

IT SERVICES

06 July 2021

Q1FY22 preview: expect a strong start to FY22E

- We expect robust Q1FY22 marked by QoQ dollar revenue growth of 1.5% to 11.4%; wage revision to impact operating margins
- Amid supply challenges, attrition and operating margin defense will be a key monitorable for Q1FY22
- We stay optimistic on IT services sector on back of pandemic induced multiyear tech refresh cycle. Prefer TCS, HCLT, TECHM, LTI.

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Expect strong start to FY22E: We expect Q1FY22 to set a strong start to FY22E as we forecast an average QoQ USD growth of 4.2% (excluding Coforge) in our coverage. We expect 1.5% to 9.1% QoQ dollar revenue growth for large cap IT players. Wipro will lead with 9.1% QoQ dollar revenue growth aided by ~700bps inorganic revenues. We expect mid-caps to report sequential dollar revenue growth of 3.3% to 11.4% with Coforge at leading end and LTI at bottom end. Coforge's revenue performance will be aided by consolidation of SLK Global.

Wage revision to impact operating margin: IT players are returning to normal wage revision cycle after pandemic led aberration in FY21. Q1FY22 will have full or partial impact of wage revision for IT companies under our coverage except for HCLT, Mphasis and Persistent. We expect an average 140 bps QoQ EBIT margin decline for our coverage universe because of salary hikes, supply constraint and rising attrition. Six companies are giving second round of wage hikes after 1st round since Sep'20 qtr. Companies are ramping up hiring as demand environment heats up, causing talent cost to shoot up.

Expect unchanged FY22 guidance: As stated by Accenture too ([IT Services - Sector Update 24Jun21.pdf](#)), demand environment continues to be robust driven by multi-year technology refresh cycle. We expect largely unchanged FY22 growth guidance from IT companies. The growth will be driven by large outsourcing opportunity, demand for hyperscaler cloud stacks and cyber-security. Cloud part of the business will continue to grow at a much faster pace vs. the total business. WPRO and HCLT joined peers with separate cloud business set up in last quarter. We expect the trend of larger volume of smaller deal TCVs to continue from Q4FY21.

Key things to watch out: 1) Amid supply challenges attrition and operating margin defense will be a key monitorable for Q1FY22, 2) large deal wins and (3) manufacturing and BFSI vertical demand trend.

Recommendation snapshot

Ticker	Price	Target	Rating
HCLT IN	980	1,190	BUY
LTI IN	4,047	4,710	BUY
MPHL IN	2,114	1,580	SELL
PSYS IN	2,904	1,340	SELL
TCS IN	3,321	3,780	BUY
TECHM IN	1,075	1,190	BUY

Price & Target in Rupees | Price as of 5 Dec 2021



Other highlights:

- **TCS'** main focus in FY22 will be to gain market share (similar to Accenture), as we believe it will continue to be the prime beneficiary of vendor consolidation. For TCS, a majority of the 4% USD sequential expected growth in Q1FY22 is likely to come from the BFSI vertical, as BFSI TCV stood at US\$3.9bn in Q4FY21. The life sciences and retail verticals should also do well. We expect a limited impact of 100bps on EBIT margin from salary hikes as TCS will turn to levers like: sub-contracting, offshoring and pyramid optimization to reign in the margin decline.
- For **Infosys**, we expect 4% QoQ USD growth and ~200bps impact on the margin due to compensation hike in Q4FY21 flowing through in Q1FY22 and rising attrition. Infosys had industry high attrition of 15.2% in Q4FY21. Similar trend is likely to repeat in FY22.
- We estimate **Wipro** to grow 9.1% QoQ USD. WPRO had guided for 2-4% growth QoQ outside Capco and Ampion acquisition. BFSI will lead growth because of Capco acquisition. Europe will continue to be strong for WPRO on the back of strong deal wins through FY21 in the region. We expect 300bps QoQ impact on margin due to supply side pressure building up, costs from Capco acquisition and salary hikes for senior management (for the rest 80%, salary hike was done in Q4FY21).
- We estimate **HCLT** to grow by a moderate 1.5% QoQ USD. Engineering services is expected to perform better. Manufacturing is expected to bounce back with 8 out of 19 large deals coming from the vertical in Q4. We expect muted EBIT margin impact of 80bps as the wage hikes will start from July on.
- We are expecting a decent growth of 3.1% QoQ USD for **TECHM**, led by enterprise as communication vertical might face some seasonality effects. EBIT margin will be impacted by 300bps because of first wage hike since FY21, visa cost and seasonality.
- For **LTI**, we expect robust growth of 3.3% QoQ because of Injezat deal ramp-up. In Q1, we expect 320bps impact on margin due to transition costs from deal ramp-up, increased hiring (similar to Q4FY21), salary hike and investment in sales and marketing.
- We expect **Coforge** to show industry leading growth of 11.4 QoQ USD (including full effect of SLK Global acquisition). Organic growth will be led by BFS and green shoots in travel. We expect ~86bps impact from wage hike, increased hiring, offset partially by better margin of SLK Global. Executable order book is also expected to be strong as travel continues to recover.
- **MTCL** is estimated to grow by 5.4% driven by RCPG, technology and BFSI. Operating margin is expected to be impacted by 90bps due to visa costs, headcount addition and rise in cost of digital talent.
- For **Mphasis** we expect a growth of 4% QoQ USD, driven primarily by Direct business as DXC continues to weaken. BCM will recover QoQ. We expect margins to expand by 70bps as no wage hikes are intended for the quarter.

