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FIRST LIGHT

07 July 2020

RESEARCH

BOB Economics Research | Monthly Chartbook

Consumption reviving, capex to recover in FY22

BOB Economics Research | Weekly Wrap

Economic recovery continues despite COVID

Allcargo Logistics | Target: Rs 100 | +7% | ADD

Robust MTO show offset by insipid CFS & P&E segments

eClerx Services | Target: Rs 420 | –12% | REDUCE

Announces Rs 1.09bn buyback – a transient trigger

IT Services | Q1FY21 Preview

Covid-19 to dent Q1; demand recovery cues key to watch

SUMMARY

India Economics: Monthly Chartbook

India's economy improved further in Jun'20 as visible in higher filing of GST e-way bills, digital payments, tractor sales and manufacturing PMIs. Consumption (FMCG) will revive as rural demand gains traction. However, services sector will take time to recover. So would capex given general government capex will be lower this year. However, general government spending will be maintained with 57% increase in Q1 borrowing to Rs 4.5tn. Elevated bond yields and a steep yield curve is a result of this. RBI has started buying long-end bonds and we estimate purchase of Rs 3.5tn in the year. 10Y yield to remain in 5.5-6% range.

Click here for the full report.

TOP PICKS

LARGE-CAP IDEAS

Company	Rating	Target
Bajaj Finance	Buy	3,000
Cipla	Buy	690
GAIL	Buy	150
Petronet LNG	Buy	305
Tech Mahindra	Buy	690

MID-CAP IDEAS

Company	Rating	Target
Alkem Labs	Buy	2,950
Chola Investment	Buy	200
Laurus Labs	Buy	630
Transport Corp	Buy	240
Mahanagar Gas	Sell	710

Source: BOBCAPS Research

DAILY MACRO INDICATORS

Indicator	Current	2D (%)	1M (%)	12M (%)
US 10Y yield (%)	0.67	0bps	(2bps)	(136bps)
India 10Y yield (%)	5.85	0bps	9bps	(85bps)
USD/INR	74.65	0.5	0.9	(9.1)
Brent Crude (US$/bbl)	42.80	(0.8)	8.2	(33.4)
Dow	25,827	0.4	0.3	(4.1)
Shanghai	3,153	2.0	7.9	4.7
Sensex	36,021	0.5	6.5	(8.8)
India FII (US$ mn)	**02 Jul**	**MTD**	**CYTD**	**FYTD**
FII-D	(16.3)	31.7	(14,250.3)	(4,490.8)
FII-E	(223.0)	(266.9)	(2,708.3)	3,894.6

Source: Bank of Baroda Economics Research

BOBCAPS Research
research@bobcaps.in

India Economics: Weekly Wrap

Early signs of global recovery are visible with improvement in global manufacturing and services PMIs and strong US jobs report. Manufacturing is recovering faster than services. As a result, global yields (except India) are edged up and equity indices closed higher. Fed minutes signal continuity of accommodative monetary policy. Global currencies gained with INR higher by 1.3% as India reported current account surplus after 17- years. Markets will closely eye industrial output data scheduled for the week.

Click here for the full report.

Allcargo Logistics

Allcargo Logistics' (AGLL) Q4FY20 consolidated revenue grew at a steady 8% YoY led by the MTO segment (+10%). EBITDA was flat at Rs 1.1bn, but adj. PAT declined 67% YoY due to higher depreciation, interest cost and tax outflow. Covid-related trade disruptions cast a shadow on AGLL's near-term business prospects. We cut our FY21/FY22 earnings by 15%/8% factoring in Ind-AS 116 changes and higher finance cost assumptions. Our Mar'21 TP remains at Rs 100 as we ascribe a value to the investments in Gati. Maintain ADD.

Click here for the full report.

eClerx Services

eClerx (ECLX) has announced a buyback worth Rs 1.09bn through the tender offer route at a maximum price of Rs 550/sh (16.7% premium over the last closing price before the board meeting intimation) – this translates into 1.99mn shares or ~5.5% of total paid-up equity shares. Unlike prior buybacks, this one will be through the open market and promoters do not intend to participate. Consequently, promoter shareholding post buyback will increase by 2.89% to 53.65%.

