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FIRST LIGHT

11 August 2023

RESEARCH

BOB ECONOMICS RESEARCH | MONETARY POLICY REVIEW

RBI maintains status quo

ALKEM LABS | TARGET: Rs 3,300 | –20% | SELL

International sales fuel growth; margin recovery positive

V-GUARD INDUSTRIES | TARGET: Rs 290 | –6% | HOLD

Strong quarter all through

IT SERVICES | Q1FY24 REVIEW

Better times ahead

Daily macro indicators

Ticker	08-Aug	09-Aug	Chg (%)
US 10Y yield (%)	4.02	4.01	(1bps)
India 10Y yield (%)	7.16	7.17	1bps
USD/INR	82.83	82.82	0.0
Brent Crude (US$/bbl)	86.2	87.6	1.6
Dow	35,314	35,123	(0.5)
Hang Seng	19,184	19,246	0.3
Sensex	65,847	65,996	0.2
India FII (US$ mn)	**07-Aug**	**08-Aug**	**Chg ($ mn)**
FII-D	(7.0)	3.2	10.2
FII-E	272.2	(7.1)	(279.2)

Source: Bank of Baroda Economics Research

SUMMARY

INDIA ECONOMICS: MONETARY POLICY REVIEW

In a unanimous decision, MPC members have decided to keep the policy rates on hold, with this, repo rate remains unchanged at 6.5%, SDF at 6.25% and MSF and bank rate at 6.75%. With a vote of 5-1, RBI has also planned to continue with stance of “withdrawal of accommodation”. Governor noted that given the uncertainty in inflation outlook, RBI remains prepared to act accordingly ‘if situation warrants’. He insisted that MPC remains focused and committed on ensuring that inflation aligns with the target level, while supporting growth. Today’s statement had a hawkish tilt with inflation projection revised upwards and we therefore expect no rate cut in FY24. The earliest possibly of rate cut has now shifted to Q1’FY25, with likelihood of a possible rate hike also on the table.

Click here for the full report.

ALKEM LABS

- Q1 revenue/EBITDA a beat as international business outperformed; adj. PAT growth in line with consensus at 65% QoQ
- Gross/EBITDA margin expanded 290bps/95bps QoQ led by softening of raw material and freight cost along with cost optimisation
- TP revised to Rs 3,300 (vs. Rs 3,000) on a higher 16x (vs. 15x) FY25E EV/EBITDA multiple; valuations expensive – retain SELL

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V-GUARD INDUSTRIES

- All-round growth in Q1 led by non-South India markets that grew at 17% YoY
- Margin outlook improves with gross margin up 250bps YoY; integration of recent acquisitions progressing well
- TP revised to Rs 290 (vs. Rs 270) on rollover – maintain HOLD

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IT SERVICES: Q1FY24 REVIEW

- Weakness in consulting, BFSI, consumer, hi-tech and telecom verticals led to deferral of order bookings
- Early signs of improvement visible especially in BFSI deal momentum from July onward
- HCLT (tier-I) and PSYS/MPHL (tier-II) relatively better placed but valuations look fair post runup

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MONETARY POLICY REVIEW

10 August 2023

RBI maintains status quo

Jahnavi Prabhakar
Economist

In a unanimous decision, MPC members have decided to keep the policy rates on hold, with this, repo rate remains unchanged at 6.5%, SDF at 6.25% and MSF and bank rate at 6.75%. With a vote of 5-1, RBI has also planned to continue with stance of "withdrawal of accommodation". Governor noted that given the uncertainty in inflation outlook, RBI remains prepared to act accordingly 'if situation warrants'. He insisted that MPC remains focused and committed on ensuring that inflation aligns with the target level, while supporting growth. Today's statement had a hawkish tilt with inflation projection revised upwards and we therefore expect no rate cut in FY24. The earliest possibly of rate cut has now shifted to Q1'FY25, with likelihood of a possible rate hike also on the table.

