



## Q3FY19 Quarterly Preview – IT Services

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## IT Services - Q3FY19 Result Preview

### Seasonally weak quarter led by furloughs and holidays

We expect Q3FY19 to be a seasonally weak quarter for all Indian IT vendors, due to lower working days and furloughs. There should be a marginal improvement in operating margin for IT vendors, given the positive impact of 2.7% QoQ depreciation of the rupee against the USD. However, lower working days, a reduction in utilization, and rise in investments for digital transformation are likely to affect margins. We believe large Indian IT vendors are likely to report USD revenue growth in the range of 1% to +2.5% QoQ. Tech Mahindra (TECM) and HCL Technologies (HCLT) are likely to lead the USD revenue growth trajectory, while Wipro (WPRO) will lag peers. We expect earnings to rise 8.7%/4.6%/ 4.2%/ 3.6%/ 1.5% QoQ for Tech Mahindra (TECM), Tata Consultancy Service (TCS) / HCL Technologies (HCLT)/ Wipro (WPRO)/ Infosys (INFY), respectively. Among the mid-cap IT universe, we expect Persistent to report robust USD revenue growth of 5% QoQ since Q2FY19 was low base on account of one project closure while NIIT Tech would report muted USD revenue growth of 1% QoQ due to high base of Q2FY19 on back of ramp up in Insurance & Travel vertical.

We are waiting for management expectations on demand conditions, growth in digital, deal inflow, and adoption of digital services across verticals. Tech Mahindra is slated to share its outlook on the telecom & enterprise business and HCLT about the seven product acquired from IBM and IMS business.

### Negative impact of cross currency to dent revenue growth

The USD appreciation against all major global currencies (EURO by 2.5%, GBP 1.8% and AUD 1.8%) will have a negative impact of 50-70bps on USD revenue of Indian IT companies. We believe the 2.7% QoQ weakening of rupee against the USD will increase rupee revenue growth and improve margin by 40-60bps for our coverage universe in Q3FY19.

### Lower utilization and working days barrier to margin

We expect a marginal improvement in the EBIT margin of most of the Indian IT vendors, on account of rupee depreciation and absence of visa cost. We believe headwinds explained above, such as fewer working days, cross currency impact, lower utilization, localization, and investment in digital will restrict margin improvement in the quarter. Higher investments for developing digital capabilities and investment in Sales & Marketing are likely to affect margin in all Indian IT vendors in the short to medium term. Among large cap companies, positive impact on EBIT margin due to the rupee depreciation and operational efficiencies are as follows: WPRO (+44bps), TECHM (+26bps), TCS (+19bps) and HCLT (+11bps). We expect INFY to report decline of 19bps in its EBIT margin during the quarter due to higher investment in enhancing digital capabilities. The EBIT margin of all the mid-tier IT companies, except KPIT (-18bps QoQ due to decline IES business) and Mphasis (-62bps QoQ due to wage hike impact), are expected to improve marginally in the range of 12-28bps QoQ.

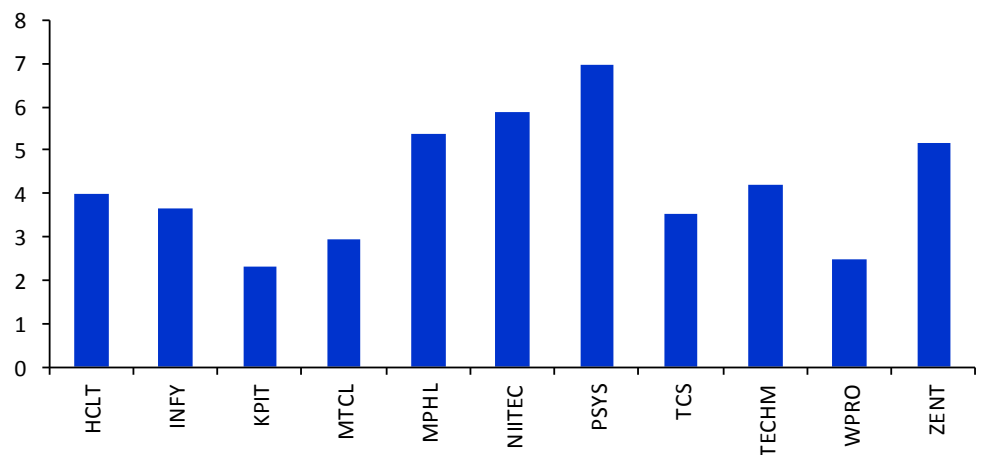
### INFY and HCLT likely to maintain revenue guidance for FY19

