FIRST LIGHT

25 September 2020

RESEARCH

Automobiles

Channel check takeaways – Dismal demand climate for MHCVs

GROUND CONNECT

Cera Sanitaryware | Target: Rs 2,440 | +9% | ADD

Demand trends improving

IT Services

Stellar outsourcing show- a positive readthrough for Indian IT

SUMMARY

Automobiles

We interacted with some multi-axle truck fleet owners – key takeaways: (1) demand far lower than commonly perceived; rising diesel cost denting profits, (2) driver shortage adding to woes, (3) threat from railways real but not immediate, (4) growing second-hand demand to impede new CV sales, and (5) scrappage policy unlikely to buoy demand. Reiterate SELL on Ashok Leyland (AL) given rich valuations amidst poor demand visibility.

Click here for the full report.

Cera Sanitaryware

Key takeaways from our interaction with the management of Cera Sanitaryware (CRS): (1) Demand has been reviving over the past few months alongside gradual unlocking of the economy. CRS's July-August sales were cumulatively at ~95% of year-ago levels vs. ~85% levels in June and 55-60% in May, (2) Tier-3 cities and below, where the impact of Covid-19 has been limited, have been key demand drivers. These markets now account for ~65% of the company's turnover (vs. ~55% historically).

Click here for the full report.

TOP PICKS

LARGE-CAP IDEAS

Company	Rating	Target
Bajaj Finance	Buy	4,000
Cipla	Buy	850
GAIL	Buy	155
Petronet LNG	Buy	310
Tech Mahindra	Buy	910

MID-CAP IDEAS

Company	Rating	Target
Alkem Labs	Buy	3,600
Chola Investment	Buy	280
Laurus Labs	Buy	1,200
Transport Corp	Buy	270
Mahanagar Gas	Sell	750

Source: BOBCAPS Research

DAILY MACRO INDICATORS

Indicator	Current	2D (%)	1M (%)	12M (%)
US 10Y yield (%)	0.67	0bps	4bps	(106bps)
India 10Y yield (%)	5.99	(2bps)	(10bps)	(77bps)
USD/INR	73.57	0	1.7	(3.6)
Brent Crude (US$/bbl)	41.77	0.1	(5.8)	(33.1)
Dow	26,763	(1.9)	(4.2)	(0.8)
Shanghai	3,280	0.2	(3.0)	11.0
Sensex	37,668	(0.2)	(2.0)	(2.4)
India FII (US$ mn)	**22 Sep**	**MTD**	**CYTD**	**FYTD**
FII-D	(35.8)	450.1	(14,639.9)	(4,880.4)
FII-E	(241.5)	531.7	5,339.1	11,942.0

Source: Bank of Baroda Economics Research

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IT Services

Accenture's (ACN) Q4FY20 dollar revenue was in line with the guided range of US$ 10.6bn-11bn, posting a decline of 1.4% QoQ and 1% CC. The guidance of 2-5% CC growth for FY21 was lower than street's estimates but aligned with the current economic climate. Positive takeaways were record bookings of US$ 14bn buoyed by high outsourcing bookings and impressive recovery in outsourcing revenue – this in turn heralds better times for Indian counterparts. We maintain a positive sector outlook and prefer TCS, HCLT and TECHM among large-caps.

Click here for the full report.

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AUTOMOBILES

24 September 2020

Channel check takeaways – Dismal demand climate for MHCVs

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We interacted with some multi-axle truck fleet owners – key takeaways below:

Demand far lower than commonly perceived; rising diesel cost denting profits: Freight demand has reached just 35-40% of pre-Covid levels pan-India. Agri demand is strong but offtake from other sectors lags. The steep 15-17% rise in diesel cost (40% of operational costs) since unlocking began in June has not been covered by the meagre 2-3% rise in freight rates, denting profitability and hence vehicle demand from fleet operators.

Driver shortage adds to woes: About 75-80% of drivers hail from Uttar Pradesh and Bihar now vs. Punjab and Haryana in the past. Mass migration of labour to rural areas during the pandemic has caused a severe paucity of drivers, stalling 30-35% of fleet operations. Even so, available capacity is ahead of demand.

