

Economy

Q3FY21 corporate performance points at robust manufacturing growth

The CSO is scheduled to release GDP numbers for Q3FY21 and Second Advance Estimates for FY21 on 26 Feb 2021. Ahead of the data release, we analyse 1,722 manufacturing companies' quarterly results for Q3FY21 to assess how the sector has performed during the quarter.

Our analysis shows the following:

- ▶ **Manufacturing companies posted flat year-on-year income growth in Q3FY21:** Total income of our sample companies recorded flat growth in Q3FY21 in year-on-year terms. This comes on the back of -39% and -10% year-on-year growth in total income in Q1 and Q2FY21 respectively. This indicates that manufacturing sector's performance is normalising after recording sharp contraction during H1FY21 which marked the worst of Covid-19 related lockdowns and restrictions.
- ▶ **Petroleum sector records large decline in total income:** Within manufacturing, petroleum sector's total income grew -10% year-on-year in Q3FY21, reflecting falling international crude oil prices. Food manufacturing companies also recorded modest decline in total income despite rising net sales. On the other hand, 'metals' and 'machinery and equipment' manufacturing companies recorded 15% and 12% year-on-year increase in total income, partly due to low base.
- ▶ **While expenditure declines 4% in Q3FY21:** Manufacturing companies' expenditure grew -4% year-on-year in Q3FY21 on top of a -39% and -14% growth in Q1 and Q2FY21 respectively. Again, petroleum manufacturing companies' expenditure declined the most, recording -13% growth in Q3FY21 due to lower international crude oil prices. All other components of manufacturing viz. food, textiles, metals and machinery & equipment recorded increasing expenditure due to rising input prices and wages. There was also evidence of large inventory drawdowns in many sectors. As a result, PBT of our sample companies surged 48% year-on-year in Q3FY21.
- ▶ **GVA-equivalent records robust growth; indicates strong manufacturing growth in Q3FY21:** Our calculation shows that GVA equivalent of manufacturing companies (i.e. wages + depreciation + interest + PBT) grew a robust 17% year-on-year in Q3FY21, after a -29% and 9% growth in Q1 and Q2FY21 respectively. Hence, we expect manufacturing sector to record healthy growth in the upcoming Q3FY21 GDP data release.
- ▶ **Rising oil prices likely to boost manufacturing performance in Q4FY21:** Continued normalisation in economic activity and sustained pick-up in demand are likely to help manufacturing sector perform well in Q4FY21 as well. Moreover, oil prices have started increasing. Lower oil prices played a major drag on manufacturing sector performance in Q3FY21. With rising oil prices, we expect this trend to reverse. Hence, rising oil prices are likely to provide a significant tailwind to manufacturing growth in Q4FY21.

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Petroleum accounts for 33% of manufacturing sector

A quick look at the composition of manufacturing sector in India shows that 'petroleum, rubber and chemicals' is the biggest component, accounting for one-third of manufacturing GVA. In Table 1, we give detailed composition of manufacturing sector:

Table 1: Composition of manufacturing sector, FY19 (current prices)

Component	% share in manufacturing GVA
Food products, beverages & tobacco <i>(Meat, fish, dairy, beverages, tobacco, grain mill)</i>	11%
Textiles, apparel & leather products <i>(Textiles, wearing apparel, leather)</i>	13%
Metal & metal products <i>(Iron & steel, basic precious, ferrous and non-ferrous metals, fabricated metal products)</i>	13%
Machinery & equipment <i>(Computer, electronic, optical and transport equipment)</i>	23%
Coke, petroleum, rubber, chemical and related products <i>(Coke & refined petroleum, chemicals, pharmaceuticals, rubber & plastics)</i>	33%
Others <i>(Wood, paper, furniture, printing)</i>	8%

Source: Mospi, I-Sec Research

We analysed Q3FY21 corporate performance of 1,722 manufacturing companies

Companies started recording Q3 corporate performance results from the first week of Feb 2021. To gauge how the manufacturing sector performed during the third quarter, we analysed corporate performance of 1,722 manufacturing companies. Below, we give details of our sample:

Table 2: Details of our sample companies

Sector	No of companies	Activities	Largest companies
Food	194	Food processing, cigarettes, breweries, coffee, tea, sugar, dairy and vanaspati	ITC, Hindustan Unilever, Nestle India, Godrej Consumer, Britannia Industries
Textiles	252	Textiles, leather	Grasim Industries, SRF, Welspun India, Vardhman Textiles, Trident
Metals	205	Steel, Aluminium, Forgings, Ferro Alloys, Zinc	Coal India, Tata Steel, Vedanta, Hindalco Industries, SAIL
Machinery & Equipment	388	Auto & auto ancillaries, computers, white goods, electric equipment, machine tools, telecom equipment	Tata Motors, Motherson Sumi, Mahindra & Mahindra, Maruti Suzuki, Bajaj Auto
Petroleum, Chemicals and Pharmaceuticals	425	Petrochemicals, pharmaceuticals, chemicals, plastics	Reliance Industries, ONGC, Indian Oil, BPCL, Aurobindo Pharma
Other manufacturing	258	Office equipment, paints, FMCG, glass, paper, packaging, printing & stationary	Asian Paints, Uflex, Berger Paints, Polyplex Corporation, Kansai Nerolac

Source: CapitaLine, I-Sec Research

As Table 2 shows, most of the companies in our sample are from 'petroleum, chemicals and pharmaceuticals' sector followed by machinery & equipment and textiles. In revenue terms, the shares of these components in our sample broadly reflect their shares in total manufacturing GVA.

Manufacturing companies record flat income growth in Q3FY21

During H1FY21, manufacturing companies' income fell sharply due to Covid-19 related lockdowns and movement restrictions. Our sample companies' total income contracted 39% and 10% in Q1 and Q2FY21 respectively. However, as the economy started gradually unlocking, manufacturing companies' financial performance started improving. In Q3FY21, our sample companies' total income recorded flat growth in year-on-year terms.

However, headline income growth hides interesting internals. Within manufacturing, petroleum and food manufacturing companies recorded declining income in Q3FY21 while rest of the components recorded robust growth. The 425 'petroleum, chemicals and pharmaceuticals' companies in our sample recorded -10% year-on-year growth in Q3FY21, after recording -17% and -39% growth in Q2 and Q1 respectively. In fact, petroleum is one of the only two sectors to record continued contraction in income growth even in Q3. This reflects declining global crude oil prices. International oil prices declined 55% year-on-year in Q1, 30% in Q2 and 29% in Q3FY21. In Chart A, we plot growth rates of international oil prices (in rupees) and petroleum manufacturing companies' total income since Mar 2012:

Chart A: % change in oil prices and petro mfg total income



Source: Bloomberg, CapitalLine, I-Sec Research

As Chart A shows, there is a high correlation between international oil prices and petroleum manufacturing companies' income. Hence, unsurprisingly in Q3FY21 petroleum manufacturing companies' total income fell in line with global oil prices.

Apart from petroleum, the only other component of manufacturing to record negative total income growth in Q3FY21 was food. Total income of food manufacturing companies in our sample declined 2% in Q3FY21 from positive growth of 3% in Q2 and -7% in Q1FY21. Interestingly, gross and net sales of food manufacturing companies in Q3FY21 increased 8% and 6% respectively. However, declining 'other income' pulled down total income growth into the negative territory. If we dig deeper into the financial records, we find that the decline in 'other income' is an anomaly. Only one large edible oil company in the 'food manufacturing' category had recorded an exceptional gain of ~Rs 7,400cr in Q3FY20. This exceptional gain in the base quarter pulled down 'other income' growth in Q3FY21 leading to the decline in headline total income growth for food manufacturing component. However, adjusting for this anomaly, total income growth for food manufacturing component stands at 5.4%.

We had pointed in our earlier research that declining input food prices (i.e. WPI food inflation) and rising manufactured food prices (i.e. WPI manufactured food inflation) bodes well for food manufacturing companies' profit margins. Q3FY21 data proves us right: although headline PBIDT growth of food manufacturing companies came in at -22% in Q3FY21, adjusting for the 'exceptional gain' in other income of the edible oil company, PBIDT growth of food manufacturing companies comes in at multi-quarter high of 13% year-on-year.