We expect INFY to maintain its constant currency (CC terms) revenue growth guidance of 6%-8% YoY for FY19. However, this will be below the NASSCOM's guidance of 7-9% YoY for the Indian IT sector. HCL Technologies is likely to maintain its revenue growth guidance of 9.5%-11.5% YoY in CC terms for FY19. We believe WPRO will offer a guidance of 1.5%-2.5% QoQ for Q4FY19.

## View

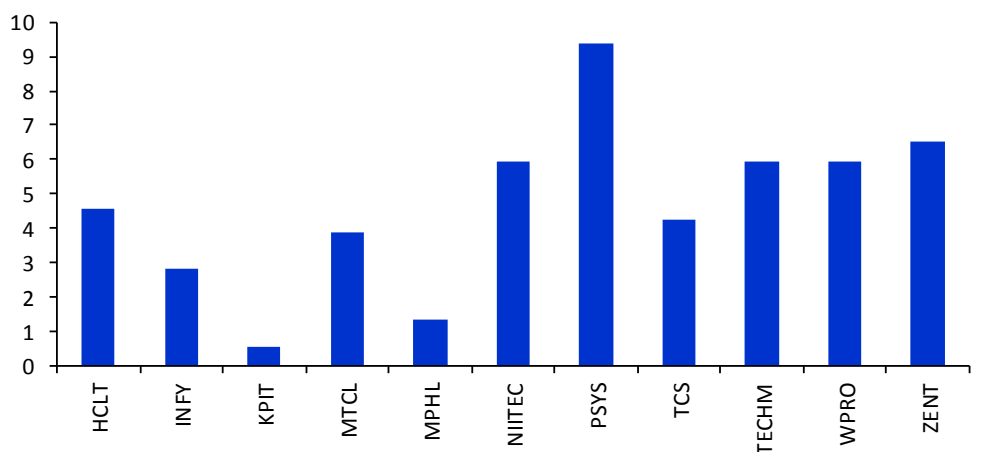
Although, many Indian IT sector stocks have corrected in Q3FY19, we believe that a strong demand trend, due to corporate digital transformation and robust deal inflow will further accelerate the pace of growth in the short term. We remain optimistic about the overall IT sector. However, headwinds persist in the form of INR appreciation and global economic slowdown, especially trade war and Brexit induced, which may lead to a downgrade in the future. Among the large caps, we prefer HCLT as the strategy of Mode 1, Mode2, and Mode 3 offerings is being implemented in line with the company's expectation, and TECHM, as its communication vertical has recovered and deal inflow is healthy. We also like INFY, due to strong visibility in order inflow and road map over next three years. Our stance on TCS is neutral, due to fair valuations. Among the mid-caps, we prefer Persistent (PSYS), as we believe traction in Alliance business and also better growth visibility in Healthcare & BFSI vertical will further aid profitability, and Mindtree (MTCL), as higher exposure in digital services is likely to improve revenue growth.