Click here for the full report.

IT Services: Q1FY21 Preview

We expect a broad-based demand-led decline in revenue and margins for IT services players in Q1FY21 due to the Covid-19 impact. We estimate 5-7% QoQ revenue shrinkage for large-caps and a 3-8% QoQ decline for mid-caps. TCVs too are likely to moderate. Operating margins are forecast to contract 180bps QoQ on average across most of our coverage despite aggressive use of traditional operating levers. We await key commentary on: (1) demand outlook for FY21, (2) pockets of growth, (3) repricing, and (4) discretionary spending patterns.

Click here for the full report.

Consumption reviving, capex to recover in FY22

India's economy improved further in Jun'20 as visible in higher filing of GST e-way bills, digital payments, tractor sales and manufacturing PMIs. Consumption (FMCG) will revive as rural demand gains traction. However, services sector will take time to recover. So would capex given general government capex will be lower this year. However, general government spending will be maintained with 57% increase in Q1 borrowing to Rs 4.5tn. Elevated bond yields and a steep yield curve is a result of this. RBI has started buying long-end bonds and we estimate purchase of Rs 3.5tn in the year. 10Y yield to remain in 5.5-6% range.

Early signs of a recovery: With GST E-way bills in Jun'20 at 86% of Jun'19 levels, 10% YoY increase in UPI payments, pick-up in tractor sales and manufacturing PMI recovering to 47.2, economic activity is showing semblance of stabilisation. Electricity demand is also now 14% below Jun'19 level. A normal monsoon bodes well for rural demand with kharif sowing already 88% higher than last year. While rural consumption and FMCG sales may recovery sooner, housing and capex related demand will come back with a lag as visible in decline in RBI's housing price index and 13% decline in states capex.

Central finances weak: General government fiscal deficit increased to 8.0% of GDP in FY20. During the first 2 months of FY21 centre's revenue collections were weak with sharp decline in direct tax collections (-15%) and indirect tax collections (-52%). However, GST collections have improved from Rs 495bn in Apr'20 to Rs 909bn in May'20 and are likely to improve further in the coming month (as visible in GST E-Way bills). Centre's revenue spending fell by 1.9% versus 13.7% increase last year. States too entered FY21 on a much weaker footing with 7.5% dcline in tax revenues and 13% fall in capex. Both Centre and States have borrowed Rs ~4.5tn in Q1FY21 as against Rs 2.9tn last year.

10Y yield likely to be in 5.5-6% range: 5.79GS2030 yield has risen by 12bps in Jun'20 on fiscal deficit concerns. RBI and Banks are likely to emerge as large buyers of government securities. RBI announced Rs 100bn swap of long-end paper with short-end paper to flatten the yield curve. We see overall OMOs of Rs 3.5tn this year. System liquidity surplus is at Rs 4.3tn (Rs 3.8tn on an average in Jun'20). With inflation softening from current levels to average 3.4% in FY21, we see 10Y yield in 5.5-6% range.

INR appreciates sharply in Jul'20: Driven by strong FII inflows of US$ 2.5bn in equity segment, INR rose by 0.1% in Jun'20. However, this was lower than the 1.2% rise in EM currencies. In Jul'20 so far, INR has risen sharply by ~1% led by an improvement in risk-sentiment. A narrowing trade deficit, robust FX reserves and resumption in foreign inflows is positive for INR. Rising international oil prices however remain a key risk.

WEEKLY WRAP

06 July 2020

Economic recovery continues despite COVID

Sameer Narang | Jahnavi
chief.economist@bankofbaroda.com

Early signs of global recovery are visible with improvement in global manufacturing and services PMIs and strong US jobs report. Manufacturing is recovering faster than services. As a result, global yields (except India) are edged up and equity indices closed higher. Fed minutes signal continuity of accommodative monetary policy. Global currencies gained with INR higher by 1.3% as India reported current account surplus after 17- years. Markets will closely eye industrial output data scheduled for the week.