Threat from railways real but not immediate: The adverse impact on roadways will depend on the pace of infrastructure buildup around the rail links. The biggest challenge of converting goods from road to rail is door-to-door delivery – costs will increase due to building of the desired infrastructure, loading and unloading from factories to railway wagons, and then last-mile transport. Thus, though rail will be faster, it may not be as cost effective.

Growing second-hand demand to impede new CV sales: Discounts on newer models remain far higher than average to lure buyers (Rs 300k-400k on a Rs 1.8mn-2mn multi-axle truck). The slowdown has forced many fleet owners to cut capacity by selling into the replacement market. Also, used truck prices are down by Rs 200k-300k from pre-Covid levels, leaving little incentive for fleet owners to add new assets. This may delay recoveries in new truck sales.

Scrappage policy unlikely to buoy demand: The wait for a scrappage policy has been more at the manufacturers' end rather than the users' end. Fleet operators cite demand and profitability as prime motives for fleet additions, rather than discounts or scrappage incentives. Fleet addition is feasible only when demand and freight rates are strong and steady, supporting aggressive finance availability.

Our view – SELL AL: In FY21 YTD, Ashok Leyland's (AL) M&HCV sales are down 86% YoY. We model for a mere 18% YoY drop in FY21 (strong recovery in H2) and a 50% YoY jump in FY22. Overall, we expect a 10% volume CAGR for FY20-FY23 with 250bps margin gains. Our aggressive growth assumptions yield EPS of Rs 3.4 for FY23. Valuations look rich at 29x FY22E EPS. We continue to value AL at 16x Sep'22E EPS and retain SELL with a Sep'21 TP of Rs 44.

GROUND CONNECT

Valuable insights from differentiated primary research

KEY RECOMMENDATIONS

Ticker	Price	Target	Rating
AL IN	70	44	SELL

Price & Target in Rupees

BACKGROUND OF CHANNEL CHECK PARTICIPANTS

Fleet owner #1

- Now operates on an asset-light model vs. ownership model earlier (built over last 10yrs)
- Sold entire fleet of >170 multi-axle trucks over the last two years, given operational and profitability issues
- Converted the business into consignment-wise contracting of trucks
- Offers 60 days' credit to corporate customers; makes advance payment of ~80% of freight cost to truck operators

Fleet owner #2

- Midsized multi-axle fleet owner with newly built fleet of 22 trucks
- 10 and 6 trucks added respectively in CY18 and CY19; only 1 truck added in CY20
- Does not plan to expand the fleet further this year given weak market conditions

ADD
TP: Rs 2,440 | ⮝ 9%

CERA SANITARYWARE | Construction Materials | 24 September 2020

Demand trends improving

We recently interacted with the management of Cera Sanitaryware (CRS). Following are the key takeaways:

- Demand has been reviving over the past few months alongside gradual unlocking of the economy. CRS's July-August sales were cumulatively at ~95% of year-ago levels vs. ~85% levels in June and 55-60% in May.
- Tier-3 cities and below, where the impact of Covid-19 has been limited, have been key demand drivers. These markets now account for ~65% of the company's turnover (vs. ~55% historically).
- CRS has a major presence in South India (~42% of FY20 revenue); this market continues to see better traction than other geographies even now.
- Sanitaryware revenue contribution has risen; share of tiles has declined due to stricter credit terms imposed by the company post Covid.
- In the sanitaryware segment, sale of entry-level products has increased due to higher demand from the affordable housing market.
- Demand for touch-free faucets has spiked after onset of the pandemic. These products have higher realisations and also better margins.
- CRS took price hikes of 3-5% in the sanitaryware segment in Aug'20, which will aid margins in H2FY21.
- Input prices remain benign, limiting margin pressure. Cost control initiatives should result in savings of at least Rs 100mn in FY21.
- Working capital has improved as cash collections remain robust despite challenges due to Covid-19. Also, inventory levels which had increased in FY20 due to the lockdown have now normalised and the company has negotiated its way to higher payable days.
- A focus on expanding the retail sales mix has seen its share rising to 73-75% of total turnover. About 50% of sales to retail dealers are on cash-and-carry mode.
- The company has added 550 dealers YoY, taking the count to 3,631 as of Jun'20.

