FIRST LIGHT

16 October 2019

RESEARCH

Wipro | Target: Rs 240 | −1% | REDUCE

Puzzling margin beat; unlikely to hold up

BOB Economics Research | Trade

Trade deficit narrows as imports shrink

Logistics | Monthly Tracker

Demand climate deteriorates further

TOP PICKS

LARGE-CAP IDEAS

Company	Rating	Target
Cipla	Buy	555
GAIL	Buy	200
HPCL	Buy	400
ONGC	Buy	200
TCS	Add	2,230

MID-CAP IDEAS

Company	Rating	Target
Alkem Labs	Buy	2,230
Future Supply	Buy	730
Greenply Industries	Buy	200
Laurus Labs	Buy	480
PNC Infratech	Buy	250

Source: BOBCAPS Research

DAILY MACRO INDICATORS

Indicator	Current	2D (%)	1M (%)	12M (%)
US 10Y yield (%)	1.73	0bps	(17bps)	(143bps)
India 10Y yield (%)*	6.68	(5bps)	4bps	(124bps)
USD/INR	71.23	(0.3)	(0.4)	3.5
Brent Crude (US$/bbl)	59.35	(1.9)	(1.4)	(26.5)
Dow	26,787	(0.1)	(1.6)	6.1
Shanghai	3,008	1.2	(0.8)	17.1
Sensex	38,214	0.2	2.2	9.6
India FII (US$ mn)	**11 Oct**	**MTD**	**CYTD**	**FYTD**
FII-D	169.0	38.0	4,011.4	3,466.8
FII-E	(80.0)	(735.9)	7,424.8	579.6

Source: Bank of Baroda Economics Research | *7.26% GS 2029

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SUMMARY

Wipro

Wipro (WPRO) reported in-line revenue growth of 1.1% QoQ CC, but a surprising beat on operating margins (18.1%, +10bps QoQ vs. −60bps est.) that materialised despite the impact of compensation revision. As per management, cost credits/ reversals shored up margins and are unlikely to accrue going ahead. Q3 revenue growth guidance at 0.8-2.8% was better than expected. We raise FY20/FY21 EPS by 3% each and roll over to a Sep'20 TP of Rs 240 (vs. Rs 230); post the recent stock correction, we up our rating a notch to REDUCE (vs. SELL).

Click here **for the full report.**

India Economics: Trade

India's trade deficit in Sep'19 reduced to US$ 10.9bn versus US$ 13.5bn in Aug'19. Exports fell again, by (-) 6.6% led by oil and gems & jewellery. Imports too contracted further. Despite onset of festive season, gold imports fell by (-) 50.8% due to higher prices. Non-oil-non-gold imports fell by (-) 8.9% on the back of current domestic slowdown. Given muted global and domestic growth backdrop, we expect trade deficit to ease in FY20 and thus support INR. Higher oil prices and Yuan depreciation remain key risks to our INR view.

Click here **for the full report.**

Logistics: Monthly Tracker

High frequency indicators, a harbinger of the logistics industry's performance, worsened in Sep'19, marking the end of a sedate Q2FY20. Container rail reported a second month of volume decline (–2% YoY), whereas container traffic at major ports slumped 4% YoY, the lowest since Feb'17. EXIM trade, too, continued to plunge (–11% YoY in Sep'19). The sluggish demand climate has taken a toll on CCRI's business (provisional volume down 2% YoY in Q2), and we expect a weak showing across our logistics coverage during the quarter.

Click here for the full report.

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REDUCE
TP: Rs 240 | ⩔ 1%

WIPRO | IT Services | 16 October 2019

Puzzling margin beat; unlikely to hold up

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Wipro (WPRO) reported in-line revenue growth of 1.1% QoQ CC, but a surprising beat on operating margins (18.1%, +10bps QoQ vs. –60bps est.) that materialised despite the impact of compensation revision. As per management, cost credits/ reversals shored up margins and are unlikely to accrue going ahead. Q3 revenue growth guidance at 0.8-2.8% was better than expected. We raise FY20/FY21 EPS by 3% each and roll over to a Sep'20 TP of Rs 240 (vs. Rs 230); post the recent stock correction, we up our rating a notch to REDUCE (vs. SELL).