Markets

- **Bonds:** Except India, global 10Y yields closed higher. Manufacturing and services activity improved globally with gradual easing of lockdown restrictions. US 10Y yield rose by 3bps (0.67%) on account of improving employment scenario. Oil prices rose by 4.3% (US$ 43/bbl) amidst hopes of revival in demand. India's 10Y yield fell by 7bps (5.85%) supported by RBI's operation twist announcement. System liquidity surplus was lower at Rs 4.3tn as on 3 Jul 2020 compared with Rs 3.7tn in the previous week.

- **Currency:** Major currencies closed higher this week as macro data globally raised hopes of a recovery. Improvement was seen in global manufacturing and services PMIs, Germany's retail sales and US labour market. As a result, DXY and JPY edged down by 0.3% each as risk-sentiment improved. INR appreciated sharply by 1.3% to a 3-month high as India reported its first current account surplus in 17-years. FII outflows were US$ 380mn.

- **Equity:** Barring Nikkei, other global indices ended the week higher on signs of global recovery and hope of availability of COVID-19 vaccine. Shanghai Comp (5.8%) surged the most followed by Dax (3.6%) and Dow (3.2%). China's economic data surprised positively. Sensex (2.4%) too ended in green for the third week in a row, with auto stocks advancing the most.

- **Upcoming key events:** In current week, markets will closely watch US non-manufacturing ISM PMI, US PPI and German factory orders. In addition, China's CPI and PPI data along with RBA's policy decision is also due. On the domestic front, apart from new unlock rules and spike in COVID cases, market will track industrial production data.

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ADD
TP: Rs 100 | ⮝ 7%

ALLCARGO LOGISTICS | Logistics | 06 July 2020

Robust MTO show offset by insipid CFS & P&E segments

Sayan Das Sharma
research@bobcaps.in

Allcargo Logistics' (AGLL) Q4FY20 consolidated revenue grew at a steady 8% YoY led by the MTO segment (+10%). EBITDA was flat at Rs 1.1bn, but adj. PAT declined 67% YoY due to higher depreciation, interest cost and tax outflow. Covid-related trade disruptions cast a shadow on AGLL's near-term business prospects. We cut our FY21/FY22 earnings by 15%/8% factoring in Ind-AS 116 changes and higher finance cost assumptions. Our Mar'21 TP remains at Rs 100 as we ascribe a value to the investments in Gati. Maintain ADD.

MTO – robust performance: Led by volume/realisation growth of 9%/1% YoY, MTO revenues rose by a healthy 10% YoY amidst muted container trade. EBIT margin of 3.7% was flat YoY. Share gain in LCL/FCL businesses and a diversified presence across major trade lanes catalysed this robust showing, per AGLL. While the company should continue to outpace global container trade (10-15% decline in CY20E), we expect MTO growth to ease to –2% in FY21 vs. +8% in FY20.

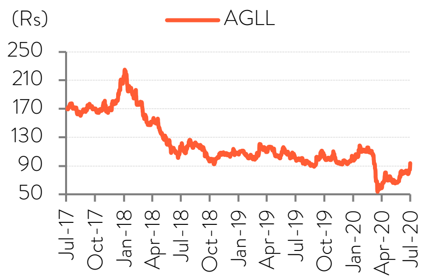
CFS/P&E disappoint: CFS/P&E revenue fell 11%/4% YoY. CFS volumes declined 9% YoY as weak EXIM trade resulted in a 14% decline in container volumes at addressable ports. Negative operating leverage dragged the EBIT margin down 460bps YoY to 22.9%. P&E posted EBIT losses due to doubtful debt provisioning and accelerated depreciation. Weak EXIM trade and a sluggish investment climate will weigh on these two segments in the near term.

