FIRST LIGHT

13 March 2023

RESEARCH

BOB ECONOMICS RESEARCH | IIP

Uptick in IIP growth

IT SERVICES

Sustainable growth story

SUMMARY

INDIA ECONOMICS: IIP

IIP growth improved to 5.2% in Jan'23 from 4.7% in Dec'22, led by improvement in manufacturing and electricity output. Our forecast was 5.1%. Within manufacturing, a broad-based improvement was visible led by electrical, coke and chemical products. Within use-based classification, capital, primary and consumer durable output outshined, signaling steam in the economic engines. However, concerns from global economy continues to impinge on this story. Exports continue to remain a drag, with subdued demand from global quarters. Industrial growth is likely to witness headwinds. The uptick in capex and thrust to infra and construction sector might not be enough and hence the growth in H2FY23 might be lower than anticipated.

Click here **for the full report.**

IT SERVICES

- Despite the inflationary environment and global economic slowdown, the outlook on tech spending budgets remains upbeat
- Most companies are seeing traction in digital transformation, automation and cost takeout deals
- Prefer INFO, HCLT and TCS, in that order

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Daily macro indicators

Ticker	08-Mar	09-Mar	Chg (%)
US 10Y yield (%)	3.99	3.90	(9bps)
India 10Y yield (%)	7.43	7.43	(1bps)
USD/INR	82.06	81.98	0.1
Brent Crude (US$/bbl)	82.7	81.6	(1.3)
Dow	32,798	32,255	(1.7)
Hang Seng	20,051	19,926	(0.6)
Sensex	60,348	59,806	(0.9)
India FII (US$ mn)	**06-Mar**	**08-Mar**	**Chg ($ mn)**
FII-D	7.2	(152.1)	(159.3)
FII-E	105.9	481.3	375.4

Source: Bank of Baroda Economics Research

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IIP

10 March 2023

Uptick in IIP growth

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Economist

IIP growth improved to 5.2% in Jan'23 from 4.7% in Dec'22, led by improvement in manufacturing and electricity output. Our forecast was 5.1%. Within manufacturing, a broad-based improvement was visible led by electrical, coke and chemical products. Within use-based classification, capital, primary and consumer durable output outshined, signaling steam in the economic engines. However, concerns from global economy continues to impinge on this story. Exports continue to remain a drag, with subdued demand from global quarters. Industrial growth is likely to witness headwinds. The uptick in capex and thrust to infra and construction sector might not be enough and hence the growth in H2FY23 might be lower than anticipated.

IIP growth improves: IIP growth edged upwards to 5.2% in Jan'23 compared with a growth of 4.7% in Dec'22. This was above our estimate of a 5.1% increase. This was led by manufacturing output rising to 3.7% in Jan'23 from 3.1% in Dec'22. Manufacturing sector gained momentum with over 14 out of 23 sub-industries registering improvement. Bulk of this gain was accounted by production of electrical equipment (13.6% versus -0.8%), beverages (13.4% versus 3.3%) and food products (8.3% versus 1.2%). Manufacture of coke (5.1% versus 2.1%) and chemicals (4.2% versus 2%) continued to clock higher growth. Slower pace of contraction was also noticed in manufacture of computers (-29.6% against -37%) and leather products (-0.4% against -11.4%). On the other hand, manufacture of wood products (-12.6%) and wearing apparel (-22.3%) disappointed. Production of pharma goods decelerated down to 9.2% (16% in Dec'22).

Electricity production accelerated to 12.7% against a growth of 10.4% in Dec'22. Moderation was seen in mining production at 8.8% against 10% in Dec'22. On a FYTD basis, IIP growth stands at 5.4%.

Capital and consumer goods shines: Within use-based, capital goods output accelerated to 4-month high to 11% in Jan'23 compared with a growth of 7.8% in Dec'22, led by government push. Primary goods output also improved to 7-month high to 9.6% from 8.4%. Intermediate and infra goods output eased down by 0.1% and 8.1% respectively. Output of consumer non-durable goods also registered moderation at 6.2% (7.6% in Dec'22) noting concerns over rural demand. On other hand, consumer durable goods output contracted at a much slower pace of (-) 7.5% in Dec'22 (-11% in Dec'22) signaling some pickup in domestic demand.

Risk remain for Q4: Concerns over global economic slowdown and elevated inflation remains tantamount to India's growth story too. Exports have been sharply hit as a result of the lackluster demand and is likely to remain worrisome in the coming months. This as result would also hit manufacturing growth, going ahead. Weakness in this sector was also witnessed as manufacturing PMI slowed down to 4-month low of 55.3 in Feb'23. Against the above backdrop, we expect IIP growth to be much lower than anticipated in H2FY24.

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IT SERVICES

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Sustainable growth story

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Revenue growth reasonable but from selective pockets: Tier-I IT service players under our universe posted a reasonable topline growth in Q3FY23, although we did observe weakness in various pockets such as mortgages, capital markets (some pockets), discretionary retail, hi-tech, medical devices, and certain segments of telecom. The inflationary environment followed by a global slowdown has not dampened the outlook on client tech budgets given the steady prioritisation of technology spending.

Growth divergence may arise among tier-I players: In our view, TCS and INFO are well placed for cost takeout deals and vendor consolidation on the back of their full suite of services, robust delivery, and expertise in multiple digital competencies. HCLT, on the other hand, is confident of industry-leading services growth in FY24 aided by healthy deal wins and a good order book. In the services business, TCS, INFO and HCLT are likely to deliver industry-leading growth in FY24, whereas we expect WPRO and TECHM to remain muted.

Deal wins, pipelines, and commentary strong in tough environment: Q3 deal win TCV was robust within the tier-I IT basket, rising 10-67% YoY (ex-TCS) with stable-to-improving book-to-bill ratios. Most companies are seeing traction in digital transformation, automation and cost takeout deals. Pipeline commentaries remain healthy across the board but point to higher deal tenures, elongated deal cycles and longer ramp-up times, implying slow revenue conversion. Managements were cautiously optimistic on demand, especially for cost optimisation projects, and indicated a strong outlook on verticals such as energy & utilities, BFSI (ex-mortgage), manufacturing, travel, and hospitality.

Prefer INFO, HCLT and TCS, in that order: We believe revenue growth rates will moderate in FY24 after the strong acceleration over the last two years from swift digital adoption. Tier-I IT is better positioned in larger and more broad-based cost takeout programmes that require strength across multiple domains and services, a global delivery model and the ability to offer competitive pricing across a range of competencies. Our pecking order for large-cap IT companies remains INFO (BUY, TP Rs 1,760), HCLT (BUY, TP Rs 1,240) and TCS (HOLD, TP Rs 3,580).

Recommendation snapshot

Ticker	Price	Target	Rating
HCLT IN	1,117	1,240	BUY
INFO IN	1,480	1,760	BUY
TCS IN	3,337	3,580	HOLD
TECHM IN	1,060	1,160	HOLD
WPRO IN	390	440	HOLD

Price & Target in Rupees | Price as of 9 Mar 2023

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Recommendation scale: Recommendations and Absolute returns (%) over 12 months

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

Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

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