BOBCAPS
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FIRST LIGHT

26 October 2020

RESEARCH

Mphasis | Target: Rs 1,410 | +4% | REDUCE

DXC remains soft but pipeline healthy – raise to REDUCE

BOB Economics Research | October MPC Minutes

Emphasis on forward guidance

Tech Mahindra | Target: Rs 980 | +16% | BUY

Communication vertical recovers; TCV robust

JK Tyre & Industries | Target: Rs 85 | +17% | BUY

Strong Q2FY21; focus on debt reduction continues

SUMMARY

Mphasis

Mphasis (MPHL) reported strong Q2FY21 revenue and margins. Revenue grew 6% QoQ CC despite DXC business dropping 14.9%. EBIT margin at 16.1% improved 40bps QoQ (15.7% est.). TCV at US$ 360mn was at its peak on the back of a healthy order book. We increase FY21-FY23 EPS by 5-10% and roll over to a revised Sep'21 TP of Rs 1,410 (vs. Rs 950). Though risks to the DXC business persist, we reset our target P/E to 16.4x based on MPHL's strong pipeline and diverse revenue mix. Raise to REDUCE from SELL.

Click here for the full report.

India Economics: October MPC Minutes

MPC members favoured forward guidance on accommodative conditions to anchor market expectations of liquidity. This along with purchase of government securities has led to reduction in term premium. Minutes show MPC members believe inflation will ease as supply restrictions are removed. Demand conditions are weak. So is pricing power with corporates. On growth, members believe consumption recovery may be short lived and an investment led recovery is likely to take time and contingent on public sector spending.

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	980

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 (%)	0.86	3bps	19bps	(91bps)
India 10Y yield (%)	5.91	0bps	(10bps)	(59bps)
USD/INR	73.54	0.1	(0.2)	(3.5)
Brent Crude (US$/bbl)	42.46	1.7	2.5	(31.1)
Dow	28,364	0.5	4.5	5.8
Shanghai	3,313	(0.4)	(0.1)	12.6
Sensex	40,558	(0.4)	6.6	3.9
India FII (US$ mn)	**21 Oct**	**MTD**	**CYTD**	**FYTD**
FII-D	(18.2)	297.8	(14,382.0)	(4,622.5)
FII-E	287.9	2,001.0	6,041.1	12,644.1

Source: Bank of Baroda Economics Research

BOBCAPS Research
research@bobcaps.in

Tech Mahindra

Tech Mahindra (TECHM) posted 2.9% QoQ CC revenue growth and stellar 390bps EBITDA margin expansion, bettering our estimates for Q2FY21. The telecom vertical has finally started recovering (+3% QoQ USD). Traction in the TME, BFSI and retail segments led QoQ recovery for the enterprise segment. TCV was robust at US$ 421mn. We raise FY21-FY23 EPS by 7-10% to bake in the Q2 beat and roll over to a revised Sep'21 TP of Rs 980 (Rs 910 earlier), based on an unchanged target P/E of 15.7x. Reiterate BUY.

Click here for the full report.

JK Tyre & Industries

JK Tyre (JKI) surprised positively on both revenue and earnings in Q2FY21, led by strong replacement demand and above-expected operating efficiencies. Revenue was up 6% YoY to Rs 22.7bn while operating margins expanded 180bps YoY. Through efficient working capital management, JKI also reduced debt by Rs 6bn in H1FY21. With no major capex lined up in the near term, we expect better leverage ratios going ahead. Maintain BUY with an unchanged Sep'21 TP of Rs 85, set at 7x Sep'22E EPS.

Click here for the full report.

REDUCE
TP: Rs 1,410 | ⮝ 4%

MPHASIS | IT Services | 23 October 2020

DXC remains soft but pipeline healthy – raise to REDUCE

Mphasis (MPHL) reported strong Q2FY21 revenue and margins. Revenue grew 6% QoQ CC despite DXC business dropping 14.9%. EBIT margin at 16.1% improved 40bps QoQ (15.7% est.). TCV at US$ 360mn was at its peak on the back of a healthy order book. We increase FY21-FY23 EPS by 5-10% and roll over to a revised Sep'21 TP of Rs 1,410 (vs. Rs 950). Though risks to the DXC business persist, we reset our target P/E to 16.4x based on MPHL's strong pipeline and diverse revenue mix. Raise to REDUCE from SELL.

