



IT

Optimistic 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 -1.1-4.1% QoQ constant currency revenue growth in Q1FY19. During the quarter, EUR, GBP and AUD depreciated versus USD QoQ, which is likely to impact revenue growth 90-140bps. We expect margins to fall marginally as wage hikes and visa costs are envisaged to be partially offset by INR depreciation and operational efficiencies. Considering positive macros and rising digital proportion, we expect revenue growth to accelerate along with significant improvement in managements' commentaries. While TCS is expected to lead the pack with 3.1% QoQ USD revenue growth, HCLT is estimated to grow 2.4% QoQ (2.1% inorganic) and Infosys 2.3%. Wipro and TECHM are estimated to dip 2.0% QoQ each. We will monitor: i) traction in digital business; ii) commentary on demand in BFSI & retail; iii) Europe revenue growth rates; iv) clients' spending in legacy businesses; and v) deal wins & pipeline. Maintain 'BUY' on Infosys, TECHM & HCLT and 'HOLD' on TCS & Wipro.

Cross-currency headwinds; BFSI, retail on the radar

With USD appreciating 2.3%, 3.0% and 3.7% QoQ against GBP, EUR and AUD, respectively (average rate), we perceive cross currency headwinds of 80-100bps for top-5 IT players. We expect revenue growth of almost all companies to pick up, barring a few company-specific issues, and optimistic commentaries. Rising outsourcing in Europe along with rapid digital adoption will help Europe sustain outperformance over North America. Demand commentaries in BFSI and retail to be monitored.

Wage hikes and visa costs likely to offset INR depreciation benefit

The INR has depreciated 3.9% against USD, which is estimated to aid 60-100bps margin expansion during the quarter. However, higher visa costs and wage hikes are likely to offset benefits of INR depreciation, resulting in QoQ margin dip. We do not foresee pricing or cost pressures in existing or new deals. While we expect HCLT and Wipro to clock flattish margins, those of TCS, Infosys and TECHM are estimated to decline 50bps, 70bps and 120bps, respectively.

Outlook: Expect significant improvement in demand commentaries

With digital services gaining scale, revenue acceleration looks certain for Indian IT companies. Improving economic outlook in the US and higher adoption of outsourcing in Europe are also driving growth. Accenture's robust Q318 results along-with persisting double digit growth in outsourcing revenues further bolsters confidence. In our view, mid caps will continue to outpace large peers. However, 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. In mid-cap space, we prefer Persistent and L&T Technology Services.

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July 2, 2018

Infosys: Developments in digital and demand in BFSI key monitorables

We estimate Infosys to post 3.2% growth QoQ in constant currency, impacted 90bps by cross currency (cc) headwinds, implying 2.3% growth in USD. All eyes will be on growth in digital services, BFSI & retail commentary, deal wins and large deal renewals during the quarter. Margin is likely to decline 70bps QoQ on account of wage hikes (120bps), higher visa costs (50bps) and higher investment in sales & digital, which will be partially offset by INR depreciation and operational efficiencies. We expect management to maintain FY19 revenue growth and margin guidance. We maintain our positive stance on Infosys anchored by strong fundamentals and attractive price. We maintain **'BUY'**.

TCS: Revenue acceleration on the cards, but already factored in

We estimate TCS to post revenue growth of 3.1% in USD terms and 4.1% in cc terms QoQ. Revenue growth will be led by ramp ups in large deals won during the previous two quarters and seasonal strengths. Momentum is expected to remain strong in all industry verticals, except BFSI, which we believe is likely to turnaround in one-two quarters. Digital is expected to sustain its robust growth trajectory as deal size gains scale. INR appreciation, robust revenue momentum and better execution is likely to restrict margin decline to 50bps as Q1 will face the impact of higher visa costs (40bps) and wage hikes (180bps). Commentary on demand outlook & client budgets in BFSI, traction in digital services and growth in Europe & APAC will be keenly monitored. We maintain **'HOLD'** due to expensive valuations.