Status quo: In line with our expectation, RBI for the 3rd time in a row has decided to keep repo rates unchanged at 6.5%. With this announcement, the SDF rate continues at 6.25% and MSF and Bank rate at 6.75%. It was noted that going ahead, higher kharif sowing, buoyant service sector and growing consumer optimism will support household consumption. Furthermore, business optimism, healthy corporate balance sheet and pick up in government capex will play an important role in renewal of capex cycle. RBI noted the external headwinds from slowing global demand, coupled with volatility in financial market evolving geopolitical conditions across the globe continue to pose risk to overall outlook.

Inflation projections revised upwards: For FY24, RBI has revised its projection upwards by 30bps to 5.4% from 5.1% in Jun'23. This is largely on account of sharp rise in the forecasts of Q2FY24 revised up 6.2% from 5.2% earlier, higher projection for Q3 (5.7% versus 5.4%). Estimates for Q4 have been retained at 5.2%. Notably, inflation for Q1FY25 has been projected at 5.2% with risk evenly balanced. The upside pressure on the headline inflation trajectory in the near term is on the back of spike in the vegetable inflation in the near term. Though some moderation is expected with arrivals of fresh goods. These forecasts are based on the assumption of normal monsoon. RBI emphaised that it will remain vigilant on any shocks on account of supply disruptions due to adverse weather conditions. It will remain proactive and ensure the impact of any such shocks on price level will not persist. RBI also noted of risk emanating from El Nino, higher global food prices due to global uncertainties and uneven distribution of South-West Monsoon. Against this, MPC will closely track the evolving inflation scenario and bring the inflation to the target and anchor inflation expectations.

However, given surplus liquidity in the system is on the rise, the RBI has announced the introduction of an incremental CRR increase of 10%. This will be on incremental deposits over May 19th when the withdrawal/exchange of the Rs 2000 note was announced. This will impound liquidity and hence in a way act as a tightening measure. Therefore, a hawkish tinge is added to the policy.

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SELL
TP: Rs 3,300 | ⩒ 20%

ALKEM LABS | Pharmaceuticals | 10 August 2023

International sales fuel growth; margin recovery positive

- **Q1 revenue/EBITDA a beat as international business outperformed; adj. PAT growth in line with consensus at 65% QoQ**
- **Gross/EBITDA margin expanded 290bps/95bps QoQ led by softening of raw material and freight cost along with cost optimisation**
- **TP revised to Rs 3,300 (vs. Rs 3,000) on a higher 16x (vs. 15x) FY25E EV/EBITDA multiple; valuations expensive – retain SELL**

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Recovery in international business fuels growth: Alkem's Q1FY24 EBITDA/adj. PAT grew 10%/65% QoQ to Rs 3.9bn/Rs 2.9bn (+91%/+125% YoY). An above-expected performance in the international business coupled with margin expansion led to a 3% EBITDA beat over consensus, though PAT was in line. International business grew 18% QoQ whereas domestic revenue slipped 6%. On a YoY basis as well, domestic business remained sluggish and underperformed the market.

Domestic business was sluggish: Management attributed subdued growth in the domestic business (+7% YoY/-6% QoQ) to delayed monsoons in the eastern part of the country. As per IQVIA, Alkem's Q1 sales grew 7.6% YoY as compared to Indian pharma market growth of 8.5%. Management expects India business to end the year at high-single-digit growth. Alkem highlighted the launch of an ophthalmic division during the quarter as it looks to build a presence in the segment.

US price erosion moderating: US business grew 18% QoQ to US$ 85mn on account of recovery and softening pricing pressure. Price erosion reduced from double digits to high single digits in Q1 – a trend that has continued in Q2 thus far. Launches as well as existing products boosted sales, and there were no one-offs during the quarter.

Cost pressure easing: Gross/EBITDA margin expanded 290bps/95bps QoQ to 59.6%/13.1% (+215bps/+525bps YoY). Per management, margin expansion was aided by softening raw material prices, easing of freight cost and implementation of ongoing cost optimisation efforts. The year-ago base quarter had one of the company's lowest EBITDA margins of 7.9%.

Maintain SELL: We tweak estimates to incorporate the Q1 print and raise our target FY25E EV/EBITDA multiple to 16x (a 10% discount to the stock's 5Y average) from 15x earlier, based on recovery in the international business and an improving margin profile. Our TP thus rises from Rs 3,000 to Rs 3,300 – we maintain SELL as we find the company expensive at current valuations of 20.1x FY25E EV/EBITDA.