- For **eclerx** we expect a growth of 1.7% QoQ USD as there will be some seasonality impact in first quarter. eClerx is also expecting double digit growth in FY22, driven by last two quarters of good growth (lack of any roll offs). Full impact of Personiv acquisition has already materialized in Q3 and Q4FY21. Also, H1FY21's depressed performance (0.8% revenue decline) will also help FY22 growth. We expect 180bps wage hike (mid-single digit) impact on margins.

Fig 1 – Q1FY22 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 Profits growth (%)	
		QoQ	YoY				QoQ	YoY	QoQ	YoY		QoQ	YoY
IT Services companies													
TCS	6,227	4.0	23.1	3.5	25.9	119,854	2.1	32.5	(100)	230	95,744	3.2	35.8
INFO	3,757	4.0	20.4	3.8	22.5	62,935	(2.3)	16.7	(197)	(28)	52,601	3.6	21.0
WPRO*	2,383	9.1	22.3	8.9	17.9	32,182	(5.8)	22.0	(300)	40	28,370	(4.6)	24.3
HCLT	2,736	1.5	16.1	1.2	19.5	39,650	(0.4)	8.3	(80)	(100)	30,688	3.0	4.5
TECHM	1,371	3.1	13.6	2.8	13.5	13,773	(14.1)	50.1	(300)	340	11,403	9.2	19.3
LTI	462	3.3	18.4	3.0	16.2	5,570	(12.0)	8.4	(320)	(120)	5,081	(6.9)	22.0
MPHL	356	4.0	17.3	3.5	16.7	4,427	9.2	23.5	70	110	3,434	8.4	24.9
MTCL	304	5.4	20.0	5.2	17.7	3,989	2.0	52.2	(90)	390	3,056	(3.7)	43.6
PSYS	162	5.9	23.5	5.6	13.6	1,670	14.0	62.3	43	320	1,279	(7.2)	42.1
COFORGE	192	11.4	37.4	11.5	12.8	1,822	6.0	49.3	(86)	122	1,685	22.6	103.3
ECLX	65	1.7	44.8	1.1	25.9	1,271	(2.7)	92.3	(180)	620	957	(2.6)	84.6

Source: BOBCAPS Research | CC – Constant Currency, * Overall

Fig 2 – Q1FY22 Currency movement

Exchange rate	Jun'20	Mar'21	Jun'21	QoQ (%)	YoY (%)
USD/INR					
Average	75.4	72.9	73.6	1.0	(2.4)
Close	75.5	72.6	74.2	2.2	(1.7)
Euro/USD					
Average	1.11	1.20	1.21	0.5	9.3
Close	1.12	1.18	1.19	0.9	6.4
GBP/USD					
Average	1.24	1.38	1.40	1.7	13.0
Close	1.24	1.37	1.39	1.6	11.9

Source: BOBCAPS Research

Fig 3 – Change in EPS estimates because of currency adjustments for Q1FY22

(Rs)	FY22E			FY23E		
	Old	New	Change (%)	Old	New	Change (%)
TCS	117.6	116.1	(1.2)	135.0	134.9	0.0
INFO	55.6	56.1	1.0	59.0	59.6	1.0
WPRO*	20.2	20.3	0.5	24.8	24.6	(0.9)
HCLT	54.8	54.2	(1.2)	63.3	62.9	(0.6)
TECHM	64.1	63.4	(1.0)	76.1	75.7	(0.5)
LTI	132.2	132.3	0.1	154.9	155.3	0.3
MPHL	80.0	80.3	0.4	93.6	94.5	1.0
MTCL	88.8	88.3	(0.6)	92.7	92.9	0.2
PSYS	63.0	64.3	2.2	69.6	69.6	0.0
COFORGE	132.1	131.3	(0.6)	163.2	163.3	0.1
ECLX	121.0	120.3	(0.6)	135.0	135.1	0.0

Source: BOBCAPS Research | * Overall

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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