

## IT

## Steady performance with improving outlook

India Equity Research | IT

We estimate the top-5 IT players—Tata Consultancy Services (TCS), Infosys, Wipro, HCL Technologies (HCLT) and Tech Mahindra (TECHM)—to clock 1.1-2.2% QoQ constant currency revenue growth in Q4FY18. This will get a further 100-120bps cross-currency tailwind boost as major global currencies—GBP, EUR, AUD—appreciated versus USD QoQ. While INR appreciated a marginal 0.5% against USD, it depreciated vis-à-vis other global currencies and is likely to lead to 30-50bps margin tailwinds. Margins are expected to remain steady QoQ (up 20-50bps QoQ for top-5 players). While we expect HCLT to lead the pack with 2.2% QoQ USD revenue growth (60bps inorganic), Infosys, TECHM, TCS and Wipro are estimated to clock 1.4%, 1.3%, 1.1% and 1.1%, respectively. We will keenly monitor: i) FY19 revenue & margin guidance; ii) Infosys' strategic roadmap; iii) level of outsourcing in Europe; iv) clients' spending in legacy businesses; v) traction in digital services; and vi) demand outlook in BFS. Maintain 'BUY' on Infosys, HCLT & TECHM and 'HOLD' on TCS & Wipro.

### Cross-currency tailwinds; BFSI and Europe under scanner

With GBP, EUR and AUD appreciating 4.8%, 4.3% and 2.2%, respectively, QoQ against USD, we perceive cross-currency tailwinds of 100-120bps for top-5 IT companies. While we foresee growth uptick in BFSI for majority companies (except TCS), we expect commentary to be incrementally positive (especially by TCS) going forward. With rising outsourcing in Europe, we expect the geography to sustain its outperformance over North America. We expect FY19 revenue guidance for Infosys and HCLT at 6.5-8.5% and 8.0-10.0%, respectively. While Infosys is expected to maintain a conservative stance on guidance, we expect HCLT's guidance to include inorganic portion of ~150bps.

### Margins expected to remain steady

While closing rates indicate that INR has depreciated 2.0% QoQ versus USD, the quarterly average rate has appreciated 0.5%. But INR has depreciated 4.1% and 3.7% versus GBP and EUR, respectively, QoQ. Hence, we foresee positive 30-50bps margin movement for IT companies. We do not foresee pricing or cost pressures in existing or new deals. Accordingly, we estimate margins to remain broadly stable as automation and pyramid rationalisation efficiencies will be offset by higher onshore hiring.

### Outlook: Revenue acceleration in FY19 on the cards

With improving economic outlook in US, higher adoption of outsourcing in Europe and digital services gaining scale, revenue acceleration looks certain for Indian IT companies. Also Retail and Energy & Utility verticals have turned around and growth revival in BFSI fuels strong prospects for IT industry. While mid caps are expected to outpace large peers during current quarter, we perceive positive bias to large caps in the medium-to-long run as digital gains scale on account of execution capabilities. We maintain 'BUY' on Infosys, HCLT & TECHM and 'HOLD' on TCS and Wipro.

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### Infosys: All eyes on guidance and strategic roadmap

We estimate Infosys to post 1.4% growth QoQ in constant currency, further aided 100bps by cross currency (cc) movements, implying 2.4% growth in USD terms. With Mr. Salil Parekh completing his first quarter in Infosys, his strategy and vision to drive the company forward will be keenly watched. Also, with TCS announcing massive deal wins, all eyes will be on deal wins and large deal renewals during the quarter. **We expect Infosys to issue a revenue growth guidance of 6.5-8.5% and maintain operating margin guidance of 23-25% for FY19.** Considering downward revision of guidance in FY18, we believe the company will be fairly conservative in issuing FY19 guidance. Margin is likely to remain stable, with currency likely to benefit 30bps QoQ. We maintain our positive stance on Infosys anchored by strong fundamentals and attractive price. We maintain **'BUY'**.

### TCS: BFSI could overshadow RoB's good show

We estimate TCS to post revenue growth of 2.3% in USD terms and 1.1% in cc terms QoQ. Despite Retail turning around, overall revenue momentum during the quarter will be affected due to slow decision making amongst its top BFS clients. Healthy momentum in rest of business (RoB) will continue spurred by high traction in digital and renewed focus on Europe. Also, digital is expected to sustain its robust growth trajectory as deal size gains scale. Commentary on demand outlook and client budgets in key verticals of BFSI and Retail will be keenly monitored. While TCS has announced massive deals wins of ~USD7bn recently, expected to ramp up in FY19, we believe industry-leading growth will only be possible if BFSI turns around dramatically. We maintain **'HOLD'**.

