

Q3 to be resilient despite seasonality

We expect Q3FY21 to be resilient with a healthy QoQ dollar growth (2-4%) for most of our IT coverage, helped by modest cross-currency tailwinds (~35bps). Margins are likely to remain resilient with only ~50bps QoQ decline on average. Expect LTI to show highest growth (7.2% CC) given its strong pipeline. We await commentary on (1) FY22 demand outlook, (2) BFSI growth momentum, (3) acquisition-related updates, (4) large deal wins in Q3, and (5) margin trajectory. Remain positive on TCS, HCLT, TECHM, LTI and Coforge.

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Good demand traction: Sequential growth in Q3 is expected to be better than normal fueled by good demand, modest currency tailwinds and fewer furloughs. Among our large-cap universe, we expect Infosys (INFO) to outperform with 3.5% QoQ dollar revenue growth, given the numerous large deals bagged this quarter. For the rest, growth is estimated at 2-3%. Within mid-caps, we expect L&T Infotech (LTI, +7.5%) and Persistent (PSYS, +5%) to lead the pack as Q3 is a seasonally strong quarter for them. LTI's robust large-deal pipeline (US\$ 1.9bn, +62% YoY) and PSYS' strong pickup in services, TSU revenues and flow-through from the Capiot acquisition are expected to drive growth.

Stable margins QoQ: We believe most companies will report stable operating margins, with at most an 80-100bps decline QoQ. Cost efficiency levers such as offshoring, automation-led approach, reduced subcontracting and increased utilisation are being used to neutralise the impact from furloughs and rupee appreciation. Wage hikes have been deferred to Q4, except for TCS and HCL Tech (HCLT), resulting in an estimated margin hit of 150bps.

In mid-caps, we expect Coforge's margins to normalise due to an ~80bps impact from hikes and travel-related weakness. Mindtree's (MTCL) margins are likely to stand strong with 20bps QoQ expansion backed by management commentary, a renewed strategy and its ongoing margin expansion cycle from Q1FY20 lows.

Europe recovery to continue: Wipro's (WPRO) accelerated M&A along with deal wins by HCLT and MTCL will ensure recovery in Europe, further aided by many captives acquired during Q3 – for instance, TCS's acquisition of Postbank Systems and the Pramerica Ireland back-offices and WPRO's takeover of Metro AG's IT units. Within verticals, BFSI, hi-tech, omni-channel retail and healthcare will have the most traction but travel will continue to be weak. Cloud will remain a strong driver of growth.

RECOMMENDATION SNAPSHOT

Ticker	Price	Target	Rating
TCS IN	2,928	3,180	BUY
INFO IN	1,260	1,210	ADD
WPRO IN	388	290	SELL
HCLT IN	951	980	BUY
TECHM IN	978	1,040	BUY
LTI IN	3,699	3,860	BUY
MPHL IN	1,530	1,410	REDUCE
MTCL IN	1,659	1,540	ADD
PSYS IN	1,498	840	SELL
COFORGE IN	2,722	2,690	BUY
ECLX IN	883	800	REDUCE
INFOE IN	4,758	2,010	SELL

Price & Target in Rupees



Key monitorables in Q3

Large deals

Q3FY21 saw a slew of large deals despite seasonality, the most notable being (1) TCS's partnership with Star Alliance, (2) WPRO's US\$ 700mn deal with Metro AG, (3) WPRO's multi-year contract with Verifone, and (4) expansion of the alliance between HCLT and IBM. (also see our report [Pickup in digital and blockchain-led deals](#)).

INFO was able to bag the highest number of large deals including (1) a US\$ 1.5bn-3.2bn infrastructure transformation and cloud migration contract with Daimler, (2) a strategic partnership with Rolls Royce, (3) a contract to provide its digital banking solution 'Finacle' to RBL, and (4) a similar deal with XacBank Mongolia. We await commentary on deal margins and revenue flow through timeline for more clarity.

