

## Indian IT performs in line with consensus

The Q4FY21 sequential growth and margin performance of India's IT services sector has been in line with our as well as consensus' optimistic estimates. BFSI emerged as the highest growing vertical, even as the recovery in manufacturing continued from Q3. With ample large deals and record TCv, most firms are on their way to double-digit revenue growth in FY22. However, supply-side pressure with record hiring and rising attrition remains a concern. We stay positive on TCS, HCLT & TECHM among large-caps and LTI & Coforge among mid-caps.

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**Good FY21 print despite Q1 dip:** Despite the Covid-19 slump in Q1FY21, Indian IT companies have shown resilience with most players registering positive YoY revenue growth in FY21, barring Wipro (WPRO), Mindtree (MTCL), and Tech Mahindra (TECHM). The BFSI and hi-tech verticals have driven growth. Manufacturing started recovering in H2FY21 while retail remained a mixed bag.

L&T Infotech (LTI) and Persistent Systems (PSYS) had the highest YoY growth at 9.5% and 12.9% USD respectively in FY21. LTI's performance is commendable as it comes on the back of 13% YoY growth in FY20. EBIT margin expanded by an average of 227bps YoY for our universe in FY21, aided by increased offshoring, higher utilisation, and lower travel, marketing and SG&A costs. Q4 revenue and margins were in line with our and the street's upbeat estimates.

**Supply pressure causing proactive hiring:** With utilisation reaching an all-time high, attrition has accelerated QoQ. TCS has been able to maintain its industry-low attrition rate despite talent shortage. Increased hiring reflects upcoming revenue, buoyant demand and ahead-of-curve supply capability buildup, besides safeguards against delivery risks due to India's Covid surge. We do not expect hiring to have a negative impact on margins as utilisation levels are likely to remain stable. Improved deal pricing will also bode well for margins in FY22.

**Double-digit growth in FY22:** Most companies are confident of achieving double-digit revenue growth in FY22, with HCL Tech (HCLT) and Coforge explicitly guiding for this (in line with our estimates). MPHL forecasts above-industry growth in its direct channel. TCS' management has said it is on track to achieve a double-digit print in FY22. We believe the uptick will be fuelled by a strong FY22 pipeline, record exit TCvs, a multiyear technology upcycle, and low base of FY21. On the margin front, most players are confident of stability and expect FY21 levels to sustain despite some higher costs anticipated in FY22.

### RECOMMENDATION SNAPSHOT

Ticker	Price	Target	Rating
TCS IN	3,159	3,780	BUY
INFO IN	1,397	1,540	ADD
HCLT IN	946	1,190	BUY
TECHM IN	1,008	1,190	BUY
LTI IN	3,800	4,710	BUY
MPHL IN	1,914	1,580	SELL
PSYS IN	2,515	1,340	SELL
COFORGE IN	3,485	4,080	BUY

Price &amp; Target in Rupees | Price as of 26 May 2021

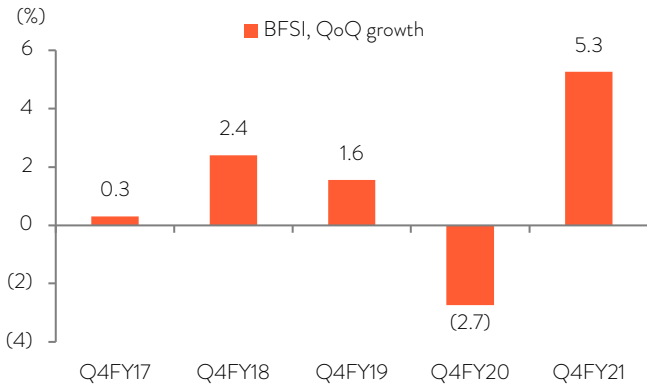


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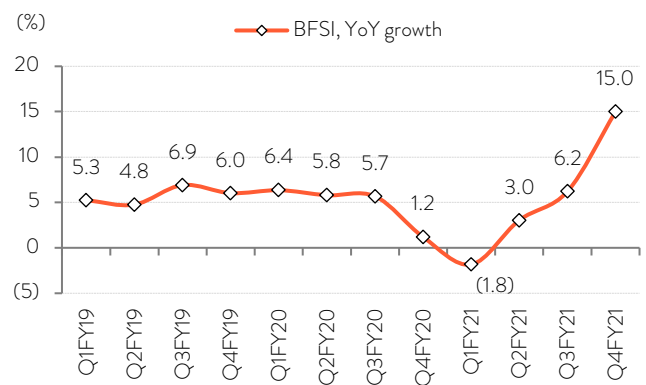
## Focus charts

