FIRST LIGHT

13 January 2022

RESEARCH

BOB Economics Research | CPI and IIP

Inflation and industrial growth: horns of dilemma?

IT Services

Demand strong; Infosys shines

Technology & Internet

ISG Q4CY21 earnings call takeaways

Daily macro indicators

Indicator	Current	2D (%)	1M (%)	12M (%)
US 10Y yield (%)	1.74	(2bps)	25bps	61bps
India 10Y yield (%)	6.57	(2bps)	20bps	65bps
USD/INR	73.91	0.2	2.5	(0.9)
Brent Crude (US$/bbl)	83.72	3.5	11.4	48.0
Dow	36,252	0.5	0.8	16.7
Shanghai	3,567	(0.7)	(2.7)	(1.1)
Sensex	60,617	0.4	3.1	22.4
India FII (US$ mn)	**10-Jan**	**MTD**	**CYTD**	**FYTD**
FII-D	(67.4)	(45.6)	(45.6)	456.6
FII-E	(19.6)	391.8	391.8	(3,173.4)

Source: Bloomberg

SUMMARY

India Economics: CPI and IIP

CPI inflation came in as per our expectation of 5.6%. Unfavorable base came into play in pushing CPI higher. Even inflationary pressure was observed in major food categories such as cereals and products, milk, oils etc. Core was also sticky at 6.1%. Industrial production eased for the third consecutive month to 1.4% in Nov'21. Notably, IIP growth over a 2-year basis fell by 0.2%. Thus RBI is faced with the double whammy and likely to be on a wait and watch mode before taking any decision on rates.

Click here **for the full report.**

IT Services

- Infosys and TCS outperformed already optimistic revenue growth expectations; Wipro's 2.3% QoQ dollar revenue growth was a miss
- Companies reiterate strong demand and indicate broadly near-term profitability status-quo
- We revise up FY23EPS for TCS, INFO and Wipro by 1%/3%/0% respectively and reiterate BUY rating on all three

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BOBCAPS Research
researchreport@bobcaps.in

Technology & Internet

- Demand for IT services strong though significant headwinds also present in the form of high attrition and supply chain disruptions
- In CY21, BFSI saw significant traction among verticals and APAC among geographies
- ISG’s CY22 guidance ascribes 20% YoY growth to the as-a-service market and just 5.1% to managed services

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CPI and IIP

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Inflation and industrial growth: horns of dilemma?

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Madan Sabnavis
Chief Economist

Authors

Dipanwita Mazumdar
Economist

Sonal Badhan
Economist

CPI inches up: Inflation for Dec'21 came in at 5.6% which was higher than that in Nov'21 when it was 4.9% and 4.5% in Oct'21. Unfavourable base (4.6% in Dec'20 against 6.9% in Nov'20) came into play in lifting CPI print higher. Inflation was higher than the country average in case of 9 items: oils and fats, non-alcoholic beverages, prepared meals and snacks, clothing and footwear, fuel and light, household goods and services, health, transport and communication and recreation and amusement categories. Core CPI (excl. food and fuel) was sticky at 6.1%. Even core excl. Pan & Tobacco, remained elevated at 6.3% in Dec'21 compared to 6.2% in Nov'21.

CPI to average at 5.2%: Inflation is sticky remaining above 5%. Even, price pressure is visible across major food categories. Core inflation is also a cause of worry and hence will be closely watched by RBI. We expect inflation to average 5.2% in FY22. While it is within the tolerance band of the MPC, it is definitely on the higher end and would ideally support the view that the repo rate needs to be hiked. However, the RBI has maintained that growth is priority and here the industrial production performance needs to be viewed in the light of the NSO projecting GDP growth at 9.2% against RBI's 9.5%.

IIP easing: Industrial output in Nov'21 eased for the third consecutive month to 1.4% from 4% in Oct'21. Slowdown was broad based with mining and manufacturing slowing the most. Within manufacturing, transport equipment and machinery production fell the most. Amongst the use-based classification, capital goods and consumer durables production contracted sharply in Nov'21.

Recovery in IIP hanging in balance: During Apr-Nov'21, IIP has risen by 17.4% compared with a decline of 15.3% in the same period over the previous year. However, a worrying trend emerged in Nov'21 as the IIP growth over a 2-year basis fell by 0.2% in Nov'21 compared with pre-pandemic levels. This trend was seen despite sharp improvement in domestic activity owing to festive and holiday season. One reason could be fewer working days and the other could be stocking of products by wholesalers well in advance. Going ahead, we expect some impact of Omicron on production as case load across the country rises and demand slows.

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IT SERVICES

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Demand strong; Infosys shines

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Ruchi Burde | Seema Nayak
researchreport@bobcaps.in

On a roll: Looking at the top-3 results, demand environment looks robust and management commentary is confident. Deal pipeline remains strong, driven by cloud, life-sciences and manufacturing verticals in particular. Europe demand remains high across the board. The deal pipeline has a greater number of small and mid-sized deals. Attrition has gone up across the board, which has kept the margins flattish despite growth outperformance. However, all three companies hinted at attrition starting to stabilize.

