

FIRST LIGHT

RESEARCH

Automobiles | Q1FY21 Preview

Negative dealer feedback and rich valuations; reduce exposure

Tata Consultancy Services | Target: Rs 2,320 | +5% | ADD

Dull quarter with few bright spots

Pharmaceuticals | Q1FY21 Preview

India sales firm despite Covid hit; good Q1 for Cipla, LPC, Laurus

IT Services

ISG Q2CY20 Index: Trends and call highlights

SUMMARY

Automobiles: Q1FY21 Preview

During Q1FY21, PV sales nosedived ~80% YoY and 3W/2W volumes slumped ~70%. HCVs reported a steeper decline of ~90% YoY while a high base and dismal April dispatches saw tractors drop 20% despite good June sales. Our dealer checks indicate that rural recovery notwithstanding, the severe lockdown-related stress across sectors could erode FY21 demand. After a sharp rally, we remain negative on AL and HMCL while downgrading EIM and BJAUT to REDUCE, and MM and TVSL to SELL. MSIL is our only BUY.

[Click here for the full report.](#)

Tata Consultancy Services

TCS's Q1FY21 performance was a mixed bag with a miss on operating performance but healthy deal wins. QoQ Growth (-7.1%, USD) was dragged down by drop in the retail, manufacturing and telecom/media businesses while BFSI was relatively resilient. Management believes that the worst is over and expects operational recovery from Q2. We trim FY21 EPS by 3% but keep FY22 earnings largely unchanged. Reiterate ADD with revised TP of Rs 2,320 (Rs 2,160 earlier) as we roll forward to Jun'22 valuations.

[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 (%)	0.66	2bps	(23bps)	(140bps)
India 10Y yield (%)	5.78	(1bps)	1bps	(77bps)
USD/INR	75.02	(0.1)	0.7	(9.4)
Brent Crude (US\$/bbl)	43.29	0.5	2.3	(35.4)
Dow	26,067	0.7	(3.8)	(3.0)
Shanghai	3,403	1.7	16.1	16.7
Sensex	36,329	(0.9)	6.0	(5.8)
India FII (US\$ mn)	07 Jul	MTD	CYTD	FYTD
FII-D	(3.6)	114.8	(14,167.2)	(4,407.7)
FII-E	(222.5)	(342.6)	(2,784.1)	3,818.9

Source: Bank of Baroda Economics Research

BOBCAPS Research

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Pharmaceuticals: Q1FY21 Preview

We expect a good Q1 for Cipla (led by OTC switch, gProventil), Alkem (deferred India sales) and LPC (Levo ramp-up) – cost savings can further aid higher margins QoQ. SUNP, ARBP and DRRD could see a soft Q1 with US sales declining 4-6% QoQ led by destocking and tepid inj. sales; India sales can surprise positively QoQ despite the Covid impact. ALPM should be stable while AJP/DIVI can see weak margin expansion QoQ. Laurus can continue to outperform. On forex (avg. basis), the USD is favourable (+5% QoQ); EMs are weak.

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IT Services

The Q2CY20 ISG Index reflects stalled deal activity (ACV down 4.7% YoY) and a drop in managed services deal sourcing due to Covid-19. ISG expects recovery in contract activity in H2CY20, but forecasts a 7.5% YoY decline in managed services deals in CY20 vs. 7% earlier. These muted trends come as no surprise – we expect deal TCV moderation in the Jun'20 quarter for IT companies under our coverage. We prefer HCLT (BUY, TP: Rs 680) and TECHM (BUY, TP: Rs 690) among large-caps and LTI (BUY, TP: Rs 2,230) among mid-caps.

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AUTOMOBILES

| Q1FY21 Preview

| 09 July 2020

Negative dealer feedback and rich valuations; reduce exposure

During Q1FY21, PV sales nosedived ~80% YoY and 3W/2W volumes slumped ~70%. HCVs reported a steeper decline of ~90% YoY while a high base and dismal April dispatches saw tractors drop 20% despite good June sales. Our dealer checks indicate that rural recovery notwithstanding, the severe lockdown-related stress across sectors could erode FY21 demand. After a sharp rally, we remain negative on AL and HMCL while downgrading EIM and BJAUT to REDUCE, and MM and TVSL to SELL. MSIL is our only BUY.