### HCLT: Commentary on IP-deals and outlook on IMS key

We estimate HCLT to clock 3.4% and 2.2% USD and cc revenue growth QoQ, respectively. We expect organic revenue to jump 1.6% QoQ due to traction in ER&D services, while inorganic revenue from IP-deals will fuel revenue growth by additional 60bps. We expect the company to issue revenue growth guidance of 8.0-10.0% for FY19, after including inorganic portion of ~150bps. Margin guidance is expected to be maintained in the 19.5-20.5% range. We believe, HCLT is well positioned to post modest revenue and earnings growth due to high exposure to ER&D vertical, robust order book and improving outlook in IMS business. We maintain **'BUY'**.

### TECHM: Cost rationalisation to further strengthen margin

We expect Q4FY18 to be a steady quarter for TECHM, with revenue expected to jump 2.5% in USD terms and 1.3% in cc terms. Inorganic revenue from IP-deals is expected to contribute 50bps to revenue spurt. Growth will be led by momentum in enterprise business. EBITDA margin is expected to expand 50bps QoQ on account of operational efficiencies and improvement in performance of acquired companies. Commentary on outlook in telecom business, capex in telecom industry and medium-to-long term margin outlook will be key monitorables. We maintain **'BUY'**.

### Wipro: Client-specific issues to delay industry-level growth

We expect Wipro to post 2.1% and 1.1% growth (lower-end of guidance) in USD and cc terms, respectively, due to client-specific issues in Utilities and Telecom. Operating margins are expected to rise 20bps QoQ. We expect management to guide for 0.0-2.0% growth in Q1FY19, which is a seasonally weak quarter for the company. Management commentary on Energy & Utility and Healthcare verticals and update on India & Middle East markets are keenly awaited. We maintain **'HOLD'**.

**Table 1: Hedge position as at Q3FY18 end**

Companies	Total hedge position (USD mn equivalent)
TCS	5,974
Infosys	1,553
Wipro	2,294
HCLT	1,813
Tech Mahindra	1,175
Cyient	117
Hexaware	167
eClerx	142
Persistent	85
MindTree	32
KPIT	37

Source: Edelweiss research

**Table 2: Quarterly average exchange rates INR versus global currencies**

	Q4FY16	Q1FY17	Q2FY17	Q3FY17	Q4FY17	Q1FY18	Q2FY18	Q3FY18	Q4FY18
USD	67.5	66.9	67.0	67.4	67.0	64.5	64.3	64.7	64.4
Q-o-Q change (%)	2.3	(0.8)	0.1	0.6	(0.6)	(3.8)	(0.3)	0.7	(0.5)
Y-o-Y change (%)	8.4	5.5	3.1	2.2	(0.7)	(3.6)	(4.0)	(4.0)	(3.9)
GBP	96.6	96.0	88.0	83.7	82.9	82.4	84.1	85.9	89.6
Q-o-Q change (%)	(3.4)	(0.6)	(8.3)	(4.9)	(1.0)	(0.6)	2.1	2.1	4.3
Y-o-Y change (%)	2.4	(1.2)	(12.6)	(16.3)	(14.2)	(14.2)	(4.4)	2.6	8.0
EURO	74.4	75.5	74.8	72.8	71.4	70.9	75.5	76.2	79.1
Q-o-Q change (%)	3.1	1.5	(1.0)	(2.7)	(1.9)	(0.7)	6.5	0.9	3.8
Y-o-Y change (%)	5.9	7.7	3.5	0.8	(4.1)	(6.2)	0.9	4.7	10.9