HCLT: Acquisition strategy and outlook on IMS on the radar

We estimate HCLT to clock 1.7% cc revenue growth QoQ, further aided by 210bps on account of the C3i acquisition. However, cc headwinds (140bps impact) will bring down the USD growth rate to 2.4%. Margin is expected to be flat QoQ as INR depreciation benefits are likely to be offset by higher visa costs (50bps) and margin dilutive acquisition (30bps). While ER&D revenue is expected to grow at a fast clip, decline in India's system integration business will be a key headwind. Management is expected to maintain revenue growth and margin guidance for FY19. Traction in ER&D business, strategy behind acquisitions, update on IP deals and outlook on IMS business are key monitorables. We maintain **'BUY'**.

TECHM: Wage hikes, after a long pause, to take a toll on margin

We estimate Q1FY19 revenue to decline 1.1% in cc and 2.0% in USD on account of strong base and seasonal weakness in the Comviva business. While Q1FY19 is expected to be a steady quarter for the enterprise business, pressure in telecom will continue. EBITDA margin is estimated to decline 120bps QoQ on account of partial wage hikes (70bps) and higher visa costs (70bps). 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: Seasonal weakness coupled with client-specific issues

We expect Wipro to post 1.0% and 2.0% revenue decline in cc and USD terms (mid-range of guidance), respectively, due to seasonal weakness and client-specific issues in utilities and telecom. Operating margin is expected to remain flat QoQ as INR depreciation benefits will be offset by higher visa costs (50bps) and wage hikes (60bps) for one month during the quarter. We expect management to guide for 1.0-3.0% growth in Q2FY19 in cc terms. Management commentary on energy & utility and healthcare verticals, update on India & Middle East markets and outlook on BPS business are keenly awaited. We maintain **'HOLD'**.

Table 1: Hedge position as at Q4FY18 end

Companies	Total hedge position (USD mn equivalent)
TCS	5,637
Infosys	1,494
Wipro	2,400
HCLT	2,400
Tech Mahindra	1,200
Cyient	119
Hexaware	201
eClerx	141
Persistent	103
MindTree	41
KPIT	39

Source: Edelweiss research

Table 2: Quarterly average exchange rates INR versus global currencies

	Q1FY17	Q2FY17	Q3FY17	Q4FY17	Q1FY18	Q2FY18	Q3FY18	Q4FY18	Q1FY19
USD	66.9	67.0	67.4	67.0	64.5	64.3	64.7	64.4	67.0
Q-o-Q change (%)	(0.8)	0.1	0.6	(0.6)	(3.8)	(0.3)	0.7	(0.5)	4.1
Y-o-Y change (%)	5.5	3.1	2.2	(0.7)	(3.6)	(4.0)	(4.0)	(3.9)	3.9
GBP	96.0	88.0	83.7	82.9	82.4	84.1	85.9	89.6	91.1
Q-o-Q change (%)	(0.6)	(8.3)	(4.9)	(1.0)	(0.6)	2.1	2.1	4.3	1.7
Y-o-Y change (%)	(1.2)	(12.6)	(16.3)	(14.2)	(14.2)	(4.4)	2.6	8.0	10.6
EURO	75.5	74.8	72.8	71.4	70.9	75.5	76.2	79.1	79.9
Q-o-Q change (%)	1.5	(1.0)	(2.7)	(1.9)	(0.7)	6.5	0.9	3.8	0.9
Y-o-Y change (%)	7.7	3.5	0.8	(4.1)	(6.2)	0.9	4.7	10.9	12.7

