

# Q4FY21 IT Services Preview



# IT Services

Healthy revenue growth to continue, deal flow to remain robust; FY22 revenue, margin outlook key

## MARKET DATA

	Close	1D (%)	1M (%)	YTD (%)
Nifty	14,867.35	1.2	(2.5)	6.1
Sensex	50,029.83	1.1	0.4	4.8
Nifty IT	25,980.40	0.5	5.8	7.1
USD / INR	73.30	0.1	0.1	0.3

## COVERAGE STOCKS

Company	Current Price (INR)	Target Price (INR)*		Upside (%)	Market Cap. (INR mn)	Fwd PE FY2023E (x)	Reco.*	
		New	Old				New	Old
TCS	3,166	3,580	3,580	13.1%	11,710,827	27.3	ACCUMULATE	BUY
Infosys	1,385	1,675	1,675	20.9%	5,902,294	22.9	BUY	BUY
HCL Technologies	1,003	1,130	1,130	12.7%	2,720,721	17.7	ACCUMULATE	BUY
Wipro	416	555	555	33.3%	2,280,418	16.6	BUY	BUY
Tech Mahindra	992	1,120	1,120	12.9%	960,272	14.9	ACCUMULATE	ACCUMULATE
Mindtree	2,075	2,085	2,050	0.5%	341,752	23.9	HOLD	BUY
Persistent Systems	1,955	2,140	1,740	9.5%	149,419	22.8	ACCUMULATE	ACCUMULATE
Tata Elxsi	2,771	2,980	2,500	7.5%	172,543	32.2	ACCUMULATE	HOLD
Sonata Software	525	575	500	9.5%	55,251	14.7	ACCUMULATE	ACCUMULATE
Happiest Minds Technologies	594	650	465	9.4%	87,259	36.0	ACCUMULATE	HOLD
Sterlite Technologies	207	260	260	25.8%	81,963	11.8	BUY	BUY
Infibeam Avenues	48	86	86	80.7%	63,358	30.1x	BUY	BUY

