FIRST LIGHT

27 October 2020

RESEARCH

BOB Economics Research | Weekly Wrap

RBI's bond purchases drive yields lower

Kotak Mahindra Bank | Target: Rs 1,635 | +15% | BUY

Above-expected quarter

Persistent Systems | Target: Rs 840 | –29% | SELL

IP revenues volatile; retain SELL

SUMMARY

India Economics: Weekly Wrap

Despite rising Covid-19 cases in Europe, US and UK yields inched up on the back of impending stimulus in US and Brexit deal. Services PMIs and consumer confidence is sliding in Europe. Thus global equity markets were largely weak. India's 10Y yield fell by 9bps as RBI steps up bond purchases and MPC minutes were dovish. Fiscal data for H1FY21 will be released towards the end of the week. As of Aug'20, Centre's spending is up by 6.2% against budgeted increase of 13.2%. We expect fiscal deficit at 7.6% of GDP.

Click here for the full report.

Kotak Mahindra Bank

Kotak Bank's (KMB) Q2FY21 PAT at Rs 21.8bn (+27% YoY) beat estimates given strong 31% YoY operating profit growth and lower provisions. Asset quality trends were reassuring with flat GNPA (ex-SC interim order) and improving collection efficiency across products. Per management, KMB's non-specific provision buffer is adequate. NBFC, securities and asset management subsidiaries saw strong traction. NIM rose 10bps QoQ to 4.5%, partly aided by the QIP in Q1. We raise FY21-FY23 EPS 10-11% and revise our Sep'21 TP to Rs 1,635 (vs. Rs 1,550).

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 (%)	0.84	(1bps)	18bps	(95bps)
India 10Y yield (%)	5.84	(7bps)	(15bps)	(66bps)
USD/INR	73.61	(0.1)	0.4	(3.8)
Brent Crude (US$/bbl)	41.77	(1.6)	(0.4)	(32.7)
Dow	28,336	(0.1)	5.7	5.1
Shanghai	3,278	(1.0)	1.7	10.9
Sensex	40,686	0.3	11.3	4.2
India FII (US$ mn)	**22 Oct**	**MTD**	**CYTD**	**FYTD**
FII-D	69.5	367.2	(14,312.6)	(4,553.1)
FII-E	166.4	2,167.4	6,207.5	12,810.5

Source: Bank of Baroda Economics Research

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Persistent Systems

Persistent Systems (PSYS) reported 3.9% QoQ dollar revenue growth, led by the services segment (+5.4% QoQ). IP business remained volatile due to a dip in reseller revenues. Alliance business saw continued YoY weakness. EBIT margin at 12.1% was up 170bps QoQ. We raise FY21 EPS by 7% baking in the Q2 performance and keep FY22/FY23 estimates largely unaltered. Rolling valuations over, we have an unchanged Sep'21 TP of Rs 840 with 13.5x target PE. Given IP revenue volatility and heady valuations, we retain SELL.

Click here for the full report.

WEEKLY WRAP

26 October 2020

RBI's bond purchases drive yields lower

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Despite rising Covid-19 cases in Europe, US and UK yields inched up on the back of impending stimulus in US and Brexit deal. Services PMIs and consumer confidence is sliding in Europe. Thus global equity markets were largely weak. India's 10Y yield fell by 9bps as RBI steps up bond purchases and MPC minutes were dovish. Fiscal data for H1FY21 will be released towards the end of the week. As of Aug'20, Centre's spending is up by 6.2% against budgeted increase of 13.2%. We expect fiscal deficit at 7.6% of GDP.

Markets

- **Bonds:** Barring India and China, global yields closed higher. US and UK 10Y yield rose the most (10bps each) on the back of progress on US fiscal stimulus and Brexit negotiations. Oil prices fell by 2.7% (US$ 41.7/bbl) owing to resurgence of COVID-19 cases in US and Europe. India's 10Y yield fell sharply by 9bps to 5.84% as RBI has increased the quantum of domestic bond purchases. System liquidity surplus was at Rs 4.17tn as on 23 Oct 2020 compared with Rs 4.19tn in the previous week.

