

Ending the year on a robust note

We expect a resilient Q4FY21 marked by healthy QoQ dollar revenue growth (2.5-5.3%) for most of our IT coverage, aided by modest cross-currency tailwinds (~60bps). TCS and LTI are likely to outperform. EBIT margins are expected to decline ~90bps QoQ on average due to sector-wide wage hikes. We await commentary on (1) FY22/FY23 demand outlook, (2) BFSI growth momentum, (3) acquisition-related updates, (4) large deal wins in Q4, and (5) margin trajectory. Remain positive on TCS, HCLT, TECHM, LTI, Coforge.

Ruchi Burde | Seema Nayak

research@bobcaps.in

Midcaps outperform: Nifty IT's Q4FY21 return of 6% is on par with that of the Nifty 50. TCS, Infosys (INFO), L&T Infotech (LTI) and Mphasis (MPHL) narrowly beat the sectoral index while Mindtree (MTCL), Persistent (PSYS) and eClerx (ECLX) outperformed with >25% returns, recovering from the Q3 mid-cap sluggish performance. This performance can also be partly attributed to Accenture's stellar Q2FY21 print (Y/E Aug), especially in the outsourcing segment (see our 19 March report: [Accenture posts stellar Q2, raises guidance](#)).

Moderate revenue growth: Barring Wipro (WPRO) and MTCL, most companies are expected to end FY21 with flattish-to-low single digit full-year growth despite a sharp decline in Q1FY21. The cloud-driven multiyear technology upcycle has aided a V-shaped recovery across the sector and we expect LTI to post the highest FY21 growth of 9-10%. For Q4, we project a modest average uptick of 4% USD sans eClerx (ECLX) where we bake in an exceptional 30% increase due to revenue coming from Personiv acquisition.

Among large-caps, TCS is likely to outperform at 5.2% QoQ USD, alongside 5.3% growth from LTI and Coforge among mid-caps. Growth will be aided by cross-currency tailwinds of ~60bps and driven by the BFSI, hi-tech and healthcare verticals for majority. Manufacturing is expected to see continued improvement but energy & utilities, retail and travel could be lukewarm.

Impact on margins: Despite headwinds of currency appreciation, wage hikes, normalised utilisation and increased hiring, we estimate a limited 90bps impact on EBIT margin on average due to structural advantages from topline growth, increased offshoring, and lower travel, branding and subcontracting costs. We expect topline-led margin expansion for TCS (won TCV~US\$1.3- 2.6bn in BFSI), ECLX (Personiv acquisition) and Coforge.

KEY RECOMMENDATIONS

Ticker	Price	Target	Rating
TCS IN	3,239	3,710	BUY
INFO IN	1,410	1,500	ADD
WPRO IN	425	450	ADD
HCLT IN	1,034	1,150	BUY
TECHM IN	998	1,130	BUY
LTI IN	4,270	4,740	BUY
MPHL IN	1,755	1,550	REDUCE
MTCL IN	2,088	1,850	ADD
PSYS IN	1,959	1,260	SELL
COFORGE IN	3,037	2,800	BUY
ECLX IN	1,121	950	REDUCE

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



Other key expectations

- For **TCS**, a majority of the sequential growth in Q4FY21 is likely to come from the BFSI vertical, with revenue from two large deals with TCV of US\$ 1.3bn-2.6bn (Prudential and Postbank Systems) flowing through during the quarter. The life sciences and retail verticals should also do well. We expect a slight 20bps QoQ uptick in EBIT margin due to the absence of salary hikes during the quarter, keeping it in the aspirational 26-28% range.
- **INFO's** Q4 sequential performance is likely to be subdued due to a high base of 6.2% growth in Q3 and also factoring in management's guidance of 4.5-5% CC growth in FY21. Salary hikes and variable pay are expected to compress EBIT margin by 165bps QoQ to 23.8%.
- We estimate 3.2% QoQ revenue growth for **WPRO**, which is at the higher end of its guided range of 1.5-3.5%. Full year growth is unlikely to be positive in FY21. EBIT margin could contract 310bps QoQ due to the impact of salary hikes for 80% of employees as well as variable payouts. Q4 will also be WPRO's first quarter post organisational restructuring by the new CEO.
- We project moderate growth of 3-3.3% QoQ each for **HCLT** and **TECHM**. For HCLT, we build in a 190bps margin impact from salary hikes while TECHM's margins should hold at Q3 levels. **LTI** is expected to post strong sequential growth of 5.3%, one of the best prints in the mid-cap pack. EBIT margin could take a 190bps QoQ hit due to wage hikes and a return to normal utilisation levels in Q4. We expect the company to post FY21 growth of 9.7%, among the highest in our coverage.
- **MTCL** and **PSYS** are likely to grow 4.7% QoQ each and **Coforge** 5.3%. While MTCL could fall short of achieving YoY growth parity for FY21, PSYS's YoY growth is estimated at 13% off a low base in FY20. We expect good sequential growth for PSYS in Q4 stemming from momentum post management change, TCV of US\$ 302mn in Q3 and its expanded relationship with IBM. Coforge's FY21 YoY growth is forecast to be in mid-single digits despite weakness in the travel vertical. We estimate 90-170bps QoQ lower margins for both MTCL and PSYS. Management commentary on the travel vertical outlook and steps taken to derisk this business will be key to watch.
- **ECLX** is estimated to grow 30% QoQ due to revenue flowthrough from the Personiv acquisition, which is also expected to raise EBIT margin by 230bps. We expect **MPHL** to post moderate growth of 2.7% because of weakness in DXC as the minimum revenue commitment is reaching its end. Its BFS growth has also been modest at best in Q3FY21. Margins are projected to remain flat QoQ with no scheduled salary hikes for the quarter.