**FIG 1 – TIER-I BFSI GROWTH SHINES QOQ...**



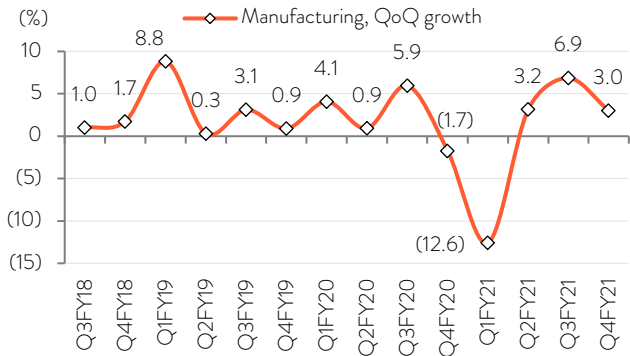
Source: Company, BOBCAPS Research | Tier-I: TCS, INFO, HCLT, WPRO, TECHM

**FIG 2 – ...AND YOY**



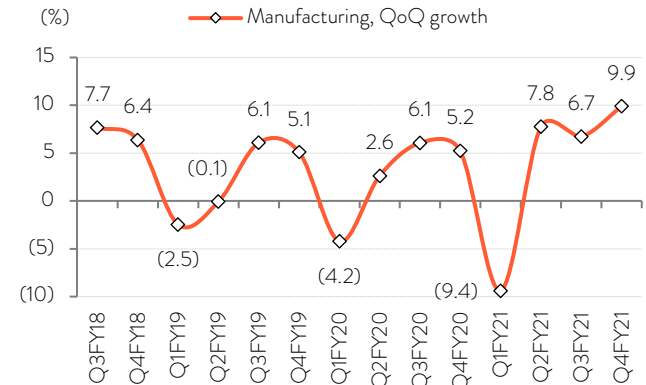
Source: Company, BOBCAPS Research

**FIG 3 – TIER-I MANUFACTURING VERTICAL MOMENTUM CONTINUES**



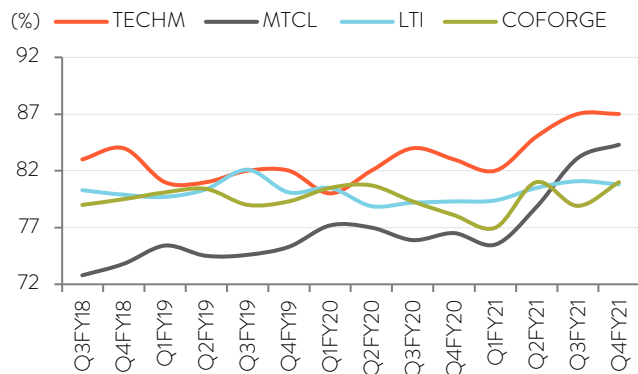
Source: Company, BOBCAPS Research

**FIG 4 – TIER-II MANUFACTURING STRENGTHENS**



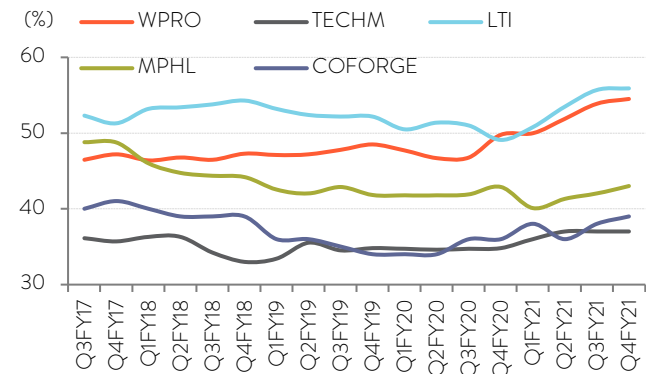
Source: Company, BOBCAPS Research | Tier II: LTI, MTCL, Coforge - (Manufacturing and Retail)

**FIG 5 – EBIT MARGIN HOLDS STEADY DRIVEN BY UTILISATION UPTICK...**



Source: Company, BOBCAPS Research

**FIG 6 – ...AND HIGHER OFFSHORING**



Source: Company, BOBCAPS Research

## Q4FY21 highlights

### Key surprises

- Coforge's robust FY22 guidance was the biggest positive surprise of Q4FY21, with the company expecting at least 17% CC organic growth (ex-inorganic revenues from SLK Global) and 19%+ margin for the organic business.
- Coforge's executable order book of US\$ 520mn as of Q4FY21 was its highest ever despite the fact that it has the largest exposure to the travel vertical (19% of Q4 sales) among peers.
- Mphasis' (MPHL) topline growth of 1.8% QoQ USD was far lower than our/street estimates. This was due to a growth slowdown in direct channel business and continued contraction in the DXC segment (-7.2% QoQ USD).
- TCS's Q4 deal win TCV of US\$ 9.2bn (+63% YoY, 50% QoQ) was a record high for the company and the sector. This sum included US\$ 3.9bn from the BFSI vertical and US\$ 1.4bn from retail.