\*Source: Bloomberg, Data as of April 1, 2021

## SECTOR OVERVIEW

- Deal wins, continuing digital investments to drive revenue in 4QFY21, margins, FY22 guidance/CY21 IT budget outlook and key vertical growth to be watched:** We expect IT stocks under our coverage to report a combined 4.1% QoQ USD revenue growth on top of the decadal high 3Q growth witnessed, as the sector continues to enjoy a growth recovery, with new deal wins, ramp up of recent deals and digital transformation investments to drive revenue. Cross-currency tailwinds are also expected to aid reported USD revenue growth by 50-120bps, with TCS to see maximum impact (120bps) owing to the highest proportion of revenue coming from these currencies. INR appreciation will lead to INR growth coming in lower than USD revenue growth.. We expect TCS and Infosys to out-perform on revenue growth among the top-tier IT pack, with 4.2% and 3.8% % QoQ constant currency (CC) revenue growth, respectively (both 5% QoQ in USD terms), led by continuing deal ramp ups as they leverage their industry leadership. Wipro is likely to report 2.8% CC revenue growth (above the mid-point of guidance) and 3.6% QoQ USD revenue growth. HCL Technologies (HCLT) and Tech Mahindra are likely to under-perform, with 1.7% and 1.1% QoQ CC growth respectively (2.6% and 2% QoQ USD growth, respectively), as HCLT sees seasonal weakness in the P&P business, while Tech Mahindra is likely to see some project completions with lack of backfill. Among mid-tier IT, we expect Happiest Minds Technologies to out-perform with 12% QoQ USD revenue growth, aided by the acquisition of PGS, along with decent organic growth of 4% QoQ. Tata Elxsi is also likely to grow revenue at a healthy pace of 6.5-7% QoQ in CC terms (6% INR growth), aided by healthy growth in its Broadcast & Communications and Healthcare & Medical Devices verticals, and recovery in the Transportation vertical. On the other hand, the other 3 firms under our coverage (Mindtree, Persistent Systems and Sonata Software) are expected to achieve CC revenue growth of 3-3.5% QoQ, led by key verticals including ISV, Retail & CPG, BFSI, Healthcare and Manufacturing. We would watch CY21 IT budget commentary, FY22 revenue and margin guidance, deal flows, wage cost inflation impact and attrition trend.
- Margin performance to see divergence, with wage hike timing, INR appreciation to have varying impact:** Even as revenue growth is likely to be healthy, we expect EBIT margin to be divergent in 4QFY21, given timing of wage hikes along with INR appreciation. Revenue growth leverage, continuing cost management and higher offshore component are key cost levers to offset impact of wage hikes and a potential partial cost return. TCS is likely to out-perform among the top-tier IT pack, with 74bps QoQ margin rise expected, while Tata Elxsi could out-perform among the mid-tier IT pack, with 39bps QoQ expansion likely. Infosys, Wipro, HCL Technologies and Tech Mahindra are all expected to post EBIT margin declines of 20-90bps QoQ owing mainly to wage hike impact (except Tech Mahindra). HCLT had awarded a one-time bonus of INR 7.5 bn to its employees, which will lead to a steep 472bps QoQ EBIT margin increase, while adjusting for this, margin should decline 89bps QoQ. Among the mid-sized IT firms, Mindtree and Persistent Systems are likely to report 80-90bps QoQ margin dip owing to wage hikes, while Sonata will report 177bps QoQ rise due to weak seasonality of the low-margin DPS business.
- CY21 IT budgets, FY22 outlook, TCV wins, wage cost inflation margin impact and attrition trends to be in focus:** We would keep a close eye on CY21 IT budget commentary, FY22 growth outlook (qualitative and quantitative), TCV data, and impact of wage cost inflation on margins, apart from attrition trends. Key vertical performance including BFSI and retail are also critical to watch, as is growth in other verticals including Hi-tech, Communications, Media and Healthcare. We would also watch for any recovery in the Travel vertical, with Sonata and Mindtree having reasonable exposure to this vertical. Infosys guidance also assumes importance, given its status as a sector bellwether along with TCS, and we expect the IT major to guide for 12-14% CC revenue growth, with a possible EBIT margin band of 22-24%, below FY21 levels in light of high wage cost inflation and part-return of cost items.
- Sector outlook and view:** We expect 4QY21 to confirm continuation of healthy growth and deal wins for the sector. Global results like Accenture and medium-term outlook for Capgemini signal continuing good times ahead for the industry. Even as stock prices have performed well over the past year and valuations are in the range of 1.3-1.5x 5-year average, we believe this will continue in light of healthy growth outlook. **We maintain a positive sector stance on the IT industry, and our stock preferences remain Infosys, HCLT and Tech Mahindra among the top-tier pack, while we remain positive on Persistent, Tata Elxsi, Happiest Minds Technologies and Sonata Software in the mid-tier pack. We raise our target prices on all these mid-tier stocks, with our earnings estimates on all 4 firms higher by 10-15% in light of better-than-expected growth momentum, and we also raise our target PE multiples to 25x for Persistent (22x earlier), 35x for Tata Elxsi (30x earlier), 16x for Sonata (14x earlier) and to 40x for Happiest Minds Technologies (30x earlier). We have ACCUMULATE ratings on all these stocks, with Tata Elxsi and Happiest Minds Technologies upgraded from HOLD.**

# IT Services

Healthy revenue growth to continue, deal flow to remain robust; FY22 revenue, margin outlook key

