श्री LAKSHMISHREE

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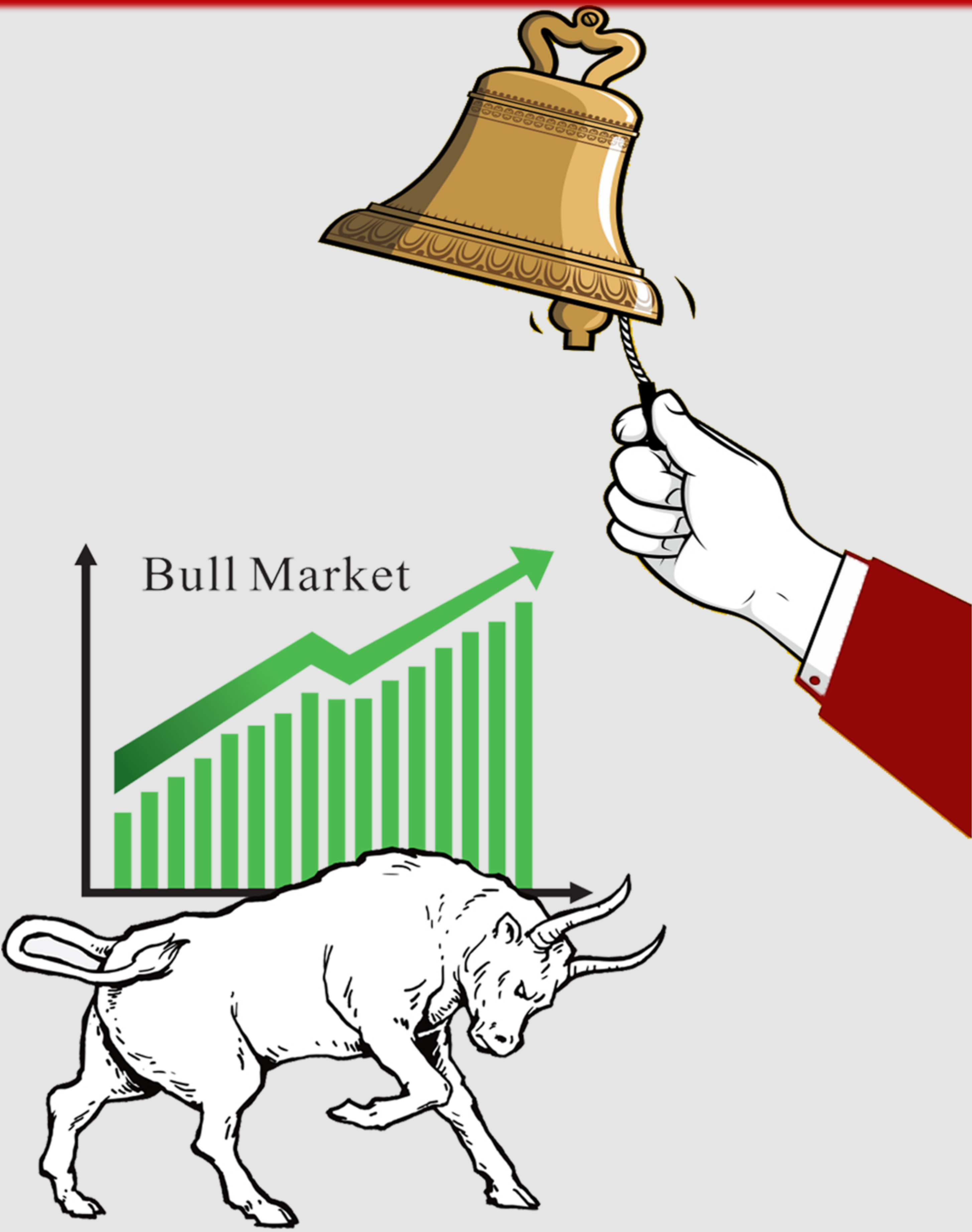
Bounce Back Continue?