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Dismal performance: While the markets have cheered a strong revival in auto sales in Jun'20, most OEMs are expected to report a dismal performance in Q1FY21. Given the steep volume declines in Q1 (PV: -80% YoY, 3W/2W: -70%, HCV: -90%, tractors: -20%), we expect our coverage companies to report a 71% YoY plunge in topline for the quarter. Negative operating leverage is likely to dent margins and drive a % YoY fall in EBITDA.

Negative feedback from channel checks: While monthly dispatches were better than expected in June, we remain cautious. Our channel checks with dealers in Rajasthan, Uttar Pradesh and Madhya Pradesh – constituting ~25% of the auto market – suggest that retail sales are not very encouraging. The initial uptick could be due to pent-up demand during the lockdown and onset of the marriage season. Dealers indicated that the tremendous pandemic-related stress across industries such as hotels, aviation, textiles, jewellery and mining could imply a significant pullback in FY21 auto demand.

Sharp stock rally also warrants caution: Most auto stocks have witnessed a price rally in the range of 50-70% during the last three months and offer very little upside from current levels. We believe the risk-reward is unfavourable and recommend that investors trim positions.

We maintain SELL on Ashok Leyland (AL) and REDUCE on Hero Moto (HMCL). We revise our estimates and target prices across our coverage, correspondingly downgrading our ratings to SELL on M&M (MM: from BUY) and TVS Motor (TVSL: from REDUCE). We also cut our ADD ratings on Bajaj Auto (BJAUT) and Eicher Motors (EIM) to REDUCE. Maruti Suzuki (MSIL) remains unchanged at BUY.

RECOMMENDATION SNAPSHOT

Ticker	Price	Target	Rating
AL IN	52	38	SELL
BJAUT IN	2,883	2,750	REDUCE
EIM IN	19,518	19,000	REDUCE
HMCL IN	2,696	2,700	REDUCE
MM IN	563	480	SELL
MSIL IN	6,020	6,500	BUY
TVSL IN	390	315	SELL

Price & Target in Rupees



ADD

TP: Rs 2,320 | ▲ 5%

**TATA CONSULTANCY
SERVICES**

| IT Services

| 10 July 2020

Dull quarter with few bright spots

TCS's Q1FY21 performance was a mixed bag with a miss on operating performance but healthy deal wins. QoQ Growth (-7.1%, USD) was dragged down by drop in the retail, manufacturing and telecom/media businesses while BFSI was relatively resilient. Management believes that the worst is over and expects operational recovery from Q2. We trim FY21 EPS by 3% but keep FY22 earnings largely unchanged. Reiterate ADD with revised TP of Rs 2,320 (Rs 2,160 earlier) as we roll forward to Jun'22 valuations.

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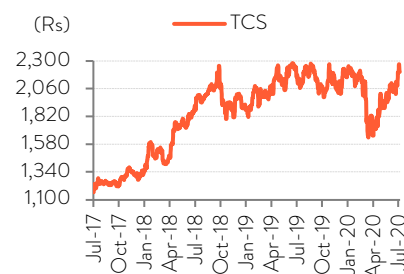
Operating performance below estimates: TCS's Q1FY21 operating performance missed estimates with a 6.9% QoQ CC revenue decline (-5% est.) and 150bps EBIT margin contraction (-90bps est.). The sharp revenue decrease overshadowed operating margin tailwinds from currency movements and non-employee cost rationalisation. Employee expense at Rs 2.5bn was flat (-0.4% QoQ) while non-employee expense at Rs 31.4bn declined 16% QoQ.

Deal wins healthy: Q1 TCV stood at a strong US\$ 6.9bn, increasing 21% YoY despite the downturn and holding above the last four-quarter average of US\$ 6.75bn. QoQ, TCV was down 22.5% from the highest ever US\$ 8.9bn recorded in Q4FY20. New contracts in BFSI and retail totaled US\$ 2.1bn and US\$ 0.9bn respectively. North America deal wins held steady at US\$ 3.3bn. The pipeline was balanced with a few big-ticket engagements and a large number of smaller wins.

Operational recovery in sight: Management believes the Q1 operating performance represents the trough in the current pandemic and expects revenue recovery from Q2FY21. Revenue growth will support operating margin revival as well.