### Cloud adoption remains a strong demand theme

Enterprises across B2B and B2C industries have been investing in digital transformation over the years. The onset of Covid-19 has led to a sharp acceleration in these investments and a rebalancing of the portfolio spend in favour of digital transformation over traditional business-as-usual IT. Cloud adoption is driving a multiyear technology spending cycle and is emerging as the new-age ERP.

Cloud is becoming the preferred computing platform for a large chunk of infrastructure and applications. Enterprises across sectors are investing in cloud to adapt to the new normal. This business is expected to remain an all-encompassing growth driver for the next three years at least. Consequently, companies such as TCS, LTI, HCLT (HCL Cloud Smart), MPHL and Infosys (INFO: Cobalt) have carved out multiple business units and fortified partnerships with large cloud hyperscalers to capitalise on the cloud-led growth opportunity.

### Scale of cloud business

- WPRO's cloud division forms a quarter of its revenue and continues to grow in high double digits.
- Coforge has a separate US\$ 100mn cloud services business.

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**Indian tech players setting up dedicated business units to leverage cloud-led demand**

## Cloud partnerships

- PSYS is working to deepen its associations with hyperscalers. Its largest customer IBM has separated its cloud framework through a 'cloud-pak' module which includes Red-Hat. PSYS' QoQ growth was led by cloud.
- MTCL has scaled up strategic partnerships with hyperscaler leaders such as Azure, Databricks, ServiceNow and Google Cloud.
- LTI has moved beyond the large cloud players via its partnership with Snowflake. It has also entered into a global partnership agreement with AWS to help accelerate cloud adoption by enterprises.

For most players, cloud demand is driving growth in the hi-tech vertical. TECHM is also working closely with hyperscalers to revive demand in many of its verticals. Several of its 5G deals are centered around cloud migration and modernising underlying cloud native architecture.

## Increased investments in Europe yielding results

In the wake of the pandemic, companies are looking to mitigate risks from a geographical standpoint. Demand in Europe is particularly strong owing to accelerated cloud adoption, digital transformation and a focus on cost optimisation by augmenting core efficiencies.

For TCS, Europe grew 8.9% QoQ USD in Q4FY21, the highest among all the company's markets. INFO has built numerous proximity centres in Europe which translated into six large deal wins from the region in Q4. WPRO's Europe revenues grew 5.4% QoQ USD, the highest among its geographies due to its acquisitions in the region. Coforge also plans to expand in Europe with its SLK Global deal. PSYS has appointed new business heads in the region and saw double-digit QoQ growth for the second consecutive quarter. The company is looking to expand its footprint and raise its Europe revenue share to at least 18% (15% in Q4).

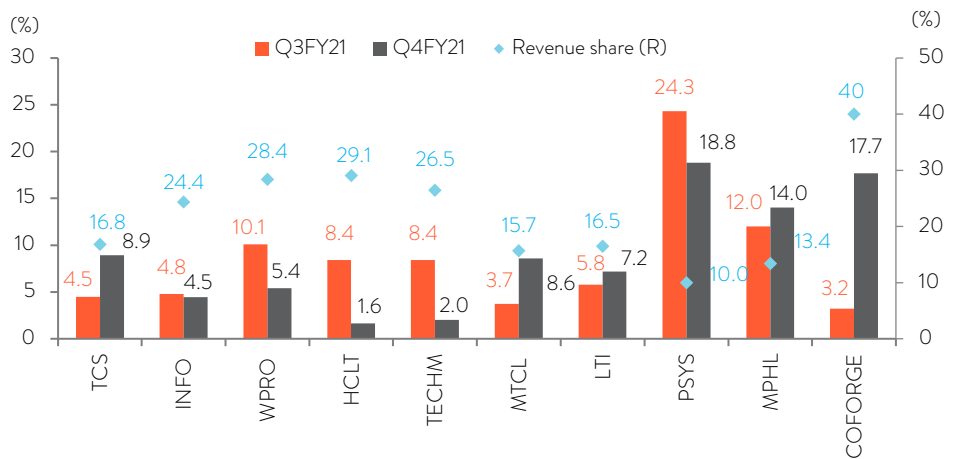
MTCL's investments have also started yielding results as the UK, Ireland and Continental Europe grew 8% QoQ in Q4. LTI's investment in Nordics SaaS has led to its first customer win in the region this quarter (selected by a pan-European financial services company to provide banking-as-a-service for its loan segment). For MPHL as well, Europe remains a key investment area where it has ramped up sales efforts. The company bagged one large deal in the region this quarter and its pipeline remains strong. It plans to add more delivery centres in eastern Europe.