This May Impact Your Investments!!



Shrinking IT Jobs Reflect The Sector's Refusal To Take Risks

The current job squeeze in India's IT sector is a more alarming development than earlier slowdowns. According to a recent Mint report, in the six months to 30 September 2023, the number of people employed by India's top software services firms has shrunk, the first such occurrence in more than 25 years. For context, India's most globally successful industry employs 2 million people, almost entirely in white collar positions.

Similar global slowdowns in the past, including the financial crisis of 2008 did see a reduction in the employee numbers of Indian IT for a couple of quarters and by a few firms. But the industry as a whole hasn't posted a full-year decline in its employee strength since the start of India's outsourcing success story in the late 1990s.

In their latest commentaries following disappointing second quarter results, companies have pointed to the fear of recession in the US which is holding back business from their usual client base. However, a closer look suggests that may not be the only reason. For one, fears of an upcoming recession already appear to be an exaggerated threat, with the US economy growing at an annual rate of 4.9 percent in the July to September period, the biggest rise seen since the last quarter of 2021. Analysts also expect that sustained by robust consumer spending the growth momentum will continue through the coming quarter.

So, while the downtrend in global growth may certainly have a role to play in the travails of the sector, a far bigger cause may lie within. India's IT services giant have been content to stick to the tried and tested models of business for over two decades. No matter how many verticals they slice themselves into, the core strength is remotely managing their customers' IT infrastructures at a much lower cost than what they would have to pay in their home markets. While that's yielded rich dividends for years, it may be fast reaching its sell-by date.

Had IT firms embraced disruptive new technologies such as generative artificial intelligence (AI) and machine learning, they would still need fewer people. The difference though is that margins would have remained unaffected. Instead, only a handful of the top firms have been able to retain margins while others like Tech Mahindra are now operating at barely viable levels.

Some years ago, another Indian industry with equal promise reached a saturation point. For nearly 15 years, Indian generics makers reaped the rewards of their ability to make versions of off-patent drugs at a fraction of their original cost and sell them in the demanding markets of the US and UK. In this period, the sector grew rapidly and profitably. Between 2003-04 exports of medicinal and pharmaceutical products from India went up from $3 billion to approximately $15 billion according to the Ministry of Chemicals & Fertilizers, Department of Pharmaceuticals. In this period, the fortunes of the biggest pharma companies soared. But by 2016-17, the party had peaked. Since then growth, except for a handful of companies, has stalled. The inability to move up the value chain into branded generics and new chemical entities is often cited as one reason for this tapering off.

The $70 billion Indian auto component sector too found itself at a crossroads by the end of the 21st century after a decade of high growth. By 1999, after some years of heady growth, exports faced a slowdown forcing the biggest players in the business to retool their strategies, including taking a closer look at the growing domestic market. Over the last five years, auto component exports from India have grown at an average annual rate of 8.8 percent to reach $20 billion in FY23, per the Automotive Component Manufacturers Association of India (ACMA).

India's phenomenally successful IT services industry may also be facing a similar moment of reckoning where it needs to heed the call for creating unique solutions through innovation. For that it needs to be a little less- risk-averse. No industry, let alone a handful of firms, can suddenly start creating wholly new technologies. Silicon Valley remains the hub of innovation because of the decades-old ecosystem that fosters R&D and encourages risk-taking. And it is this last that has been completely missing from the arsenal of India's IT giants. In 2019, Microsoft ploughed a billion dollars into OpenAI which has since pioneered AI research with products like ChatGPT and DALL-E. It is the kind of money that India's debt-free and cash rich IT giants could have easily afforded. Instead, they chose to reward shareholders, including as in the case of TCS, Wipro and HCL, their promoters, through generous dividends and buybacks.

There's a price to be paid for such timidity.