Other components of manufacturing such as metals (15%), machinery (12%), textiles (6%), and other manufacturing (1%) recorded robust income growth during Q3FY21. In case of metals and 'machinery & equipment', strong growth in Q3FY21 seems to be partly due to low base. Sales of both these components had recorded double-digit contraction in the Dec 2019 quarter and the current pick-up could partly reflect mere normalisation. However, there are also indications of this momentum sustaining into the current quarter.

Table 3: Gross Sales of manufacturing companies, % year-on-year

Component	Q3FY20	Q4FY20	Q1FY21	Q2FY21	Q3FY21
Food	8%	-2%	-12%	7%	8%
Textiles	-2%	-16%	-50%	-11%	6%
Metals	-10%	-16%	-32%	6%	16%
Machinery & Equipment	-9%	-21%	-51%	-7%	12%
Petroleum	-3%	-3%	-36%	-11%	-4%
Others	0%	-7%	-40%	-11%	0%
Total manufacturing	-4%	-10%	-38%	-7%	4%

Source: CapitaLine, I-Sec Research

Table 4: Total Income of manufacturing companies, % year-on-year

Component	Q3FY20	Q4FY20	Q1FY21	Q2FY21	Q3FY21
Food	17%	-1%	-7%	3%	-2%
Textiles	-2%	-21%	-49%	-3%	6%
Metals	-10%	-15%	-31%	6%	15%
Machinery & Equipment	-9%	-21%	-50%	-7%	12%
Petroleum	-5%	-3%	-39%	-17%	-10%
Others	1%	-7%	-40%	-11%	1%
Total manufacturing	-5%	-10%	-39%	-10%	0%

Source: CapitaLine, I-Sec Research

Manufacturing companies cut expenditure by 4% in Q3FY21 led by cheaper input prices

In Q2FY21, manufacturing companies in our sample cut expenditure by 14% year-on-year. Sharper decline in expenditure compared to income led to the sector as a whole recording robust performance in the quarter. This trend continued in Q3FY21 when manufacturing companies in our sample cut expenditure by 4% compared to flat income growth.

Again, the headline expenditure numbers hide internals. Out of the six manufacturing components, only two viz. petroleum and 'other manufacturing' (paints, printing, paper, wood, furniture and miscellaneous manufacturing) recorded declining expenditure in Q3FY21. However, given the high collective weightage of these components in manufacturing sector, they pulled down headline expenditure growth into the red.

Petroleum sector recorded 13% decline in total expenditure, mainly aided by lower international oil prices. This is reflected in its lower 'raw material' and 'purchase of finished goods' costs. All other components recorded significant uptick in input prices, a

fact corroborated by rising wholesale price inflation. Metals sector recorded 6% increase in 'raw material costs' and 102% increase in 'purchase of finished goods' costs, reflecting the sharp uptick in base metals prices in the country in recent months.

In an encouraging sign, almost all components of manufacturing recorded rising employee costs in Q3FY21. While manufacturing sector as a whole recorded 5% year-on-year increase in wage costs, the rise was sharper in some components such as petroleum (10%), food manufacturing (8%) and metals (6%). Textile was the only major component to record declining wage costs in Q3FY21.

There are also signs of sharp inventory drawdown in some sectors. Petroleum, metals and machinery & equipment manufacturing recorded large inventory drawdowns in Q3FY21 after recording inventory build-up in the preceding quarter.