Revenue growth lacks consistency: WPRO posted in-line Q2 revenue growth of 1.1% QoQ CC, backed by the retail, manufacturing, energy and technology verticals. We note that performance trends remain volatile as only two of the four verticals had consecutive growth quarters. BFSI revenues dipped 0.1% QoQ CC. Revenue from the top client and top 5 clients declined by 13.1% and 6.8% QoQ (in US$ terms) respectively.

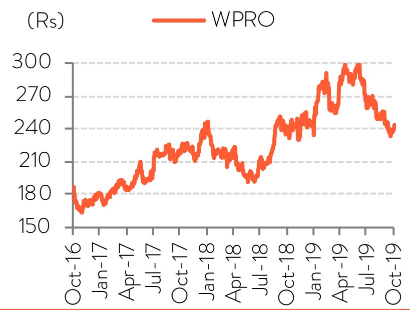
Operating margins stage a puzzling beat: IT services EBIT margins clocked in at 18.1%, up 10bps QoQ vs. our estimate of a 60bps decline. We find the margin beat perplexing considering (1) headwinds from two months of wage revision, (2) moderation in gross utilisation by 250bps QoQ to 71.4%, and (3) contraction in offshore revenue mix by 100bps QoQ to 46.7%. The energy and utility verticals reported a surprising 440bps QoQ EBIT margin upswing and accounted for ~140% of incremental operating profits.

Dec'19 quarter guidance healthy: WPRO has guided for revenue growth in the range of 0.8-2.8% QoQ in Q3FY20, ahead of our/street estimates of 0-2% QoQ growth and comparable with the 1-3% QoQ guidance for the Dec'18 quarter. The growth outlook includes 0.3% inorganic revenue contribution.

Ticker/Price	WPRO IN/Rs 244
Market cap	US$ 20.3bn
Shares o/s	5,950mn
3M ADV	US$ 16.6mn
52wk high/low	Rs 302/Rs 222
Promoter/FPI/DII	74%/9%/17%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Total revenue (Rs mn)	5,46,359	5,89,060	5,98,179	6,39,994	6,85,737
EBITDA (Rs mn)	1,05,418	1,21,661	1,24,784	1,33,329	1,42,937
Adj. net profit (Rs mn)	80,046	90,074	91,910	99,258	1,07,739
Adj. EPS (Rs)	13.3	14.9	15.4	16.7	18.1
Adj. EPS growth (%)	4.0	12.3	3.4	8.0	8.5
Adj. ROAE (%)	15.9	17.1	16.4	16.8	15.8
Adj. P/E (x)	18.3	16.3	15.8	14.6	13.5
EV/EBITDA (x)	14.6	12.7	11.1	10.9	9.7

Source: Company, BOBCAPS Research

TRADE

15 October 2019

Trade deficit narrows as imports shrink

India's trade deficit in Sep'19 reduced to US$ 10.9bn versus US$ 13.5bn in Aug'19. Exports fell again, by (-) 6.6% led by oil and gems & jewellery. Imports too contracted further. Despite onset of festive season, gold imports fell by (-) 50.8% due to higher prices. Non-oil-non-gold imports fell by (-) 8.9% on the back of current domestic slowdown. Given muted global and domestic growth backdrop, we expect trade deficit to ease in FY20 and thus support INR. Higher oil prices and Yuan depreciation remain key risks to our INR view.

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Exports continue to decline: India's exports fell by (-) 6.6% in Sep'19 compared with (-) 6% in Aug'19. This was led by (-) 18.6% decline in oil exports (-10.7% in Aug'19) and (-) 5.6% dip in gems & jewellery (-3.5% in Aug'19). Barring pharma products (+8.7%), all other non-oil exports declined, albeit less sharply than Aug'19. Overall, in Q2FY20 exports fell by (-) 3.7% versus 10.3% in Q2FY19 and (-) 1.3% in Q1FY20, thus imparting a negative demand impulse to the economy. In FYTD20, export growth has dipped by (-) 2.5% vs 12.5% in FYTD19. Region wise, exports to Asia-Pacific (ex-China) and Europe continue to fall. We expect the trend to continue as global growth remains weak.

