FIRST LIGHT

12 January 2022

RESEARCH

India Strategy | Macro & Micro

India at takeoff point

Technology & Internet | Q3FY22 Preview

Strong demand to offset seasonality

Daily macro indicators

Indicator	Current	2D (%)	1M (%)	12M (%)
US 10Y yield (%)	1.76	0bps	28bps	61bps
India 10Y yield (%)	6.59	5bps	22bps	67bps
USD/INR	74.04	0.6	2.3	(0.9)
Brent Crude (US$/bbl)	80.87	(1.1)	7.6	45.3
Dow	36,069	(0.4)	0.3	16.3
Shanghai	3,594	0.4	(2.0)	1.8
Sensex	60,396	1.1	2.7	22.6
India FII (US$ mn)	**07-Jan**	**MTD**	**CYTD**	**FYTD**
FII-D	1.2	21.7	21.7	524.0
FII-E	66.4	411.5	411.5	(3,153.8)

Source: Bloomberg

SUMMARY

India Strategy: Macro & Micro

- India poised for secular uptick in per capita income as underlying building blocks now largely in place
- Capex cycle still about two years away – initial recovery likely to be led by the consumption sector with industrial revival back-ended
- Recommend careful stock selection and a sector-led investment approach; prefer consumer and IT

Click here **for the full report.**

Technology & Internet: Q3FY22 Preview

- Q3FY22 expected to be a strong quarter despite seasonality due to high demand and a robust deal pipeline
- Revenue growth of midsized companies likely to outperform larger peers; margins set to remain flattish QoQ across the board
- Prefer LTI & COFORGE among mid-caps and TECHM among the Big-5

Click here **for the full report.**

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MACRO & MICRO

11 January 2022

India at takeoff point

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India on track for secular rise in per capita income: India's population growth has moderated to ~1% – a level at which several developed economies have seen an acceleration in per capita income levels. While higher growth has its own demographic dividends, we believe the population of a country should be proportional to its resources and hence moderation in India's population curve is a positive. This coupled with several government-led reforms over the last 7-8 years indicates that India will likely see a faster uptick in per capita income during this decade.

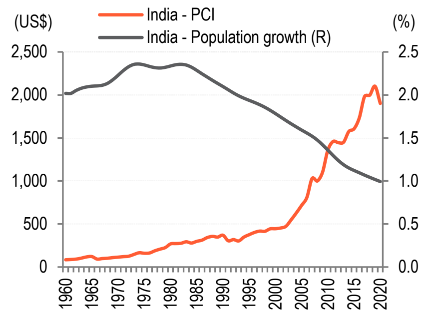
Capex cycle delayed: Our analysis indicates that the country's capex cycle could remain muted for another 18-24 months amid excess capacity in several sectors. Capex will continue to be dominated by the Centre, states and public sector till private sector capex picks up. Our channel checks suggest that several corporates are now contemplating large-scale expansion but remain in the planning stage. We expect a bulk of this outlay to be incurred over FY24-FY26. The consumption sector will likely continue to grow ahead of GDP in the near term given a rebound arising from Covid-related easing, robust agri production, rising employment and subsidy payouts.

IPO conundrum: A spate of listings has raised ~Rs 1.3tn over the last two years but just about 1.3% of the proceeds are earmarked explicitly for new capex. This doesn't augur well for a quick, near-term recovery in the capex cycle.

Time to be selective: Given lingering worries over inflation-induced tapering and tightening globally, we believe it is time to be selective and to focus on stocks with better risk-reward tradeoff. Moreover, given global headwinds, we would prefer large-caps over small-caps near term.

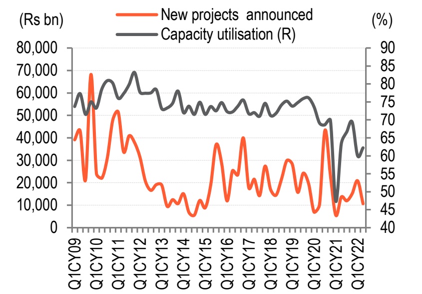
Prefer consumer and IT sectors: We have built a sector-wise investment matrix capturing both fundamental and financial parameters to aid in stock selection. We believe near term, consumption-led GDP growth will have a better outcome for consumer discretionary players and retail-focused lenders. The IT sector will continue to gain from digitisation. Commodities are likely to start reverting to their mid cycle while banks should see limited near-term impact from fintech firms.

India per capita income vs. population growth



Source: BOBCAPS Research, World Bank

Capacity utilisation vs. private capex



Source: CMIE, BOBCAPS Research

TECHNOLOGY & INTERNET | Q3FY22 Preview | 11 January 2022

Strong demand to offset seasonality

- **Q3FY22 expected to be a strong quarter despite seasonality due to high demand and a robust deal pipeline**
- **Revenue growth of midsized companies likely to outperform larger peers; margins set to remain flattish QoQ across the board**
- **Prefer LTI & COFORGE among mid-caps and TECHM among the Big-5**

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Demand momentum to offset seasonal weakness: Despite Q3 being a seasonally weak quarter, we expect average growth of 4.1% across our coverage IT services universe given the robust demand momentum. HCLT and TECHM are likely to lead revenue growth among large-caps at 4.2% and 4.1% QoQ CC respectively. We expect PSYS/LTI to lead the mid-cap pack with 7.8%/6.1% QoQ CC growth. Overall, midsized companies will likely outperform their larger peers. We build in cross-currency headwinds of 30-70bps largely led by appreciation of the GBP and EUR against the USD.

Operating margins to hold steady sequentially: We expect sequentially steady operating margins for Indian technology players. Barring declines for TCS, INFO and PSYS, we build in a sequentially flat-to-modest increase in operating margin for our IT services coverage. On an annual basis, however, we expect to see margin contraction for 9 out of our 11 coverage companies in this space due to the two wage hikes effected by them since Dec'20. Attrition is likely to remain heightened. Companies are trying to balance rising hiring costs by recruiting more freshers and optimising the pyramid.

Encouraging Accenture numbers: Accenture posted its highest ever growth of 27% YoY in local currency terms in Q4FY21 (Y/E Aug), with a robust 21% uptick in outsourcing, indicated a thriving demand environment. The growth was broadbased with positive indicators on all fronts. Outsourcing and consulting bookings increased 42% and 17% YoY. Attrition also slowed slightly. FY22 guidance saw a big jump. All this bodes well ahead of Indian IT's Q3FY22 results.

Cloud remains a key growth driver: Workload migration to the cloud is still at a ~30% level on average. These are early stages of IaaS (infrastructure as a service) adoption and there exists ample headroom for growth over the next couple of years. We will watch for TCV momentum, impact of furlough on margins, cloud revenue growth and any guidance upgrades. For now, we raise target prices for our IT services universe on rolling valuations forward to Dec'23. In addition, we have increased our target multiples for INFO, HCLT and ECLX on elevated growth expectations (Fig 4).

Recommendation snapshot

Ticker	Price	Target	Rating
COFORGE IN	5,767	7,040	BUY
ECLX IN	2,833	3,690	BUY
HCLT IN	1,344	1,560	BUY
INFO IN	1,856	2,170	BUY
LTI IN	7,174	8,270	BUY
MPHL IN	3,207	3,650	HOLD
MTCL IN	4,584	3,540	SELL
PSYS IN	4,492	4,240	HOLD
TCS IN	3,916	4,720	BUY
TECHM IN	1,737	1,970	BUY
WPRO IN	694	850	BUY

Price & Target in Rupees | Price as of 11 Jan 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

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