Maintain ADD: AGLL acquired an additional 26% stake in Gati through an open offer in Q4, raising its controlling stake to 47%. Despite a 15%/8% cut in earnings estimates for FY21/FY22, we maintain our Mar'21 TP of Rs 100 (core business valued at an unchanged 9x FY22E EPS) as we ascribe a value to the Gati investments post completion of the open offer.

Ticker/Price	AGLL IN/Rs 94
Market cap	US$ 308.6mn
Shares o/s	246mn
3M ADV	US$ 0.1mn
52wk high/low	Rs 123/Rs 49
Promoter/FPI/DII	70%/13%/4%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20P	FY21E	FY22E
Total revenue (Rs mn)	60,492	68,949	73,462	71,576	82,041
EBITDA (Rs mn)	3,771	4,485	5,035	4,780	6,050
Adj. net profit (Rs mn)	1,808	2,478	2,010	1,721	2,380
Adj. EPS (Rs)	7.4	10.1	7.3	7.0	9.7
Adj. EPS growth (%)	(26.9)	42.5	(27.5)	(4.2)	38.2
Adj. ROAE (%)	9.6	12.5	8.7	7.8	10.2
Adj. P/E (x)	12.7	9.3	12.8	13.4	9.7
EV/EBITDA (x)	6.6	5.6	5.1	6.6	6.0

Source: Company, BOBCAPS Research

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REDUCE
TP: Rs 420 | ∨ 12%

ECLERX SERVICES | IT Services | 06 July 2020

Announces Rs 1.09bn buyback – a transient trigger

Ruchi Burde | Seema Nayak
research@bobcaps.in

Event: eClerx (ECLX) has announced a buyback worth Rs 1.09bn through the tender offer route at a maximum price of Rs 550/sh (16.7% premium over the last closing price before the board meeting intimation) – this translates into 1.99mn shares or ~5.5% of total paid-up equity shares. Unlike prior buybacks, this one will be through the open market and promoters do not intend to participate. Consequently, promoter shareholding post buyback will increase by 2.89% to 53.65%.

Financial implications: As per our calculations, the buyback is likely to be EPS-accretive by ~3% and will increase ROE by ~30bps. The buyback premium is significantly lower than the average ~37% premium over the prior three issues (which were through tender mechanism). Moreover, the issue size is lower than our estimate of Rs 2.5bn+ and will use only ~14% of cash & cash equivalents (of Rs 7.7bn as at end-Q4FY20).

A temporary trigger: The share price has fallen by a steep 25% in CY20 YTD and the buyback will help to arrest the decline. The stock has already inched up ~8% in the past week in the runup to the announcement. Nonetheless, we see this as a transient trigger in the absence of operational performance improvement (we forecast a 22%/23% EBIT/EPS decline in FY21).

Maintain REDUCE: Over the last three years, ECLX has witnessed a structural downward reset to operating margins led by a changing business mix in favour of onsite revenues. The impact of Covid-19 on its CLX business will ensure delayed recovery. REDUCE.

FIG 1 –ECLERX BUYBACK SUMMARY

Particulars	FY17	FY18	FY19	FY21
Buyback size (Rs mn)	2,340	2,580	2,620	1,095
No. of equity shares	1.17	1.29	1.63	1.99
% of equity	2.78	3.23	4.23	5.50
Buyback size (Rs per share)	2,000	2,000	1,600	550
Premium over last price (%)	40.2	33.3	39.6	16.7
Date of announcement (Board meeting)	14-Oct-16	22-Dec-17	14-Mar-19	3-Jul-20

Source: Company, BOBCAPS Research

Ticker/Price	ECLX IN/Rs 477
Market cap	US$ 240.3mn
Shares o/s	38mn
3M ADV	US$ 0.7mn
52wk high/low	Rs 762/Rs 320
Promoter/FPI/DII	50%/25%/25%

