FIRST LIGHT

15 July 2020

RESEARCH

BOB Economics Research | Wholesale Inflation

WPI contracts, but at a slower pace

Wipro | Target: Rs 180 | –20% | SELL

Strong operational performance despite all odds

Mindtree | Target: Rs 930 | –5% | REDUCE

Cloudy revenue visibility

Logistics | Q1FY21 Preview

Management commentary holds key in washout quarter

SUMMARY

India Economics: Wholesale Inflation

WPI contracted by 1.8% in Jun'20 from 3.2% in May'20 led by 13.6% decline in fuel and power index in Jun'20 compared with 19.8% in May'20. Food inflation inched up to 3.1% in Jun'20 from 2.3% in May'20. Manufactured inflation rebounded as it rose by 0.1% in Jun'20 from a decline of 0.4% in May'20. Higher international commodity and fuel prices along with rising domestic food prices imply WPI has bottomed out. However, the difference between CPI and WPI will be elevated in the year due to rigidities associated with lockdown.

Click here **for the full report.**

Wipro

Despite a sharp US dollar revenue decline of 7.3% QoQ, Wipro (WPRO) delivered a strong Q1 operational performance with EBIT margins rising 150bps QoQ. The revenue impact stemmed from lower volumes, pricing discounts and reduced realisation on fixed-price projects. Given Covid uncertainty and CEO transition, we remain skeptical about mid-term growth. We increase FY21/FY22 EPS by ~9%/2% to bake in stronger margins – reiterate SELL as we roll forward to a Jun'21 TP of Rs 180 (Rs 170 earlier).

Click here **for the full report.**

TOP PICKS

LARGE-CAP IDEAS

Company	Rating	Target
Bajaj Finance	Buy	3,000
Cipla	Buy	690
GAIL	Buy	150
Petronet LNG	Buy	305
Tech Mahindra	Buy	690

MID-CAP IDEAS

Company	Rating	Target
Alkem Labs	Buy	2,950
Chola Investment	Buy	200
Laurus Labs	Buy	630
Transport Corp	Buy	240
Mahanagar Gas	Sell	710

Source: BOBCAPS Research

DAILY MACRO INDICATORS

Indicator	Current	2D (%)	1M (%)	12M (%)
US 10Y yield (%)	0.62	(3bps)	(9bps)	(147bps)
India 10Y yield (%)	5.79	3bps	(1bps)	(65bps)
USD/INR	75.19	0	0.9	(9.7)
Brent Crude (US$/bbl)	42.72	(1.2)	10.3	(35.7)
Dow	26,086	0	1.9	(4.7)
Shanghai	3,443	1.8	17.9	17.0
Sensex	36,694	0.3	8.6	(5.7)
India FII (US$ mn)	**10 Jul**	**MTD**	**CYTD**	**FYTD**
FII-D	62.4	8.9	(14,273.1)	(4,513.6)
FII-E	(124.1)	(157.6)	(2,599.1)	4,003.9

Source: Bank of Baroda Economics Research

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Mindtree

Mindtree (MTCL) reported an operational beat in Q1FY21 led by above-expected margins. Despite a challenging environment, operating margins expanded 110bps QoQ on 1.9% QoQ CC topline growth. Deal wins were healthy, albeit led by renewals. Management expects continued margin resilience in the near term but the revenue outlook remains cloudy. We raise FY21/FY22 EPS by 9%/10% on upbeat operating margins. Rolling valuations forward, we have a revised Jun'21 TP of Rs 930 (Rs 880 earlier). Retain REDUCE.

Click here for the full report.

Logistics: Q1FY21 Preview

Q1FY21 will be a non-event as consensus estimates and stock prices already bake in an abysmal quarter. Instead, management commentary on growth recovery and on-the-ground trends would be in focus and will drive earnings revisions, in our view. Revenue for our coverage universe is set to plummet in the range of 16-67% YoY, with only CCRI posting net profits. On the positive side, it appears that Q1 will bear the brunt of the pandemic as lead indicators in June herald gradual demand recovery. TCIEXP remains our top pick.

Click here for the full report.

WHOLESALE INFLATION

14 July 2020

WPI contracts, but at a slower pace

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WPI contracted by 1.8% in Jun'20 from 3.2% in May'20 led by 13.6% decline in fuel and power index in Jun'20 compared with 19.8% in May'20. Food inflation inched up to 3.1% in Jun'20 from 2.3% in May'20. Manufactured inflation rebounded as it rose by 0.1% in Jun'20 from a decline of 0.4% in May'20. Higher international commodity and fuel prices along with rising domestic food prices imply WPI has bottomed out. However, the difference between CPI and WPI will be elevated in the year due to rigidities associated with lockdown.