Key monitorables in Q4

FY22 guidance

Global demand for IT services remains robust as indicated by Accenture's upgraded FY21 guidance by 2.5% CC growth, strong outsourcing growth and robust double-digit YoY cloud growth in Q1 and Q2FY21. We expect healthy double-digit YoY growth guidance for FY22 from INFO, HCLT, LTI, WPRO and Coforge. For large-caps, we await commentary on large deal momentum.

Margin outlook

We expect EBIT margin expansion of 10-620bps YoY in Q4FY21, averaging at 213bps for our coverage. With margins for most IT companies improving through Q2 (by 80-400bps QoQ) and remaining strong in Q3FY21, management's FY22 and FY23 outlook is awaited. Any indication of significant margin impact due to supply-side constraints, rising attrition and low utilisation will be negative news, especially at current valuations.

Captive takeovers and acquisitions

During Q4, WPRO acquired Ampion (in the cybersecurity space) and Capco (technology consultancy), while TECHM bought Ireland-based BPO firm Perigord. Q3FY21 saw several acquisitions – HCLT acquired DWS and Cisco SON, ECLX bought Personiv – and captive takeovers as well. TCS bought the IT back offices of Pramerica and Postbank Systems and WPRO acquired Metro AG's back offices in Europe. Updates regarding any further M&A are awaited as MTCL, PSYS, MPHL and LTI are actively looking to acquire.

FIG 1 – BOBCAPS IT UNIVERSE: Q4FY21 ESTIMATES

Company	Revenues (US\$ mn)	US\$ revenue growth (%)		CC growth (%) (QoQ)	EBIT (Rs mn)	EBIT growth (%)		EBIT margins (%)	EBIT margins (bps)		PAT (Rs mn)	PAT growth (%)	
		QoQ	YoY			QoQ	YoY		QoQ	YoY		QoQ	YoY
IT Services companies													
TCS	5,999	5.2	10.2	4.4	119,178	6.6	18.9	26.8	20	180	92,776	6.3	14.6
INFO	3,516	2.5	12.7	1.9	64,237	(2.5)	30.4	23.8	(165)	259	52,476	0.6	19.8
WPRO*	2,137	3.2	3.1	2.6	28,773	(14.9)	10.7	17.6	(310)	100	25,173	(16.0)	9.2
HCLT	2,695	3.0	6.0	2.4	41,797	(5.3)	7.7	21.0	(190)	70	33,270	(16.8)	5.3
TECHM	1,352	3.3	4.5	2.6	15,810	2.9	66.5	15.8	(10)	580	13,388	3.8	84.3
LTI	450	5.3	9.9	4.7	6,234	(4.1)	23.8	18.7	(190)	200	5,162	(0.6)	20.8
MPHL	345	2.7	7.9	2.2	4,257	5.1	11.1	16.5	10	10	3,275	0.6	(7.3)
MTCL	287	4.7	3.1	4.3	3,959	(0.1)	54.8	18.6	(90)	620	2,892	(11.4)	40.2
PSYS	153	4.7	20.5	4.4	1,248	(8.5)	45.7	11.0	(167)	177	1,009	(16.5)	20.4
COFORGE	169	5.3	9.4	3.8	1,888	22.0	22.8	15.1	207	120	1,625	31.6	30.8
ECLX	69	30.1	45.4	29.5	1,396	43.3	136.1	27.0	230	25	1,119	57.3	102.4

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

We tweak EPS for TCS and TECHM to bake in cross currency adjustments for Q4.

FIG 2 – REVISED EPS ESTIMATES

(Rs)	FY22E			FY23E		
	Old	New	Change (%)	Old	New	Change (%)
TCS	120.2	119.1	(0.9)	140.1	139.9	(0.1)
INFO	53.3	53.3	0.0	58.9	58.9	0.0
WPRO*	18.8	18.8	0.0	23.7	23.7	0.0
HCLT	55.3	55.3	0.0	63.2	63.2	0.0
TECHM	64.0	63.6	(0.5)	75.8	76.3	0.7
LTI	136.1	136.1	0.0	161.5	161.5	0.0
MPHL	81.2	81.2	0.0	95.7	95.7	0.0
MTCL	77.8	77.8	0.0	81.0	81.0	0.0
PSYS	57.0	57.0	0.0	68.2	68.2	0.0
COFORGE	115.6	115.6	0.0	131.1	131.4	0.2
ECLX	106.9	106.9	0.0	115.8	115.6	(0.1)

Source: BOBCAPS Research

FIG 3 – CURRENCY MOVEMENT

Exchange rate	Q4'20	Q3'21	Q4'21	QoQ (%)	YoY (%)
USD/INR					
Average	73.0	73.8	72.9	(1.2)	(0.2)
Close	75.4	73.6	72.6	(1.3)	(3.7)
Euro/USD					
Average	1.10	1.20	1.20	0.5	9.2
Close	1.23	1.22	1.18	(3.3)	(4.3)
GBP/USD					
Average	1.28	1.33	1.38	3.7	7.9
Close	1.23	1.35	1.37	1.7	10.8

Source: BOBCAPS Research

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Recommendations and Absolute returns (%) over 12 months

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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