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FIRST LIGHT

07 October 2019

RESEARCH

BOB Economics Research | Monetary Policy Review

Room for another rate cut

IT Services | Q2FY20 Preview

Q2 to set tone for second-half and beyond

SUMMARY

India Economics: Monetary Policy Review

RBI reduced repo rate by 25bps thus taking cumulative rate cuts by the central bank to 135bps since Feb'19. A sharp reduction in growth now estimated at 6.1% in FY20 (6.9% earlier) justifies the rate cutting cycle. Inflation has and is expected to remain below RBI's target of 4%. While another 25bps repo rate cut is likely in Dec'19, it will bring real policy rates in the range of 1-1.25% (3.7% inflation in FY21) thus putting an end to the rate cut cycle. Accommodative liquidity conditions will continue for transmission.

Click here for the full report.

IT Services: Q2FY20 Preview

Despite global trade, revenue growth for tier-I Indian IT services players has held steady for the last three quarters. Q2FY20 will offer critical insights into growth visibility for the rest of the year. We expect continued stability in YoY CC terms, steady sequential growth and margin gains for large players ex-WPRO. The recent flurry of big deal wins for key players and record outsourcing wins for Accenture offer some bright spots. We prefer HCLT & TCS among large-caps and NITEC & MPHL among mid-caps.

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TOP PICKS

LARGE-CAP IDEAS

Company	Rating	Target
Cipla	Buy	555
GAIL	Buy	200
ONGC	Buy	200
TCS	Add	2,360
HPCL	Buy	400

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 (%)	1.53	(7bps)	4bps	(165bps)
India 10Y yield (%)	6.61	(5bps)	9bps	(154bps)
USD/INR	70.88	0.3	2.1	3.7
Brent Crude (US$/bbl)	57.71	0	(1.6)	(31.8)
Dow	26,201	0.5	0.3	(1.6)
Shanghai	2,905	(0.9)	(0.6)	3.0
Sensex	38,107	(0.5)	4.2	8.4
India FII (US$ mn)	**30 Sep**	**MTD**	**CYTD**	**FYTD**
FII-D	(79.1)	(352.9)	3,894.2	3,349.6
FII-E	(216.7)	738.0	7,944.1	1,098.9

Source: Bank of Baroda Economics Research

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MONETARY POLICY REVIEW

04 October 2019

Room for another rate cut

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RBI reduced repo rate by 25bps thus taking cumulative rate cuts by the central bank to 135bps since Feb'19. A sharp reduction in growth now estimated at 6.1% in FY20 (6.9% earlier) justifies the rate cutting cycle. Inflation has and is expected to remain below RBI's target of 4%. While another 25bps repo rate cut is likely in Dec'19, it will bring real policy rates in the range of 1-1.25% (3.7% inflation in FY21) thus putting an end to the rate cut cycle. Accommodative liquidity conditions will continue for transmission.

KEY HIGHLIGHTS

- RBI cuts repo rate by 25bps, stance remained unchanged at accommodative.
- Inflation forecast at 3.5-3.7% for H2FY20 and 3.6% for Q1FY21.
- GDP forecast lowered to 6.1% in FY20 from 6.9% earlier.

Inflation forecast revised upward: RBI has revised its Q2FY20 projection upward to 3.4% from 3.1% in Aug'19. This is mainly driven by higher than estimated food inflation. However, other forecasts remain unchanged at 3.5-3.7% for H2FY20 and 3.6% for Q1FY21. Food inflation is likely to ease on the back of better than expected monsoon, reservoir levels (115% of last years' average) and adequate buffer stocks of pulses. Additionally, global slowdown is estimated to keep crude prices in check. However, upside risks to inflation may emerge from higher crude prices in the event of a geo-political crisis. The new forecasts are in line with our projection of 3.5% and 3.7% for FY20/ FY21.

FY20 growth forecast at 6.1%: RBI lowered its GDP forecast for FY20 by 80bps to 6.1% as Q1FY20 GDP growth at 5% was much lower than RBI's estimate of 6.8% (Apr'19 MPR). MPC noted that muted domestic demand and sluggish exports continue to impinge on the growth outlook. However, recent economic measures by the government such as easing FDI norms, bank recap and corporate tax cuts are positive for growth. Coupled with a cumulative 135bps cut in policy rates and better transmission in the future (3-4 quarter lag) , growth is expected to pick up to 6.9% in H2FY20 and 7% in FY21.

Widening output gap implies room for more cuts: The negative output gap has widened further and inflation is expected to remain below RBI's target of 4% in the medium-term. MPC members noted that they will continue with accommodative stance as long as it is necessary to revive growth. Thus RBI will be reducing repo rate further in Dec'19 as aggregate demand remains below trend. We expect another 25bps cut in repo rate taking the cumulative rate cuts to 160bps since Feb'19. With inflation expected at 3.7% in FY21, real policy rate is expected to stabilise at 1-1.25% level implying an end to current policy rate cutting cycle.

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IT SERVICES | Q2FY20 Preview | 04 October 2019

Q2 to set tone for second-half and beyond

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Stable growth trends expected in Q2: In the last one year, the Nifty IT index has underperformed broader markets (–5% vs. –3.1% for Nifty 50) on twin concerns of escalating global trade tensions and the visa-linked rise in delivery costs. While the latter impact has surfaced via margin moderation, the revenue growth trajectory for tier-I IT services companies has held steady at 10.1-10.9% YoY CC (aggregate for TCS, INFO, HCLT, WPRO and TECHM) over the last three quarters. We expect similar 10.2% YoY CC growth in the Sep'19 quarter before onset of the seasonally weak H2.

Results to dictate tone of H2: The Sep'19 quarter will be critical to establishing growth visibility for H2FY20 and beyond, after the mixed bag thrown up in Q1 (upsets from Tech Mahindra (TECHM) and Wipro (WPRO), positive surprises from Infosys (INFO) and HCL Tech (HCLT), subdued showing from TCS). Our estimates factor in ~150bps moderation in YoY CC growth for H2FY20 vs. H1. That said, the slew of large deal wins in Q2 (TECHM's AT&T deal, TCS's GM deal, HCLT's Aperam deal, Accenture's record offshore deal wins) present upside risks to our estimates. Key to watch in Q2 will be the pace of digital contract upscaling, large deal wins and management commentary.

HCLT to lead quarterly scoreboard: Large-cap players are likely to post 1-5.9% QoQ CC revenue growth, with HCLT at the top end and WPRO at the bottom end of the range. Excluding inorganic revenue tailwinds, we expect TCS to lead with 2.6% QoQ CC growth. Similarly, we forecast 1.4-11.9% QoQ CC growth for tier-II players, led by Hexaware (both organically and on reported basis).

Margin expansion QoQ: EBIT margins should improve sequentially for tier-I players, except WPRO due to the wage hike impact. YoY margins are expected to contract (ex-WPRO whose Q2FY19 EBIT margin included a one-off charge).

RECOMMENDATION SNAPSHOT

Ticker	Price	Target	Rating
TCS IN	2,080	2,360	ADD
INFO IN	796	820	ADD
WPRO IN	239	230	SELL
HCLT IN	1072	1,230	BUY
TECHM IN	706	660	REDUCE
LTI IN	1511	2,010	BUY
MPHL IN	937	1,150	BUY
MTCL IN	710	670	SELL
HEXW IN	368	390	ADD
PSYS IN	556	650	REDUCE
NITEC IN	1371	1,550	BUY
ECLX IN	407	490	SELL

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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