BOBCAPS
TRUST | INNOVATION | EXCELLENCE

FIRST LIGHT

13 April 2020

RESEARCH

BOB Economics Research | Monthly Chartbook

A few more weeks before visibility improves

BOB Economics Research | IIP

Industrial growth rebounds in Feb, will slip in March

IT Services

ISG Index: Covid-19 to forestall deal activity in Q2CY20

TOP PICKS

LARGE-CAP IDEAS

Company	Rating	Target
Bajaj Finance	Buy	3,000
Cipla	Buy	570
Eicher Motors	Buy	25,000
Petronet LNG	Buy	330
Reliance Industries	Buy	1,500

MID-CAP IDEAS

Company	Rating	Target
Alkem Labs	Buy	2,870
Greenply Industries	Buy	205
Laurus Labs	Buy	510
Transport Corp	Buy	355
Ashok Leyland	Sell	64

Source: BOBCAPS Research

DAILY MACRO INDICATORS

Indicator	Current	2D (%)	1M (%)	12M (%)
US 10Y yield (%)	0.77	6bps	1bps	(169bps)
India 10Y yield (%)	6.44	3bps	26bps	(93bps)
USD/INR	76.31	(0.9)	(3.4)	(10.4)
Brent Crude (US$/bbl)	32.84	3.0	(27.5)	(54.2)
Dow	23,434	3.4	(9.4)	(10.4)
Shanghai	2,815	(0.2)	(7.2)	(13.2)
Sensex	29,894	(0.6)	(20.4)	(22.5)
India FII (US$ mn)	**7 Apr**	**MTD**	**CYTD**	**FYTD**
FII-D	(151.4)	(312.3)	(10,071.8)	(312.3)
FII-E	134.1	(162.4)	(6,765.4)	(162.4)

Source: Bank of Baroda Economics Research

BOBCAPS Research
research@bobcaps.in

SUMMARY

India Economics: Monthly Chartbook

With 70% of economy in a lockdown, we see sharp reduction in domestic consumption and investment demand. With only essential goods and services functioning, more than half of consumption demand is impacted. Exports too will see a sharp deceleration. Notably, most states are likely to extend the lockdown by another two weeks. Thus we see economic activity opening up gradually. This implies government revenues will also be lower than FY21BE. This has been the case for FY20RE as well. Bond markets are now pricing-in extra issuances in FY21 because of which spread of 10Y Gsec and SDLs over repo rate has increased to ~210bps and ~360bps. Yields will come down only when visibility on the economy improves which is likely to take a few more weeks.

Click here for the full report.

India Economics: IIP

Industrial growth rose to a 7-month high of 4.5% in Feb'20 from 2.1% in Jan'20. The acceleration was led by mining at 10% and electricity at 8.1%. Manufacturing output was also higher at 3.2%. Consumption and investment were weak. Next few readings will see a large decline as impact of lockdown will be visible. Barring pharma and a few essential goods, most capacity as of now is lying idle. However, manufacturing sector is likely to rebound faster as shop floors adjust to social distancing. Services sector will take longer.

Click here for the full report.

IT Services

As per ISG, Q1CY20 managed services deals – a more relevant indicator for Indian IT services players – were on track for 9-10% YoY growth pre-Covid-19. But deal momentum fizzled out in March, closing Q1CY20 at 2.2% YoY growth. Q2CY20 is likely to register historic decline in deal activity (ISG expects a record 17% QoQ (and 21% YoY) drop in managed services deal activity). Amid Covid-19 led challenges, we expect tier-I companies to be relatively resilient – TCS and HCL Tech are our preferred picks in this category. With the March quarter results relatively shielded from the lockdown impact, we recommend realigning portfolios in favour of tier-I and trimming exposure to midcap names.

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A few more weeks before visibility improves

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Discretionary demand to fall: With only essential goods (grocery, food and medicines) and services (government services, healthcare, telecom) free from nationwide lockdown, consumption demand will see a large drop. We estimate over half of consumption demand which is discretionary in nature will be impacted. Rural demand too will suffer as remittances from urban to rural will see a large dip. At the same time, with agri sector continuing to remain functional demand from this segment will sustain.

Growing fiscal concerns: Prelimnary data for Mar'20 indicates that centre's direct tax collections have fallen short by Rs 1.4tn from target of Rs 11.7tn. In addition, disinvestment receipts till Feb'20 (FYTD basis) at Rs 352bn will also fall short of target of Rs 650bn. Indirect tax collections on the other hand which have held up till Feb'20 at Rs 8.7tn vs RE of Rs 9.9tn, will see a sharp dip in the coming months. Hence, we expect fiscal deficit will be far higher than FY21BE of 3.5%. The same holds true for states which will have to sustain spending while revenues will be far lower.

Yields have increased: While 10Y yield did fall by 23bps in Mar'20, the same has increased by 30bps this month on the back of concerns over excess issuances by the Centre as revenues are likely to see a large drop. Centre has already announced an economic package of Rs 1.7tn and more will follow. States too will have to borrow more as transfers from Centre and their own revenue sources dry up. The spread between 10Y Gsec and SDLs has increased to ~120bps and that between 10Y Gsec and repo rate is now at ~210bps. Once uncertainty and volatility eases, we do expect yields to come down.

Pressure on INR for now: INR depreciated to a record low at 76.28/$ in Mar'20. FII outflows touched a high of US$ 16.6bn in Mar'20 and FX reserves fell for the first time in 6-months. While INR has depreciated to a fresh historic low at 76.31/$ in Apr'20 and continues to remain above the 76/$ mark, FII outflows are receding. In addition, lower oil prices are a big positive for INR. Thus we do see INR appreciating once volatility recedes.

