Daily Voice | Financial sector to see moderation in earnings, JM Financial's Vinay Jaising

Volume growth drive by retail India consumption and fall in commodity prices to lead to better margins should be the two key parameters to watch out for in Q1FY24.

SUNIL SHANKAR MATKAR | JUNE 30, 2023 / 08:33 AM IST

Vinay Jaising of JM Financial Services

Earnings for first quarter of FY24 will begin next month. "Volume growth driven by retail India consumption and fall in commodity prices to lead to better margins should be the two key parameters to watch out for," Vinay Jaising is the MD - Portfolio Management Services at JM Financial Services says in an interview to Moneycontrol.

Impact of El Nino could be largely showcased in Q2FY2024, he feels.

He says the financial sector which has grown by over 45 percent in FY23 will see moderation in earnings to 12-15 percent.

Vinay with over 27 years of experience in the Indian equity markets says he like banks, but not excited about the remaining part of the financial service businesses.

Q: Do you see less possibility of recession in the developed markets?

The US 2-year & 10-year rates are close to peak backwardation with the 2-year being at 4.7 percent and 10-year at 3.7 percent, this difference has widened from 50 bps a month ago to ~100 bps. The raise of debt ceiling has not softened it. (Source: Bloomberg)

In the recent FOMC meeting, the Staff projections suggested a possible 50 bps hike by the end of the year to curtail the core inflation, considering resilient growth. US Manufacturing PMI in May 23 at 54.3 has inched up from 50.2. Services PMI too has increased to 54.9 versus 53.6. US has tightened the liquidity (QT) by almost $500 billion YTD to $21.1 trillion and its debt at almost $32 trillion is at all-time high. This means a higher possibility of recession and US being forced to slow down the economy further by raising rates. (Source: Bloomberg)

Q: Do you think the building material is the best part to play in the real estate game?

The building material space has tiles, cement, pipes, paints and other building consumables; all of which gain from lower coal prices, oil prices and other commodities. This implies their margin could improve in the quarters to come as far as the pricing power is being marinated by them, which we have seen so far.

The second advantage the building material space has is it caters to replacement market which the real estate industry does not cater to.

Q: Are you excited about IT and financial services businesses?

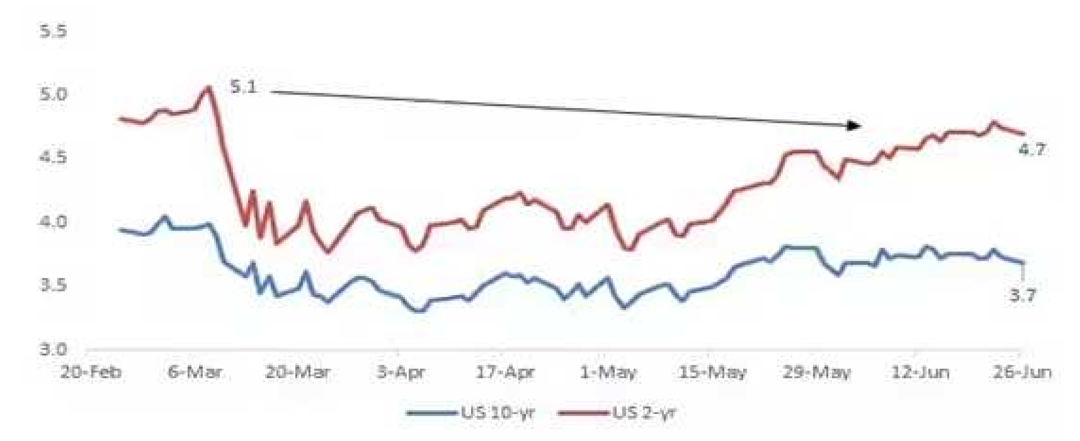
Due to our conservative stances on US Economic growth we are concerned on global facing sectors. We are also witnessing a falling current account deficit (CAD) due to lower commodity prices which should strengthens the rupee. These two parameters make us underweight the IT sector despite attractive valuations in certain pockets.

The financial sector has in the last 3 years post COVID increased its contribution in earnings to indices to 33 percent. We are bullish on the loan book growth which has been a steady 15 percent plus in the last 15 months as against 11-12 percent historically. However, we believe NIMs (net interest margin) seem to have peaked out in the near to medium term.

