priyagold and Anmol are countering higher raw material costs by cutting retailers' margin, but they fear it will start impacting their sales. Milk prices have gone up, as the cost of cattlefeed like de-oiled rice bran cake, jowar, maize and molasses have gone up by around 30 per cent in the last year.

In many cases, companies have been able to raise prices. But, this has been able to only partly offset the increase in raw material prices. Take Apollo Tyres. In January, it raised prices by three per cent. But, in the past six months, its raw material costs have increased 15 per cent, and it could do with another raise of 8-9 per cent.

Vehicle makers, many of whom are Apollo's customers, provide a price increase with a lag when commodity prices go up but when these go down, they want to reduce prices almost immediately, explains Suman Sarkar, CFO, Apollo Tyres. Analysts expect Apollo's operating margins to come down by 200 basis points in Q4.