- **Currency:** Except INR, other global currencies closed higher against the dollar. DXY fell by 1% ahead of elections and uncertainty over stimulus deal. GBP rose by 1% in the week as negotiations on post-Brexit trade deal resumed this week. CNY also rose by 0.2% as China's industrial production and retail sales rose more than expected. INR depreciated by 0.4% despite lower oil prices (down by 2.7%) and FII inflows (US$ 1.1bn).

- **Equity:** Barring Nikkei and Sensex, other global indices ended the week lower amidst uncertainty over rising Covid-19 cases and subdued flash services PMIs. Dax (2%) declined the most followed by Shanghai Comp (1.7%). However, Sensex (1.8%) ended the week in green led by real estate and metal stocks.

- **Upcoming key events:** In the current week, markets keenly await Q3 GDP prints of US, Euro Area, Germany and France. In addition, policy decisions of BoJ and ECB, Germany's IFO business climate index, China's industrial profits and official PMIs are also due. On the domestic front, Central government finances, core sector and RBI's OMO auctions will be released later in the week.

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BUY
TP: Rs 1,635 | ⮝ 15%

KOTAK MAHINDRA BANK

| Banking | 26 October 2020

Above-expected quarter

Kotak Bank's (KMB) Q2FY21 PAT at Rs 21.8bn (+27% YoY) beat estimates given strong 31% YoY operating profit growth and lower provisions. Asset quality trends were reassuring with flat GNPA (ex-SC interim order) and improving collection efficiency across products. Per management, KMB's non-specific provision buffer is adequate. NBFC, securities and asset management subsidiaries saw strong traction. NIM rose 10bps QoQ to 4.5%, partly aided by the QIP in Q1. We raise FY21-FY23 EPS 10-11% and revise our Sep'21 TP to Rs 1,635 (vs. Rs 1,550).

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Flat proforma GNPA a positive: GNPA ratio declined to 2.55% (2.7% in Q1) given the SC directive of not classifying standard accounts as NPA. Even had the bank tagged NPAs, GNPA ratio would have been flat at 2.7%, which is positive in our view. Collection efficiency is now in the mid-90s and close to February levels. Bounce and resolution rates are near-normal for secured products (CV/CE, tractor, home loans) and improving MoM for unsecured products. Aided by the ECLG scheme, SME/MSME asset quality is stable. KMB has ~6% market share in the scheme and has disbursed ~80% of the sanctioned limit.

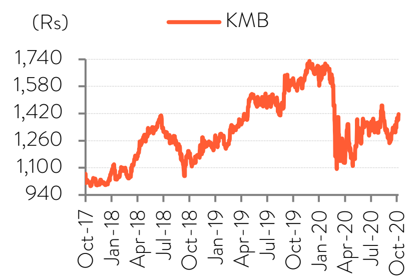
Gearing up for growth: The overall loan book declined by 4% YoY given a sharp drop in corporate, SME, CV and select unsecured segments. Management highlighted its intent to be more aggressive on the asset side via higher customer acquisition, deepening relationships and cross-selling.

Maintain BUY: We like KMB for its proven and stable leadership, strong liability franchise, best-in-class margins and sound underwriting standards. We raise our FY21-FY23 earnings estimates by 10-11% to factor in lower operating expenses and credit costs. Maintain BUY with a revised Sep'21 SOTP-based TP of Rs 1,635 (vs. Rs 1,550).