Source: Bloomberg, Edelweiss research

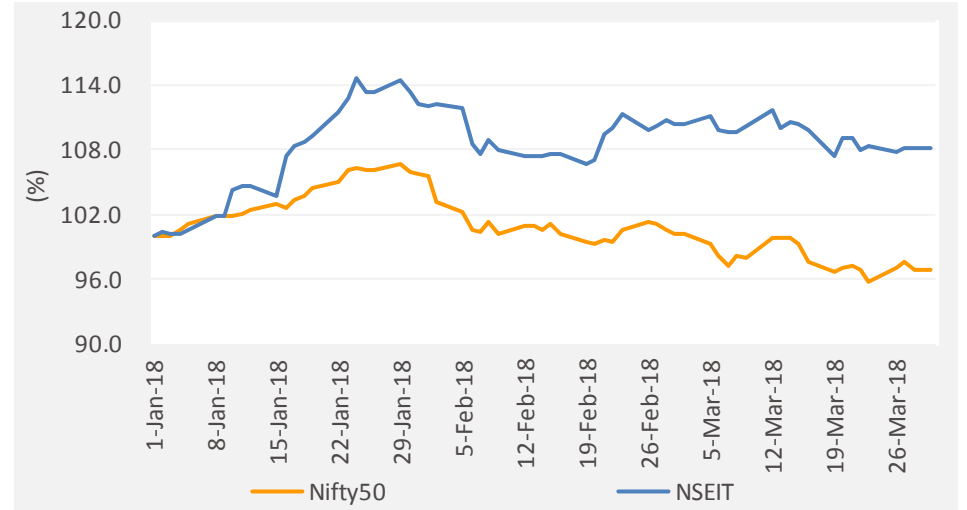
**Table 3: Quarter end closing exchange rates for INR vis-à-vis major global currencies**

	Q4FY16	Q1FY17	Q2FY17	Q3FY17	Q4FY17	Q1FY18	Q2FY18	Q3FY18	Q4FY18
USD	66.2	67.5	66.6	67.9	64.9	64.6	65.3	63.9	65.2
Q-o-Q change (%)	0.1	2.0	(1.4)	2.0	(4.5)	(0.4)	1.1	(2.2)	2.0
Y-o-Y change (%)	5.7	6.1	1.6	2.7	(2.1)	(4.4)	(2.0)	(6.0)	0.5
GBP	95.3	90.9	86.4	83.5	80.9	83.8	87.4	86.3	91.6
Q-o-Q change (%)	(2.8)	(4.6)	(4.9)	(3.4)	(3.1)	3.5	4.3	(1.3)	6.2
Y-o-Y change (%)	2.8	(9.2)	(13.2)	(14.8)	(15.1)	(7.9)	1.1	3.3	13.2
EURO	75.2	75.2	74.4	71.7	69.3	73.7	77.1	76.5	80.8
Q-o-Q change (%)	4.2	0.1	(1.1)	(3.7)	(3.3)	6.3	4.6	(0.7)	5.6
Y-o-Y change (%)	10.6	5.7	1.2	(0.6)	(7.8)	(2.0)	3.6	6.8	16.6

Source: Bloomberg, Edelweiss research

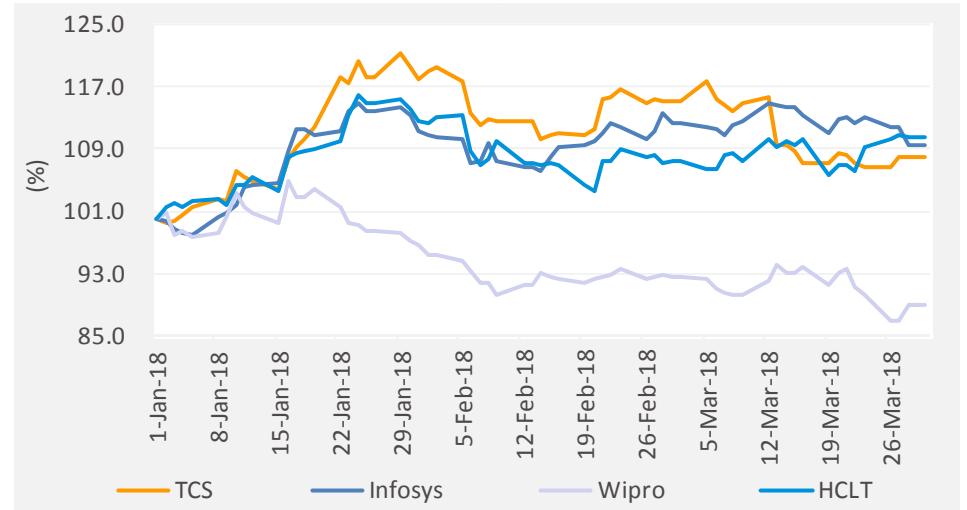
Since the number of companies under coverage is huge it is impossible to include all the price charts in one note. However, if client requests for a particular price chart we can provide the same.