Food inflation accelerates: Food inflation rose to 3.1% in Jun'20 from 2.3% in May'20 led by fruits and vegetables. Prices of vegetables declined at a much slower pace of 9.2% in Jun'20 from a decline of 12.5% in May'20 led by tomato (drop of 45.6% in Jun'20 from 56.5% in May'20) and potato (increase of 56.2% in Jun'20 from 52.2% in May'20). Cereal prices too edged upwards to 2.7% in Jun'20 on the back of sharp jump in paddy prices (4.5% in Jun'20 from 1.2% in May'20). Prices of protein-based items such as eggs, meat and fish also inched up to 4.5% in Jun'20 from 1.9% in May'20. Food inflation is expected to moderate on the back of normal rainfall and improved sowing.

Deflation in fuel and power eases: Fuel and power inflation fell by 13.6% in Jun'20 versus 19.8% drop in May'20. Key drivers were mineral oil and electricity. Mineral oil price index fell by 27.4% versus 37.4% decline seen in May'20. On the other hand, electricity prices rose by 5.2% compared with increase of 2.9% in the last month. Within the mineral oils index, deflation in ATF, Naphtha and LPG reduced the most. Coal prices fell in Jun'20 (2%) after remaining steady at 2.3% for last 5 months. High base effect in mineral fuel index will play out till Dec'20.

Core still in deflation: Core inflation contracted by 0.9% in Jun'20 versus decline of 1.3% in May'20. Manufactured inflation rose by 0.1% versus 0.4% drop seen in May'20. Of the 22 commodities, prices of 13 commodities rose, with basic metals, electrical equipment, chemical products and pharma products taking the lead. With improvement in global demand, international commodity prices are now inching up and are 10.3% lower in Jul'20 (MTD) as against a decline of 11.7% in Jun'20.

SELL
TP: Rs 180 | ∨ 20%

WIPRO | IT Services | 15 July 2020

Strong operational performance despite all odds

Despite a sharp US dollar revenue decline of 7.3% QoQ, Wipro (WPRO) delivered a strong Q1 operational performance with EBIT margins rising 150bps QoQ. The revenue impact stemmed from lower volumes, pricing discounts and reduced realisation on fixed-price projects. Given Covid uncertainty and CEO transition, we remain skeptical about mid-term growth. We increase FY21/FY22 EPS by ~9%/2% to bake in stronger margins – reiterate SELL as we roll forward to a Jun'21 TP of Rs 180 (Rs 170 earlier).

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Aggressive cost control: WPRO underperformed our estimates on the revenue front with a 4.7% QoQ decline (including ISRE). IT services revenue fell 7.3% QoQ in US dollar terms (–7.5% CC) vs. our estimate of a 6.1% drop. In a positive surprise, segmental EBIT margin in IT services increased 150bps QoQ to 19% vs. our forecast of 150bps QoQ contraction. Cost of revenues contracted 260bps QoQ, showcasing good operational efficiency. Traditional levers such as variable workforce cost reduction, automation, better utilisation and higher offshore realisation were used to the fullest.

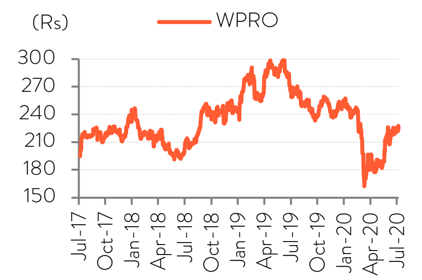
Pipeline expected to improve in H2FY21: The current deal pipeline is robust, with a YoY increase in order book. While slower decision-making remains a concern, deal wins are gaining momentum in IMS, cloud, digital, and engineering and security services.

3Cs to drive demand: With a new CEO at the helm, WPRO's key focus is on profitable growth and tight control over operations. Operating margins are expected to hold within a narrow band around 19% in Q2FY21. Stability is returning in the consumer business, technology services and communications. Company expects the 3Cs – Cloud, Collaboration and Cybersecurity – to fuel demand going forward.

Ticker/Price	WPRO IN/Rs 225
Market cap	US$ 17.1bn
Shares o/s	5,715mn
3M ADV	US$ 22.9mn
52wk high/low	Rs 276/Rs 159
Promoter/FPI/DII	74%/9%/17%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue (Rs mn)	5,89,060	6,13,401	5,96,647	6,32,299	6,79,365
EBITDA (Rs mn)	1,21,661	1,24,867	1,17,460	1,24,983	1,38,503
Adj. net profit (Rs mn)	90,074	95,295	87,207	91,316	1,03,522
Adj. EPS (Rs)	14.9	16.7	14.8	15.5	17.6
Adj. EPS growth (%)	12.3	11.6	(10.9)	4.7	13.4
Adj. ROAE (%)	17.1	16.9	14.6	13.5	13.6
Adj. P/E (x)	15.1	13.5	15.2	14.5	12.8
EV/EBITDA (x)	11.3	10.4	10.4	9.7	8.4

Source: Company, BOBCAPS Research

REDUCE
TP: Rs 930 | ∀ 5%

MINDTREE | IT Services | 15 July 2020

Cloudy revenue visibility

Mindtree (MTCL) reported an operational beat in Q1FY21 led by above-expected margins. Despite a challenging environment, operating margins expanded 110bps QoQ on 1.9% QoQ CC topline growth. Deal wins were healthy, albeit led by renewals. Management expects continued margin resilience in the near term but the revenue outlook remains cloudy. We raise FY21/FY22 EPS by 9%/10% on upbeat operating margins. Rolling valuations forward, we have a revised Jun'21 TP of Rs 930 (Rs 880 earlier). Retain REDUCE.