Ticker/Price	TCS IN/Rs 2,204
Market cap	US\$ 110.3bn
Shares o/s	3,753mn
3M ADV	US\$ 98.9mn
52wk high/low	Rs 2,303/Rs 1,506
Promoter/FPI/DII	72%/17%/11%

Source: NSE

STOCK PERFORMANCE

Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue (Rs mn)	14,64,630	15,69,490	15,91,402	18,17,106	20,32,632
EBITDA (Rs mn)	3,95,050	4,21,100	4,24,612	5,11,077	5,71,048
Adj. net profit (Rs mn)	3,15,240	3,23,400	3,04,048	3,83,401	4,27,497
Adj. EPS (Rs)	84.0	86.2	81.0	102.2	113.9
Adj. EPS growth (%)	25.3	2.6	(6.0)	26.1	11.5
Adj. ROAE (%)	35.5	37.0	32.8	34.7	32.5
Adj. P/E (x)	26.2	25.6	27.2	21.6	19.4
EV/EBITDA (x)	20.8	19.5	19.4	16.1	14.1

Source: Company, BOBCAPS Research



India sales firm despite Covid hit; good Q1 for Cipla, LPC, Laurus

We expect a good Q1 for Cipla (led by OTC switch, gProventil), Alkem (deferred India sales) and LPC (Levo ramp-up) – cost savings can further aid higher margins QoQ. SUNP, ARBP and DRRD could see a soft Q1 with US sales declining 4-6% QoQ led by destocking and tepid inj. sales; India sales can surprise positively QoQ despite the Covid impact. ALPM should be stable while AJP/DIVI can see weak margin expansion QoQ. Laurus can continue to outperform. On forex (avg. basis), the USD is favourable (+5% QoQ); EMs are weak.

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Key to watch: Covid impact on India sales and cost-cutting measures will be closely watched. **(1) Ajanta (AJP):** Clarity on FY21 guidance. **(2) Alembic (ALPM):** Update on Sartans shortage, fund raising plans. **(3) Aurobindo (ARBP):** US injectable sales recovery. **(4) Cipla:** Goa warning letter remediation, respiratory filings. **(5) Dr Reddy's (DRRD):** Update on Nuvaring/Copaxone CRL. **(6) Divi's (DIVI):** QoQ margin pick-up, CS ramp-up. **(7) Lupin (LPC):** QoQ margin increase, Solosec recovery, gProAir approval (H1FY21), FDA reinspection for Somerset/Goa sites. **(8) Laurus:** TLE400 scale-up timeline, ARV demand outlook. **(9) Sun Pharma (SUNP):** FY21 guidance, update on specialty products, US antitrust litigation.

RECOMMENDATION SNAPSHOT

Ticker	Rating
AJP IN	BUY
ALPM IN	BUY
ALKEM IN	BUY
ARBP IN	BUY
CIPLA IN	BUY
DIVI IN	REDUCE
DRRD IN	ADD
LAURUS IN	BUY
LPC IN	ADD
SUNP IN	REDUCE

FIG 1 – Q1FY21: US REVENUE EXPECTATIONS

(US\$ mn)	Q2FY19	Q3FY19	Q4FY19	Q1FY20	Q2FY20	Q3FY20	Q4FY20	Q1FY21E	QoQ (%)	YoY (%)
AJP	11	9	11	15	16	22	20	18	(10.6)	23.5
ALPM	60	43	44	49	77	72	81	72	(11.4)	46.1
ALKEM	69	74	69	69	76	82	84	88	4.4	27.9
ARBP	318	338	352	384	405	418	415	395	(4.9)	2.8
CIPLA	108	118	162	160	136	133	119	125	5.1	(21.8)
DRRD	210	209	212	233	204	225	251	242	(3.6)	3.8
LPC	178	197	247	220	189	193	219	213	(2.9)	(3.3)
SUNP (ex-Taro)	183	186	264	259	179	203	202	190	(5.8)	(26.5)
TARO	159	176	180	161	161	148	175	165	(5.7)	2.4

