

RESEARCH
Technology & Internet | Q4FY22 Preview

Demand unhindered but margins to contract QoQ

SUMMARY
Technology & Internet: Q4FY22 Preview

- We expect most of our IT coverage to perform well in Q4, with 2.5-5% QoQ CC topline growth, and mid-tier players likely to outshine tier-I
- Margin pressure to persist due to supply-side issues – we estimate an average margin decline of 33bps QoQ (ex-COFORGE)
- Our top picks remain LTI and TECHM among IT companies and AFFLE in the internet space

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Daily macro indicators

Indicator	04-Apr	05-Apr	Chg (%)
US 10Y yield (%)	2.40	2.55	15bps
India 10Y yield (%)	6.9	6.90	0bps
USD/INR	75.55	75.33	0.3
Brent Crude (US\$/bbl)	107.5	106.6	(0.8)
Dow	34,922	34,641	(0.8)
Hang Seng	22,502	22,040	(2.1)
Sensex	60,612	60,177	(0.7)
India FII (US\$ mn)	31-Mar	04-Apr	Chg (\$ mn)
FII-D	(23.9)	45.9	69.8
FII-E	1,144.7	192.0	(952.7)

Source: Bank of Baroda Economics Research

BOBCAPS Research

research@bobcaps.in



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Ruchi Burde | Seema Nayak
 researchreport@bobcaps.in

Expect good growth on the back of steady demand: We expect demand to hold firm in Q4FY22 despite disruptions due to the ongoing Russia-Ukraine war. Most IT companies under our coverage have limited exposure to these geographies, barring some delivery centres present there. Q4 demand is likely to be broad-based across verticals. For most companies, we expect growth to lie in the 2.5-5% QoQ CC range (higher for PSYS given a significant inorganic growth component). Deal pipelines should remain robust, as in Q3. Q4FY22 will experience some cross-currency headwinds due to appreciation of the GBP against the USD.

Margin headwinds to persist: We anticipate an EBIT margin impact in Q4 at 33bps on average across our coverage (ex-Coforge) due to higher employee cost (retention bonuses, salary hikes, higher attrition). Companies are using operational levers to minimise margin pressures, including offshoring, pyramid optimisation, fresher hires, and hiring in tier-2/3 cities (including setup of delivery centres in the interiors of India).

Pushing the inorganic peddle...: The Indian IT sector has seen a surge in M&A activity from Q3FY22, especially among the top-5 players. Post Q2FY22, our coverage companies have together made over 15 acquisitions, including 7 by TECHM alone. PSYS was among the few mid-sized companies in the fray with 3 acquisitions – Shree Partners, SCI and Data Glove. We thus model for an inorganic growth component of 2-2.5% QoQ for TECHM and PSYS in Q4FY22.

...to drive higher guidance: Companies are using the inorganic route to plug the gaps in terms of skill, geographical presence, and in-demand capabilities. Many Indian IT players have bought targets in Europe, besides the US, with M&A activity in this geography at its strongest since 2007. Most acquisitions help improve near-shore presence in the areas of digital and data engineering (both HCLT and TECHM have invested in digital engineering companies in Europe). This should lead to elevated growth guidance for FY23.

Top picks: Our top BUY-rated picks remain LTI (TP Rs 8,490) and TECHM (Rs 1,940) among IT companies and AFFLE (Rs 1,720) among internet companies.

Recommendation snapshot

Ticker	Price	Target	Rating
AFFLE IN	1,272	1,720	BUY
COFORGE IN	4,558	7,080	BUY
ECLX IN	2,416	3,790	BUY
HCLT IN	1,195	1,610	BUY
INFO IN	1,861	2,250	BUY
INFOE IN	4,746	6,780	BUY
INMART IN	5,069	7,660	BUY
JUST IN	782	990	BUY
LTI IN	6,338	8,490	BUY
MPHL IN	3,318	3,470	HOLD
MTCL IN	4,390	5,610	BUY
PSYS IN	4,916	4,580	HOLD
TCS IN	3,815	4,770	BUY
TECHM IN	1,489	1,940	BUY
WPRO IN	599	850	BUY

Price & Target in Rupees | Price as of 5 Apr 2022



Disclaimer

Recommendation scale: Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

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