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■ Q3 RESULTS PREVIEW

TEPID PERFORMANCE TO CONTINUE

If in the last quarter investors were worried about contracting margins, now they are worried about slowing revenue growth

SANJAY KR SINGH

AS Q3FY09 RESULTS begin to trickle in, investors will watch them carefully for a feel of the corporate sector's state of health. The results will also determine how the stock markets fare this year: whether they get back on the road to recovery or continue to languish.

Most analysts are expecting a slowdown in revenue growth, a contraction in margins, and a negative growth in earnings growth (all year-on-year). (*See table for estimates by various securities companies.*) The exact estimates, of course, vary from one agency to another. This may be attributed to the difference in their coverage universe -- i.e., the stocks they track — and the difference in their outlook.

According to market experts, the impact of Q3 results, which investors expect will be poor, has already been factored into the prices. Says Amitabh Chakraborty, president (equity), Religare Capital Markets: "The worst results are expected from sectors such as auto (-39 per cent decline in PAT), oil and gas (-40 per cent), real estate (-37 per cent), and metals (-25 per cent). The price correction in these sectors is already in the range of 35-60 per cent. On the other hand, the three best-performing sectors like IT, Pharma and Banking have corrected much less at 16-24 per cent."

While the markets have already corrected sharply, one can't completely rule out a further decline. Says Hitesh Agrawal, head of research, Angel Broking: "Poorer-than-expected results could lead to further downward adjustment in earnings and consequently the stock price."

Meanwhile, investors' concerns have changed between the time when Q2 results were expected and now. Says Dipen Shah, head of research, Kotak Securities: "Earlier, investors were concerned about falling margins, but now their concern has shifted more towards how badly the economic slowdown will affect revenue growth."

Slowing revenue growth

As said, the major concern now is slowing revenue growth and how long this will last. "Much will depend on how the fiscal stimulus packages work out. If domestic spending from the government increases, we could see demand coming in. It will also depend on improvement in the global economic situation. Export growth has slowed down. Only when the global situation improves will export growth stabilise. When we see how things pan out over the next quarter on these two fronts, we will know how soon the slowdown in revenue growth will end," says Shah.

We expect the worst results from auto, oil and gas, real estate, and metals. Prices in these sectors have already corrected 35-60%

AMITABH CHAKRABORTY, President (equity), Religare Capital Markets

PAST PERFORMANCE

SENSEX COMPANIES	GROWTH RATE(%)		
	Q4FY08	Q1FY09	Q2FY09
Sales	26.9	30.6	26.2
EBITDA	28.0	25.0	12.0
PAT	30.0	17.2	10.6

*All figures are y-on-y

Shrinking EBITDA margin

Over the last two quarters, concern has centered around contracting margins. In Q3, too, EBITDA margin is likely to contract. "This is the result of high raw material costs during 2008, which companies were not able to pass on completely to consumers," says Shah.

Concern regarding EBITDA margin will, however, abate in future because of the sharp decline in commodity prices. Cost-cutting exercises initiated by companies will also begin to show up.

WHO IS EXPECTING WHAT IN Q3

ESTIMATES FROM KOTAK SECURITIES

Kotak universe (90 companies)	Growth Rate
Revenue growth	22.0%
PAT growth excluding banks + NBFCs	12.0%
PAT growth for all	5.5%
EBITDA margin (ex-banking)	-100 bps

(Kotak does not cover all Sensex companies and hence does not have Sensex related estimates)

ESTIMATES FROM RELIGARE CAPITAL

Estimates for Sensex companies	
Sales growth	4.0%
EBITDA growth	-2.0%
PAT growth	-4.0%
Religare universe (155 companies)	
Sales growth	-2.1%
EBITDA growth	-2.0%
PAT growth	-11.4%
EBITDA margin	-27 bps
PAT margin	-153 bps
Sensex EPS	Rs 884 for FY09; Rs 952 FY10

ESTIMATES FROM ANGEL BROKING

Sensex estimates	
Revenue growth	4.0%
EBITDA margin	-140 bps
Earnings growth	-3.0%
Sensex EPS	Rs 902 for FY09; Rs 969 for FY10

All estimates are y-on-y

And falling profit growth

Profit growth is also likely to decline. Says Agrawal: "Higher depreciation charges as corporates continue towards project completion, and higher interest charges, which are the result of high debt levels, are expected to curtail any significant improvement in profit growth." While interest rates moderated in Q3, they are expected to moderate even further in Q4. So again, high interest cost will not be a cause for concern in future.

Further, mark-to-market losses on foreign currency loans, and IT companies' mark-to-market losses on currency hedges, both of which are the result of the depreciation of the rupee, are also expected to impact bottomlines. Both these will lead to lower "other income" and in turn affect profit growth.

Finally, if you are an avid investor, pay close attention to the management commentary that accompanies the results. This could provide you with clarity about the likely course of corporate results over the next couple of quarters, and hence the likely direction of the stock markets during 2009. ♦

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Sectors expected to do well

FMCG
Strong performance this quarter due to inelastic demand, strong cash flows, and low leverage. Players passed on higher input costs to customers. Decline in input costs will raise margins in Q4.

BANKS
Cut in deposit rates will lower cost of funds, but the benefits will come with a lag, once old deposits mature. Drop in lending rates will lead to contraction in net interest income this quarter. Treasury gains expected to offset increasing NPAs.

IT
Depreciation of the rupee protected revenue growth this quarter. But global economic slowdown and disarray in financial services sector expected to take a toll.

PHARMA
Forex losses expected to hit pharma companies. Stick to companies with strong balance sheets (without FCCB conversion risk and low debt). Go with companies having free cash flow. Short term slowdown in CRAMs expected.

CAPITAL GOODS
Sales growth strong due to strong execution ability of players like BHEL and L&T. Margins under pressure due to high raw material costs in past. High interest cost to affect margins this quarter due to working-capital intensive nature. Companies supplying equipment to power sector to do well. Positive impact of falling prices to become evident from Q4. In future, economic slowdown could affect demand unless government spending revives demand.

Sectors expected to do poorly

AUTO
Economic slowdown resulted in lower demand, especially for commercial vehicles. High interest rates affected demand for both passenger and commercial vehicles. High raw material costs raised costs.

REALTY
Fall in demand due to high prices and high interest rates. Companies over-leveraged. Falling interest rates, price discounts and move towards lower-cost housing could revive demand.

MINING AND METALS
Slowdown in world economic growth leading to declining prices and volumes.

CEMENT
Slowdown in construction and real estate impacting demand. Supply outstripping demand because of recent capacity additions, hence unable to increase price. Higher costs of coal and power in past. Need to send cement to distant markets also leading to higher costs and affecting profitability.

MEDIA
Slowdown in advertising revenue affecting revenue. Margins affected by high operating costs. Advertising revenue could slow down further in future. Subscription revenue may increase due to increased penetration of distribution.