Source: Company, BOBCAPS Research

FIG 2 – Q1FY21 PREVIEW: EXPECT GOOD QUARTER FOR CIPLA, LPC, LAURUS AND ALKEM

Companies	Sales (Rs mn)			EBITDA (Rs mn)			PAT (Rs mn)			EBITDA margin (%)		
	Q1FY21E	YoY (%)	QoQ (%)	Q1FY21E	YoY (%)	QoQ (%)	Q1FY21E	YoY (%)	QoQ (%)	Q1FY21E	Q1FY20	Q4FY20
AJP	6,100	(0.3)	(10.6)	1,511	(10.3)	(9.2)	963	(16.1)	(5.1)	24.8	27.5	24.4
ALPM	11,609	22.3	(3.7)	2,994	33.1	(8.4)	1,835	24.1	(21.9)	25.8	23.7	27.1
ALKEM	20,656	11.7	0.8	3,204	21.1	5.7	2,395	29.0	26.8	15.5	14.3	14.8
ARBP	59,659	9.6	(3.1)	12,682	10.6	(5.5)	7,389	15.6	(14.4)	21.3	21.1	21.8
CIPLA	41,953	5.2	(4.1)	7,402	(18.2)	16.8	3,137	(34.4)	27.6	17.6	22.7	14.5
DRRD	43,237	12.5	(2.4)	9,176	26.3	(2.4)	5,338	(19.5)	(30.2)	21.2	18.9	21.2
LPC	39,878	(9.7)	3.7	5,675	(34.0)	8.0	2,464	(18.7)	(19.4)	14.2	19.5	13.7
SUNP	81,486	(1.3)	0.9	14,785	(18.5)	5.6	9,186	(30.4)	14.0	18.1	22.0	17.3
DIVI	14,400	26.3	4.6	5,029	30.8	12.1	3,506	28.3	4.7	34.9	33.7	32.6
LAURUS	8,264	50.1	(1.5)	1,752	110.3	(8.6)	789	421.5	(28.3)	21.2	15.1	22.8

Source: Company, BOBCAPS Research



IT SERVICES

09 July 2020

ISG Q2CY20 Index: Trends and call highlights

The Q2CY20 ISG Index reflects stalled deal activity (ACV down 4.7% YoY) and a drop in managed services deal sourcing due to Covid-19. ISG expects recovery in contract activity in H2CY20, but forecasts a 7.5% YoY decline in managed services deals in CY20 vs. 7% earlier. These muted trends come as no surprise – we expect deal TCV moderation in the Jun'20 quarter for IT companies under our coverage. We prefer HCLT (BUY, TP: Rs 680) and TECHM (BUY, TP: Rs 690) among large-caps and LTI (BUY, TP: Rs 2,230) among mid-caps.

Ruchi Burde | Seema Nayak

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About ISG: ISG is one of the largest third-party outsourcing deal advisors globally and publishes the ISG Index every quarter where it assesses contracting activity in the IT sector. ISG classifies the contracts into Managed Services (more relevant for Indian IT) and As-a-Service sourcing. Below are key takeaways from the ISG Q2CY20 Index conference call on deal sourcing trends in the global IT services sector.

Absence of large deals hits managed services: The ISG Index shows a 4.7% YoY decline in global commercial outsourcing contracts with annual contract value (ACV) of US\$ 5mn or more in Q2CY20. Managed services deals are estimated to have declined 15.7% YoY vs. 2.2% growth in Q1, owing to delays or cancellation of large deals. About 90% of managed services deals in Q2 were below US\$ 50mn ACV (or smaller deals). The decline was especially pronounced in APAC and EMEA while America reported YoY growth on a weak Q2CY19 base.

ISG lowers CY20 outlook after baking in H2 recovery: ISG trimmed its CY20 managed services outlook and now expects a 7.5% YoY decline vs. a 7% decline earlier. The revised outlook bakes in sequential recovery in managed services deals in Q3 and Q4 CY20. As-a-service contracts are expected to grow 11% YoY in CY20.

Puzzling vertical trends: ISG's expectation of a larger impact on BFSI in Q3CY20 (-16% YoY) vs. travel & transportation (-13% YoY) and retail & CPG (-10% YoY) is puzzling. In the current Covid-19 environment, travel & transportation and retail have been more severely affected than BFSI. Telecom/ media and hi-tech (business services) are expected to be resilient (-5% YoY). Similarly, Q1 and H1CY20 vertical trends read together suggest deal activity slackened in BFSI and telecom/media, while surging in retail/CPG. ISG said this contrasting trend was due to the existing pipeline where deals were in the signing stage.

RECOMMENDATION SNAPSHOT

Ticker	Price	Target	Rating
TCS IN	2,219	2,160	ADD
INFO IN	775	760	ADD
WPRO IN	223	170	SELL
HCLT IN	575	680	BUY
TECHM IN	583	690	BUY
LTI IN	2,054	2,230	BUY
MPHL IN	921	780	SELL
MTCL IN	988	880	REDUCE
HEXW IN	338	350	ADD
PSYS IN	721	590	REDUCE
NITEC IN	1,539	1,430	ADD
ECLX IN	463	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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