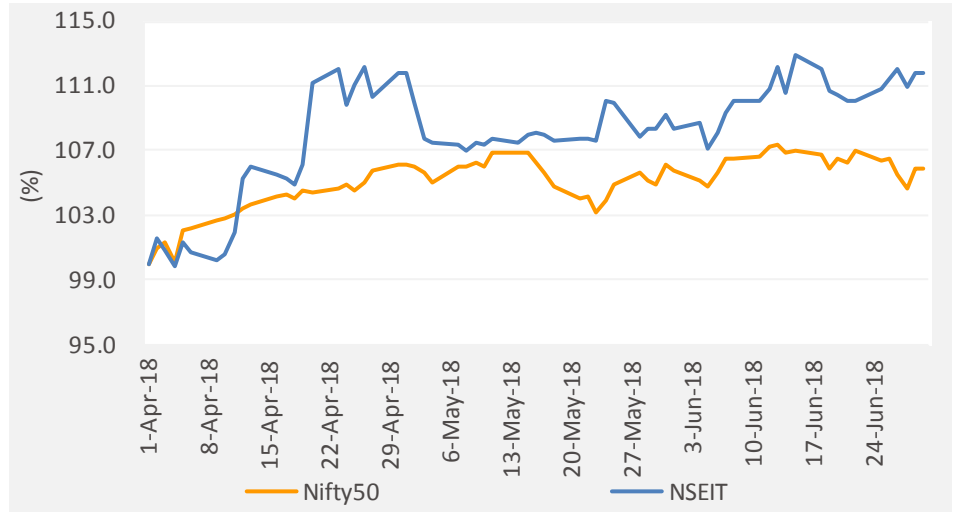
Source: Bloomberg, Edelweiss research

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

	Q1FY17	Q2FY17	Q3FY17	Q4FY17	Q1FY18	Q2FY18	Q3FY18	Q4FY18	Q1FY19
USD	67.5	66.6	67.9	64.9	64.6	65.3	63.9	65.2	68.5
Q-o-Q change (%)	2.0	(1.4)	2.0	(4.5)	(0.4)	1.1	(2.2)	2.0	5.1
Y-o-Y change (%)	6.1	1.6	2.7	(2.1)	(4.4)	(2.0)	(6.0)	0.5	6.0
GBP	90.9	86.4	83.5	80.9	83.8	87.4	86.3	91.6	90.0
Q-o-Q change (%)	(4.6)	(4.9)	(3.4)	(3.1)	3.5	4.3	(1.3)	6.2	(1.7)
Y-o-Y change (%)	(9.2)	(13.2)	(14.8)	(15.1)	(7.9)	1.1	3.3	13.2	7.5
EURO	75.2	74.4	71.7	69.3	73.7	77.1	76.5	80.8	79.8
Q-o-Q change (%)	0.1	(1.1)	(3.7)	(3.3)	6.3	4.6	(0.7)	5.6	(1.3)
Y-o-Y change (%)	5.7	1.2	(0.6)	(7.8)	(2.0)	3.6	6.8	16.6	8.3

