

Q2 to set tone for second-half and beyond

Despite global trade, revenue growth for tier-I Indian IT services players has held steady for the last three quarters. Q2FY20 will offer critical insights into growth visibility for the rest of the year. We expect continued stability in YoY CC terms, steady sequential growth and margin gains for large players ex-WPRO. The recent flurry of big deal wins for key players and record outsourcing wins for Accenture offer some bright spots. We prefer HCLT & TCS among large-caps and NITEC & MPHL among mid-caps.

Ruchi Burde

research@bobcaps.in

Stable growth trends expected in Q2: In the last one year, the Nifty IT index has underperformed broader markets (-5% vs. -3.1% for Nifty 50) on twin concerns of escalating global trade tensions and the visa-linked rise in delivery costs. While the latter impact has surfaced via margin moderation, the revenue growth trajectory for tier-I IT services companies has held steady at 10.1-10.9% YoY CC (aggregate for TCS, INFO, HCLT, WPRO and TECHM) over the last three quarters. We expect similar 10.2% YoY CC growth in the Sep'19 quarter before onset of the seasonally weak H2.

Results to dictate tone of H2: The Sep'19 quarter will be critical to establishing growth visibility for H2FY20 and beyond, after the mixed bag thrown up in Q1 (upsets from Tech Mahindra (TECHM) and Wipro (WPRO), positive surprises from Infosys (INFO) and HCL Tech (HCLT), subdued showing from TCS). Our estimates factor in ~150bps moderation in YoY CC growth for H2FY20 vs. H1. That said, the slew of large deal wins in Q2 (TECHM's AT&T deal, TCS's GM deal, HCLT's Aperam deal, Accenture's record offshore deal wins) present upside risks to our estimates. Key to watch in Q2 will be the pace of digital contract upscaling, large deal wins and management commentary.

HCLT to lead quarterly scoreboard: Large-cap players are likely to post 1-5.9% QoQ CC revenue growth, with HCLT at the top end and WPRO at the bottom end of the range. Excluding inorganic revenue tailwinds, we expect TCS to lead with 2.6% QoQ CC growth. Similarly, we forecast 1.4-11.9% QoQ CC growth for tier-II players, led by Hexaware (both organically and on reported basis).

Margin expansion QoQ: EBIT margins should improve sequentially for tier-I players, except WPRO due to the wage hike impact. YoY margins are expected to contract (ex-WPRO whose Q2FY19 EBIT margin included a one-off charge).

RECOMMENDATION SNAPSHOT

Ticker	Price	Target	Rating
TCS IN	2,080	2,360	ADD
INFO IN	796	820	ADD
WPRO IN	239	230	SELL
HCLT IN	1072	1,230	BUY
TECHM IN	706	660	REDUCE
LTI IN	1511	2,010	BUY
MPHL IN	937	1,150	BUY
MTCL IN	710	670	SELL
HEXW IN	368	390	ADD
PSYS IN	556	650	REDUCE
NITEC IN	1371	1,550	BUY
ECLX IN	407	490	SELL

Price & Target in Rupees



Infosys likely to upgrade FY20 outlook

We expect INFO to upgrade its revenue guidance to 9.5-10.5% YoY CC growth vs. 8.5-10% currently on healthy deal win momentum and strong growth in H1FY20. The company is likely to retain its EBIT margin outlook at 21-23%. WPRO is expected to guide for 0-2% QoQ growth in the Dec'19 quarter. We expect HCLT to retain its FY20 revenue (14-16% YoY CC growth) and EBIT margin (18.5-19.5%) outlook.

FIG 1 – SEP'19 QUARTER ESTIMATES

Company	Revenues (US\$ mn)	US\$ revenue growth (%)		CC growth (%) QoQ	EBIT margins (%)	EBIT (Rs mn)	EBIT growth (%)		EBIT margins (bps)		Net profits (Rs mn)	Net profit growth (%)	
		QoQ	YoY				QoQ	YoY	QoQ	YoY		QoQ	YoY
TCS	5,576	1.7	6.9	2.6	25.1	98,709	7.1	1.0	100	(140)	81,943	0.8	3.0
INFO	3,212	2.6	13.5	3.2	21.3	47,176	5.5	4.0	80	(160)	38,409	0.1	6.3
WPRO*	2,045	0.3	1.8	1.0	17.4	24,743	0.3	(2.9)	(60)	(110)	21,532	(9.8)	14.0
HCLT	2,483	5.1	18.3	5.9	18.8	32,957	17.5	11.1	170	(110)	25,862	16.5	1.8
TECHM	1,265	1.4	3.8	2.2	12.4	11,059	11.4	(16.5)	90	(290)	9,407	(1.9)	(11.6)
LTI	353	1.0	9.6	1.4	15.5	3,934	(0.8)	(11.0)	(50)	(350)	3,505	(1.4)	(12.4)
MPHL	305	2.6	10.6	2.9	16.6	3,579	12.1	13.8	110	20	2,874	8.6	6.1
MTCL	268	1.5	8.8	2.0	9.4	1,785	52.3	(22.2)	310	(360)	1,303	40.6	(36.8)
HEXW	210	11.5	22.9	11.9	14.0	2,031	6.2	8.9	(60)	(140)	1,715	13.4	(0.4)
PSYS	123	2.8	4.0	3.0	8.2	714	(12.5)	(31.2)	(160)	(420)	685	(16.9)	(22.2)
NITEC	144	4.9	9.3	5.1	13.5	1,373	38.9	4.4	320	(100)	1,079	23.1	(3.5)
ECLX	52	1.4	2.9	1.4	15.5	568	16.1	(22.0)	170	(500)	435	9.5	(37.8)