Finance companies will also largely normalize their earnings from FY2024 hence on a YoY basis Loan book growth should largely equate to net profit growth. Historically the growth in net profit for financial sector FY20-23 was 37 percent CAGR as against our estimates of 12-15 percent CAGR FY23-25.

Hence though we like banks we are not excited about the remaining part of the financial service businesses. We think the profit contribution for Index is changing from incrementally financial sector to capex relative sectors like Auto, Industrials, Cement and Telecom. (Source: JM View)

US 2-year 10-year moved up in the last month



Source: Bloomberg

Q: Do you think the macro positives are fully priced in in the market? What are the next triggers for equity markets?

India's macro factors are going from strength to strength. Firstly, we are not seeing signs of recession – the 2-year and 10-year rate are at 7 percent and 7.1 percent a contango of 10 bps and even the earnings cycle for India Inc. seems to be reviving. The Indian GDP is growth at almost 4x the rest of the world and adding 15-20 percent of the world's incremental GDP as against having a market share of ~3.5 percent of the world GDP.

Our PMI numbers are in expansion mode and increasing; inflation levels have gone to a comfort zone level of almost 4 percent and CAD is falling helping our forex and our currency. Our capex cycle is starting and corporate earnings is robust. This is exactly the opposite of what is happening in the rest of the world. (Source: Bloomberg)

The FI ownership at ~19 percent lower than its peak of 21 percent making it technically look better as well and the Make in India story is also throwing newer business models for investors to study and invest. (Source: Bloomberg)

The key trigger or more important question which we will need to wait and watch really is "Can India decouple from the rest of the World?

- Manufacturing PMI: May 23 – 58.7 vs Apr 23 – 57.2
- Composite PMI: May 23 – 61.6 vs Apr 23 – 61.6
- Services PMI: May 23 – 61.2 vs Apr 23 – 62.0
- CPI YoY: May 23 – 4.3% vs Apr 23 – 4.7%
- WPI YoY: May 23 – -3.48% vs Apr 23 – -0.92%
- Trade Deficit: May 23 – $ 22.1bn vs Apr 23 – $15.2bn
- Forex Reserves : $ 594 Bn
- GDP: Q1 2023 6.1% vs 4.4% Q4 2022
- GST May 23 collection up 12% y/y at Rs1.57 Trn
- RBI repo rate – Status Quo at 6.5%
- IIP YoY: Apr 23 – 4.2% vs Mar 23 – 1.1%

(Source: Bloomberg)

Q: Key factors to watch out for in Q1FY24 earnings that will start next month?

Volume growth drive by retail India consumption and fall in commodity prices to lead to better margins should be the two key parameters to watch out for. Impact of El Nino could be largely showcased in Q2F2024.

Also the financial sector which has grown by over 45 percent in FY23 will see moderation in earnings to 12-15 percent. (Source: JM View)

Sector	1 Line Comment
Financial Services	Loan growth to be stable, Normalization of NIMs to begin due to the cost of fund transmission. Credit costs will continue to be in check.
Energy	Weaker crude oil and gas prices will lead to disappoint earnings for Oil and Gas cos, higher marketing margins should lead to bumper earnings for OMCs
Consumption	FMCG: Volume recovery should continue as companies pass on the benefit of lower RM costs to consumers. F&B companies are benefiting from resilient growth which should lead to 10% y-o-y revenue growth (and 15%+ q-o-q growth) with continued margin improvement on lower commodity prices
Technology	Deceleration in $ revenue growth and pressure on margins due to increasing competitive intensity
Automobile	Volume growth and higher average selling price to drive revenue growth. Lower commodity prices and operating leverage to drive margin expansion.
Healthcare	Domestic to remain steady, US generic expected to improve marginally with price erosion easing (also base effect) and new launches
Industrials	Order inflow and execution momentum is expected to continue in the coming quarter. Key things to watch: Margins sustenance post easing of raw material prices and Commentary on tendering/ordering in rest of FY24, which will help ascertain the opportunity pipeline.
Metals	Weak steel prices to hurt margins in 1QFY24 vs 4QFY23
Agro & Specialty Chemical	1Q on Agro is higher which is seasonal, Specialty impacted on higher channel inventory and lower demand in the interim
Cement	Sequentially margins are expected to improve on back of lower Coal/pet coke prices
Telecom	A stable quarter with revenue growth and EBITDA driven by volume growth; Lower capex should lead to strong FCF

Source: JM Views