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FIRST LIGHT

10 January 2023

RESEARCH

INDIA STRATEGY | MACRO & MICRO

2023 - Precursor to a breakout

BOB ECONOMICS RESEARCH | FINANCIAL STABILITY REPORT

Key highlights

TATA CONSULTANCY SERVICES | TARGET: Rs 3,580 | +8% | HOLD

Demand drivers intact with some pockets of slowdown

CAPITAL GOODS

Data centre capex to nudge up product demand

Daily macro indicators

Indicator	05-Jan	06-Jan	Chg (%)
US 10Y yield (%)	3.72	3.56	(16bps)
India 10Y yield (%)	7.33	7.37	5bps
USD/INR	82.55	82.73	(0.2)
Brent Crude (US$/bbl)	78.7	78.6	(0.2)
Dow	32,930	33,631	2.1
Hang Seng	21,052	20,992	(0.3)
Sensex	60,353	59,900	(0.8)
India FII (US$ mn)	**04-Jan**	**05-Jan**	**Chg ($ mn)**
FII-D	(52.3)	(9.3)	43.0
FII-E	(296.9)	(151.9)	144.9

Source: Bank of Baroda Economics Research

SUMMARY

INDIA STRATEGY | MACRO & MICRO

- Building blocks largely in place for a faster rise in India's per capita income but key macro catalysts awaited
- 2023 likely to be a tale of contrasting halves for the stock market with high volatility in H1 and focus on growth in H2; best to be stock-specific
- Capex rally set to gather pace in H2CY23, aiding a breakout in 2024E; prefer retail lenders and consumption plays in the short term

Click here **for the full report.**

INDIA ECONOMICS: FINANCIAL STABILITY REPORT

Despite an uncertain global macros, FSR highlighted that Indian economy has remained fairly resilient. However, downside risks to growth cannot be ruled out. As per Systemic Risk Survey of RBI, almost all surveyed respondents expect medium to very high probability of a global recession in 2023. Within macroeconomic risks, RBI has flagged that corporate sector risk, pace of infrastructure development and risks to real estate prices have increased. Risk to domestic inflation on the other hand has declined.

Click here **for the full report.**

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TATA CONSULTANCY SERVICES

- Q3 revenue growth of 2.9% QoQ CC beat consensus and came in higher than our estimate
- EBIT margin held strong at 24.5%, marginally below our forecast; order book was stable at US$ 7.8bn
- Maintain HOLD and TP of Rs 3,580, set at 25x FY25E EPS

Click here for the full report.

CAPITAL GOODS

- India's data centre capacity estimated to more than double in 3Y to 1.8GW, a 32% CAGR and cumulative US$ 4.4bn opportunity
- Expansion to open up growth avenues for power and cooling products, albeit limited to an estimated 2-5% of TTM revenue for capital goods players
- SIEM (BUY, TP Rs 3,500) looks best placed as its addressable market covers 37% of potential data centre spends

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MACRO & MICRO

09 January 2023

2023 – Precursor to a breakout

- **Building blocks largely in place for a faster rise in India's per capita income but key macro catalysts awaited**
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- **Capex rally set to gather pace in H2CY23, aiding a breakout in 2024E; prefer retail lenders and consumption plays in the short term**

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India on track for secular rise in per capita income…: India's population growth has moderated to ~1%, a level at which several developed economies have seen an acceleration in per capita income levels. While higher population growth has its own demographic dividends, we believe a country's populace should be proportional to its resources and hence moderation in India's curve is a positive. This coupled with improvement in several socioeconomic parameters over the last decade could herald a swifter uptick in per capita income this decade.

…but structural impetus awaited: Our analysis indicates that most countries which saw a faster rise in income levels benefited from added structural tailwinds – be it global manufacturing outsourcing for China, digitisation for South Korea, or the post-war construction book in the US and Germany. Such tailwinds are currently missing for India given the clouded global outlook. We believe a combination of the China-Plus-One strategy, PLI schemes and FTAs with large economies can catalyse a broad-based capex cycle along with consumption growth. In our view, 2024 will be the first year of a sustainable growth phase that could spur a bull market for the mid-to-long term.