**Chart 1: NSEIT massively outperformed Nifty during Q4FY18**



Source: Bloomberg

**Chart 2: Wipro underperformed peers during the quarter**



Source: Bloomberg

Table 4: Quarterly estimates and comments

Stock		Q4FY18E (INR mn)	Q3FY18 (INR mn)	Q-o-Q growth (%)	Q4FY17 (INR mn)	Y-o-Y growth (%)	Key things to watch out for
Infosys	Revenues	181,476	177,940	2.0	171,200	6.0	Revenues expected to grow 1.4% QoQ in cc terms, aided 100bps by currency movement (USD growth 2.4% QoQ). EBITDA margin expected to rise 30bps QoQ due to absence of wage hikes and operational efficiencies negating impact of ramping of US workforce. Guidance for FY19, Mr. Salil Parekh strategy and long term roadmap for Infosys, commentary on digital, client spendings and deal wins will be key monitorables.
	Revenues (USD mn)	2,821	2,755	2.4	2,569	9.8	
	EBITDA	49,692	48,170	3.2	46,580	6.7	
	EBITDA margin (%)	27.4	27.1		27.2		
	PAT	38,157	36,970	3.2	36,030	5.9	
TCS	Revenues	315,077	309,040	2.0	296,420	6.3	CC revenue growth of 1.1% QoQ, further aided 120bps by cross currency (2.3% growth in USD terms). Revenue growth to be impacted due to softness in key BFSI clients, while rest of business will continue good momentum. EBITDA margins expected to rise 30bps QoQ on account of operational efficiencies. Commentary on spends by BFSI and Retail clients, level of outsourcing in Europe are key monitorables.
	Revenues (USD mn)	4,897	4,787	2.3	4,452	10.0	
	EBITDA	85,288	82,880	2.9	81,330	4.9	
	EBITDA margin (%)	27.1	26.8		27.4		
	PAT	67,264	65,310	3.0	66,080	1.8	
Wipro	Revenues	139,071	136,690	1.7	139,875	(0.6)	Wipro to post USD revenue and cc revenue growth of 2.1% and 1.1% QoQ respectively, as customer related issues (in utility and telecom) will continue to impact the company. We foresee 20bps QoQ expansion in adjusted margins (margins were impacted by 240bps last quarter due to client insolvency). Demand outlook in energy & utilities vertical, traction in BPM, demand from India & MEA geographies, are key monitorables.
	Global IT rev (USD mn)	2,056	2,013	2.1	1,955	5.2	
	EBITDA	28,909	24,928	16.0	32,264	(10.4)	
	EBITDA margin (%)	20.8	18.2		23.1		
	PAT	22,448	19,371	15.9	22,611	(0.7)	
HCL Tech	Revenues	132,277	128,080	3.3	120,530	9.7	Expect HCL Tech to post USD revenue growth of 3.4% (inorganic revenues of 60bps and cross currency tail-winds of 120bps). Despite seasonal weakness in IP business, expect margins to expand 30bps on account of operational efficiencies. Revenue and margin guidance for FY19, update on IP-deals, outlook in IMS, traction in ER&D traction to be keenly monitored.
	Revenues (USD mn)	2,056	1,988	3.4	1,817	13.2	
	EBITDA	30,921	29,640	4.3	26,490	16.7	
	EBITDA margin (%)	23.4	23.1		22.0		
	PAT	22,482	21,940	2.5	23,280	(3.4)	
Tech Mahindra	Revenues	79,777	77,760	2.6	74,950	6.4	We estimate TECHM's revenue to grow 1.3% in cc terms and 2.5% in USD terms QoQ. Inorganic revenues from IP-deals will contribute 50bps to growth. Growth to be led by momentum in enterprise business. EBITDA margin to further expand 50bps QoQ, on account of operational efficiencies and improvement in performance of acquired companies. Commentary on Network business, capex in telecom industry, long term margin outlook will be keenly monitored.
	Revenues (USD mn)	1,240	1,209	2.5	1,131	9.6	
	EBITDA	13,386	12,647	5.8	8,987	48.9	
	EBITDA margin (%)	16.8	16.3		12.0		
	Adjusted PAT	9,548	9,432	1.2	5,880	62.4	

Table 4: Quarterly estimates and comments (contd...)