Table 5: Total Expenditure of manufacturing companies, % year-on-year

Component	Q3FY20	Q4FY20	Q1FY21	Q2FY21	Q3FY21
Food	5%	1%	-6%	5%	4%
Textiles	-13%	-12%	-31%	-11%	0%
Metals	-13%	-6%	-27%	1%	4%
Machinery & Equipment	-18%	-17%	-47%	-8%	9%
Petroleum	2%	8%	-43%	-22%	-13%
Others	-2%	-7%	-38%	-14%	-3%
Total manufacturing	-6%	-2%	-39%	-14%	-4%

Source: CapitaLine, I-Sec Research

Table 6: Raw material costs of manufacturing companies, % year-on-year

Component	Q3FY20	Q4FY20	Q1FY21	Q2FY21	Q3FY21
Food	9%	-5%	-6%	5%	3%
Textiles	-10%	-12%	-62%	-22%	1%
Metals	-15%	-16%	-40%	-7%	6%
Machinery & Equipment	-18%	-21%	-65%	-5%	20%
Petroleum	-12%	-4%	-53%	-33%	-22%
Others	-7%	-9%	-44%	-14%	3%
Total manufacturing	-12%	-11%	-51%	-19%	-4%

Source: CapitaLine, I-Sec Research

Table 7: Purchase of finished goods costs of manufacturing companies, % year-on-year

Component	Q3FY20	Q4FY20	Q1FY21	Q2FY21	Q3FY21
Food	-7%	13%	0%	21%	31%
Textiles	-14%	-10%	-61%	-37%	-12%
Metals	-55%	-19%	-15%	38%	102%
Machinery & Equipment	-7%	14%	-56%	-5%	16%
Petroleum	3%	5%	-53%	-14%	-2%
Others	1%	1%	-58%	-30%	-2%
Total manufacturing	0%	5%	-51%	-12%	2%

Source: CapitaLine, I-Sec Research

Table 8: Employee expenses of manufacturing companies, % year-on-year

Component	Q3FY20	Q4FY20	Q1FY21	Q2FY21	Q3FY21
Food	6%	1%	3%	7%	8%
Textiles	5%	2%	-25%	-16%	-5%
Metals	0%	-1%	-4%	-2%	6%
Machinery & Equipment	-3%	-1%	-19%	-8%	1%
Petroleum	7%	5%	1%	10%	10%
Others	9%	6%	-9%	-7%	-1%
Total manufacturing	2%	1%	-9%	-1%	5%

Source: CapitaLine, I-Sec Research

Manufacturing sector's 'GVA-equivalent' posts 17% growth in Q3FY21

Manufacturing sector's GVA-equivalent i.e. wages + interest + depreciation + PBT posted robust growth during Q3FY21. The GVA-equivalent shares a strong correlation with manufacturing GVA and is a leading indicator of the sector's quarterly performance. In many cases, it is a better predictor of manufacturing sector's performance than IIP since the latter captures *volume of production* while the former captures *value of production*.

In Table 9, we give our calculation of manufacturing sector's GVA equivalent:

Table 9: Manufacturing sector's GVA equivalent

Component	Q3FY20	Q4FY20	Q1FY21	Q2FY21	Q3FY21
Food	40%	-6%	-8%	-2%	-16%
Textiles	3%	-38%	-104%	22%	22%
Metals	-17%	-37%	-35%	18%	45%
Machinery & Equipment	47%	-31%	-47%	-2%	18%
Petroleum	7%	-58%	-8%	14%	12%
Others	9%	-2%	-29%	0%	11%
Total manufacturing	10%	-40%	-29%	9%	17%

Source: CapitaLine, I-Sec Research

Healthy growth in manufacturing sector's GVA-equivalent in Q3FY21 bodes well for the sector's overall performance during the quarter. We expect manufacturing sector to record strong growth in Q3FY21.

Rising oil prices likely to boost manufacturing performance in Q4FY21

Continued normalisation in economic activity and sustained pick-up in demand are likely to help manufacturing sector perform well in Q4FY21 as well. Moreover, oil prices have started increasing. During Jan-Feb 2021, oil prices averaged \$57.8/barrel or Rs 4213/barrel. Although they are still 1-2% lower in year-on-year terms, we expect full quarter average to be higher than Q4FY20 average. As mentioned earlier, lower oil prices played a major drag on manufacturing sector performance in Q3FY21. With rising oil prices, we expect this trend to reverse. Hence, rising oil prices are likely to provide a significant tailwind to manufacturing growth in Q4FY21.

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