# FIRST LIGHT

17 November 2020

## RESEARCH

### IT Services | Q2FY21 Review
V-shaped recovery in Q2

### BOB Economics Research | Wholesale Inflation
Core drives WPI higher, food moderates

### Mahanagar Gas | Target: Rs 750 | –15% | SELL
Margins surge but volume recovery lags peers

### Oil & Gas
Petroleum demand soars for first time since lockdown

## SUMMARY

### IT Services: Q2FY21 Review

Q2FY21 has been a much-awaited recovery quarter for Indian IT, exhibiting a V-shaped rebound marked by growth and margin outperformance across the sector. Traction in cloud and digital business fueled order pipeline revival and higher TCV. We expect the momentum to continue over the near-to-midterm, barring seasonality in Q3, with most of our coverage headed for positive growth in FY21. Coforge has shown agility in handling the pandemic – we upgrade the stock to BUY from ADD and raise our Sep'21 TP to Rs 2,690 (vs. Rs 2,630).

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### India Economics: Wholesale Inflation

WPI rose to 1.5% in Oct'20 (1.3% in Sep'20) led by core which increased to 1.7% in Oct'20 from 1% in Sep'20. Manufactured products too turned costly (2.1% in Oct'20 from 1.6% in Sep'20). Food prices showed moderation (5.8% in Oct'20 from 6.9% in Sep'20), led by cereals and a few protein based items. Low oil prices remain the biggest driver of benign WPI outlook. The moderation in food inflation bodes well for much anticipated decline in CPI. However, its trajectory will remain above RBI's target thus leaving limited room to reduce policy rates.

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## TOP PICKS

### LARGE-CAP IDEAS

| Company | Rating | Target |
|---|---|---|
| Cipla | Buy | 900 |
| GAIL | Buy | 155 |
| Petronet LNG | Buy | 330 |
| TCS | Buy | 3,180 |
| Tech Mahindra | Buy | 980 |

### MID-CAP IDEAS

| Company | Rating | Target |
|---|---|---|
| Alkem Labs | Buy | 3,600 |
| Greenply Industries | Buy | 150 |
| Laurus Labs | Buy | 410 |
| Transport Corp | Buy | 300 |
| Mahanagar Gas | Sell | 750 |

Source: BOBCAPS Research

### DAILY MACRO INDICATORS

| Indicator | Current | 2D (%) | 1M (%) | 12M (%) |
|---|---|---|---|---|
| US 10Y yield (%) | 0.88 | (9bps) | 11bps | (94bps) |
| India 10Y yield (%) | 5.91 | 0bps | 1bps | (61bps) |
| USD/INR | 74.65 | (0.4) | (1.9) | (3.7) |
| Brent Crude (US$/bbl) | 43.50 | (0.6) | 4.3 | (30.1) |
| Dow | 29,080 | (1.1) | 0.8 | 4.7 |
| Shanghai | 3,339 | (0.1) | (0.6) | 14.7 |
| Sensex | 43,357 | (0.5) | 6.8 | 7.6 |
| **India FII (US$ mn)** | **11 Nov** | **MTD** | **CYTD** | **FYTD** |
| FII-D | 10.7 | 190.9 | (14,038.8) | (4,279.3) |
| FII-E | 1,155.5 | 3,678.3 | 10,224.7 | 16,827.7 |

Source: Bank of Baroda Economics Research

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## Mahanagar Gas

Mahanagar Gas's (MAHGL) Q2FY21 PAT outperformed at Rs 1.4bn (–46% YoY, +3x QoQ). Q2 highlights: (a) Volumes were above estimates at 2.1mmscmd (–31% YoY), recovering 88% QoQ. (b) EBITDA margins swelled to Rs 11.6/scm (+17% YoY), driving the overall beat on earnings. We expect the extended lockdown in the Mumbai region to keep CNG volumes sluggish until H1FY22, leading us to cut FY21/FY22 earnings by 8%/13%. Our Sep'21 DCF-based TP remains unchanged at Rs 750. Maintain SELL.

**Click here for the full report.**

## Oil & Gas

India's petroleum product consumption jumped 15% MoM (+2% YoY) to 17.8mmt in October as fuels across segments exhibited resurgent growth in tandem with the Indian economy's emergence from the world's strictest lockdown. A YoY comparison shows strong demand trends for all major petroleum products except ATF (–50% YoY).