2023 a study in contrasts: We expect H1CY23 to see signs of structural slowdown in China and a further growth taper in Europe and the US, in turn prompting earnings cuts globally, including in India. However, once the market is able to absorb these downgrades, we believe the stronger global growth outlook for 2024 coupled with limited downside to valuation multiples will gradually encourage a risk-on mindset in H2. Note, energy concerns will ebb from Q2 as winter ends in the West. This apart, we will likely see more domestic projects under implementation six months down the line given the ramp up in new project announcements – a key metric for sustained economic growth, in our view.

Stock-specific approach preferred in near term: We believe a stock-specific approach along with a largely defensive stance will help investors outperform the wider market. Our preference for retail-focused lenders and consumption themes continues. We also reiterate a portfolio from our previous study that tends to outperform in bear markets (Fig 28). Overall, we expect modest low-double-digit returns for the Nifty 50 in 2023.

FINANCIAL STABILITY REPORT

07 January 2023

Key highlights

Chief Economist
Economist

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- What has been a respite is that banking system has remained resilient with adequate capital buffers and moderate levels of non-performing loans
- Not only this, stronger capital levels of NBFCs, robust growth in AUMs of domestic mutual funds also point towards stability of overall financial system. Another important development has been that the GNPA ratio of large borrowers has improved significantly to 6.4% in Sep'22 from over 10% in Mar'21. Almost all the profitability indicators of SCBs have improved in Sep'22 compared to Mar'22.
- Stress test results also indicated that Indian banks are well capitalized and are in a well equipped position to absorb any macroeconomic shocks. Capital levels are well above requirement even during severe stress period. Under baseline scenario, GNPA ratio of SCBs is likely to improve to 4.9% in Sep'23 from 5% in Sep'22.

Credit Growth

- SCBs credit growth has picked up pace and reached a decade high of 17.4% on 16 Dec 2022 (level seen last in 2011).
- A broadbased increase has been seen across sectors, population groups, geography, type of accounts and bank groups. PVBs have registered higher credit growth than PSBs.
- Within total advances the share of services and personal loans have moved up. Credit growth has also expanded for agriculture and industry sector.

Deposit

- Deposit growth across all SCBs have grown by 9.8% in Sep'22. As on 16 Dec 2022, aggregate deposits have grown by 9.4%.
- Growth of current and saving account have also moderated. In response to higher interest rate, term deposits have attracted accretions.

HOLD

TP: Rs 3,580 | ⮝ 8%

TATA CONSULTANCY SERVICES

| Technology & Internet | 09 January 2023

Demand drivers intact with some pockets of slowdown

- **Q3 revenue growth of 2.9% QoQ CC beat consensus and came in higher than our estimate**
- **EBIT margin held strong at 24.5%, marginally below our forecast; order book was stable at US$ 7.8bn**
- **Maintain HOLD and TP of Rs 3,580, set at 25x FY25E EPS**

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Broad-based revenue growth: Despite a seasonally weak quarter, TCS reported above-estimated Q3FY23 revenue of US$ 7.1bn, up 2.9%/13.5% QoQ/YoY CC. Q3 saw a broad-based uptick across services, led by cloud, consulting & service integration, cognitive business operations and enterprise application services. Revenue growth was driven by North America and the UK (+15.4% YoY), along with market share gains through vendor consolidation. All the verticals grew sequentially with strong growth in retail & CPG (+ 18.7% YoY) and life sciences & healthcare (+14.4%).

Stable deal wins to drive growth: TCS registered deal bookings worth US$ 7.8bn in Q3, with a book-to-bill ratio of 1.1x (vs. 1.2x in Q2FY23), below the average deal TCV of US$ 8.4bn in the last eight quarters. Deal win numbers are partly impacted by currency movements. Wins included US$ 2.5bn in BFSI and US$ 1.2bn in retail & CPG, with US$ 4bn coming from North America. TCS saw positive traction in cost takeout and transformation projects.

Net negative hiring led to higher utilisation: Net hiring was a negative ~2.2k and pushed up utilisation during the quarter. Attrition decreased to 21.3% LTM (-20bps QoQ) and management expects it to taper down further in H2FY23.

Margin to stabilize at 25% near term: EBIT margin expanded by ~50bps QoQ to 24.5%, aided by easing supply challenges, improved productivity, higher utilization and currency tailwinds (partly offset by higher third-party and travel expenses). The improvement will show up prominently from Q1FY24 on the back of a more efficient employee pyramid, lower subcontracting costs and productivity improvement based on the hypothesis that the high costs towards backfilling attrition, wage revision, subcontracting and capacity building have peaked out last quarter.