**Exhibit 1: INR Revenue QoQ Growth (%) in Q3FY19E**



Source: Company, DART

**Exhibit 2: EBIT QoQ Growth (%) in Q3FY19E**



Source: Company, DART

**Exhibit 3: Quarterly performance – Large caps**

(₹ mn)	Q3FY19E	Q2FY19	Q3FY18	QoQ	YoY	Comments
<b>Infosys</b>						
Sales (US\$ mn)	2,965	2,921	2,755	1.5	7.6	US\$ revenue growth of 1.5% QoQ
Sales	213,526	205,960	175,656	3.7	21.6	INR revenue growth of 3.7% QoQ
EBIT	50,179	48,793	42,433	2.8	18.3	Margin to decline 19bps QoQ
PAT	41,599	40,966	37,217	1.5	11.8	Cross currency headwind 50bps
EPS	10.5	10.3	9.3	1.5	12.4	
EBIT margin (%)	23.5	23.7	24.2	(19 bps)	(66 bps)	
<b>TCS</b>						
Sales (US\$ mn)	5,298	5,215	4,787	1.6	10.7	US\$ revenue growth of 1.6% QoQ
Sales	381,594	368,540	309,040	3.5	23.5	INR revenue growth of 3.5% QoQ
EBIT	101,886	97,710	77,810	4.3	30.9	Healthy Deal Inflow
PAT	82,677	79,010	65,310	4.6	26.6	Margin to improve 19bps QoQ
EPS	22.1	21.1	17.4	4.6	26.8	Cross currency headwind 70bps
EBIT margin (%)	26.7	26.5	25.2	19 bps	152 bps	
<b>Wipro</b>						
Sales (US\$ mn) - IT services	2,061	2,041	2,013	1.0	2.4	US\$ revenue growth of 1% QoQ
Sales (Including IT products)	149,045	145,410	136,690	2.5	9.0	INR revenue growth of 2.5% QoQ
EBIT	20,270	19,130	19,650	6.0	3.2	Margin improvement by 44bps
PAT	19,568	18,889	19,361	3.6	1.1	
EPS	3.9	3.8	3.9	3.6	0.9	
EBIT margin (%)	13.6	13.2	14.4	44 bps	(78 bps)	
<b>HCL Tech</b>						
Sales (US\$ mn)	2,145	2,099	1,988	2.2	7.9	US\$ revenue growth of 2.2% QoQ
Sales	154,496	148,581	127,995	4.0	20.7	Recovery in IMS business
EBIT	30,899	29,552	25,064	4.6	23.3	Mode 3 business to aid growth
PAT	26,297	25,247	21,909	4.2	20.0	Inorganic growth of 1% from H&D
EPS	19.1	18.3	15.9	4.2	19.9	Margin to improve by 11bps
EBIT margin (%)	20.0	19.9	19.6	11 bps	42 bps	
<b>Tech Mahindra</b>						
Sales (US\$ mn)	1,248	1,218	1,209	2.5	3.3	US\$ revenue growth of 2.5% QoQ
Sales	89,913	86,298	77,760	4.2	15.6	Better deals in telecom
EBIT	14,026	13,242	9,896	5.9	41.7	Enterprise to grow on back of HCI
PAT	11,572	10,643	9,431	8.7	22.7	
Adj. EPS	13.8	14.5	11.2	(4.8)	23.3	
EBIT margin (%)	15.6	15.3	12.7	26 bps	287 bps	
<b>OFSS</b>						
Sales	12,756	12,133	10,591	5.1	20.4	Healthy License fee revenue
EBIT	5,102	4,863	4,058	4.9	25.7	Margins to improve 168bps YoY
PAT	3,642	3,520	2,897	3.5	25.7	
EPS	42.7	41.3	34.0	3.5	25.7	
EBIT margin (%)	40.0	40.1	38.3	(8 bps)	168 bps	