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Ticker/Price	CRS IN/Rs 2,245
Market cap	US$ 395.0mn
Shares o/s	13mn
3M ADV	US$ 0.2mn
52wk high/low	Rs 2,790/Rs 1,986
Promoter/FPI/DII	54%/15%/30%

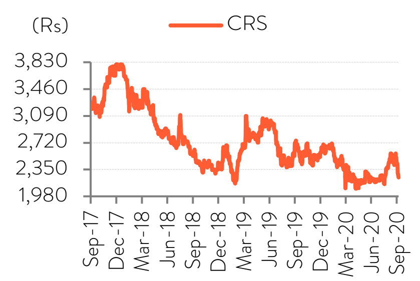
Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY21E	FY22E	FY23E
Total revenue (Rs mn)	10,508	12,409	13,742
EBITDA (Rs mn)	1,132	1,772	1,974
Adj. net profit (Rs mn)	627	1,157	1,287
Adj. EPS (Rs)	48.2	89.0	98.9
Adj. EPS growth (%)	(44.6)	84.4	11.2
Adj. ROAE (%)	7.9	13.4	13.5
Adj. P/E (x)	46.6	25.2	22.7
EV/EBITDA (x)	25.1	16.1	14.5

Source: Company, BOBCAPS Research

STOCK PERFORMANCE



Source: NSE

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IT SERVICES

24 September 2020

Stellar outsourcing show- a positive readthrough for Indian IT

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Accenture's (ACN) Q4FY20 dollar revenue was in line with the guided range of US$ 10.6bn-11bn, posting a decline of 1.4% QoQ and 1% CC. The guidance of 2-5% CC growth for FY21 was lower than street's estimates but aligned with the current economic climate. Positive takeaways were record bookings of US$ 14bn buoyed by high outsourcing bookings and impressive recovery in outsourcing revenue – this in turn heralds better times for Indian counterparts. We maintain a positive sector outlook and prefer TCS, HCLT and TECHM among large-caps.

Performance meets guidance but below consensus: ACN's Q4 revenue of US$ 10.8bn declined by 1.4% QoQ and 1% in CC terms – weaker than Q3 when revenue grew 1.3% CC. The decline was led by a 5% QoQ dip in Europe and flattish growth in the US. As in the last quarter, health and public services was the only vertical showing growth, rising 4% QoQ and 11% YoY. Resources declined the most, by 6% QoQ and 11% YoY. BFSI fell by low single digits. Pressure continued in the troubled verticals of travel, transportation, energy and utilities, which form 20% of revenues (these saw mid-teen declines YoY).

Stellar outsourcing performance – positive for Indian IT: Demand erosion due to the pandemic led to a decline of 8.2% YoY in consulting revenues (vs. a 3.8% YoY decline the previous quarter). However, the healthy performance from the outsourcing business was a surprise and contrasted with the consulting business. Outsourcing revenue grew 5.9% YoY, marking a notable acceleration over the previous quarter (+2.7% YoY). Given the skew towards outsourcing for Indian IT players, ACN's stellar performance suggests a positive readthrough for them.

Record high outsourcing bookings: ACN registered one of its highest ever new order bookings of US$ 14bn in Q4, after a dip to US$ 11bn in Q3. Outsourcing bookings at US$ 7.5bn (+10.5% YoY) marked a historical high. The company's FY21 (Aug-ending) guidance of 2-5% YoY CC growth bakes in a strong recovery in H2 (high-single-digit to low-double-digit growth) and hints at a robust FY22 (Mar-ending) for Indian IT players.

Covid- a tipping point for cloud: Management believes that Covid-19 will accelerate cloud adoption and digital transformation, with the 20:80 rule for cloud vs. on-premise mix in enterprises likely to reverse. ACN's US$ 3bn investment in 'Accenture Cloud First' is a testament to soaring cloud demand.

RECOMMENDATION SNAPSHOT

Ticker	Price	Target	Rating
TCS IN	2,332	2,620	BUY
INFO IN	975	1,020	ADD
WPRO IN	305	246	SELL
HCLT IN	788	920	BUY
TECHM IN	752	910	BUY
LTI IN	2,414	3,290	BUY
MPHL IN	1,265	950	SELL
MTCL IN	1,248	1,220	ADD
HEXW IN	467	500	BUY
PSYS IN	1,181	840	SELL
NITEC IN	2,114	2,110	ADD

Price & Target in Rupees

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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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