Stock		Q4FY18E (INR mn)	Q3FY18 (INR mn)	Q-o-Q growth (%)	Q4FY17 (INR mn)	Y-o-Y growth (%)	Key things to watch out for
Info Edge	Revenues	2,466	2,272	8.6	2,084	18.3	Revenue expected to grow 18.3% YoY due to strong growth in 99acres (base affected due to demonetisation) and Shiksha (>20% YoY). Expect growth to remain steady in Naukri business (13.5% YoY growth in billings). Considering substantial advertisements in all 4 businesses, we expect margin decline of 130bps QoQ. Commentary on competition in Naukri and 99acres, advertising strategy, investee companies' performance are key monitorables.
	EBITDA	824	788	4.5	632	30.4	
	EBITDA margin (%)	33.4	34.7		30.3		
	PAT	730	703	3.8	329	122.0	
Cyient	Revenues	10,477	9,834	6.5	9,410	11.3	Revenues to grow 7.1% in USD terms majorly due to strong growth in DLM business. We expect Services business to remain flat QoQ (Q3FY18 was very strong) with DLM business growing ~90% QoQ (due to major deals being pushed from previous quarter). Margins expected to decline 40bps QoQ. Commentary on deal pipeline, demand in ER&D and traction in DLM business to be keenly monitored.
	Revenues (USD mn)	163	152	7.1	141	15.5	
	EBITDA	1,487	1,431	3.9	1,247	19.2	
	EBITDA margin (%)	14.2	14.6		13.3		
	PAT	1,062	1,088	(2.4)	784	35.4	
Hexaware	Revenues	10,355	10,048	3.1	9,605	7.8	We expect revenues of Hexaware to grow 2.5% QoQ in cc terms and 3.1% QoQ in USD terms. EBITDA margins expected to expand 30bps on account of absense of partial impact of wage hike and operational efficiencies. Growth in IMS and BPS service offerings, outlook on the top-10 clients, demand environment in BFSI are key monitorables.
	Revenues (USD mn)	161	156	3.1	145	11.2	
	EBITDA	1,681	1,599	5.2	1,623	3.6	
	EBITDA margin (%)	16.2	15.9		16.9		
	PAT	1,276	1,210	5.4	1,139	12.0	
eClerx	Revenues	3,482	3,399	2.5	3,315	5.0	Revenue expected to rise 3.1% QoQ in USD terms and 1.9% in cc terms as all key revenue headwinds are now behind. Despite company focussing of ramping up lower margin onsite and managed services business, we expect EBITDA margin expected to expand 50bps on tighter execution and return in revenue growth. Demand outlook, particularly for short-term projects, growth in top-10 clients, digital pipeline will be key monitorables.
	Revenues (USD mn)	50	49	3.1	48	5.2	
	EBITDA	941	900	4.5	1,023	(8.0)	
	EBITDA margin (%)	27.0	26.5		30.9		
	PAT	660	575	14.8	748	(11.8)	
Persistent	Revenues	7,634	7,919	(3.6)	7,271	5.0	USD revenues expected to decline 3.2% QoQ on account of USD8mn dip in IP revenues. While a USD3-4mn fall was anticipated on account of seasonal weakness in the Alliance, additional decline is on account of ramp down in one of its key IP products. Margins also expected to take 400bps QoQ hit as major part of IP revenue flow down to profitability. Outlook for IP revenues, commentary on IBM Watson deal, traction in digital, update on ISV business are key monitorables.
	Revenues (USD mn)	119	123	(3.2)	109	8.8	
	EBITDA	1,033	1,375	(24.9)	1,188	(13.0)	
	EBITDA margin (%)	13.5	17.4		16.3		
	PAT	683	917	(25.5)	728	(6.1)	