Source: Company, DART

**Exhibit 4: Quarterly performance – Mid caps**

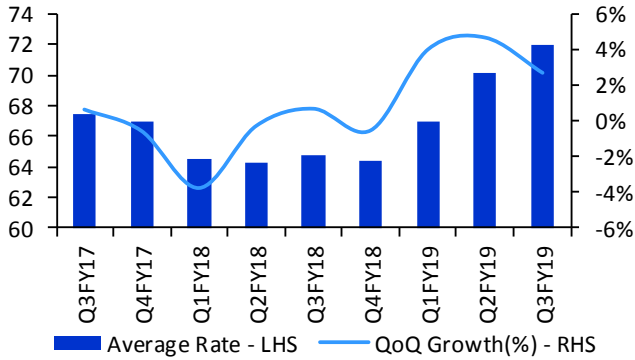
(₹ mn)	Q3FY19E	Q2FY19	Q3FY18	QoQ	YoY	Comments
<b>NIIT Technologies</b>						
Sales (US\$ mn)	133	132	115	1.0	15.8	US\$ revenue growth of 1% QoQ
Sales	9,609	9,074	7,565	5.9	27.0	INR revenue growth of 5.9% QoQ
EBIT	1,393	1,315	985	6.0	41.5	Margins to remain flat QoQ
PAT	1,211	1,118	756	8.3	60.2	
EPS	19.6	18.1	12.3	8.3	59.4	
EBIT margin (%)	14.5	14.5	13.0	1 bps	148 bps	
<b>KPIT</b>						
Sales (US\$ mn)	153	153	141	0.5	8.5	US\$ revenue growth of 0.5% QoQ
Sales	11,038	10,789	9,160	2.3	20.5	INR revenue growth of 2.3% QoQ
EBIT	1,104	1,098	710	0.5	55.5	IES & SAP to decline in Q3
PAT	892	821	597	8.7	49.4	
EPS	4.7	4.3	3.2	8.7	46.1	
EBIT margin (%)	10.0	10.2	7.8	(18 bps)	225 bps	
<b>Mindtree</b>						
Sales (US\$ mn)	251	246	214	2.0	17.3	US\$ revenue growth of 2% QoQ
Sales	18,071	17,554	13,777	2.9	31.2	INR revenue growth of 2.9% QoQ
EBIT	2,385	2,296	1,655	3.9	44.1	Margins to improve 12bps QoQ
PAT	2,043	2,063	1,415	(1.0)	44.4	
EPS	12.5	12.6	8.6	(1.0)	45.0	
EBIT margin (%)	13.2	13.1	12.0	12 bps	119 bps	
<b>Mphasis</b>						
Sales (US\$ mn)	280	276	258	1.5	8.6	US\$ revenue growth of 1.5% QoQ
Sales	20,176	19,149	16,607	5.4	21.5	INR revenue growth of 5.4% QoQ
EBIT	3,188	3,145	2,566	1.4	24.2	Wage hike to dent margins
PAT	2,714	2,709	2,150	0.2	26.2	
EPS	14.2	14.2	11.2	0.2	27.0	
EBIT margin (%)	15.8	16.4	15.5	(62 bps)	35 bps	
<b>Persistent</b>						
Sales (US\$ mn)	124	118	123	5.0	1.3	US\$ revenue decline of 5% QoQ
Sales	8,938	8,356	7,919	7.0	12.9	Last Qtr impacted by project close
EBIT	1,135	1,038	983	9.4	15.5	
PAT	968	881	917	9.9	5.6	
EPS	12.1	11.0	11.5	9.9	5.1	
EBIT margin (%)	12.7	12.4	12.4	28 bps	29 bps	
<b>Zensar</b>						
Sales (US\$ mn)	141	138	123	2.5	15.4	US\$ revenue growth of 2.5% QoQ
Sales	10,187	9,687	7,937	5.2	28.4	Better growth in Digital App Serv.
EBIT	1,070	1,004	894	6.5	19.6	Margins to improve 14bps
PAT	950	934	591	1.7	60.8	
EPS	21.0	20.6	13.0	1.7	61.2	
EBIT margin (%)	10.5	10.4	11.3	14 bps	(76 bps)	