IIP

09 April 2020

Industrial growth rebounds in Feb, will slip in March

Industrial growth rose to a 7-month high of 4.5% in Feb'20 from 2.1% in Jan'20. The acceleration was led by mining at 10% and electricity at 8.1%. Manufacturing output was also higher at 3.2%. Consumption and investment were weak. Next few readings will see a large decline as impact of lockdown will be visible. Barring pharma and a few essential goods, most capacity as of now is lying idle. However, manufacturing sector is likely to rebound faster as shop floors adjust to social distancing. Services sector will take longer.

Sameer Narang
Jahnavi | Dipanwita Mazumdar
chief.economist@bankofbaroda.com

IIP growth accelerates: Industrial output rose by 4.5% in Feb'20 to its highest in 7-months, from 2.1% in Jan'20. The acceleration was led by mining which expanded by 10% from 4.4% in Jan'20, followed by electricity at 8.1% from 3.1% in Jan'20. Manufacturing output also improved to an increase of 3.2% from 1.6% in Jan'20. Within manufacturing, basic metals (increased by 18%), chemicals products (up by 8%) and other non- metallic products (up by 8%) were the biggest contributors to growth. In Q4FY20 so far (Jan-Feb'20), industrial growth has improved to 0.9% versus (-) 1.6% in Q3. The revival is driven by all three components: electricity output at 1.5% versus decline of 6% in Q3, mining at 1.9% versus drop of 0.1% in Q3 and manufacturing at 0.6% versus dip of 1.3% in Q3.

Intermediate and primary goods supported growth: Intermediate goods output rose by 22.4% in Feb'20 versus 15.8% in Jan'20 within which MS slabs, fragrances/oil essentials were the biggest contributor to growth. Primary goods output also rose by 7.4% versus 1.8% in Jan'20 led by electricity and refinery products. Infrastructure & construction goods rose by 0.1% versus a decline of 2.2% in Jan'20. FMCG output remained flat compared to a contraction of 0.3% in Jan'20. Capital and consumer durables both declined sharply by 9.7% in Feb'20 compared with a fall of 4.3% in Jan'20 and 6.4% versus a decline of 4% in Jan'20 respectively.

Industrial output to decline: With most manufacturing facilities apart from essential goods in the country under lockdown to tackle the COVID-19 outbreak, industrial production will be severely impacted in the coming days and weeks. Resumption will be gradual and normalcy will be returned in a phased manner. Given the above backdrop, we believe industrial output will see a decline in Q1FY21.

KEY HIGHLIGHTS

- IIP rose to 4.5% in Feb'20 versus 2.1% in Jan'20.
- Led by mining, electricity, primary and intermediate goods.
- COVID-19 to impact growth lower in near term.

IT SERVICES

09 April 2020

ISG Index: Covid-19 to forestall deal activity in Q2CY20

Ruchi Burde
research@bobcaps.in

Deal momentum plummets in March: Data from the ISG Index, which measures global commercial outsourcing contracts with annual contract value (ACV) of US$ 5mn or more, shows Q1CY20 ACV increased by 6.9% YoY to US$ 14.8bn (+6.7% YoY in Q4CY19), supported by a growth rebound in America. America ACV rose 8.7% YoY (–3.1% in Q4CY19), backed by broad-based growth across managed services and as-a-service deals. Q4 and Q1 America trends read together suggest deal activity surged in the BFSI and healthcare & pharma verticals, while slackening in retail/CPG and manufacturing.

As per ISG, Q1CY20 managed services deals – a more relevant indicator for Indian IT services players – were on track for 9-10% YoY growth pre-Covid-19. But deal momentum fizzled out in March, closing Q1CY20 at 2.2% YoY growth.

Q2CY20 to register historic decline in deal activity: ISG expects a record 17% QoQ (and 21% YoY) drop in managed services deal activity for Q2CY20. The travel/transport/hospitality and retail/CPG verticals are likely to bear the brunt (–45% and –28% respectively), while telecom/media and healthcare/pharma should see the least impact (–3% and –8% respectively). ISG has slashed its CY20 expectations to a 7% decline in managed services deals (vs. growth of 3.2% earlier) and 12% growth for as-a-service deals (vs. 23.5% earlier).

Other call highlights: (1) About 60% of clients are demanding concessions, discounts (25-30%) and relaxed payment terms to ease short-term business disruptions. Lower productivity (~80% of normal) will exacerbate short-term challenges for IT vendors. (2) Roughly 60% of clients are evaluating a 15-25% cut in discretionary technology spends, which accounts for ~30% of the global outsourcing spend. A fifth of deals in the pipeline are also likely to be delayed.

Our view: We advocate that the ISG Index be taken with a pinch of salt considering its frequent revisions to base data. Nonetheless, we expect protracted Covid-19-led challenges for Indian IT services players to dent FY21 growth and profit momentum. In such a scenario, tier-I companies should be relatively resilient – TCS and HCL Tech are our preferred picks in this category. With the March quarter results relatively shielded from the lockdown impact, we recommend realigning portfolios in favour of tier-I and trimming exposure to midcap names.

RECOMMENDATION SNAPSHOT

Ticker	Rating
TCS IN	ADD
INFO IN	ADD
WPRO IN	SELL
HCLT IN	BUY
TECHM IN	REDUCE
LTI IN	BUY
MPHL IN	ADD
MTCL IN	SELL
HEXW IN	BUY
PSYS IN	REDUCE
NITEC IN	SELL
ECLX IN	SELL

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

ADD – Expected return from >+5% to +15%

REDUCE – Expected return from -5% to +5%

SELL – Expected return <-5%

Note: Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

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