## Exhibit 1: Quarterly result expectation for companies under coverage

INR Mn	Q4Y21E	Q4FY20A	YoY %	Q3FY21A	QoQ %	Remarks
<b>Tata Consultancy Services (TCS)</b>						
Sales (USD Mn)	5,987	5,444	10.0	5,702	5.0	USD revenue growth is likely to come in at 5% QoQ, with CC growth likely at a healthy 3.8% QoQ. Cross-currency tailwinds will aid reported USD growth by 120 bps. We expect EBIT margin to rise 74bps QoQ aided by growth leverage and cost control, with adjusted PAT likely to grow nearly 10% QoQ.
Net Sales	436,455	399,460	9.3	420,150	3.9	
EBIT	119,420	100,250	19.1	111,840	6.8	
Adj. Net Profit	95,425	80,490	18.6	87,010	9.7	Key Parameters: (1) Order book/TCV growth, (2) IT budget outlook for CY21, (3) Sustainable margin profile for FY22, wage hike timeline with high wage cost inflation and return of some cost items including travel to query the pitch for profitability, (4) Key vertical performance, mainly BFSI and Retail, and recovery in troubled verticals including Energy.
OPM (%)	27.4	25.1	226 bps	26.6	74 bps	
NPM (%)	21.9	20.1	171 bps	20.7	115 bps	
<b>Infosys</b>						
Sales (USD Mn)	3,692	3,197	15.5	3,516	5.0	USD revenue is likely to rise 5% QoQ, while CC revenue growth is likely at 4.2% QoQ with favourable cross-currency tailwinds to boost reported USD revenue growth by 74 bps. EBIT margin is likely to decline 62bps QoQ on wage hike impact, some return of cost items, while APAT is likely to rise 9.7% QoQ aided by higher other income and lower tax rate.
Net Sales	269,129	232,670	15.7	259,270	3.8	
EBIT	66,714	49,270	35.4	65,890	1.3	
Net Profit	55,552	43,210	28.6	51,970	6.9	Key Parameters: (1) FY22 guidance - we expect the IT major to guide for 12-14% CC revenue growth, with a possible EBIT margin band of 22-24%, below FY21 levels in light of high wage cost inflation and part-return of cost items, (2) New deal TCV, (3) Commentary on CY21 IT budgets, (4) Key vertical outlook including BFSI and Retail, and improvement in troubled verticals like Energy, (5) Digital revenue proportion.
OPM (%)	24.8	21.2	361 bps	25.4	(62 bps)	
NPM (%)	20.6	18.6	207 bps	20.0	60 bps	
<b>HCL Technologies</b>						
Sales (USD Mn)	2,684	2,543	5.5	2,617	2.6	USD revenue growth is likely to come in at 2.6% QoQ (1.7% QoQ in CC terms), as weak seasonality in the P&P business impacts total growth, even as ITBS and ER&D growth is likely to be healthy at 3-3.5% QoQ. EBIT margin is likely to decline steeply by 472bps QoQ owing to a one-time bonus of INR 7.5 bn awarded to employees, which will drive down PAT by 29% QoQ, given that 3Q tax rate was also lower owing to a one-time item. Adjusted for the one-time bonus, EBIT margin is likely to decline 89 bps QoQ owing to wage hikes awarded to a particular band of employees.
Net Sales	195,664	185,900	5.3	193,020	1.4	
EBIT	35,532	38,810	(8.4)	44,160	(19.5)	
Net Profit	28,328	31,540	(10.2)	39,820	(28.9)	Key Parameters: (1) FY22 revenue and margin guidance, (2) CY21 IT budget outlook, (3) Digital growth through Mode 2, (4) Key vertical growth including Manufacturing, BFSI and Retail, (5) P&P business seasonality impact.
OPM (%)	18.2	20.9	(272 bps)	22.9	(472 bps)	
NPM (%)	14.5	17.0	(249 bps)	20.6	(615 bps)	
<b>Wipro</b>						
ITS Sales (USD Mn)	2,125	2,091	1.6	2,051	3.6	USD revenue for the Combined IT Services business is likely to rise 3.6% QoQ in USD terms and 2.8% QoQ in CC terms, slightly above mid-point of guidance. IT EBIT margin should decline 100bps QoQ on wage hike and INR appreciation. Consolidated EBIT margin is likely to fall 71bps QoQ, with lower other income restricting PAT growth to 2.2% QoQ.
Cons. Sales (INR Mn)	154,777	154,705	0.0	150,967	2.5	
Cons. EBIT	27,395	26,506	3.4	27,797	(1.4)	
Net Profit	25,099	24,558	2.2	24,656	1.8	Key Parameters: (1) 1QFY22 CC revenue growth guidance, (2) IT budget outlook, (3) Vertical commentary, (4) Progress on the 5 key growth pillars as outlined in its recent analyst meet, (5) Updates on Capco acquisition, if any.
OPM (%)	17.7	17.1	57 bps	18.4	(71 bps)	
NPM (%)	16.2	15.9	34 bps	16.3	(12 bps)	

# IT Services

Healthy revenue growth to continue, deal flow to remain robust; FY22 revenue, margin outlook key