Source: Company, DART



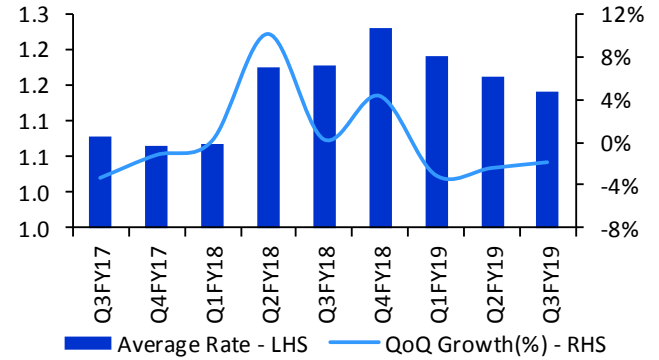
## Currency Movement

**Exhibit 5: USD/INR**



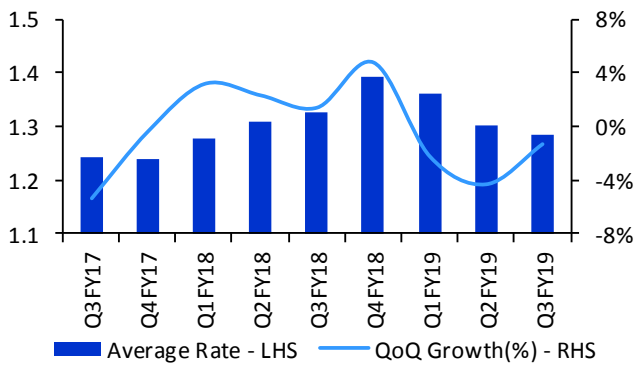
Source: Company, DART

**Exhibit 6: Exhibit 6: EUR/USD**



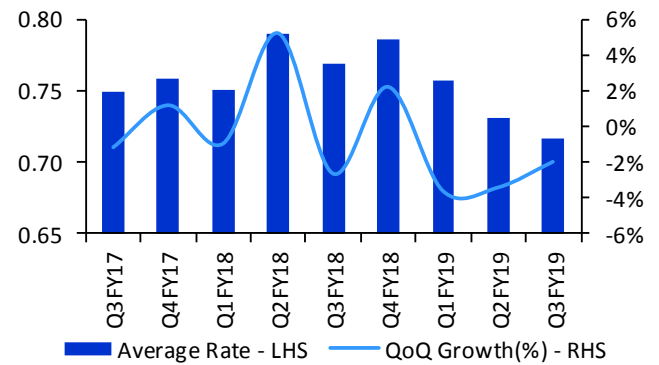
Source: Company, DART

**Exhibit 7: Exhibit 7: GBP/USD**



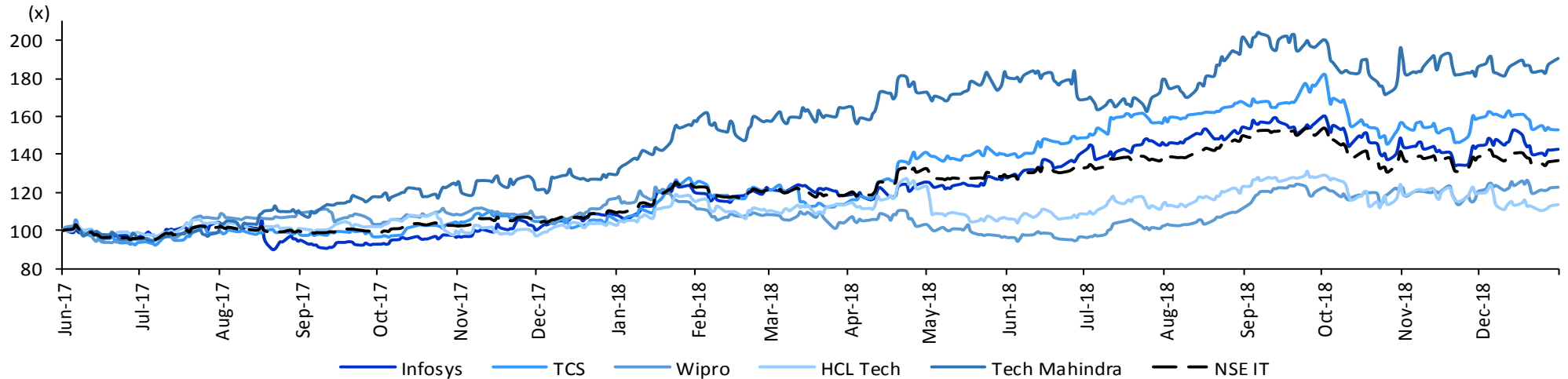
Source: Company, DART

**Exhibit 8: Exhibit 8: AUD/USD**

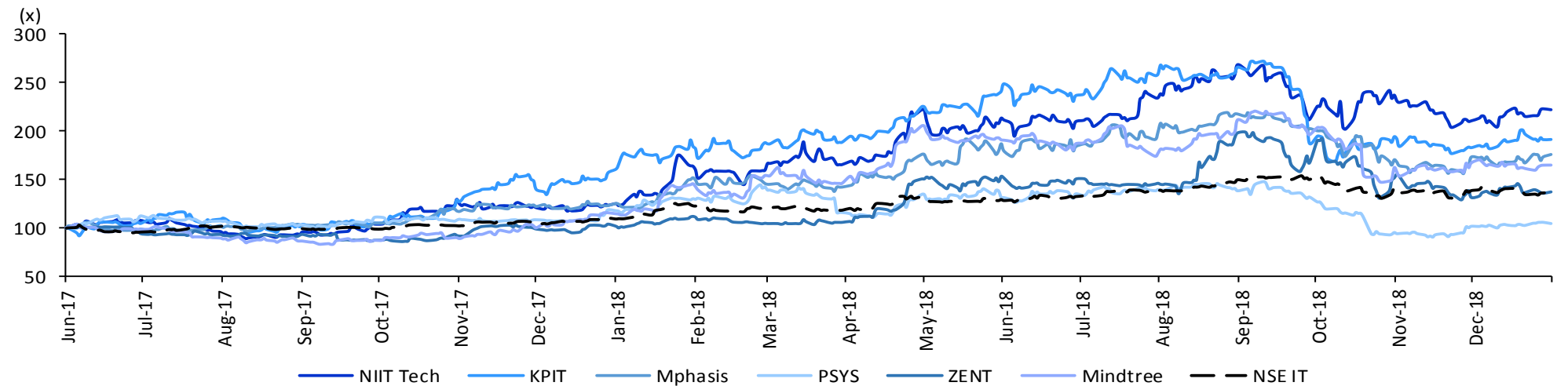


Source: Company, DART

## Stock price performance – Large caps



## Stock price performance – Mid-caps



Source: Company, DART



## Financials and Valuations

	Mcap (₹ bn)	CMP (₹)	TP (₹)	Upside (%)	Reco.	Net Sales (₹ mn)				CAGR %	EBIT Margin (%)				EPS (₹)				CAGR %
						FY18	FY19E	FY20E	FY21E	FY18-21E	FY18	FY19E	FY20E	FY21E	FY18	FY19E	FY20E	FY21E	FY18-21E
HCL Tech	1,339	949	1,300	37	Buy	505,728	602,865	693,295	785,296	15.8	19.7	20.4	20.0	19.9	63.8	76.4	85.8	96.2	14.7
Infosys	1,448	668	840	26	Buy	705,106	825,533	950,790	1,066,973	14.8	24.3	24.5	24.8	24.7	39.9	41.5	46.9	51.1	8.6