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Margins surprise positively: MTCL reported an above-expected operating performance on the back of a margin beat. Revenue at US$ 253mn was down 9.1% QoQ vs. our estimate of an 8% decline. EBITDA margins at 16.9% expanded 110bps QoQ against our estimate of a 50bps decline. Margin expansion was supported by higher offshore volumes (+5.9% QoQ) and SG&A expense optimisation (–29% QoQ or 490bps operating margin tailwind). Lower subcontracting expenses and travel costs collectively contributed 320bps in margin tailwinds.

Renewals prop up deal wins: Deal win TCV at US$ 391mn (+21% YoY, –0.5% QoQ) was healthy, but aided by renewals. Surprisingly, renewal deal TCV at US$ 315mn stood at a record high. Management indicated that large deal closures have slowed. The company discontinued disclosures on digital contract wins from Q1FY21.

Revenue outlook uncertain: Management expects continued margin gains in Q2FY21 aided by the absence of visa costs and knowledge transfer revenue flow-through from deals under transition. The revenue outlook remains uncertain but MTCL expects a better Q2. Management anticipates slow recovery in travel, transportation and hospitality while hinting at positive traction in the hi-tech and CPG verticals.

Ticker/Price	MTCL IN/Rs 978
Market cap	US$ 2.1bn
Shares o/s	165mn
3M ADV	US$ 14.6mn
52wk high/low	Rs 1,063/Rs 652
Promoter/FPI/DII	74%/11%/15%

Source: NSE

STOCK PERFORMANCE

Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue (Rs mn)	70,215	77,643	78,448	89,137	97,686
EBITDA (Rs mn)	10,645	10,623	12,972	16,113	17,659
Adj. net profit (Rs mn)	7,542	6,309	7,845	9,743	10,835
Adj. EPS (Rs)	45.8	38.3	47.6	59.2	65.8
Adj. EPS growth (%)	32.1	(16.3)	24.3	24.2	11.2
Adj. ROAE (%)	24.9	19.5	23.2	25.0	24.1
Adj. P/E (x)	21.4	25.5	20.5	16.5	14.9
EV/EBITDA (x)	15.0	15.0	12.1	9.5	8.3

Source: Company, BOBCAPS Research

BOBCAPS
TRUST | INNOVATION | EXCELLENCE

LOGISTICS | Q1FY21 Preview | 14 July 2020

Management commentary holds key in washout quarter

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Q1FY21 will be a non-event as consensus estimates and stock prices already bake in an abysmal quarter. Instead, management commentary on growth recovery and on-the-ground trends would be in focus and will drive earnings revisions, in our view. Revenue for our coverage universe is set to plummet in the range of 16-67% YoY, with only CCRI posting net profits. On the positive side, it appears that Q1 will bear the brunt of the pandemic as lead indicators in June herald gradual demand recovery. TCIEXP remains our top pick.

Q1FY21 to be a non-event: Q1 will be a peculiar quarter where challenging externalities wreak havoc on the operating performance of all logistics players irrespective of business segments. Logistics companies under our coverage are estimated to witness YoY revenue declines in the range of 16-67%, with all but two companies reporting operating losses. Nonetheless, Q1 is likely to be a non-event as stock prices already reflect the near-term headwinds. Instead, management's commentary on growth outlook, on-ground demand trends, and working capital will take centerstage and determine earnings revisions.

CCRI, TCIEXP to post operating profit: Among our coverage universe, we expect only Container Corp (CCRI) to post operating and net profits, as container rail was the least affected segment. TCI Express (TCIEXP) is likely to just about break even thanks to its low operating leverage and cost cuts. Abysmal auto production numbers will severely dent the performance of Mahindra Logistics (MLL) and Transport Corp's (TPRC) 3PL segment. Road transporters – VRL Logistics (VRLL) and TRPC's freight business – are expected to be the worst hit as the lockdown has exacted the heaviest toll on trucking.

Worst is behind us: Q1 is likely to have seen the worst of the pandemic as lead economic indicators suggest steady recovery. Originating traffic of the Indian Railways dipped only 8% YoY in June, after a 35%/22% plunge in April/May. The downslide in major port cargo has also eased to 15% YoY vs. drops of 21%/23% in April/May. E-way bill generation has reached 434mn in June, ~80% of pre-Covid levels. With gradual easing of restrictions, demand for logistics services should rise, though full-fledged recovery is still a few months away.

Prefer companies with strong balance sheets: We retain our preference for companies with strong balance sheets and low operating leverage. TCIEXP remains our top pick in the sector.

RECOMMENDATION SNAPSHOT

Ticker	Rating
AGLL IN	ADD
CCRI IN	REDUCE
MAHLOG IN	BUY
TCIEXP IN	BUY
TPRC IN	BUY
VRLL IN	BUY

MAHLOG = MLL

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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