SBI's Q2 Shows Retail Focus, But Capex Coming Soon

India's economic growth hinges on how fast and strong private investment grows but capex has so far eluded the country. Economic data have hardly given clarity on the same, but perhaps there is no better direction to look at than how the country's largest bank is lending.

The details are encouraging but fall short of instilling optimism on capex.

State Bank of India (SBI) updated its second quarter performance on November 4 and the contours of its loan book and the growth in different segments offers a good glimpse of how India is borrowing and whether private capex is coming back.

The lender's loan book grew at 13 percent year-on-year, which is a deceleration from around 15 percent in the quarters of FY23. Much of the loan book growth was driven by retail lending and specifically unsecured personal loans. SBI's unsecured personal loans expanded by 18 percent, faster than its entire loan book and even the retail loan book which grew by 15 percent. Auto loans grew by 20 percent while home loan growth lagged at 13 percent. Long story short, Indians are bingeing on vehicles and consumer durables while going cautious on housing. Consumption would continue to power the country's growth this year.

This corroborates an existing trend seen widely among banks and the surge in unsecured personal loans. The fact that September set the ball rolling on the festival season indicates that unsecured retail loans would continue to show elevated growth. Chief Dinesh Khara is not perturbed by this growth because SBI is lending to high creditworthy customers such as salaried employees, mainly those working in the public sector. "We are not concerned about our unsecured book. Our unsecured book is better than our secured book. Around 86 percent of our unsecured book is to salaried customers," Khara said at the post-Q2FY24 quarterly results meet.

The corporate loan growth story is perking up but has a long way to go. SBI's corporate loan book showed a growth of 6.6 percent, mainly driven by the services sector. The infrastructure loan book hardly grew as a contraction of the telecom loan book offset the 11 percent growth in loans to the roads and ports sector. Indeed, capex continues to be restricted to the roads sector.

In services though, the growth was impressive at 19 percent. Loans to iron and steel grew by a stately 36 percent while aviation was right behind at 25 percent. Even commercial real estate, that banks usually avoid, showed a neat growth of 12.5 percent. SBI's peers have indicated that besides working capital, there has been a healthy demand for capex related loans as well.

The bright side in corporate loans was the credit to small and medium enterprises (SME) that showed a 22.7 percent jump for the second quarter. Indeed, SME loans grew the fastest, even exceeding that of retail loans. SBI and even other banks have been pursuing SMEs even though bank chiefs have simultaneously been cautious about these borrowers. Recall that during the pandemic, such small business loans came under extreme duress, and some didn't recover at all despite forbearance.

But the pursuit of SME has been relentless by banks and some of it has been from the demand side too. SME loans fetch higher yields for banks and are one way to keep net interest margins intact during a time of an increase in cost of funds for banks.

SBI too will continue to lend to small businesses with caution, according to the bank.

The upshot is that India's economic growth would continue to be powered by the consumption engine in addition to the seasonal sugar rush of festival spending. Private capex is looking up but is yet to significantly increase. Early signs through higher loan offtake to roads, iron and steel and other peripheral industries to infrastructure bode well for capex growth.

For SBI, there is little doubt that its balance sheet growth will be sustained in FY24. The bank is targeting a loan growth of roughly 15 percent and this looks easy to achieve. However, the lender is getting less bang for every buck it lends because of high operating expenses and borrowing costs. Deposit growth continues to lag and SBI may need to hike deposit rates to attract more customers. Its investments in tech, branches, staff cost, and pension provisions are keeping operating overheads high and the outlook here is not conducive for profitability.

This explains why operating profit declined sequentially for the bank even though its income growth was decent. So far, SBI's profitability has been driven by old bad business turning good. Gross bad loans are down to a mere 2.5 percent and therefore the need for provisioning has come down sharply. But profitability can sustain only if new business grows faster and brings in more money. Net interest margins have shrunk and could remain under duress for SBI. Even though new business growth may quicken, the lender is unlikely to squeeze more profit out of every rupee lent.