Ruchi Burde | Seema Nayak
research@bobcaps.in

Diversified revenue mix: Revenue growth of 6% QoQ CC beat our estimate of 1.6% due to a strong pickup in direct revenue (10.9% QoQ CC), which offset a 14.9% revenue decline in DXC. Strong momentum in banking and capital markets aided revenue mix diversification. Overall, QoQ growth was uplifted by higher investment in sales, improved client mining and a focus on Europe revenues as well as direct channel growth. EBIT margin stood at 16.1%, expanding 40bps QoQ, marginally outperforming our estimate of 15.7%.

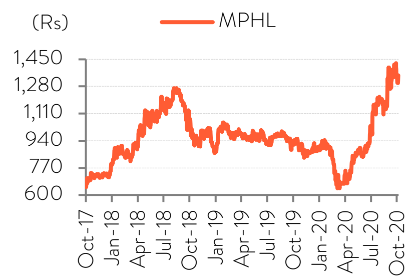
TCV at record high: Direct business TCV stood at an all-time high of US$ 360mn in Q2, coming from the areas of cloud, modernisation and big data. About 73% of TCV was from new-gen areas. MPHL's cloud pipeline has grown 3x YoY. TTM deal wins crossed US$ 1bn for the first time in Q2. MPHL saw increased number of large deals bagged (US$ 200mn+ TCV), with most of them being transformation-led and integrated in nature.

Improved growth visibility: MPHL's outlook on the banking and capital markets vertical remains upbeat. Europe is expected to remain a significant growth driver even beyond FY21. Per management, the pipeline is up 75% YoY, lending improved visibility for the near-to-mid-term. EBIT margin is guided to lie within 15.5-16.5% in FY21.

Ticker/Price	MPHL IN/Rs 1,350
Market cap	US$ 3.4bn
Shares o/s	186mn
3M ADV	US$ 9.6mn
52wk high/low	Rs 1,465/Rs 630
Promoter/FPI/DII	52%/29%/14%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue (Rs mn)	77,311	88,436	98,575	115,343	129,106
EBITDA (Rs mn)	13,240	16,505	18,228	22,667	25,408
Adj. net profit (Rs mn)	10,734	11,849	12,141	15,160	17,092
Adj. EPS (Rs)	57.7	63.7	65.2	81.4	91.8
Adj. EPS growth (%)	30.9	10.4	2.5	24.9	12.7
Adj. ROAE (%)	20.0	21.4	19.9	22.5	22.9
Adj. P/E (x)	23.4	21.2	20.7	16.6	14.7
EV/EBITDA (x)	18.8	15.2	13.8	11.1	9.7

Source: Company, BOBCAPS Research

OCTOBER MPC MINUTES

23 October 2020

Emphasis on forward guidance

MPC members favoured forward guidance on accommodative conditions to anchor market expectations of liquidity. This along with purchase of government securities has led to reduction in term premium. Minutes show MPC members believe inflation will ease as supply restrictions are removed. Demand conditions are weak. So is pricing power with corporates. On growth, members believe consumption recovery may be short lived and an investment led recovery is likely to take time and contingent on public sector spending.

Sameer Narang
Jahnavi | Sonal Badhan
chief.economist@bankofbaroda.com

Growth to recover gradually: MPC stated that growth is expected to recover gradually from a steep contraction in Q1, as several economic indicators suggest a pickup in activity. A second wave of COVID-19 infections pose a risk to growth. MPC members also pointed out that potential output may take several years to repair. Dr. Patra noted that empirical evidence suggests that consumption led recoveries are shallow and short-lived. In addition, he believes there is an anecdotal sense that economy's potential output has fallen.

