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11 October 2024

RESEARCH

[SECTOR REPORT] PHARMACEUTICALS

Transforming from volume-driven to value-driven sector

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BSNL margin pain pops up

AUTOMOBILES | Q2FY25 PREVIEW

PV demand takes a breather; bracing for strong festive recovery

CONSUMER STAPLES | Q2FY25 PREVIEW

2QFY25: Slower sales, margin pressure. Eyes on 2H

SUMMARY

[SECTOR REPORT] PHARMACEUTICALS

- The Indian pharma market is shifting from generics to innovation, resulting in higher focus on R&D
- Biopharma companies to dominate due to lower penetration; however generic companies to continue to grow due to off patent opportunities
- We have BUYs on ERIS, for its large chronic portfolio, and ARBP, for its biosimilars pipeline; downgrade AJP to SELL for its lack of innovation

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TATA CONSULTANCY SERVICES

- 1.1% CC QoQ revenue growth was in line. Margin pain of BSNL order, not visible thus far, showed up
- Lack of mega deals has meant a 20% drop in TCV in 1HFY25. Pressure builds in 2H for TCV to support consensus revenue estimate for FY26
- Client-specific rescoping impacted international revenue growth. This has lasted for longer than expected. Re-initiating coverage soon

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BOBCAPS Research
research@bobcaps.in

AUTOMOBILES: Q2FY25 PREVIEW

- Aggregate 2W volume growth likely to remain strong at ~11% YoY for our coverage in Q2 with healthy margin recovery of 120bps
- PV segment growth muted at 6%/2% YoY/QoQ in the monsoon season; OEMs attempt to push demand by extending seasonal discounts
- Tractor segment gains traction with 6% YoY volume growth backed by above-normal monsoon, although MHCV segment awaits recovery

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- 2QFY25 sales trends likely similar / marginally better vs the Jun quarter; with slight pickup in the latter part of Sep, coinciding with the harvest
- Margins are under pressure from commodity inflation (palm, vegetable oil, tea, coffee, etc) with only partial pass through so far
- Key things to focus on: Sep and Oct trends in rural; inventory position in General Trade; cost inflation and pricing plans

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PHARMACEUTICALS

10 October 2024

Transforming from volume-driven to value-driven sector

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Foram Parekh
research@bobcaps.in

India's pharma sector expected to grow ~10x by FY47: According to the Economic Survey 2024, the Indian pharma market (IPM) is valued at US$ 50bn by turnover. As per the Ernst & Young report "Reimagining Pharma and Healthcare for India@100, Nov'23", India's pharma sector is expected to reach US$ 450bn by FY47. This growth is to be driven by all segments where generic companies will likely benefit from drugs worth US$ 250bn going off patent by 2030, while Contract Development and Manufacturing Organization (CDMO) companies will likely benefit from the Biosecure Act passed recently in the US. Till date the sector's growth was driven by branded generics, but the next focus is on innovative products.

Increasing investments towards R&D: India's pharma market has become very competitive, hence most Indian pharma companies have increased their R&D either organically or through external innovators. In the changing landscape of the global pharma market, companies are either working on low-competition complex generic/specialty/biologics/biosimilars or bringing innovative drugs to the market through in-licensing/acquisitions. Companies focusing on organic innovation have increased their R&D expenditure to 7-9% of sales, from 5-7% previously, where ~40% of their R&D is towards biosimilars/specialty products.

Strong innovation pipeline: Large Indian Pharma companies have on average strong cash balances of ~US$ 1bn which can support their investments in the development of innovative products. For eg, SUNP was an early investor in specialty products, which has reached US$ 1bn in sales. DRRD is transforming from a generics company to a healthy pipeline of NCE/NBE molecules through Horizon 2, while ERIS has shifted from being a pure Derma to a Super Specialty player.