That puts SBI in a tough position for the rest of the year.

Look What Our Research Analyst Has To Say...

It was a mixed week with bears gaining upper hand and bulls failing to hold major levels. Gold and OIL are on the rise indicating money flowing out of equities and into safe heaven commodities. The large cap to small caps ratio is overbought and above 1.6 which is again an indication that money within equities will flow into large caps and profit booking will continue in mod and small cap stocks. Rallies towards 19300-19350 zone will be an opportunity to liquidate longs and increase cash to deplot on corrections towards 18600 odd levels. Supports for the week are placed at 18800.

Anshul Jain

Sr. Research Analyst

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Wealth Bagger Stock Picks For The Week

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JK LAKSHMI CEMENT

About The Company

JK Lakshmi Cement, an ISO 9002 certified company, started its operation in 1938 in the Sirohi district in Rajasthan. It manufactures a wide range of cement. It is part of a diversified JK Group having business ventures in various segments such as paper, tyres, sugar, agri genetics and clinic research. The company has a network of 70 cement dumps and over 2200 dealers spread across the states of Rajasthan, Gujarat, Delhi, Haryana, U.P, Uttaranchal, Punjab, J&K, Mumbai and Pune. The combined capacity of the Company today stands at 4.75 MT per annum.

It became the first cement manufacturer in north India to introduce colour bags to promote its product. The company's product is chosen for various important projects such as IGNP, Sardar Sarovar Dam and also by major corporations like L&T, Reliance, Essar and the Airport Authority of India.

Particulars

Market Cap.	EPS	Net Profit	Promoter Holding	52 Week H / L
₹ 8,765 Cr	₹ 30.4	₹ 368 Cr	46.3%	897 / 606

Outlook & Valuation

JKLC is expected to focus more on - 1) geo-mix optimization, 2) increasing the share of trade sales and premium products, 3) better brand visibility, 4) sustainable growth, and 5) digitization and automation to increase yield value per tonne. It aims to improve EBITDA/t by INR300 through revenue growth and efficiency measures in the next 18 months. The company has growth plans for Nagaur (Rajasthan), Durg (Chhattisgarh) and Kutch (Gujarat) regions. JKLC aims to increase its capacity to 30mtpa by FY30 from 18mtpa now.

Volume growth opportunities are limited for JKLC in the standalone business and growth will be seen after the completion of UCWL expansion. However, replacement of clinker sales with cement will boost cement volumes. JKLC has seen some improvement in price positioning of its brands vs. peers, though it is not as per expectations