KPIT Tech	40	211	290	37	Buy	36,656	43,422	49,314	55,920	15.1	8.0	10.0	10.5	11.0	13.2	17.6	21.3	25.7	24.7
Mindtree	137	834	1,150	38	Accumulate	54,628	70,704	81,547	92,580	19.2	10.4	12.8	14.0	14.8	34.8	47.9	57.9	68.9	25.6
Mphasis	183	946	1,250	32	Accumulate	65,459	77,405	88,329	100,669	15.4	15.1	18.0	18.6	19.0	43.5	59.0	69.2	81.6	23.3
NIIT Tech	70	1,129	1,425	26	Buy	29,914	36,986	44,002	49,869	18.6	12.5	14.3	15.1	15.8	45.6	70.5	83.1	100.7	30.3
OFSS	308	3,609	4,800	33	Accumulate	45,275	52,255	57,458	62,477	11.3	38.6	40.7	41.4	41.2	145.2	179.2	213.4	233.3	17.1
Persistent	49	613	880	44	Buy	30,337	35,825	39,484	44,744	13.8	10.2	12.9	14.3	15.8	40.4	50.3	61.0	75.3	23.1
TCS	7,129	1,901	2,050	8	Reduce	1,231,040	1,450,969	1,647,198	1,887,481	15.3	24.8	25.7	26.0	26.2	68.9	82.0	92.8	107.0	15.8
Tech Mah	613	693	925	33	Buy	307,730	349,397	403,601	459,061	14.3	11.8	13.7	14.0	14.3	45.2	47.5	56.3	67.8	14.5
WIPRO	1,597	324	315	(3)	Reduce	544,871	596,905	667,709	731,024	10.3	15.2	15.0	15.7	15.3	16.0	16.9	19.4	21.0	9.5
Zensar Tech	52	232	280	21	Accumulate	31,077	37,758	44,119	51,324	18.2	9.6	11.6	12.6	13.3	10.7	15.4	18.5	22.5	28.3