TCS delivered sanguine results: TCS reported QoQ USD growth of 3%, exceeding our estimate of 2%. The growth was broad based across verticals with growth for most between 2-4 % QoQ USD. Geography wise India grew the most at 11% QoQ USD. EBIT margin stood at 25%, roughly in-line with our estimates of 25.3%. TCV stood at USD7.6 bn, flat QoQ. Attrition jumped to 15.3%, up 340bps QoQ. TCS hired ~28000 employees in Q3.

Infosys sprints ahead: Infosys reported 6.3% QoQ USD revenue, exceeding our (2.9%) and street's estimate by a distance. TCV at USD 2.53bn was up 17.7% QoQ USD. The growth was broad-based led by 'others' segment, life-sciences and manufacturing which were up by 28.4%/12.3%/ 10.2%, QoQ USD. BFSI was up by a muted 3.7%. The impressive performance led to a major FY22 growth guidance upgrade from 16.5-17.5% CC to 19.5%-20%. EBIT margin at 23.5% was flattish QoQ. The only major dampener was attrition soaring to 25.5%, up 540bps QoQ.

Wipro underperformed: Wipro underperformed our estimate of 3.3% growth with a QoQ USD growth of 2.3%. The growth was broad-based with retail and BFSI driving the momentum with 4.7% and 3.5% growth. EBIT margin at 17.6% was below our estimate of 18.1%. However, the Q4FY22 revenue growth guidance of 2-4% QoQ CC, was in line with our estimates, translating into FY22 growth of 27-28%. Pipeline is strong with a mix of small and mid-sized deals. **We adjust TCS FY23/24 EPS by 1%/1%, INFO'S by 3%/3%. WPRO's by -0.1%/0%, factoring in the results. We keep the target multiples intact for all (TCS/INFY/WPRO:36.5x/34x/29x). Maintain BUY**

Recommendation snapshot

Ticker	Price	Target	Rating
INFO IN	1,877	2,250	BUY
TCS IN	3,860	4,770	BUY
WPRO IN	691	850	BUY

Price & Target in Rupees | Price as of 12 Jan 2022

TECHNOLOGY & INTERNET

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Robust demand: ISG's conference call today focused on global trends emerging in the IT industry, including tailwinds such as strong demand, a robust deal pipeline and increased M&A traction, as well as headwinds of wage inflation, the great resignation, supply chain disruptions and Covid impact. Record-high ACV was seen in managed services (US$ 8.6bn) and as-a-service (US$ 14bn) in CY21. Combined market ACV stood at US$ 23bn, up 30% YoY. The emergence of small and midsized deals is another key trend, resulting from enterprises moving toward fast-paced transformation.

Attrition to persist: ISG estimates that attrition will persist in the near-to-mid-term but should normalise within the next couple of quarters. Currently, the industry average attrition rate is over 20%. Wage inflation has occurred because of this high churn. Both managed services and T&M (time & material) are seeing wage inflation. In managed services, rates are steady for existing contracts while in T&M, rates have risen 4-7% for in-demand skills. Providers are recruiting more freshers and ramping up training. Mass hiring and subcontracting have also increased.

BFSI leads among verticals: BFSI demand remains robust in both managed services and as-a-service segments. The combined market ACV for BFSI rose 30% in CY21 while as-a-service grew 38%. Other verticals with high combined market ACV growth are travel & hospitality and retail, CPG & manufacturing, up 36% and 38% respectively. APAC's combined market ACV grew the most among geographies at 44% YoY. America grew by 27%, followed by EMEA at 23%. The DACH region was affected by supply chain disruptions whereas Eastern Europe saw record high ACV.

Strong outlook for as-a-service market: ISG has guided for 20% YoY growth for the as-a-service market in CY22. It expects managed services to grow 5.1% which looks subdued and is below the CY21 estimate (+10.1% YoY in Q3CY21). However, this is still 2.5x the historical industry average growth rate over CY10-CY20.

Emerging trends in manufacturing: The top 5 trends on C-level agendas are IoT and cybersecurity, ESG, monetisation of software and services, M&A for new skills and capabilities, and building a future-ready supply chain.

Recommendation snapshot

Ticker	Price	Target	Rating
COFORGE IN	5,767	7,040	BUY
ECLX IN	2,833	3,690	BUY
HCLT IN	1,344	1,560	BUY
INFO IN	1,856	2,170	BUY
LTI IN	7,174	8,270	BUY
MPHL IN	3,207	3,650	HOLD
MTCL IN	4,584	3,540	SELL
PSYS IN	4,492	4,240	HOLD
TCS IN	3,916	4,720	BUY
TECHM IN	1,737	1,970	BUY
WPRO IN	694	850	BUY

Price & Target in Rupees | Price as of 11 Jan 2022

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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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