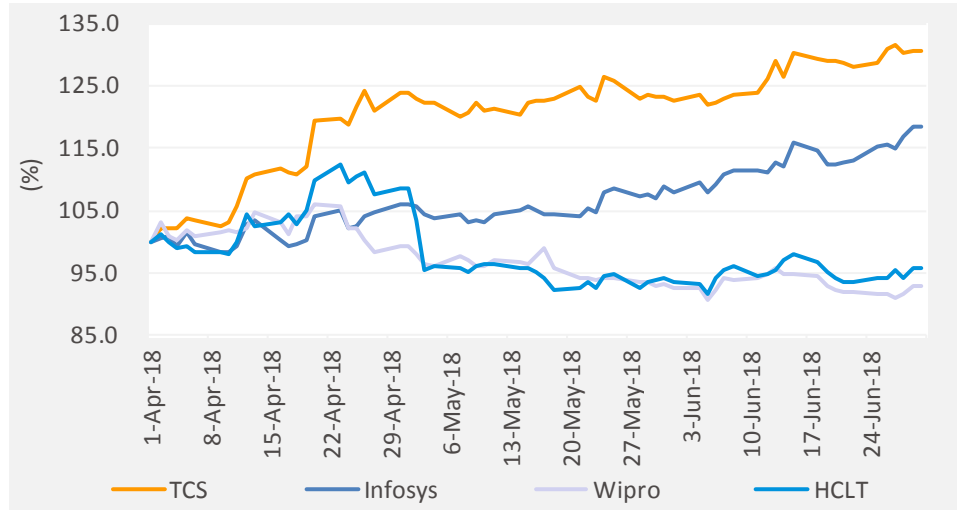
Source: Bloomberg, Edelweiss research

Chart 1: NSEIT outperformed Nifty during Q4FY18



Source: Bloomberg

Chart 2: TCS outperformed peers during the quarter



Source: Bloomberg

Table 4: Quarterly estimates and comments

Stock		Q1FY19E (INR mn)	Q4FY18 (INR mn)	Q-o-Q growth (%)	Q1FY18 (INR mn)	Y-o-Y growth (%)	Key things to watch out for
Infosys	Revenues	1,92,338	1,80,830	6.4	1,70,780	12.6	Revenues expected to grow 3.2% QoQ in cc terms, impacted 90bps due to cross currency headwinds (USD growth 2.3% QoQ). EBITDA margin expected to decline 50bps QoQ as operational efficiencies and INR depreciation benefits will be offset by wage hikes, higher visa costs, investment in digital. Commentary on demand environment, strategy for digital, client spendings and deal wins will be key monitorables.
	Revenues (USD mn)	2,871	2,805	2.3	2,651	8.3	
	EBITDA	51,111	49,300	3.7	45,610	12.1	
	EBITDA margin (%)	26.6	27.3		26.7		
	PAT	38,489	36,900	4.3	34,830	10.5	
TCS	Revenues	3,43,310	3,20,750	7.0	2,95,840	16.0	Expect revenue growth of 4.1% QoQ in cc terms, driven by ramp-ups in major deal-wins last year. However, we foresee 100bps cross currency impact, bringing down USD growth to 3.1%. EBITDA margins expected to decline 50bps QoQ on account of visa costs (40bps) and wage hikes (180bps), offset by INR depreciation and operational efficiencies. Commentary on spends by BFSI and Retail clients, growth in digital, outsourcing levels in Europe are key monitorables.
	Revenues (USD mn)	5,124	4,972	3.1	4,591	11.6	
	EBITDA	91,040	86,520	5.2	74,120	22.8	
	EBITDA margin (%)	26.5	27.0		25.1		
	PAT	72,218	69,040	4.6	59,450	21.5	
Wipro	Revenues	1,39,894	1,37,686	1.6	1,36,261	2.7	Wipro to post USD revenue and cc revenue decline of 2.0% and 1.0% QoQ respectively on account of seasonally weaker quarter for the company and client specific issues. Adjusted margins expected to remain flat QoQ as INR depreciation benefits will be offset by partial wage hike, visa costs and weak quarter. Demand outlook in energy & utilities vertical, traction in BPM, demand from India & MEA geographies, are key monitorables.
	Global IT rev (USD mn)	2,021	2,062	(2.0)	1,972	2.5	
	EBITDA	24,913	24,530	1.6	26,683	(6.6)	
	EBITDA margin (%)	17.8	17.8		19.6		
	PAT	18,490	18,028	2.6	20,765	(11.0)	
HCL Tech	Revenues	1,39,756	1,31,790	6.0	1,21,490	15.0	Expect HCL Tech to post USD revenue growth of 2.4% (inorganic revenues 210bps and cross currency headwinds of 140bps). Expect margins to remain flat QoQ as INR depreciation benefits will be offset by visa costs and integration of lower margin acquisition. Update on IP-deals, outlook in IMS, traction in ER&D traction and strategy behind acquisitions to be keenly monitored.
	Revenues (USD mn)	2,086	2,038	2.4	1,884	10.7	
	EBITDA	32,201	30,360	6.1	26,810	20.1	
	EBITDA margin (%)	23.0	23.0		22.1		
	PAT	23,089	22,290	3.6	21,710	6.4	
Tech Mahindra	Revenues	81,663	80,545	1.4	73,361	11.3	We estimate TECHM's revenue to decline 1.1% in cc terms and 2.0% in USD terms QoQ due to weak quarter for Comviva business and strong base. Enterprise business is expected to continue strong growth. EBITDA margin to decline 120bps QoQ due to visa costs (70bps), wage hikes (70bps), revenue decline, offset by INR depreciation. Commentary on Network business and 5G capex, outlook for Enterprise business and long term margin expectations will be keenly monitored.
	Revenues (USD mn)	1,219	1,244	(2.0)	1,138	7.1	
	EBITDA	13,330	14,119	(5.6)	9,347	42.6	
	EBITDA margin (%)	16.3	17.5		12.7		
	Adjusted PAT	9,394	12,258	(23.4)	7,985	17.6	