Guidance upgrades

Global demand for IT services remains robust as indicated by Accenture's upgraded FY21 guidance, strong outsourcing growth and robust double-digit YoY cloud growth in Q1 (Y/E August; see our report [Strong outsourcing growth continues; FY21 guidance raised](#)). We expect guidance upgrades by INFO, HCLT, LTI and Coforge. WPRO is likely to provide Q4FY21 guidance and updates on its renewed strategy and organisational structure.

Captive takeovers and acquisitions

Q3FY21 saw several acquisitions – HCLT acquired DWS and CISCO SON, eClerx acquired Personiv – and captive takeovers. Updates regarding any further M&A are awaited. TCS acquired the IT back offices from Pramerica and Postbank Systems and WPRO bought Metro AG's back offices in Europe. With parts of Europe going back into lockdown, management commentary regarding growth prospects in Europe is awaited.

FIG 1 – BOBCAPS IT SERVICES UNIVERSE: Q3FY21 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*	5,587	3.0	0.0	2.6	24.7	102,072	(2.9)	2.3	(150)	(30)	79,775	(8.5)	(2.0)
INFO	3,428	3.5	5.7	3.2	25.6	64,922	4.2	28.2	25	366	52,254	7.6	15.9
WPRO**	2,052	3.0	(2.0)	2.7	18.0	28,288	(0.1)	3.9	(20)	60	24,547	(1.2)	(0.3)
HCLT	2,587	3.2	1.7	2.8	20.1	38,473	(4.2)	4.8	(150)	(10)	30,075	(4.6)	(1.3)
TECHM	1,291	2.0	(4.6)	1.7	14.2	13,568	1.9	15.1	0	200	11,680	9.9	5.2
LTI	435	7.5	10.3	7.2	19.0	6,097	2.4	33.6	(90)	280	4,889	7.0	29.8
MPHL	335	2.0	5.2	1.7	15.9	3,936	0.3	6.6	(30)	(40)	3,034	1.4	3.3
MTCL	270	3.6	(1.75)	3.3	17.5	3,494	4.8	47.8	20	540	2,549	0.5	29.4
PSYS	143	5.0	10.4	4.8	12.0	1,272	4.4	57.8	(6)	308	1,027	0.7	16.8
COFORGE	161	3.8	6.3	3.3	13.0	1,543	(2.9)	3.5	(80)	(92)	1,388	13.6	8.0
ECLX	49	2.0	(4.5)	1.8	23.7	872	(1.4)	2.0	(80)	100	667	8.5	(4.8)

Source: BOBCAPS Research | *Adjusted for legal expenses in Q2FY21 | **Overall | CC – Constant Currency

FIG 2 – CURRENCY MOVEMENT

Exchange rate	Dec'19	Sep'20	Dec'20	QoQ (%)	YoY (%)
USD/INR					
Average	71.3	74.0	73.8	(0.3)	3.5
Close	71.3	73.7	73.6	(0.2)	3.2
Euro/USD					
Average	1.11	1.18	1.20	1.3	7.6
Close	1.12	1.17	1.22	4.7	9.0
GBP/USD					
Average	1.30	1.31	1.33	1.6	2.3
Close	1.31	1.28	1.35	5.5	2.6

Source: BOBCAPS Research

Info Edge – expect a dull Q3

We expect Info Edge (INFOE) to register a sales decline of 12% YoY in Q3FY21 due to a high base of last year and continued YoY declines in both billing (-20%) and deferred revenues (-21.9%) in Q2FY21. Sustained weakness in real estate (99 acres) and the job market (Naukri.com) is expected to weigh heavy on INFOE's Q3 performance. The IT and banking sectors are likely to perform better than the rest for Naukri.com. Jeevansaathi.com is projected to perform marginally better than the company's other platforms, continuing from Q2FY21.

We expect INFOE's EBITDA margin to remain stable at ~20%. Increased Zomato funding (latest ~US\$ 3.9bn) and rising insurance demand (PolicyBazaar) are the only potential positives. Reiterate SELL at an unchanged TP of Rs 2,010.

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BUY – Expected return >+15%

ADD – Expected return from >+5% to +15%

REDUCE – Expected return from -5% to +5%

SELL – Expected return <-5%

Note: Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

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