	Mcap (₹ bn)	CMP (₹)	TP (₹)	Upside (%)	Reco.	P/E (x)				ROE (%)				EV/EBITDA (x)			
						FY18	FY19E	FY20E	FY21E	FY18	FY19E	FY20E	FY21E	FY18	FY19E	FY20E	FY21E
HCL Tech	1,339	949	1,300	37	Buy	14.9	12.4	11.1	9.9	24.7	26.2	24.4	22.8	10.9	8.7	7.8	6.8
Infosys	1,448	668	840	26	Buy	16.8	16.1	14.2	13.1	23.9	25.6	28.6	30.0	6.2	5.5	4.7	8.8
KPIT Tech	40	211	290	37	Buy	15.9	12.0	9.9	8.2	15.4	18.0	18.4	18.7	9.4	6.3	5.2	4.0
Mindtree	137	834	1,150	38	Accumulate	24.0	17.4	14.4	12.1	21.4	25.3	24.6	23.9	17.6	11.8	9.1	7.2
Mphasis	183	946	1,250	32	Accumulate	21.7	16.0	13.7	11.6	13.0	16.2	16.9	17.5	14.1	9.7	7.7	6.1
NIIT Tech	70	1,129	1,425	26	Buy	24.8	16.0	13.6	11.2	16.2	22.8	22.7	22.6	12.3	9.2	7.0	5.4
OFSS	308	3,609	4,800	33	Accumulate	24.9	20.1	16.9	15.5	31.0	28.7	26.6	22.8	15.6	12.3	10.3	8.8
Persistent	49	613	880	44	Buy	15.2	12.2	10.1	8.1	16.0	17.7	18.7	19.9	10.0	6.8	5.3	3.8
TCS	7,129	1,901	2,050	8	Reduce	27.6	23.2	20.5	17.8	29.4	37.4	43.1	44.3	20.8	17.4	15.1	13.0
Tech Mah	613	693	925	33	Buy	15.3	14.6	12.3	10.2	21.5	21.0	22.8	23.8	12.1	9.5	7.8	6.3
WIPRO	1,597	324	315	(3)	Reduce	20.3	19.2	16.7	15.5	15.7	15.2	14.9	14.6	13.9	12.2	10.3	9.2
Zensar Tech	52	232	280	21	Accumulate	21.8	15.0	12.5	10.3	15.4	19.4	19.9	20.7	14.0	9.4	7.2	5.6

CMP as on 3<sup>rd</sup> Jan 2018

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### DART RATING MATRIX

Total Return Expectation (12 Months)

<b>Buy</b>	<b>&gt; 20%</b>
<b>Accumulate</b>	<b>10 to 20%</b>
<b>Reduce</b>	<b>0 to 10%</b>
<b>Sell</b>	<b>&lt; 0%</b>

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