Ticker/Price	KMB IN/Rs 1,417
Market cap	US$ 37.9bn
Shares o/s	1,979mn
3M ADV	US$ 75.1mn
52wk high/low	Rs 1,740/Rs 1,001
Promoter/FPI/DII	30%/40%/30%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Net interest income	112,590	134,997	151,531	172,320	197,106
NII growth (%)	1812.1	1990.2	1224.8	1371.9	1438.3
Adj. net profit (Rs mn)	36,116	59,472	71,336	83,614	96,372
EPS (Rs)	25.5	31.1	36.7	42.3	48.7
P/E (x)	55.5	45.5	38.6	33.5	29.1
P/BV (x)	6.4	5.6	4.5	4.0	3.5
ROA (%)	1.7	1.8	1.9	2.0	2.0
ROE (%)	12.2	13.1	12.8	12.5	12.8

Source: Company, BOBCAPS Research

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SELL
TP: Rs 840 | ⮟ 29%

PERSISTENT SYSTEMS | IT Services | 26 October 2020

IP revenues volatile; retain SELL

Persistent Systems (PSYS) reported 3.9% QoQ dollar revenue growth, led by the services segment (+5.4% QoQ). IP business remained volatile due to a dip in reseller revenues. Alliance business saw continued YoY weakness. EBIT margin at 12.1% was up 170bps QoQ. We raise FY21 EPS by 7% baking in the Q2 performance and keep FY22/FY23 estimates largely unaltered. Rolling valuations over, we have an unchanged Sep'21 TP of Rs 840 with 13.5x target PE. Given IP revenue volatility and heady valuations, we retain SELL.

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IP revenues decline: PSYS reported 3.9% QoQ USD growth in Q2, slightly ahead of our 3.1% estimate. IP revenue declined 3.3% while services grew 5.4%. IP revenue was volatile due to seasonality and a dip in reseller business (royalty revenue held strong). Top client concentration increased 13.8% QoQ. Europe business remained weak with a 22.6% decline. BFSI/healthcare/tech-emerging verticals grew 4.2%/1.8%/4.5% QoQ. Operating margin was up 170bps QoQ to 12.1% (11.1% est.) due to increased offshoring and reduced employee costs. PSYS plans to implement salary hikes starting Nov'20.

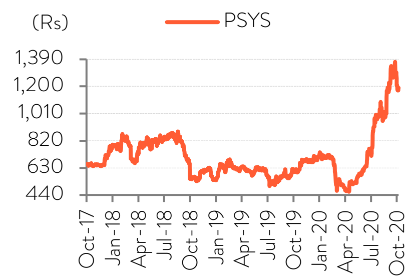
Healthy deal wins: The deal pipeline looks healthy going into FY21 with several multimillion-dollar engagements across the BFSI, healthcare, hi-tech and industrial verticals. PSYS won a KYC-supporting deal in BFSI, an application modernisation deal leveraging cloud from a US-based pharma company, and a multimillion, multiyear deal with a global media player.

Upbeat management outlook: Management stated that digital projects continued their momentum in Q2, the Alliance segment pipeline has increased, and revenue from the Capiot acquisition will flow through starting Q3FY21. PSYS is also positive regarding opportunities emerging from IBM's split into two separate companies.

Ticker/Price	PSYS IN/Rs 1,189
Market cap	US$ 1.3bn
Shares o/s	80mn
3M ADV	US$ 4.0mn
52wk high/low	Rs 1,391/Rs 420
Promoter/FPI/DII	30%/26%/44%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue (Rs mn)	33,659	35,658	41,106	46,363	51,422
EBITDA (Rs mn)	5,805	4,930	6,722	7,794	8,880
Adj. net profit (Rs mn)	3,516	3,403	3,991	4,479	5,227
Adj. EPS (Rs)	43.9	42.7	50.0	56.2	65.5
Adj. EPS growth (%)	8.8	(2.9)	17.3	12.3	16.7
Adj. ROAE (%)	15.7	14.1	15.3	15.6	16.4
Adj. P/E (x)	27.1	27.9	23.8	21.2	18.2
EV/EBITDA (x)	16.1	18.9	13.9	11.9	10.2

Source: Company, 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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