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

Stock		Q1FY19E (INR mn)	Q4FY18 (INR mn)	Q-o-Q growth (%)	Q1FY18 (INR mn)	Y-o-Y growth (%)	Key things to watch out for
Info Edge	Revenues	2,577	2,407	7.1	2,225	15.8	Revenue expected to grow 15.8% YoY due to strong growth in 99acres (29% YoY). Expect growth to remain steady in Naukri (14% YoY) and Shiksha (15%) businesses. Jeevansathi growth to be impacted due to intense competition. Ad expenses expected to remain high for all 4 businesses during the quarter. Commentary on competition in Naukri, Jeevansathi and 99acres, investee companies' performance, update on Zomato, strategy for policybazaar are key monitorables.
	EBITDA	711	593	19.9	703	1.1	
	EBITDA margin (%)	27.6	24.7		31.6		
	PAT	640	566	13.1	642	(0.4)	
Cyient	Revenues	10,830	10,618	2.0	9,070	19.4	Revenues expected to decline 1.8% in USD terms majorly due to seasonally weak quarter for DLM business. Services business to grow 2.1% QoQ in USD terms (3.2% cc), with DLM declining 27% QoQ (up 35% YoY; organic growth 20% YoY). Margins expected to expand 30bps QoQ as INR depreciation benefit and efficiencies will be offset by partial wage hikes and visa costs. Commentary on demand in ER&D and traction in DLM business to be keenly monitored.
	Revenues (USD mn)	162	165	(1.8)	141	14.9	
	EBITDA	1,557	1,492	4.4	1,160	34.3	
	EBITDA margin (%)	14.4	14.1		12.8		
	PAT	1,215	1,215	0.0	877	38.6	
Hexaware	Revenues	11,313	10,490	7.8	9,836	15.0	We expect revenues of Hexaware to grow 4.6% QoQ cc and 4.1% QoQ in USD terms. EBITDA margins expected to expand 90bps QoQ on account of benefits of INR depreciation 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)	169	162	4.1	153	10.6	
	EBITDA	1,855	1,626	14.1	1,598	16.1	
	EBITDA margin (%)	16.4	15.5		16.2		
	PAT	1,419	1,342	5.7	1,224	15.9	
eClerx	Revenues	3,635	3,611	0.7	3,332	9.1	Revenue to decline 1.8% QoQ in USD terms and 1.0% in cc terms, as anticipated, on account of much stronger base. We expect EBITDA margin to expand 30bps on tighter execution and 20bps due to INR depreciation. Demand outlook in offshore business, growth in top-10 clients, onshore business strategy, ramping up of North Carolina centre, deal pipeline will be key monitorables.
	Revenues (USD mn)	52	53	(1.8)	49	5.7	
	EBITDA	836	814	2.8	990	(15.5)	
	EBITDA margin (%)	23.0	22.5		29.7		
	PAT	632	639	(0.9)	792	(20.2)	
Persistent	Revenues	8,163	7,525	8.5	7,280	12.1	USD revenues to grow 4.2% QoQ in USD terms (impacted 40bps by cross currency headwinds) on account of robust growth in digital and modest growth in Services and Alliance business. Margins expected to recoup 140bps QoQ on account of INR depreciation and operational efficiencies. Outlook for IP revenues, commentary on IBM Watson deal, traction in digital, update on services and Accelerite business are key monitorables.
	Revenues (USD mn)	122	117	4.2	113	7.9	
	EBITDA	1,320	1,111	18.9	1,044	26.5	
	EBITDA margin (%)	16.2	14.8		14.3		
	PAT	839	737	13.8	751	11.7	