## Exhibit 1: Quarterly result expectation for companies under coverage

INR Mn	Q4Y21E	Q4FY20A	YoY %	Q3FY21A	QoQ %	Remarks
<b>Tech Mahindra</b>						
Sales (USD Mn)	1,335	1,295	3.1	1,309	2.0	USD revenue is likely to rise 2% QoQ (1.1% QoQ in CC terms), with some project completions and lack of backfill leading to subdued sequential growth. Margin is likely to remain flat to slightly declining, with lack of healthy revenue growth and INR appreciation to adversely impact this by 22 bps, while higher other income and a lower tax rate should aid PAT growth of 2.3% QoQ.  Key Parameters: (1) TCV deal wins, (2) 5G commentary, (3) Commentary on CY21 IT budgets, (4) Revenue growth and sustainable margin outlook for FY22, (5) Commentary on key Enterprise verticals including Manufacturing, Retail, BFSI and Energy.
Net Sales	97,320	94,902	2.5	96,471	0.9	
EBIT	15,291	9,496	61.0	15,371	(0.5)	
Net Profit	13,404	8,039	66.7	13,098	2.3	
OPM (%)	15.7	10.0	571 bps	15.9	(22 bps)	
NPM (%)	13.8	8.5	530 bps	13.6	20 bps	
<b>Mindtree</b>						
Sales (USD Mn)	285	278	2.4	274	4.0	USD revenue is expected to rise 4% QoQ, with CC growth likely to come in at 3.5% QoQ, aided by all-round growth in key vertical including Hi-tech, Retail & CPG and BFSI verticals, while Travel & Hospitality could see some recovery. Margins are likely to decline 81 bps QoQ owing to wage hike impact, which will lead to PAT declining 6% QoQ.  Key Parameters: (1) IT budget outlook for FY22 for its set of clients, (2) Growth and margin outlook for FY22, (3) Non-Microsoft client growth, (4) Deal TCV, and (5) Time frame for recovery in the Travel & Hospitality vertical.
Net Sales	20,781	20,505	1.3	20,237	2.7	
EBIT	3,900	2,558	52.5	3,962	(1.6)	
Net Profit	3,070	2,062	48.9	3,265	(6.0)	
OPM (%)	18.8	12.5	629 bps	19.6	(81 bps)	
NPM (%)	14.8	10.1	472 bps	16.1	(136 bps)	
<b>Persistent Systems</b>						
Sales (USD Mn)	151	127	18.8	146	3.2	USD revenue is likely to grow 3.2% QoQ, aided by deal wins and TSU business, even as Alliances business will see seasonal softness. EBIT margin is likely to decline 88 bps on one month wage hike impact, which will lead to PAT declining 2.5% QoQ.  Key Parameters: (1) IT budget commentary for CY21, (2) FY22 growth and margin outlook, (3) Progress on cross-sell strategy between TSU and Alliances business, (4) Top client IBM growth, (5) Deal wins including one year executable order book.
Net Sales	11,000	9,264	18.7	10,754	2.3	
EBIT	1,298	857	51.5	1,364	(4.8)	
Net Profit	1,180	838	40.7	1,209	(2.5)	
OPM (%)	11.8	9.2	255 bps	12.7	(88 bps)	
NPM (%)	10.7	9.0	168 bps	11.2	(52 bps)	
<b>Tata Elxsi</b>						
Sales (USD Mn)	N.A.	N.A.	N.A.	N.A.	N.A.	Revenue is likely to rise by 6% QoQ in INR terms, aided by recovery in Transportation vertical and growth in Broadcast & Communications and Healthcare & Medical Devices verticals, as well as Design growth. Margin should see a slight improvement on growth leverage, which will boost PAT growth (likely to rise 6.5% QoQ).  Key Parameters: (1) Growth outlook for FY22, (2) Wage hike timeline and margin impact in FY22, (3) Growth recovery in Transportation vertical, (4) Progress in verticals adjacent to Transportation such as Rail and Off-highway Equipment, and (5) Developments on cash return or M&A activity.
Net Sales	5,057	4,389	15.2	4,771	6.0	
EBIT	1,425	978	45.7	1,326	7.5	
Net Profit	1,120	821	36.5	1,052	6.5	
OPM (%)	28.2	22.3	589 bps	27.8	39 bps	
NPM (%)	22.2	18.7	345 bps	22.1	10 bps	

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## Exhibit 1: Quarterly result expectation for companies under coverage