EQUITAS SMALL FINANCE BANK

About The Company

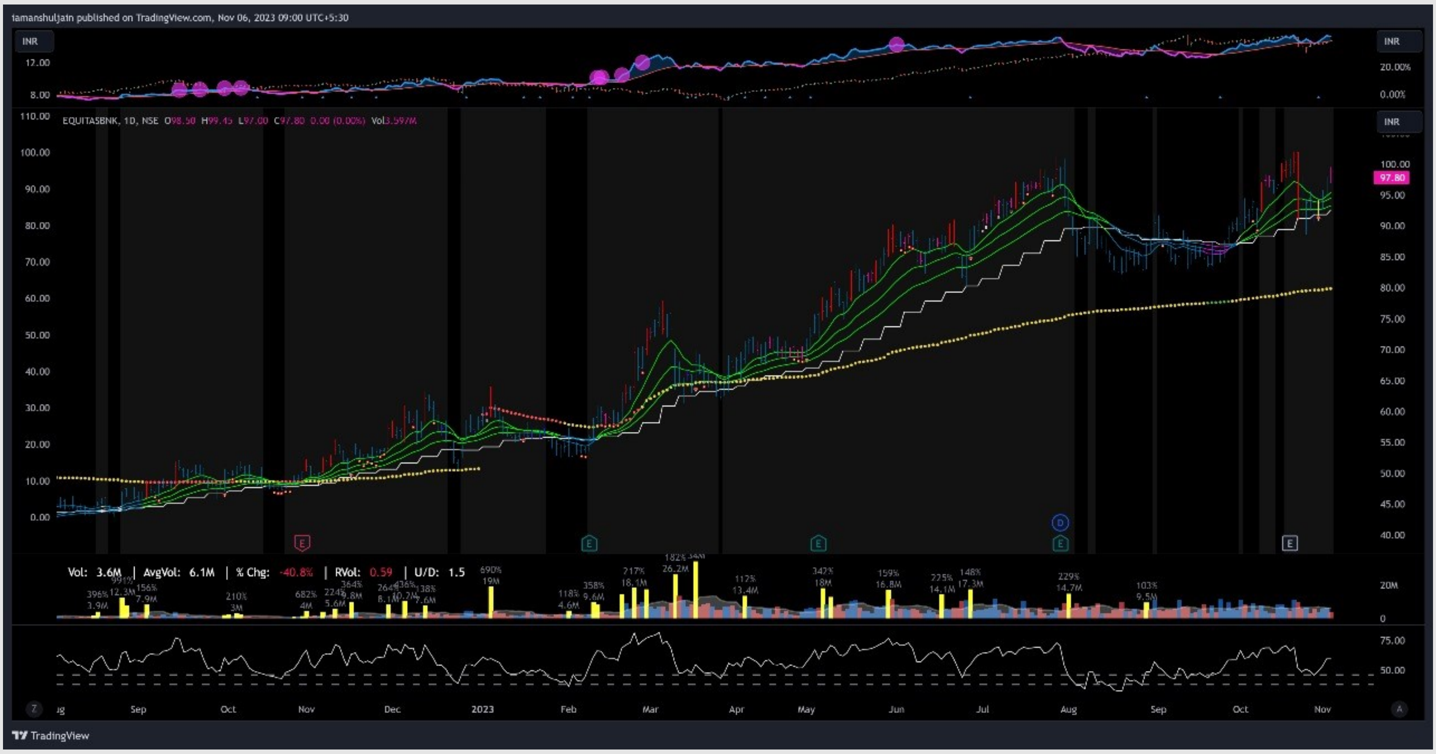
Equitas Small Finance Bank Limited is a Small Finance Bank (SFB), licensed by the Reserve Bank of India under Section 22 of the Banking Regulation Act, 1949 to carry on the business of Small Finance Bank. The Bank commenced the business of SFB on September 5, 2016. It is the first Private Sector Bank from Tamil Nadu to commence operations post-Indian Independence.

ESFBL, with pan-India operations, is focused on providing financing solutions for individuals and micro and small enterprises (MSEs) that are underserved by formal financing channels while providing a comprehensive banking and digital platform for all.

Particulars

Market Cap.	EPS	Net Profit	Promoter Holding	52 Week H / L
₹ 10,917 Cr	₹ 6.56	₹ 750 Cr	0.00%	102 / 49.8

Outlook & Valuation



EQUITASB reported strong profitability in FY23, with RoA expanding to 1.9% (avg. of 2.2% in 2HFY23). It was driven by steady margins, healthy loan growth and controlled credit costs. The bank focuses on building a diversified loan book, with small business loans (SBL), vehicle finance, microfinance (MFI) and housing finance being the key business segments. Loan growth was strong at 33% in FY23, and we estimate a robust 27% CAGR in loans over FY23-25. EQUITASB has made good progress in building a granular liability franchise, with a rising mix of retail deposits. The CASA mix is healthy at 42.3%. We expect deposit traction to remain strong even as the CASA mix declines further.

The bank has been consistently investing in business by adding new branches and building digital infrastructure and capabilities, which has kept operating expenses elevated. The bank has demonstrated strong improvements in asset quality, with X bucket collection efficiency improving to 99.6% for MFI, 99.6% for SBLs and 99% for vehicle finance.

THANK YOU

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