

RESEARCH

BOB Economics Research | Weekly Wrap

India yield curve flattens

Mindtree | Target: Rs 1,850 | +11% | ADD

Good growth; onset of a positive cycle

Automobiles

Spiking RM costs to puncture earnings

SUMMARY

India Economics: Weekly Wrap

Global yields fell, equity markets were lower and DXY index rose as world economy battles another wave of Covid-19. US jobless claims rose and retail sales were below estimates. Oil prices fell. Commodity prices continue to rise led by China's growth at 2.3%, above estimates. Indian 2Y yield rose by 30bps after RBI mopped up Rs 2tn at cut-off of 3.55%. Notably, Covid-19 curve in India continues to flatten. Long-end yields are relatively stable and trajectory of the same will depend on fiscal deficit glide path to be released on 1 Feb.

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

Mindtree

Mindtree (MTCL) reported a strong Q3FY21 performance with dollar revenue growth of 5% QoQ and EBIT margin at an all-time high of 19.6% (+230bps QoQ). Management expects continued margin resilience in the near term despite impending wage hikes. Deal wins were healthy at US\$ 312mn. We raise FY21/FY22/FY23 EPS by 12%/11%/8% on higher margin assumptions and hike our target P/E to 23.4x (vs. 21x). Rolling valuations over, we have a revised Dec'21 TP of Rs 1,850 (vs. Rs 1,540). Retain ADD.

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TOP PICKS

LARGE-CAP IDEAS

Company	Rating	Target
Cipla	Buy	900
GAIL	Buy	155
Petronet LNG	Buy	330
TCS	Buy	3,710
Tech Mahindra	Buy	1,040

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 (%)	1.08	(5bps)	18bps	(74bps)
India 10Y yield (%)	5.95	6bps	6bps	(68bps)
USD/INR	73.07	0	0.8	(2.8)
Brent Crude (US\$/bbl)	55.10	(2.3)	8.6	(15.0)
Dow	30,814	(0.6)	2.0	5.0
Shanghai	3,566	0	5.9	16.0
Sensex	49,035	(1.1)	6.0	16.9
India FII (US\$ mn)	14 Jan	MTD	CYTD	FYTD
FII-D	(45.0)	(428.6)	(428.6)	(4,522.2)
FII-E	220.4	2,440.3	2,440.3	32,416.1

Source: Bank of Baroda Economics Research

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Automobiles

Input costs make up 65-70% of revenues for most auto manufacturers. Since the Q2FY21 results were announced, prices have spiked abruptly for steel (97%), aluminium (17%), lead (7%), natural rubber (15%) and crude derivatives (29%). We have been flagging the rich valuations of the auto pack and are now doubly concerned given the corrosive impact of commodity price inflation on auto margins. We expect sharp downgrades to consensus margin estimates and recommend a strong SELL on all auto OEM and tyre companies.

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WEEKLY WRAP

18 January 2021

India yield curve flattens

Global yields fell, equity markets were lower and DXY index rose as world economy battles another wave of Covid-19. US jobless claims rose and retail sales were below estimates. Oil prices fell. Commodity prices continue to rise led by China's growth at 2.3%, above estimates. Indian 2Y yield rose by 30bps after RBI mopped up Rs 2tn at cut-off of 3.55%. Notably, Covid-19 curve in India continues to flatten. Long-end yields are relatively stable and trajectory of the same will depend on fiscal deficit glide path to be released on 1 Feb.

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Markets

- **Bonds:** US 10Y yield closed lower by 3bps (1.08%) as Fed Chair indicated that policy will remain accommodative. Rising Covid-19 cases meant yields were largely stable to lower globally. Oil prices too fell by 1.6% (US\$ 55/bbl). However, India's 2Y yield rose by 30bps as RBI mopped up Rs 2tn at cut-off of 3.55% thus pushing short-end yields higher. System liquidity surplus was at Rs 5.1tn as on 15 Jan 2021 versus Rs 5.6tn last week.
- **Currency:** DXY rose by 0.7% on safe-haven demand amidst resurgence in Covid-19 cases globally despite rising US jobless claims and poor retail sales. GBP rose by 0.2% in the week as BoE Governor quashed expectations of negative interest rates. INR rose by 0.2% supported by lower oil prices and FII inflows (US\$ 588mn).
- **Equity:** Barring Nikkei and Sensex, other global indices ended lower this week led by resurgence in Covid-19 cases and imposition of lockdown restrictions in many parts of the world. FTSE (2%) declined the most followed by Dax (1.9%). However, Sensex (0.5%) ended the week in green led by tech and oil & gas stocks.
- **Covid-19 tracker:** Global cases rose by 4.96mn in the week ending 15 Jan 2021 compared with 4.90mn in the previous week, led by surge in US and Europe. India added 114k cases in the week versus 127k in the earlier week.
- **Upcoming key events:** In the current week, flash global PMIs, policy decisions of ECB and BoJ and Germany's ZEW index is due. On the domestic front, news flow surrounding budget expectations and progress on vaccine will impact the markets.