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

Stock		Q1FY19E (INR mn)	Q4FY18 (INR mn)	Q-o-Q growth (%)	Q1FY18 (INR mn)	Y-o-Y growth (%)	Key things to watch out for
L&T Infotech	Revenues	21,317	20,012	6.5	16,707	27.6	Revenue growth to be 3.0% QoQ in cc terms, impacted 80bps by cross currency movements (cc growth of 3.8%). On adjusted basis, margins to expand 90bps QoQ on account of operational efficiencies and INR depreciation. Management commentary on deal-wins during the quarter, spendings in BFSI vertical, performance in top-10 clients are key monitorables.
	Revenues (USD mn)	318	309	3.0	259	22.7	
	EBITDA	3,944	2,919	35.1	2,799	40.9	
	EBITDA margin (%)	18.5	14.6		16.8		
	PAT	3,349	2,893	15.8	2,673	25.3	
L&T Technology Services	Revenues	10,967	10,548	4.0	8,226	33.3	Expect revenue to grow 0.8% QoQ in USD terms. On adjusted basis, organic revenue growth expected to be 3.5% cc and 2.7% in USD terms, as last quarter had one time revenues of USD3mn. Margins expected to improve 120bps on account of operational efficiencies. Other income to be inflated by USD12mn on account of sale of intellectual property. Management commentary on deal wins during the quarter, outsourcing in ER&D space and top-10 client performance key monitorables.
	Revenues (USD mn)	164	162	0.8	128	28.2	
	EBITDA	1,833	1,640	11.8	1,257	45.8	
	EBITDA margin (%)	16.7	15.5		15.3		
	PAT	2,097	1,591	31.8	980	114.0	
Just Dial	Revenues	2,114	2,005	5.5	1,900	11.3	Revenue growth to be 11.3% YoY, driven by higher realisations. Growth in campaigns is also anticipated as benefit from ads accrue. We expect margins to improve 80bps QoQ on higher revenue growth. Management strategy on advertising campaign, traction in listings in core business are key monitorables.
	EBITDA	500	458	9.1	325	53.8	
	EBITDA margin (%)	23.6	22.8		17.1		
	PAT	427	390	9.7	382	12.0	

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	1,300	734	16.8	13.9	9.8	7.4	20.4	21.3
HCL Tech	Buy	926	18,824	13.3	12.1	9.5	8.5	24.9	24.7
Hexaware	Hold	458	1,985	23.6	20.4	17.3	14.8	27.0	26.9
Info Edge	Buy	1,186	2,111	44.2	36.4	34.9	28.1	15.3	16.4
Infosys	Buy	1,307	41,671	18.4	16.6	12.7	11.2	24.4	26.4
Just Dial	Buy	555	492	18.5	16.1	9.6	7.6	15.3	15.1
Cyient	Buy	767	1,263	18.1	15.6	12.0	10.2	18.9	19.4
Persistent Systems	Buy	811	947	16.1	13.6	9.4	7.5	17.7	18.4
TCS	Hold	1,848	1,03,252	24.8	22.2	17.9	15.9	30.6	30.4
Tech Mahindra	Buy	655	9,377	14.2	12.4	8.6	7.3	20.3	20.6
Wipro	Hold	262	17,267	14.0	12.7	10.9	10.1	16.8	17.5
L&T Infotech	Buy	1,671	4,198	21.9	18.4	17.1	13.6	32.9	32.9
L&T Technology Services	Buy	1,218	1,822	20.5	17.0	16.1	12.6	31.4	31.9

Source: 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.

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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
28-Jun-18	IT	Most bullish in a decade – Conviction gets stronger; <i>Sector Update</i>		
18-Jun-18	IT	BFSI back with a bang; connects to most bullish thesis; <i>Sector Update</i>		
14-Jun-18	Just Dial	Cashing in on rising user connect; <i>Visit Note</i>	566	Buy

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
Buy	appreciate more than 15% over a 12-month period
Hold	appreciate up to 15% over a 12-month period
Reduce	depreciate more than 5% over a 12-month period

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