Inflationary pressures to subside: All the MPC members were of the view that inflation will begin to subside from Q3FY21 onwards with Dr. Saggar expecting a decline beginning in Oct'20 with headline converging to core inflation, and both softening. The key reasons for this are: removal of supply side bottlenecks, good monsoon and weak demand. According to Dr. Patra, deviation of inflation from its target was mainly owing to supply shocks in food and fuel category (71% contribution), followed by unanchored inflation expectations (28%) and exchange rate and asset prices (12%). Inflation is pulled down by 15% by negative demand shock.

MPC remains accommodative: Shri Shaktikanta Das, RBI Governor, noted that there exists space for rate cuts if inflation evolves in line with expectations. In the current policy, focus was on forward guidance. Shri Das stated that enhanced guidance should strengthen and quicken the pace of transmission to longer-term yields. Dr. Patra too said that policy should remain accommodative and exploit the headroom that opens up when inflation recedes. With supply side restrictions easing, RBI expects inflation to recede to 5.4% in Q3 and 4.5% in Q4. It will settle in the range of 4.1-4.4% next year. Any further increase in international commodity prices and mean reversion in certain core inflation categories may lead to an upward surprise.

KEY HIGHLIGHTS

- MPC members see inflation ebbing in H2FY21.
- Growth to recover only gradually.
- Further rate cuts seem difficult.

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BUY
TP: Rs 980 | ⮝ 16%

TECH MAHINDRA | IT Services | 23 October 2020

Communication vertical recovers; TCV robust

Tech Mahindra (TECHM) posted 2.9% QoQ CC revenue growth and stellar 390bps EBITDA margin expansion, bettering our estimates for Q2FY21. The telecom vertical has finally started recovering (+3% QoQ USD). Traction in the TME, BFSI and retail segments led QoQ recovery for the enterprise segment. TCV was robust at US$ 421mn. We raise FY21-FY23 EPS by 7-10% to bake in the Q2 beat and roll over to a revised Sep'21 TP of Rs 980 (Rs 910 earlier), based on an unchanged target P/E of 15.7x. Reiterate BUY.

Ruchi Burde | Seema Nayak
research@bobcaps.in

Strong growth momentum: Revenue growth of 2.9% QoQ CC exceeded our estimate of 1.3%, backed equally by growth in supply and demand. The enterprise segment grew 4.3% QoQ CC and communication was up 0.8% after two quarters of decline. Within enterprise, technology, media and entertainment (TME), BFSI and retail revived the most. Alliances with cloud hyperscalers have also seen increased focus. EBIT margin at 14.2% surged 410bps QoQ on lower SG&A and employee cost. Margin tailwinds arose from the supply and demand side (+160bps each), increased cost efficiency (+160bps) ; offset by normalisation from seasonality (-70bps).

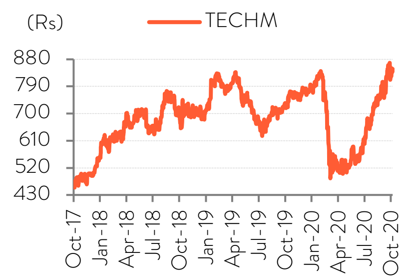
Deal win recovery: With numerous multiyear wins across the software engineering services, communication, healthcare, ENU and BFSI verticals, net new TCV stood at US$ 421mn (+45% QoQ, –72% YoY). Q2 TCV was a mix of large- and medium-sized deals. Communication segment wins totaled US$ 208mn and enterprise US$ 214mn. The deal funnel is also at an all-time high.

Positive outlook: The communication vertical recovered as a few deal reversals from Q1 were recouped. The 5G space is expected to see increased activity in coming quarters, especially in services and core digital transformation. TECHM expects retail and manufacturing to recover from Q3.