**Table 4: Quarterly estimates and comments (contd...)**

Stock		Q4FY18E (INR mn)	Q3FY18 (INR mn)	Q-o-Q growth (%)	Q4FY17 (INR mn)	Y-o-Y growth (%)	Key things to watch out for
L&T Infotech	Revenues	19,656	18,837	4.3	16,772	17.2	Revenue growth to be 4.1% QoQ- aided by inorganic revenues (140bps) and cross currency tailwinds (80bps). Margins to expand 60bps QoQ on account of operational efficiencies and strong revenue momentum. Management commentary on deal wins during the quarter, outlook for FY19, spendings in BFSI vertical, performance in top-10 clients are key monitorables.
	Revenues (USD mn)	306	294	4.1	254	20.2	
	EBITDA	3,480	3,215	8.2	3,191	9.0	
	EBITDA margin (%)	17.7	17.1		19.0		
	PAT	3,045	2,829	7.6	2,546	19.6	
L&T Technology Services	Revenues	10,005	9,691	3.2	8,123	23.2	Expect revenue to grow 2.0% QoQ in cc terms and 3.0% in USD terms. Margins are expected to improve 70bps on account of higher billing rates, better SG&A management and higher ofshoring. Management commentary on deal wins during the quarter, outsourcing in ER&D space, traction in telecom vertical and top-10 client performance are key monitorables.
	Revenues (USD mn)	155	151	3.0	121	28.2	
	EBITDA	1,604	1,485	8.0	1,338	19.9	
	EBITDA margin (%)	16.0	15.3		16.5		
	PAT	1,282	1,265	1.4	965	32.9	
Just Dial	Revenues	1,988	1,968	1.0	1,817	9.4	Revenue growth to be 9.4% YoY, driven by higher realisations. Growth in campaigns is also anticipated as benefit from ads accrue and impact on SMEs (due to GST) recede. We expect margins to rationalise 60bps QoQ on higher variable pay. Management strategy on advertising campaign, traction in listings in core business and plan of action in JD Omni are key monitorables.
	EBITDA	459	466	(1.3)	322	42.8	
	EBITDA margin (%)	23.1	23.7		17.7		
	PAT	400	286	39.9	254	57.8	

Source: Company, Edelweiss research

**Table 5: Valuations and recommendations snapshot**

Company	Rating	CMP (INR)	Mcap (USD mn)	P/E (x)		EV/EBITDA(x)		ROE (%)	
				FY19E	FY20E	FY19E	FY20E	FY19E	FY20E
eClerx Services	Hold	1,214	721	15.1	12.6	8.7	6.5	21.1	21.9
HCL Tech	Buy	969	20,749	14.3	12.7	10.2	8.7	24.4	23.5
Hexaware	Hold	416	1,897	21.8	18.4	15.4	13.2	26.4	26.9
Info Edge	Buy	1,231	2,305	43.7	36.0	33.6	26.9	17.9	18.8
Infosys	Buy	1,140	38,302	16.0	13.9	10.5	9.1	24.9	26.4
Just Dial	Hold	475	492	18.5	16.1	9.6	7.6	15.3	15.1
Cyient	Buy	680	1,177	16.3	14.2	9.8	8.4	18.6	19.1
Persistent Systems	Buy	674	829	13.1	11.3	7.3	5.9	18.0	18.2
TCS	Hold	2,908	85,602	20.0	17.9	14.2	12.7	31.9	31.6
Tech Mahindra	Buy	617	9,288	14.4	12.5	9.5	8.0	18.6	19.1
Wipro	Hold	284	19,749	15.5	14.2	12.0	10.9	18.5	18.4
L&T Infotech	Buy	1,417	3,748	19.3	16.2	14.9	11.9	31.8	32.2
L&T Technology Services	Buy	1,231	1,939	21.6	17.4	16.5	13.0	30.5	31.8

Source: Edelweiss research

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### **Coverage group(s) of stocks by primary analyst(s): IT**

Cyient, eClerx Services, HCL Technologies, Hexaware Technologies, Infosys, Info Edge, Just Dial, L& T Infotech, L& Technology Services, Persistent Systems, Tata Consultancy Services, Tech Mahindra, Wipro

#### Recent Research

Date	Company	Title	Price (INR)	Recos
27-Mar-18	<b>Tejas Networks</b>	FY18 revenue likely to decline; outlook strong; <i>EdelFlash</i>	368	Buy
27-Mar-18	<b>Persistent Systems</b>	Caution: Dent in Q4 IP revenue anticipated; <i>EdelFlash</i>	784	Buy
27-Feb-18	<b>IT</b>	Digital drive - The race begins; <i>Sector Update</i>		

#### Distribution of Ratings / Market Cap

##### Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	161	67	11	240
* 1 stocks under review				
	> 50bn	Between 10bn and 50 bn	< 10bn	
Market Cap (INR)	156	62	11	

#### Rating Interpretation

Rating	Expected to
<b>Buy</b>	appreciate more than 15% over a 12-month period
<b>Hold</b>	appreciate up to 15% over a 12-month period
<b>Reduce</b>	depreciate more than 5% over a 12-month period



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