Source: BOBCAPS Research | *Refers to IT Services business

USD appreciation against major currencies to pose 60-90bps cross-currency headwinds for IT majors in Q2

We expect margin gains from INR depreciation vs. USD to be partly offset by INR appreciation vs. European currencies, especially GBP

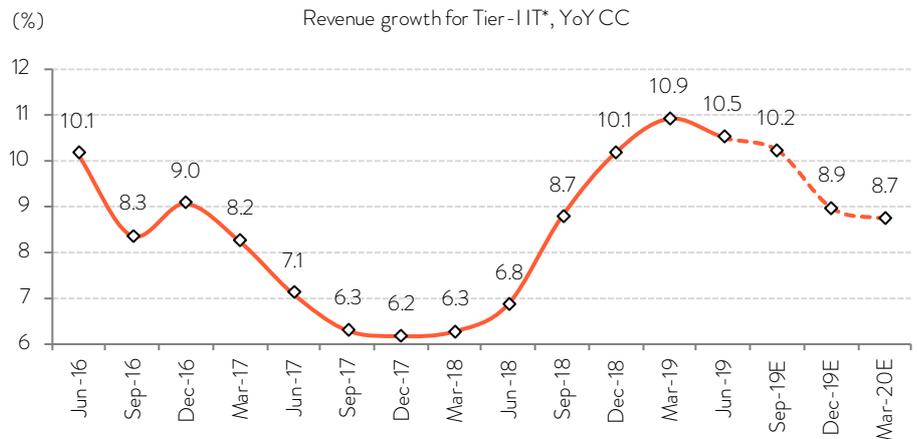
FIG 2 – SEP'19 QUARTER EXCHANGE RATES

Exchange rate	Sep'18	Jun'19	Sep'19	QoQ (%)	YoY (%)
USD/INR					
Average	70.69	69.52	70.48	1.4	(0.3)
Close	72.55	68.92	70.84	2.8	(2.4)
Euro/USD					
Average	1.17	1.12	1.10	(1.7)	(5.5)
Close	1.16	1.14	1.09	(4.0)	(6.2)
GBP/USD					
Average	1.31	1.27	1.22	(4.0)	(6.5)
Close	1.31	1.27	1.23	(2.7)	(5.8)
Average					
Euro/INR	82.56	78.06	77.81	(0.3)	(5.7)
GBP/INR	92.45	88.56	86.16	(2.7)	(6.8)

Source: RBI, BOBCAPS Research

Q2FY20 performance critical to establish growth visibility for H2FY20 and beyond

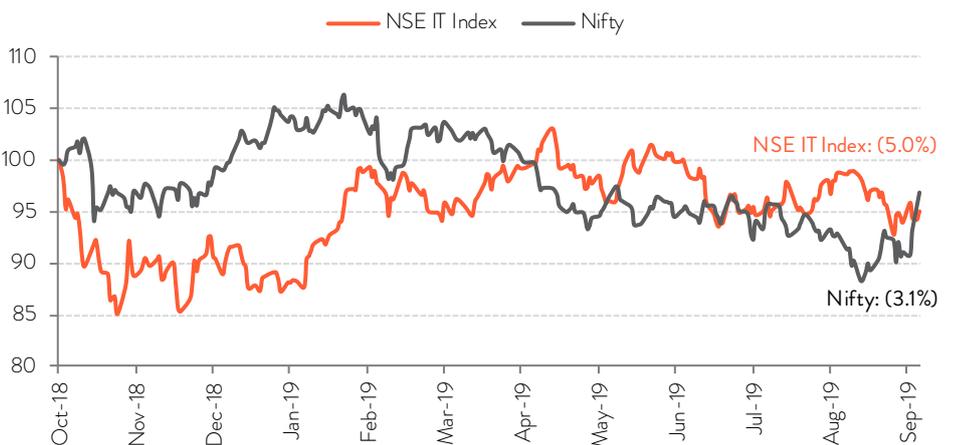
FIG 3 – GROWTH TRAJECTORY LARGELY STEADY OVER LAST 3 QUARTERS DESPITE GLOBAL MACRO CONCERNS



Source: Company, BOBCAPS Research | *Above chart plots aggregate YoY constant currency revenue growth for Tier-I IT players, namely TCS, INFO, HCLT, WPRO and TECHM

Twin concerns of escalating trade tensions and rising delivery cost (on stringent US visa regime) subdued IT stocks over last one year

FIG 4 – NIFTY IT INDEX HAS UNDERPERFORMED BROADER MARKETS IN LAST 1 YEAR



Source: Bloomberg, BOBCAPS Research. Indexed to prices as on 1st Oct 2018.

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