Ticker/Price	TECHM IN/Rs 848
Market cap	US$ 10.1bn
Shares o/s	873mn
3M ADV	US$ 63.0mn
52wk high/low	Rs 888/Rs 471
Promoter/FPI/DII	36%/39%/25%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue (Rs mn)	347,421	368,677	385,822	448,388	501,377
EBITDA (Rs mn)	63,368	57,261	66,649	81,088	90,275
Adj. net profit (Rs mn)	42,975	42,505	45,483	51,911	57,976
Adj. EPS (Rs)	47.7	48.3	51.7	59.0	65.9
Adj. EPS growth (%)	11.9	1.2	7.0	14.1	11.7
Adj. ROAE (%)	21.4	19.8	19.4	19.8	19.9
Adj. P/E (x)	17.8	17.6	16.4	14.4	12.9
EV/EBITDA (x)	11.6	12.9	11.0	8.9	7.6

Source: Company, BOBCAPS Research

BUY
TP: Rs 85 | ▲ 17%

JK TYRE & INDUSTRIES | Auto Components | 23 October 2020

Strong Q2FY21; focus on debt reduction continues

JK Tyre (JKI) surprised positively on both revenue and earnings in Q2FY21, led by strong replacement demand and above-expected operating efficiencies. Revenue was up 6% YoY to Rs 22.7bn while operating margins expanded 180bps YoY. Through efficient working capital management, JKI also reduced debt by Rs 6bn in H1FY21. With no major capex lined up in the near term, we expect better leverage ratios going ahead. Maintain BUY with an unchanged Sep'21 TP of Rs 85, set at 7x Sep'22E EPS.

Mayur Milak | Nishant Chowhan, CFA
research@bobcaps.in

Strong Q2FY21: At Rs 22.7bn (+6% YoY), consolidated revenue was 10% ahead of our estimate, led by strong traction in the farm and MHCV segments. Replacement volumes grew 22% YoY, ahead of overall volume growth of ~12%. Softer raw material costs and better operating efficiencies further boosted EBITDA margins to 15.6%, up 180bps YoY. Adj. PAT for Q2 declined 59% YoY to Rs 890mn due to a one-off tax reversal gain in Q2FY20.

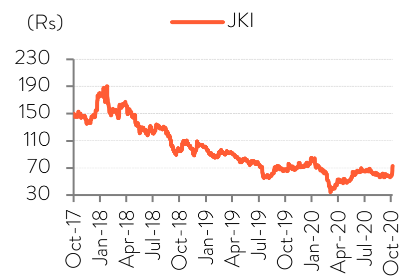
Potential rerating in sight: Despite negative earnings growth in FY20, JKI managed to reduce its net D/E to 2.1x (from 2.4x in FY19). Further, led by efficient working capital management, the company also reduced its debt by Rs 6bn in H1FY21 (overall debt reduction of Rs 12bn in the last one year). While we currently value the stock at 7x one-year forward EPS, a discount of 60% to the market leader, we see a case for rerating as leverage ratios improve.

Maintain BUY: We forecast a revenue/EBITDA/PAT CAGR of 9%/11%/13% for JKI over FY20-FY23, backed by strong replacement demand, reviving offtake from OEMs and benign raw material prices. Maintain BUY with a Sep'21 TP of Rs 85.

Ticker/Price	JKI IN/Rs 73
Market cap	US$ 243.4mn
Shares o/s	246mn
3M ADV	US$ 1.1mn
52wk high/low	Rs 88/Rs 32
Promoter/FPI/DII	56%/3%/1%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue (Rs mn)	103,699	87,249	83,648	101,189	111,931
EBITDA (Rs mn)	10,251	9,876	9,774	12,092	13,441
Adj. net profit (Rs mn)	1,706	2,472	887	2,595	3,561
Adj. EPS (Rs)	6.9	10.0	3.6	10.5	14.5
Adj. EPS growth (%)	137.9	44.9	(64.1)	192.5	37.2
Adj. ROAE (%)	7.0	10.2	3.5	9.5	11.7
Adj. P/E (x)	10.5	7.3	20.2	6.9	5.0
EV/EBITDA (x)	7.1	7.5	7.2	5.5	4.8

Source: Company, BOBCAPS Research

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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