Prefer ERIS and ARBP: We assume coverage on ERIS (BUY, TP Rs 1,648) and upgrade ALPM (TP Rs 1,412), ALKEM (TP Rs 7,225) and ARBP (Rs 1,728) to BUY. We downgrade AJP (TP Rs 2,736) to SELL from BUY. In our view, ERIS is the best play for its large chronic portfolio in the domestic market, while ARBP is a better play for biosimilars. We attribute a SELL to AJP due to its concentrated portfolio and lack of innovation.

Recommendation snapshot

Ticker	Price	Target	Rating
AJP IN	3,345	2,736	SELL
ALKEM IN	6,137	7,225	BUY
ALPM IN	1,191	1,412	BUY
ARBP IN	1,466	1,728	BUY
ERIS IN	1,396	1,648	BUY

Price & Target in Rupees | Price as of 10 Oct 2024

NOT RATED

TATA CONSULTANCY SERVICES

| IT Services | 11 October 2024

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Girish Pai
research@bobcaps.in

BSNL order props up growth again despite international softness: Against the backdrop of client-specific issues in healthcare and life sciences in North America and in the UK, peak revenue has been hit in its BSNL order which helped deliver growth in 2QFY25.

Margin hit due to third-party items. Trajectory different from the one guided for three months ago: The margin pain from the BSNL order which was not visible thus far to everyone's surprise (for three quarters now) has suddenly popped up. But the hit of ~420bps in YoY terms has been softened by the dramatic decline in Subcontractor (~250bps) and SGA costs (~170bps). The margin trajectory is quite different from the one guided three months back.

TCV addition must perk up in 2H: 1HFY25 TCV was down ~20% YoY. TCS indicated that the base had a few mega deals which were absent in 1HFY25. With the BSNL deal coming to an end in FY25 (unless there is a follow-on deal immediately) current consensus expectations on growth for FY26 requires a strong 2H on the TCV front. Not sure whether the lack of mega deals is an industry problem or a TCS specific one. TCS also talked about elongation of deal closure timelines. Maybe this is 'wait and watch' in the evolving political situation in the US.

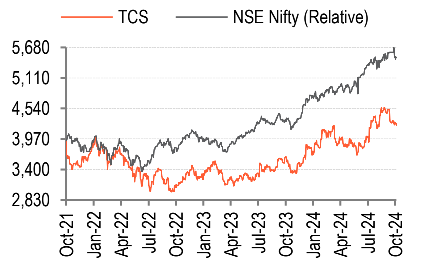
Multiple quarters of compression of book of business: TCS has seen significant revenue leakage for multiple quarters now with instances of clients ramping down or rescoping continuing to impact international revenue growth. That probably explains the cautious commentary of management three months ago when TCS seemingly delivered a decent 1QFY25. TCS is holding out hope that after a weakish 3Q due to normal furloughs, revenue growth should pick up in 4Q.

Hoping for better discretionary spend and capex by customers: TCS was of the view that with inflation moving down globally, and the first fed fund rate cut done, it expects discretionary spend and capital investments to make a comeback driving growth. However currently the demand situation on growth remains very much like what it was in the last few quarters with a big focus on cost take out.

Ticker/Price	TCS IN/Rs 4,227
Market cap	US$ 182.2bn
Free float	28%
3M ADV	US$ 129.3mn
52wk high/low	Rs 4,592/Rs 3,311
Promoter/FPI/DII	72%/12%/11%

Source: NSE | Price as of 10 Oct 2024

Stock performance



Source: NSE

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Milind Raginwar
research@bobcaps.in

Mixed bag for passenger vehicles (PV); SUV segment remains preferred choice: We expect tepid aggregate revenue growth for PV OEMs (original equipment manufacturers) in our coverage (MSIL and MM) in Q2FY25. OEMs focus continues on premium products (SUV segment). MM showcased the Thar ROXX in 2QFY25, and the 3XO compact SUV's initial bookings are very encouraging. MSIL launched the New Swift S-CNG in the hatchback segment in 2QFY24. Gross margin growth is likely to average ~115bps driven by MM; backed by limited cost head-winds, while EBITDA margins are a mixed bag with MM gaining (300bps) and MSIL dropping marginally.