Key changes

Target	Rating
▲	◀ ▶

Ticker/Price	ALKEM IN/Rs 4,141
Market cap	US$ 6.0bn
Free float	41%
3M ADV	US$ 8.5mn
52wk high/low	Rs 4,243/Rs 2,855
Promoter/FPI/DII	57%/6%/16%

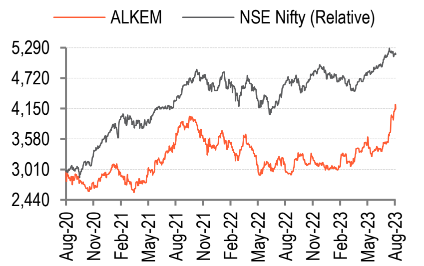
Source: NSE | Price as of 10 Aug 2023

Key financials

Y/E 31 Mar	FY23A	FY24E	FY25E
Total revenue (Rs mn)	1,15,993	1,27,954	1,42,181
EBITDA (Rs mn)	16,095	20,482	23,626
Adj. net profit (Rs mn)	10,872	15,552	18,363
Adj. EPS (Rs)	90.9	130.1	153.6
Consensus EPS (Rs)	90.9	130.5	156.5
Adj. ROAE (%)	14.4	18.8	19.3
Adj. P/E (x)	45.5	31.8	27.0
EV/EBITDA (x)	30.6	23.8	20.1
Adj. EPS growth (%)	(34.5)	43.0	18.1

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE

HOLD
TP: Rs 290 | ∀ 6%

V-GUARD INDUSTRIES | Consumer Durables | 10 August 2023

Strong quarter all through

- **All-round growth in Q1 led by non-South India markets that grew at 17% YoY**
- **Margin outlook improves with gross margin up 250bps YoY; integration of recent acquisitions progressing well**
- **TP revised to Rs 290 (vs. Rs 270) on rollover – maintain HOLD**

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Robust quarter: VGRD posted strong 19% YoY topline growth (13% ex-Sunflame acquisition) to Rs 12.1bn accompanied by improved margins in Q1FY24. Gross margin expanded 250bps YoY to 32.5% with a 60bps rise in EBITDA margin to 8.6% owing to softer commodity prices and cost optimisation, partly offset by higher employee cost. All business categories did well, with durables and electricals logging ~10% YoY growth each and electronics rising ~20%. The durables business margin has returned to positive territory, and we expect the company to improve its margin profile in the coming quarters.

High contribution from non-South markets: In Q1, VGRD's revenue from the South India market grew 10% YoY while the non-south markets increased 17%, which could have been even better but for unseasonal rains in the northern region. Markets outside the south contributed close to 50% of revenue for the quarter.

Margins guided to improve further: Softer commodity prices aided gross margin expansion in Q1, and management expects further gains ahead buoyed by upcoming festive season demand in Q2 and Q3. Lower raw material cost is also helping with inventory and working capital management, though the benefits will be partially offset by higher A&P spends going forward.

Recent acquisitions progressing well: New acquisitions Simon Electric and Sunflame are progressing well. The integration of Simon is ongoing, whereas Sunflame – which the company plans to keep separate as of now – has a management team in place following the completion of key personnel hiring. We expect healthy synergies from these acquisitions going forward.

Maintain HOLD: Although VGRD has guided for stronger margins, the company is still facing headwinds in the form of inflation and rising competition in the sector. We thus retain HOLD and continue to value the stock at a 30x P/E multiple, a 15% discount to the 3Y average, while rolling valuations over to Jun'25E for a revised TP of Rs 290 (vs. Rs 270). On the whole, we prefer HAVL in the consumer durables space.