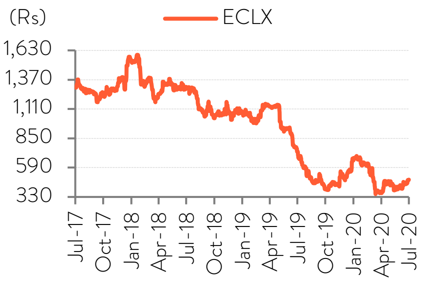
Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY20P	FY21E	FY22E
Total revenue (Rs mn)	14,376	13,797	16,326
EBITDA (Rs mn)	3,249	2,837	3,710
Adj. net profit (Rs mn)	2,087	1,614	2,220
Adj. EPS (Rs)	55.5	42.9	59.0
Adj. EPS growth (%)	(7.7)	(22.7)	37.5
Adj. ROAE (%)	17.5	11.8	15.4
Adj. P/E (x)	8.6	11.1	8.1
EV/EBITDA (x)	4.7	5.4	3.5

Source: Company, BOBCAPS Research

STOCK PERFORMANCE



Source: NSE

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IT SERVICES | Q1FY21 Preview | 06 July 2020

Covid-19 to dent Q1; demand recovery cues key to watch

We expect a broad-based demand-led decline in revenue and margins for IT services players in Q1FY21 due to the Covid-19 impact. We estimate 5-7% QoQ revenue shrinkage for large-caps and a 3-8% QoQ decline for mid-caps. TCVs too are likely to moderate. Operating margins are forecast to contract 180bps QoQ on average across most of our coverage despite aggressive use of traditional operating levers. We await key commentary on: (1) demand outlook for FY21, (2) pockets of growth, (3) repricing, and (4) discretionary spending patterns.

Ruchi Burde | Seema Nayak
research@bobcaps.in

Expect sharp QoQ revenue decline: Based on the sector's Q4FY20 results, we expect TCS/Infosys (INFO) to report dollar revenue declines of 5.4%/5.7% QoQ in Q1FY21. Wipro is estimated to see a sharper fall of 6.1% on account of CEO transition and higher exposure to the retail vertical. Tech Mahindra (TECHM) could be a laggard among large-caps due to sustained weakness in its communications business and headwinds in the BPO and enterprise segments.

Mindtree (MTCL) looks headed for an 8% QoQ decline due to a lumpy revenue mix, while travel and hospitality exposure could drive a 5.7% drop for NIIT Tech. We expect Persistent Systems, eClerx, Hexaware and L&T Infotech (LTI) to decline in the range of 5-7%. Among mid-caps, Mphasis could fall the least (~3%).

Severe margin impact: Operating margins face several headwinds from (1) a lower revenue base, (2) higher bench costs due to reduced utilisation, (3) work-from-home costs, (4) increased subcontractor and localisation costs due to H1B visa challenges and travel restrictions, and (5) competitive pricing to retain clients. In our view, these challenges will outweigh the tailwinds of currency depreciation, low travel costs, and deferred hiring, promotions and bonuses. Barring LTI and MTCL, we expect ~180bps QoQ margin declines on average for our coverage.

Key areas of concern: While healthcare, hi-tech, telecom and CPG will see better demand, verticals such as manufacturing, auto, energy, utilities, retail, travel and hospitality will see a stronger and immediate fallout from the pandemic. Large players such as TCS and INFO have also expressed concerns over BFSI due to low/negative interest rates. IMS and run-business will see demand for higher productivity. New deal wins are expected to moderate post a strong Q4, and small- and mid-cap players will face the risk of vendor consolidation. In a silver lining for the sector, cloud, collaborative tools, cybersecurity and virtualisation feature among the emerging areas of demand.

RECOMMENDATION SNAPSHOT

Ticker	Price	Target	Rating
TCS IN	2,263	2,160	ADD
INFO IN	764	760	ADD
WPRO IN	223	170	SELL
HCLT IN	579	680	BUY
TECHM IN	581	690	BUY
LTI IN	2,000	2,230	BUY
MPHL IN	911	780	SELL
MTCL IN	961	880	REDUCE
HEXW IN	335	350	ADD
PSYS IN	651	590	REDUCE
NITEC IN	1,436	1,430	ADD
ECLX IN	480	420	REDUCE

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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