Maintain HOLD: The stock is trading at 25.3x/23.2x FY24E/FY25E EPS. We believe TCS is well positioned to deliver industry-leading growth and margins in the long run. However, considering the current volatile macro environment, poor quality of deal wins and delays in decision-making, we retain HOLD and continue to value the stock at 25x FY25E EPS, similar to Accenture, translating to a TP of Rs 3,580.

Key changes

Target	Rating
◀ ▶	◀ ▶

Ticker/Price	TCS IN/Rs 3,320
Market cap	US$ 147.4bn
Free float	28%
3M ADV	US$ 66.8mn
52wk high/low	Rs 4,043/Rs 2,926
Promoter/FPI/DII	72%/17%/11%

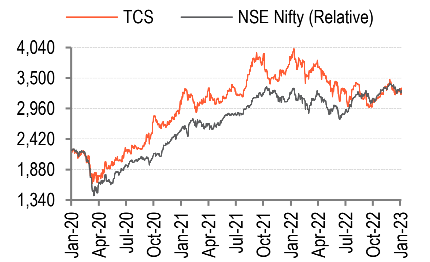
Source: NSE | Price as of 9 Jan 2023

Key financials

Y/E 31 Mar	FY22A	FY23E	FY24E
Total revenue (Rs mn)	19,17,540	22,23,757	24,76,435
EBITDA (Rs mn)	5,30,570	5,82,248	6,66,207
Adj. net profit (Rs mn)	3,83,270	4,16,294	4,80,791
Adj. EPS (Rs)	103.6	113.8	131.4
Consensus EPS (Rs)	107.2	119.2	130.1
Adj. ROAE (%)	43.3	41.3	38.7
Adj. P/E (x)	32.0	29.2	25.3
EV/EBITDA (x)	22.9	20.8	18.1
Adj. EPS growth (%)	13.9	9.8	15.5

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE

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CAPITAL GOODS

09 January 2023

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Explosive growth in domestic data centres…: As highlighted in our Nov'22 capital goods initiation report, On the cusp of a capex supercycle, data centres in India are poised to add ~350MW of capacity per year till CY25 fuelled by hybrid operating models and rising internet penetration. This represents a 32% CAGR to 1.8GW over CY22-CY25, indicating a US$ 4.4bn opportunity (at Rs 350mn/MW; USDINR Rs 80).

…backed by accelerated digitisation: Among the key end users of data centres are high-growth industries such as IT services, telecom and BFSI, where we can expect waves of growth led by emerging trends such as 5G penetration, digital currencies and healthcare digitisation. The proposed Data Protection Bill lends further impetus to domestic data centre capex given the requirement for localised data storage/processing.

New growth avenues for power and cooling products…: Technology and infrastructure comprise ~80% of data centre capex, with land forming the balance 20%. Of the total capex, 33% would be expended on power equipment (UPS, HV/MV/LV switchgears, backup generator sets) and 20% on cooling products (half of which would be for chillers).

…but at relatively low revenue contribution: Our analysis of listed power product players suggests data centre business will form less than 10% of revenue – in the range of 2-5% for companies such as ABB, SIEM and KKC (11% for POWERIND due to its lower base than peers; Fig 3). Similarly, in cooling products, we estimate single-digit revenue contribution for HVAC players such as VOLT and BLSTR (Fig 5). Our estimates assume a 30% contract win rate.

SIEM best placed: In addressable market terms, we believe SIEM's product portfolio is capable of catering to 37% of potential data centre spends. The opportunity for other product companies (ABB, POWERIND, KKC) is in the range of 10-14%. Similarly, the total addressable market for VOLT and BLSTR in the cooling business is ~10% of data centre outlay. As such, our capital goods picks remain LT (TP Rs 2,390), SIEM (Rs 3,500), AIAE (Rs 3,100), POWERIND (Rs 3,600) and KECI (Rs 500).

Recommendation snapshot

Ticker	Price	Target	Rating
ABB IN	2,844	3,100	HOLD
AIAE IN	2,510	3,100	BUY
KECI IN	486	500	BUY
KKC IN	1,431	1,300	HOLD
LT IN	2,087	2,390	BUY
POWERIND IN	3,288	3,600	BUY
SIEM IN	2,892	3,500	BUY
TMX IN	1,963	2,100	HOLD

Price & Target in Rupees | Price as of 6 Jan 2023

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Recommendation scale: Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

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