ADD

TP: Rs 1,850 | ▲ 11%

MINDTREE

| IT Services

| 18 January 2021

Good growth; onset of a positive cycle

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Travel and manufacturing recovery: MTCL's dollar revenue increased 5% QoQ vs. 3.6% estimated, its highest third-quarter growth in a decade, driven by 12.6% growth in travel, media and services and a 5.5% uptick in manufacturing. Q3 marked a large deal win from a large airline. BFSI was flattish, up ~1%. TCV at US\$ 312mn rose 3% QoQ and 51% YoY. The 9M order book has crossed the US\$ 1bn mark. Overall, MTCL delivered growth on par with tier-I IT players.

Ticker/Price	MTCL IN/Rs 1,664
Market cap	US\$ 3.7bn
Shares o/s	165mn
3M ADV	US\$ 23.9mn
52wk high/low	Rs 1,780/Rs 692
Promoter/FPI/DII	74%/11%/15%

Source: NSE

Margins surprise: EBIT margin was at an all-time high of 19.6% (+230bps QoQ) aided by good topline growth and higher gross margins. Utilisation was also at an all-time high of 83.4%, up 430bps QoQ. Q4 will see headwinds from pending salary hikes, but management is confident of delivering a 20%+ EBITDA margin nevertheless. MTCL has embarked on a positive cycle following new CEO takeover, resulting in elevated margins due to an aggressive focus on profitable growth (using levers such as utilisation, offshoring, deep account mining and rationalisation of long-tail).

STOCK PERFORMANCE



Source: NSE

Healthy pipeline; positive outlook: Per management, demand has grown in the areas of simplification of operations, cost takeout, vendor consolidation and customer experience. MTCL's new 4*4*4 strategy has received a good client response. Management anticipates a healthy deal win ratio and pipeline.

KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue (Rs mn)	70,215	77,643	80,109	94,876	105,993
EBITDA (Rs mn)	10,645	10,623	16,449	20,011	20,930
Adj. net profit (Rs mn)	7,542	6,309	10,867	12,816	13,330
Adj. EPS (Rs)	45.8	38.3	66.0	77.8	81.0
Adj. EPS growth (%)	32.1	(16.3)	72.3	17.9	4.0
Adj. ROAE (%)	24.9	19.5	31.3	30.8	27.1
Adj. P/E (x)	36.3	43.4	25.2	21.4	20.5
EV/EBITDA (x)	25.6	25.6	16.4	13.2	12.3

Source: Company, BOBCAPS Research



AUTOMOBILES

18 January 2021

Spiking RM costs to puncture earnings

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Steel: Steel forms ~60% of the raw material used in a car. Since Sep'20, steel prices have surged >90% (from ~US\$ 540 to >US\$ 1,000), which can have a devastating impact on margins. Even if steel averages at US\$ 750-800, auto companies will need to hike prices by over 15% to maintain Q2FY21 margins.

Natural rubber and crude derivatives: Natural rubber and crude derivatives are the key components in tyres. Combined input costs are at ~70% of revenue. With a 15% jump in natural rubber and ~29% spike in crude derivative prices, we estimate that input costs will get dearer by 23% over Q2FY21 levels. To mitigate this impact, tyre companies will have to effect price hikes of over 15%.

Our estimates vs. consensus: Aggregate estimates for our auto coverage are marginally higher than consensus on revenue (by 5%/2% for FY22/FY23) but lower on EBITDA (by 9%/14%). We believe this is a function of our lower gross margin assumptions. Aggregate adj. PAT estimates for our coverage companies are thus 17%/19% below consensus. (refer Fig. 1)

Consensus margins at high risk of downgrade – SELL OEM and tyre stocks:

Our revenue forecasts are higher than the street, limiting any positive surprise on volume growth. After the steep >10% price hike taken by most automakers due to BSVI transition, we see little scope for further hikes, implying the RM cost burden will erode margins in the near-to-medium term. The street's view of gross margin expansion in FY22 and FY23 looks overstated, leaving us skeptical of current valuations which are running much ahead of long-term averages. We expect sharp downgrades to consensus estimates as commodity prices stabilise.

We thus recommend a strong SELL on all auto OEM and tyre companies. Our top SELLS are Ashok Leyland, Maruti Suzuki, Hero Moto, TVS Motor, Escorts, Apollo Tyres, MRF, JK Tyre, Balkrishna Industries, CEAT and TVS Srichakra.

RECOMMENDATION SNAPSHOT

Ticker	Price	Target	Rating
AL IN	114	60	SELL
BJAUT IN	3,565	2,800	SELL
EIM IN	2,860	2,200	SELL
ESC IN	1,268	1,150	SELL
HMCL IN	3,155	2,900	SELL
MSIL IN	7,768	6,900	SELL
MM IN	800	630	SELL
TVSL IN	498	350	SELL
VSTT IN	1,849	2,300	BUY
APTY IN	177	140	SELL
BIL IN	1,607	1,340	SELL
CEAT IN	1,199	780	SELL
JKI IN	87	70	SELL
MDA IN	86	110	BUY
MRF IN	85,598	67,000	SELL
SWE IN	1,350	1,300	SELL
SRTY IN	1,791	1,200	SELL

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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