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**IT SERVICES** | Q2FY21 Review | 13 November 2020

# V-shaped recovery in Q2

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**Q2FY21 has been a much-awaited recovery quarter for Indian IT, exhibiting a V-shaped rebound marked by growth and margin outperformance across the sector. Traction in cloud and digital business fueled order pipeline revival and higher TCV. We expect the momentum to continue over the near-to-midterm, barring seasonality in Q3, with most of our coverage headed for positive growth in FY21. Coforge has shown agility in handling the pandemic – we upgrade the stock to BUY from ADD and raise our Sep'21 TP to Rs 2,690 (vs. Rs 2,630).**

**V-shaped recovery:** Contrary to the street's expectations of a muted U-shaped turnaround for Indian IT, tier-I companies have swiftly recouped losses by growing 6.1% QoQ in Q2FY21 (post 6.1% contraction in Q1) and tier-II stocks also saw a similar V-shaped recovery pattern. Growth momentum has been expedited by a boom in cloud demand. Supply-side issues also stand resolved.

**Rebound in key verticals:** Demand has rebounded across BFS, life-sciences, hi-tech and retail-CPG. BFS saw a pickup in mortgage and lending services as well as digital transformation programmes, while insurance had a mixed showing. Manufacturing and travel saw some recovery but will take longer to normalise. Vendor consolidation post Covid-19 has helped companies in our coverage gain market share (e.g. Coforge in the airlines segment). Emerging areas of demand include cloud partnerships with hyperscalers, data-driven products, cybersecurity, customer experience, cost optimisation, automation and supply chain revamp.

**Margins climb higher:** Indian IT companies reported operating margin expansion in the range of 80-400bps QoQ in Q2, backed by higher utilisation, increased offshoring, SG&A reduction, and lower travel and branding costs. Players are also winding up the timebound Covid discount offered to clients during Q4F20 and Q1FY21, besides undertaking pyramid optimisation. We expect margins to be slightly impacted in Q3 due to salary hikes and rising marketing and travel spend.

**FY22 to see growth acceleration:** Most IT companies are headed for positive growth in FY21 post Q2 (vs. earlier expectations of a decline). TCV has largely recovered to pre-pandemic levels, even hitting peaks for some (Infosys, Coforge, Mphasis). Growing cloud pipeline and digital transformation demand in BFSI and retail-CPG should fuel stellar growth in FY22, on a lower base of FY21.

## RECOMMENDATION SNAPSHOT

| Ticker | Price | Target | Rating |
|---|---|---|---|
| TCS IN | 2,657 | 3,180 | BUY |
| INFO IN | 1,124 | 1,210 | ADD |
| WPRO IN | 344 | 290 | SELL |
| HCLT IN | 828 | 980 | BUY |
| TECHM IN | 839 | 980 | BUY |
| LTI IN | 3,022 | 3,590 | BUY |
| MPHL IN | 1,317 | 1,410 | REDUCE |
| MTCL IN | 1,348 | 1,540 | ADD |
| PSYS IN | 1,142 | 840 | SELL |
| COFORGE IN | 2,304 | 2,690 | BUY |
| ECLX IN | 715 | 600 | SELL |

Price & Target in Rupees

WHOLESALE INFLATION

16 November 2020

# Core drives WPI higher, food moderates

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**WPI rose to 1.5% in Oct'20 (1.3% in Sep'20) led by core which increased to 1.7% in Oct'20 from 1% in Sep'20. Manufactured products too turned costly (2.1% in Oct'20 from 1.6% in Sep'20). Food prices showed moderation (5.8% in Oct'20 from 6.9% in Sep'20), led by cereals and a few protein based items. Low oil prices remain the biggest driver of benign WPI outlook. The moderation in food inflation bodes well for much anticipated decline in CPI. However, its trajectory will remain above RBI's target thus leaving limited room to reduce policy rates.**

**WPI inflation firms up:** WPI inched up to 1.5% in Oct'20 compared with 1.3% in Sep'20. This was on account of higher core inflation. Food inflation eased to 5.8% in Oct'20 from 6.9% in Sep'20.

**Core inflation inches up:** Core inflation rose to 1.7% in Oct'20 from 1% in Sep'20. Manufactured inflation rose to 2.1% from 1.6% in Sep'20. Of the 22 commodities, prices of 14 commodities rose, with manufactured food, basic metals, and pharmaceutical products taking the lead. This was in-line with higher international commodity prices which went up by 5.2% in Oct'20 on YoY basis versus an increase of 4.7% in Sep'20. A further increase in global commodity prices is not ruled out with potential vaccine on the horizon.

**Food inflation eases:** Food inflation moderates to 5.8% in Oct'20 from 6.9% in Sep'20 driven by sharp deceleration in vegetable prices (increase of 25.2% in Oct'20 from 36.5% in Sep'20). Tomato prices reached a 4-month low of 14% in Oct'20 compared with 99.3% in Sep'20. Cereal inflation increased by 5.2% in Oct'20 led by sharp contraction in wheat prices (8.1% in Oct'20 from 5.2% in Sep'20). Paddy prices too moderated by 0.6% in Oct'20. Protein based items such as pulses and eggs continue to see inflationary pressure at 15.9% and 17.3% respectively in Oct'20. Milk prices edged lower marginally to 5.5% in Oct'20.