INR Mn	Q4Y21E	Q4FY20A	YoY %	Q3FY21A	QoQ %	Remarks
<b>Sonata Software</b>						
IITS Sales (USD Mn)	42.2	44.4	(4.9)	41.0	3.0	USD revenue growth is likely at 3% QoQ in the IITS business aided by traction in key verticals including Hi-tech, Retail, Manufacturing and Commodities, while some recovery could be seen in Travel. Consolidated EBIT margin is likely to rise 177 bps QoQ even as a wage hike will impact IITS margins, due to weak seasonality in the lower-margin DPS business.  Key Parameters: (1) FY22 growth outlook for IITS business, (2) Travel vertical recovery, (3) Microsoft account growth, and (4) Wage hike timeline for FY22.
Cons. Sales (INR Mn)	10,363	9,287	11.6	13,962	(25.8)	
Cons. EBIT	933	738	26.4	1,010	(7.7)	
Net Profit	666	618	7.7	538	23.7	
OPM (%)	9.0	7.9	105 bps	7.2	177 bps	
NPM (%)	6.4	6.7	(23 bps)	3.9	257 bps	
<b>Happiest Minds Technologies</b>						
Sales (USD Mn)	29.4	N.A.	-	26.2	12.0	USD revenue growth is likely at 12% QoQ including full quarter impact of PGS acquisition; organic growth likely at 4% QoQ led by robust digital investments by clients across verticals. EBIT margin is likely to remain flattish in the absence of any wage hike impact, with PAT likely to grow 7.4% QoQ.  Key Parameters: (1) CY21 IT budget outlook, (2) Qualitative FY22 revenue and margin outlook, (3) PGS acquisition revenue impact, (4) PGA acquisition financing, and (5) Further scope for M&A, given large cash balance on the books and healthy cash generation each quarter.
Net Sales	2,140	N.A.	-	1,928	11.0	
EBIT	511	N.A.	-	461	10.9	
Net Profit	453	N.A.	-	422	7.4	
OPM (%)	23.9	N.A.	-	23.9	(2 bps)	
NPM (%)	21.2	N.A.	-	21.9	(71 bps)	
<b>Sterlite Technologies</b>						
Sales (USD Mn)	N.A.	N.A.	N.A.	N.A.	N.A.	For 4QFY21, we expect STL to report revenue of INR 14,500 Mn, up 10.3% QoQ on steadily improving volumes and utilisation of OF and OFC capacity, and aided by Optotec acquisition. YoY growth is likely at a healthy 25%. Consolidated EBITDA is expected to rise by 13.4% QoQ (rise of 20.5% YoY), as growth leverage and improving volumes boost operating profit. EBITDA margin is likely to rise 50 bps QoQ, and decline 67 bps YoY. Net profit is expected at INR 950 Mn, up 9.7% QoQ and up 18.3% YoY.  Key parameters: 1) New order wins 2) Demand outlook 3) Any major deal wins on fibre and service in domestic and international market
Net Sales	14,500	11,601	25.0	13,144	10.3	
EBITDA	2,610	2,166	20.5	2,301	13.4	
APAT	950	803	18.3	866	9.7	
EBITDAM (%)	18.0%	18.7	(67 bps)	17.5	50 bps	
NPM (%)	6.4%	6.9	(120bps)	6.6	140bps	
<b>Infibeam Avenues</b>						
Sales (USD Mn)	34	19	76.5	31	6.5	We expect top line to increase 6.3% QoQ and 78.1% YoY led by exponential spurt in volumes of transactions processed with onboarding of a greater number of merchants for online receipt of payments. Payment gateway, which contributes 90-95% of their payments business (73% of total revenue) has been seeing strong growth in volumes of transactions processed with signing up of more vendors for the services. We have forecasted uptake in margins in Q4FY21 on Q-o-Q basis to the tune of 10% points in Operating margin and 820 bps in Net Profit margin led by likely fall in depreciation with peak capex cycle being over for the company and strong uptick in transaction processed volumes.  Key Parameters: (1) Activity in platform business post strategic tie-up with different players (2) Growth in Gross Transaction Value in the payment business (3) Daily volume data from UAE / Saudi Arabia / Oman market (4) Commentary on expansion of business in the US market
Net Sales	2,421	1,359	78.1	2,278	6.3	
EBIT	486	100	386.0	229	112.3	
Net Profit	335	274	22.3	128	161.7	
OPM (%)	20.1	7.3	1,280 bps	10.1	1,000 bps	
NPM (%)	13.8	20.2	(630 bps)	5.6	820 bps	

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Rating Legend (Expected over a 12-month period)	
Our Rating	Upside
Buy	More than 15%
Accumulate	5% – 15%
Hold	0 – 5%
Reduce	-5% – 0
Sell	Less than – 5%

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