Two-wheeler (2W) growth packed with rural and high-end variants: Volume data shows healthy growth across the 2W pack continues even in the lean season backed by pick up in rural demand with 13% YoY growth, despite HMCL's weak show. This is driven by the CNG Freedom model launched by BJAUT and a couple of high-end launches by TVSL. Even so, we expect gross margins for our coverage to show strong gains averaging 150bps.

Commercial vehicles (CV) await recovery: CVs are awaiting revival, with AL's volumes increasing 4% YoY (aided by the bus segment). We expect higher volumes to fuel healthy revenue growth both YoY and sequentially. Management forecasts AL's gross margin will remain range bound and hover at ~10-11% dragged largely by the weakness in the MHCV segment. EIM's CV segment has fared well, with volumes rising 6%/5% YoY/QoQ. TTMT's (Not Rated) volumes decreased sharply by ~20% YoY.

Tractors: Volumes in the tractor segment increased steadily YoY, gaining on above-normal monsoons. MM's tractor volumes increased 3%/5% YoY/YTD. ESCORTS' volumes rose 8%/2% YoY/YTD gains. The gains in the tractor segment are encouraging, indicating that 5% YoY industry growth in FY25 may be revised upwards.

Top picks: We prefer MM in the passenger vehicles segment and AL in the commercial vehicles segment.

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Lokesh Gusain
research@bobcaps.in

2QFY25 summary: We expect sales trends remained flat to slightly better vs the Jun quarter. EBITDA growth likely lagged sales growth as inflation in palm oil, vegetable oil, etc, impacted gross margins towards the latter half of 2QFY25. With sequentially flat to only slightly better sales, the rise in A&P spend as a percentage of sales will appear to be higher but investors should focus on the areas of incremental spend. For instance, DABUR spend on OTC/healthcare is a positive given a wetter/cooler 2Q plus a buildup to the upcoming harsher-than-usual winter season; however, spend in Health Food Drinks by HUL is a negative.

Key focus areas: (1) Sequential trends in rural demand will be a focus. We do not expect any meaningful improvement in 2QFY25. Commentary on Sep and Oct trends will be key. Most relevant for DABUR, HUL, BRIT and MRCO.
(2) Destocking risk/inventory status due to channel shift from traditional to quick commerce needs to be clarified by FMCG majors – concerns post the magnitude of inventory correction at DABUR. (3) Cost inflation and pricing plans of FMCG companies will show the degree of rationality in the industry. Gradual small inflation will likely help in share gains from smaller/regional players.

FY25E outlook and our view: Rural indicators are favourable with CPI, monsoon and sowings improving through the Sep'24 quarter – see here, here and here. However, pickup in demand likely started only towards the end of Sep, coinciding with the harvesting season. We expect a meaningful boost in demand in the Dec quarter on post-Kharif cash flow for farmers combined with a favourable irrigation backdrop for Rabi. We are positive on FMCG on rural recovery with harsher winter likely to have a positive impact in select pockets of OTC/healthcare/tea/bakery.

Name	BoB EBITDA – YoY	Consensus EBITDA – YoY	Date	Estimated / confirmed
NEST	9%	n/m	17-Oct-24	Confirmed
HUVR	3%	2%	18-Oct-24	Estimated
ITC	-6%	-4%	24-Oct-24	Estimated
MRCO	-8%	-8%	29-Oct-24	Confirmed
DABUR	-17%	-13%	30-Oct-24	Confirmed
TATACONS	11%	15%	31-Oct-24	Estimated
GCPL	2%	n/m	31-Oct-24	Estimated
BRIT	20%	29%	07-Nov-24	Estimated

Sources: Refinitiv consensus as on 10 Oct 2024, Company reports, BoB Research

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Name of the Research Entity: **BOB Capital Markets Limited**
Registered office Address: **1704, B Wing, Parinee Crescenzo, G Block, BKC, Bandra East, Mumbai 400051**
SEBI Research Analyst Registration No: **INH000000040 valid till 03 February 2025**
Brand Name: **BOBCAPS**
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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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