**Deflation in fuel and power continues**: Fuel and power inflation contracted by 10.9% in Oct'20 versus decline of 9.5% in Sep'20. Mineral oil index fell by 15.8% versus decline of 15% in Sep'20. This is attributable to sharp pace of contraction in petrol, diesel, ATF and Kerosene. International oil prices were down by 30.4% in Oct'20 (YoY) versus 32.8% decline in Sep'20. We expect deflation in fuel and power to continue given oil price outlook remains favourable.

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**SELL**
TP: Rs 750 | ∀ 15%

**MAHANAGAR GAS** | Oil & Gas | 13 November 2020

# Margins surge but volume recovery lags peers

**Mahanagar Gas's (MAHGL) Q2FY21 PAT outperformed at Rs 1.4bn (–46% YoY, +3x QoQ). Q2 highlights: (a) Volumes were above estimates at 2.1mmscmd (–31% YoY), recovering 88% QoQ. (b) EBITDA margins swelled to Rs 11.6/scm (+17% YoY), driving the overall beat on earnings. We expect the extended lockdown in the Mumbai region to keep CNG volumes sluggish until H1FY22, leading us to cut FY21/FY22 earnings by 8%/13%. Our Sep'21 DCF-based TP remains unchanged at Rs 750. Maintain SELL.**

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**Volume recovery lags peers:** MAHGL's CNG volumes surged 2.6x QoQ to 117mmscm (–42% YoY) in Q2, but relatively underperformed peers. Revival to pre-Covid demand levels could be delayed to H1FY22 considering the extended lockdown in Mumbai (buses being hit the most as school reopening stands postponed to FY22). Over the long term, rising infrastructure constraints in Mumbai for CNG outlet expansion and improving alternate travel options (metro) suggest volume growth may remain weak.

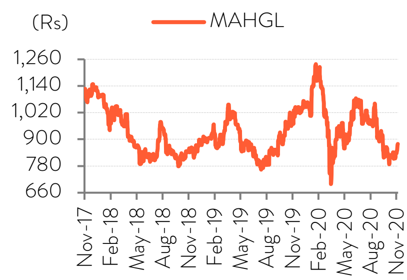
**Margins surge:** Q2 EBITDA margin expanded to Rs 11.6/scm as CNG volumes increased, and MAHGL used its pricing advantage primarily to limit the YoY impact on earnings. We raise our margin estimates to ~Rs 11/scm (from Rs 10 earlier) but trim volume assumptions by ~10% over FY21/FY22. These margins may not sustain beyond FY21 as MAHGL would need to chase volume growth, especially in the industrial and commercial PNG segments.

**Maintain SELL:** Muted FY20-FY23 earnings trends accompanied by recurring concerns over CNG volume growth are likely to add fuel to the sustained derating in multiples seen over the last quarter. MAHGL lags peers on volume growth and would need to compromise on margins eventually. Expansion into new areas could also be delayed due to the pandemic impact.

| | |
|---|---|
| Ticker/Price | MAHGL IN/Rs 879 |
| Market cap | US$ 1.2bn |
| Shares o/s | 99mn |
| 3M ADV | US$ 12.4mn |
| 52wk high/low | Rs 1,246/Rs 664 |
| Promoter/FPI/DII | 33%/30%/38% |

Source: NSE

## STOCK PERFORMANCE




Source: NSE

## KEY FINANCIALS

| Y/E 31 Mar | FY19A | FY20A | FY21E | FY22E | FY23E |
|---|---|---|---|---|---|
| Total revenue (Rs mn) | 27,911 | 29,721 | 24,145 | 29,290 | 35,006 |
| EBITDA (Rs mn) | 8,855 | 10,528 | 9,936 | 10,725 | 12,384 |
| Adj. net profit (Rs mn) | 5,464 | 7,935 | 6,875 | 7,254 | 8,349 |
| Adj. EPS (Rs) | 55.3 | 80.3 | 69.6 | 73.4 | 84.5 |
| Adj. EPS growth (%) | 14.3 | 45.2 | (13.4) | 5.5 | 15.1 |
| Adj. ROAE (%) | 24.3 | 29.7 | 22.2 | 21.4 | 22.5 |
| Adj. P/E (x) | 15.9 | 10.9 | 12.6 | 12.0 | 10.4 |
| EV/EBITDA (x) | 9.7 | 8.1 | 8.5 | 7.8 | 6.8 |