Key changes

Target	Rating
▲	◄►

Ticker/Price	VGRD IN/Rs 308
Market cap	US$ 1.6bn
Free float	44%
3M ADV	US$ 1.4mn
52wk high/low	Rs 335/Rs 225
Promoter/FPI/DII	56%/13%/19%

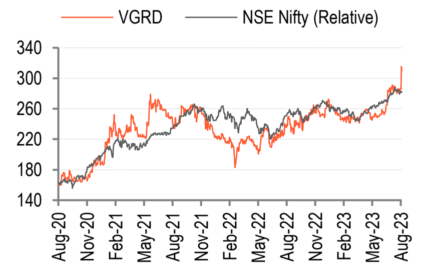
Source: NSE | Price as of 10 Aug 2023

Key financials

Y/E 31 Mar	FY23A	FY24E	FY25E
Total revenue (Rs mn)	41,260	51,095	57,608
EBITDA (Rs mn)	3,199	5,507	6,145
Adj. net profit (Rs mn)	1,891	3,458	3,849
Adj. EPS (Rs)	4.4	8.0	8.9
Consensus EPS (Rs)	4.4	7.6	8.4
Adj. ROAE (%)	12.5	19.8	18.8
Adj. P/E (x)	70.5	38.5	34.6
EV/EBITDA (x)	41.7	24.2	21.7
Adj. EPS growth (%)	(16.9)	82.9	11.3

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE

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IT SERVICES | Q1FY24 Review | 10 August 2023

Better times ahead

- Weakness in consulting, BFSI, consumer, hi-tech and telecom verticals led to deferral of order bookings
- Early signs of improvement visible especially in BFSI deal momentum from July onward
- HCLT (tier-I) and PSYS/MPHL (tier-II) relatively better placed but valuations look fair post runup

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Revenue to get back on track: Despite a poor performance in Q1FY24, we expect technology companies under our coverage to deliver managed services revenue growth around the average guidance of 5% YoY for CY23. Average contract value for managed services grew 6% YoY in Q2CY23 driven by the manufacturing and healthcare verticals, while consulting, BFSI, retail and consumer packaged goods (CPG), hi-tech, and telecom were a material drag on growth. Cloud businesses were also down in Q1 as compared to the Covid phase.

Order bookings sluggish: Due to the difficult global macro climate, Q1 commentary universally pointed to tardy decision-making, elongated working capital cycles, longer approval thresholds for deal renewals/signings, and extended transition timelines from project start to finish that limit the pricing cushion on future deal wins. Companies, thus, resorted to various levers, such as productivity, pricing, utilisation, automation, subcontracting cost, pyramid structure and portfolio mix, to preserve margins. On the bright side, the EMEA region in general (and the UK in particular) saw demand traction, with 5 of 10 large deals wins for key players coming from the region.

Cost takeout still at the fore: Deal wins for the quarter sat in two broad categories (1) full-stack portfolio services deals from vendor consolidation and cost optimisation, and (2) growth and transformational deals backed by hyperscalers and newer technologies. Smaller client enterprises focused on cost-of-delivery models that include fresher billings, higher utilisation, lower subcontracting cost and lower SG&A expense.

Valuation: Within tier-I IT services, we believe HCLT (HOLD, TP Rs 1,240) is better placed than peers. Its IT and business services (IT&BS) segment was flattish in Q1, but we expect engineering and R&D services (ER&D) and software business to drive up the topline and margins once discretionary spend kicks in. Mid-caps that look better placed in the medium term are (i) PSYS (HOLD, TP Rs 5,330) with top client deal renewals, setup of offshore delivery centres and healthy deal wins/pipeline, and (ii) MPHL (HOLD, TP Rs 2,541) given resolution of mortgage-related issues with its top 5 clients and healthy deal wins/pipeline. However, given the recent runup in IT sector valuations, we would await a better entry point into these stocks.

Recommendation snapshot

Ticker	Price	Target	Rating
AFFLE IN	1,100	1,110	HOLD
COFORGE IN	5,147	4,830	HOLD
HCLT IN	1,134	1,240	HOLD
INFO IN	1,389	1,760	BUY
MPHL IN	2,349	2,541	HOLD
PSYS IN	4,845	5,330	HOLD
TCS IN	3,442	3,580	HOLD
TECHM IN	1,236	1,130	HOLD
WPRO IN	419	420	HOLD

Price & Target in Rupees | Price as of 10 Aug 2023

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BUY – Expected return >+15%

HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

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