Imports fall further: Import growth declined for the 4th month to (-) 13.9% from (-) 13.4% in Aug'19, a 38-month low. This was led by a (-) 18.3% decline in oil imports versus (-) 8.9% dip in Aug'19 due to lower international oil prices. Gold imports continue to decline at (-) 50.8% compared with (-) 62.5% in Aug'19. Non-oil-non-gold imports contracted for the 8th consecutive month, albeit at a slower pace of (-) 8.9% versus (-) 9.3% in Aug'19. Within this, except chemicals (+4.4%) all other items noted a decline with imports of ores and minerals (-26%) and electronics (-24.2%) declining the most. Capital goods declined by (-) 9.4% in Sep'19 versus (-) 20.1% in Aug'19.

Trade deficit narrows to 7-month low: India's trade deficit narrowed to US$10.9bn from US$ 13.5bn in Aug'19 led by lower imports. In FYTD20 now trade deficit is lower at US$ 84bn compared with US$ 98.2bn in FYTD19 led by oil (lower by US$ 5.6bn) as well as non-oil-non-gold imports (lower by US$ 10.8bn). With oil prices remaining low and sluggish domestic consumption, we expect CAD to narrow to 1.5% of GDP in FY20 compared with 2% of GDP in FY19. This will be help anchor INR at current levels. However, depreciation of Yuan and spike in oil prices remain key risks.

KEY HIGHLIGHTS

- Export growth fell to (-) 6.6% versus (-) 6% in Aug'19.
- Imports contracted further by (-) 13.9% in Sep'19 compared with (-) 13.4% in Aug'19.
- Trade deficit shrank to US$ 10.9bn versus US$ 13.5bn in Aug'19.

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LOGISTICS | Monthly Tracker | 15 October 2019

Demand climate deteriorates further

High frequency indicators, a harbinger of the logistics industry's performance, worsened in Sep'19, marking the end of a sedate Q2FY20. Container rail reported a second month of volume decline (–2% YoY), whereas container traffic at major ports slumped 4% YoY, the lowest since Feb'17. EXIM trade, too, continued to plunge (–11% YoY in Sep'19). The sluggish demand climate has taken a toll on CCRI's business (provisional volume down 2% YoY in Q2), and we expect a weak showing across our logistics coverage during the quarter.

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Container rail volumes continue to decline: After contracting for the first time in nearly three years in Aug'19 (–3% YoY), container rail volumes slipped again in Sep'19 (–2% YoY to 5mn tonnes). EXIM/domestic volumes both fell –1%/ –4% YoY. However, the decline in EXIM container rail volumes was lower than that in container traffic at major ports (–4% YoY in tonnage terms), indicating possible market share gain for railways in Sep'19. Lead distance and net tonne-km (NTKM) dipped 3% and 5% YoY respectively.

Q2FY20 ended on a flat note with total volumes down 0.2% YoY. Container Corp (CCRI) reported a 2% YoY decline in Q2 provisional volumes (in TEU terms) due to lower EXIM traffic (–3% while domestic business grew +2%).

Container traffic at major ports slumps: Container movement at major ports dropped 4% YoY in Sep'19 (in TEU terms) after a strong showing in Aug'19 (+10% YoY). This was the first decline in volumes since Feb'17 and was led by a slowdown at key container ports - JNPT (–7% YoY) and Chennai (–29%). Vizag (+27%), Tuticorin (+22% YoY), and Kolkata (9%) provided some cushion. Overall cargo traffic at major ports dipped marginally by 0.5% YoY.

EXIM trade slides again, Aug industrial output slumps: Merchandise exports/imports declined 7%/14% YoY in Sep'19 (US$ terms), on the heels of a similar 6%/13% YoY decline in Aug'19, due to subdued domestic consumption and tepid global trade. Non-oil, non-gold exports/imports were down 4%/9% YoY. Aug'19 industrial output slumped to –1.1% YoY (+4.6% in Jul'19), owing to lower manufacturing output (–1.2% YoY) which slumped to near five-year low.

Expect poor Q2: Lead indicators and channel checks all point to tepid demand for logistics services. Consequently, we expect logistics companies under our coverage to report a weak Q2FY20 (see our **quarterly preview** for details).

RECOMMENDATION SNAPSHOT

Ticker	Price	Target	Rating
AGLL IN	100	125	BUY
CCRI IN	595	575	ADD
FSCS IN	506	730	BUY
MAHLOG IN	365	525	BUY
TCIEXP IN	719	840	BUY
TRPC IN	279	365	BUY

Price & Target in Rupees

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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