Source: Company, BOBCAPS Research

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**OIL & GAS**

13 November 2020

# Petroleum demand soars for first time since lockdown

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- India's petroleum product consumption jumped 15% MoM (+2% YoY) to 17.8mmt in October as fuels across segments exhibited resurgent growth in tandem with the Indian economy's emergence from the world's strictest lockdown.
- A YoY comparison shows strong demand trends for all major petroleum products except ATF (–50% YoY). The latter is because the airlines are not yet operating at normal capacity.
- Petrol and diesel consumption stood at 2.7mmt (+8% MoM, +4.5% YoY) and 7mmt (+27% MoM, +7.5% YoY) respectively in Oct'20. ATF offtake was at 0.4mmt (+98% MoM, –50% YoY) – this remains the worst hit fuel but demand has risen to 51% of normal levels (as against an average of 25% since the start of FY20).
- Demand for fuel oil (+9% MoM, +13% YoY), bitumen (+49% MoM, +58% YoY) and pet coke (+4% MoM, –22% YoY) showed marked MoM improvement as refinery operations and construction activities gathered pace. Consumption of naphtha, a petrochemical feedstock, soared to 1.3mmt (+14% MoM, +17% YoY). LPG, the only fuel that grew even during the lockdown period, rose to 2.4mmt (+3% YoY, +7% MoM).
- Based on OMCs' earnings commentary, the outlook on marketing margins looks robust. With volume growth recovery likely from H2FY21, this outlook improves even further. Expected announcement of the BPCL divestment would provide additional impetus to a rerating for IOCL and HPCL.

## KEY RECOMMENDATIONS

| Ticker | Price | Target | Rating |
|---|---|---|---|
| IOCL IN | 84.7 | 170 | BUY |
| BPCL IN | 393 | 480 | BUY |
| HPCL IN | 215 | 440 | BUY |

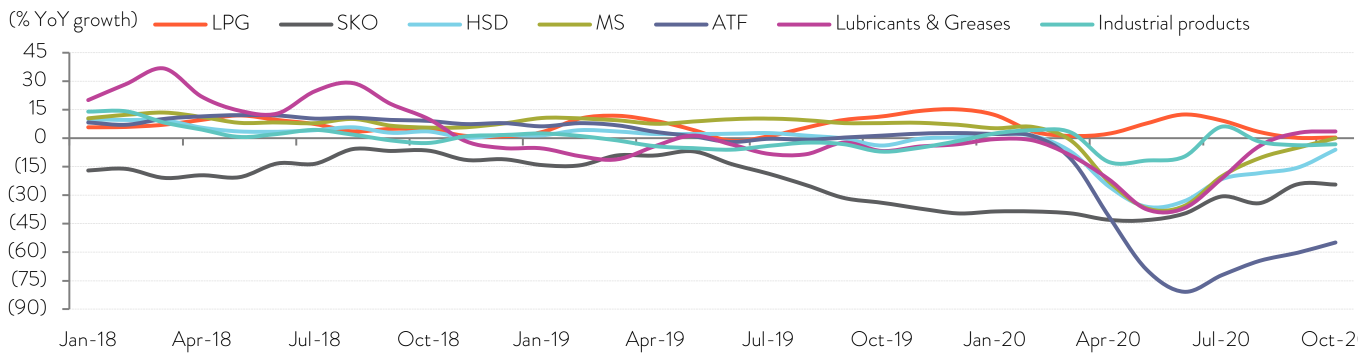
Price & Target in Rupees

## PETRO PRODUCT CONSUMPTION

| ('000 mt) | Oct'20 | YoY (%) | H1FY21 | YoY (%) |
|---|---|---|---|---|
| LPG | 2,422 | 2.6 | 13,278 | 5.8 |
| SKO | 139 | (18.3) | 928 | (33.0) |
| HSD | 6,994 | 7.5 | 30,896 | (25.2) |
| MS | 2,654 | 4.5 | 12,117 | (20.8) |
| Naphtha | 1,299 | 17.1 | 6,577 | 2.8 |
| ATF | 355 | (49.7) | 1,190 | (70.5) |
| LDO | 69 | 42.9 | 343 | 6.4 |
| Lubes & Greases | 316 | 5.9 | 1,572 | (16.4) |
| FO & LSHS | 532 | 13.2 | 2,791 | (8.5) |
| Bitumen | 662 | 58.3 | 2,684 | (5.8) |
| Petcoke | 1,394 | (22.2) | 9,064 | (5.5) |
| Others | 941 | (4.8) | 4,930 | (18.9) |
| **Total** | **17,777** | **2.1** | **86,370** | **(17.6)** |

Source: PPAC

## FIG 1 – QUARTERLY ROLLING CONSUMPTION GROWTH FOR PETROLEUM PRODUCTS




Source: PPAC, BOBCAPS Research

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**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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