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**QoQ growth from Europe has outpaced N. America over last three quarters for tier-I IT**

**Indian tech players continue to invest in Europe**

**FIG 7 – EUROPE REVENUE SHARE AND QOQ GROWTH**



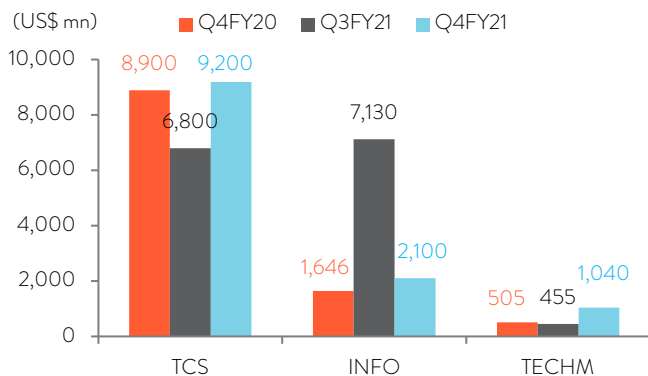
Source: Company, BOBCAPS Research

### Deal pipeline surpasses Q3 levels

TCS’s total order book in FY21 was worth US\$ 31.6bn, up 17% YoY. The company closed the year with its highest TCV of US\$ 9.2bn in Q4, comprising a mix of large and small contracts. Most deals are transformative in nature. For INFO, TCV was muted due to an exceptionally high base of US\$ 7.1bn in Q3FY21. WPRO had a good quarter with wins worth US\$ 1.4bn (12 large deals) including a mega >US\$ 1bn deal. HCLT bagged contracts worth US\$ 3.1bn composed of 19 transformational projects. TECHM’s TCV has crossed US\$ 1bn post Covid.

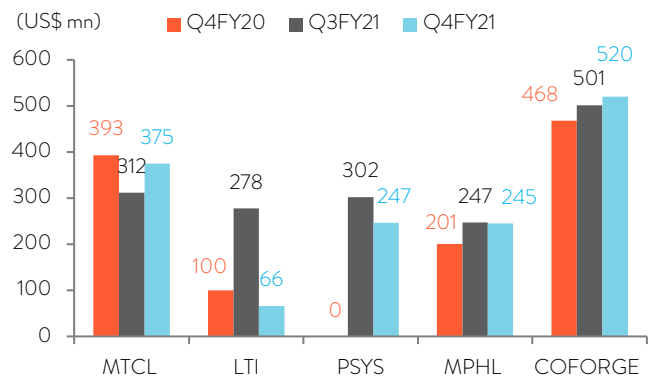
MTCL’s order book grew 20% sequentially in Q4. However, PSYS and LTI saw a decline in TCV QoQ. MPHL had four quarters of >US\$ 200mn net new TCV in FY21, closing the year at a strong US\$ 1.1bn on TTM basis (+55% YoY). Coforge’s executable order book of US\$ 520mn as of Q4FY21 was its highest ever, despite having 19% of revenues from the troubled travel vertical.

**FIG 8 – STELLAR TCV PERFORMANCE BY TIER-I...**



Source: Company, BOBCAPS Research | INFO – Large deal wins; TECHM and TCS – Overall order book

**FIG 9 – ...AND TIER-II PLAYERS**



Source: Company, BOBCAPS Research | MTCL, PSYS – Overall deal wins; LTI – Large TCV; Coforge – Executable order book; MPHL – New TCV

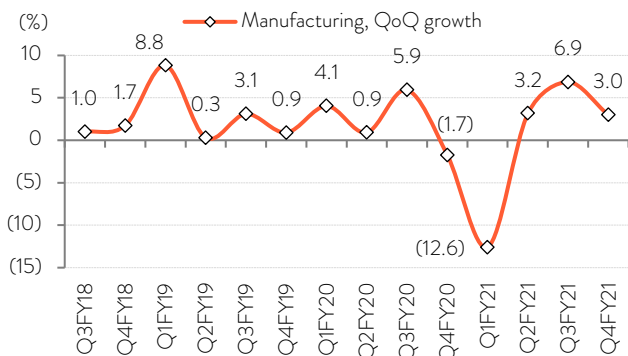
## Manufacturing and BFSI stay in the lead

### Recovery in manufacturing vertical continues

Some of the sectors worst affected by Covid-19 such as manufacturing, travel and retail are seeing traction from pent-up demand. Supply chain optimisation and omnichannel commerce have gained momentum post pandemic. During Q4FY21, INFO, LTI, TCS, MTCL and HCLT have all registered a significant uptick in manufacturing vertical revenues.

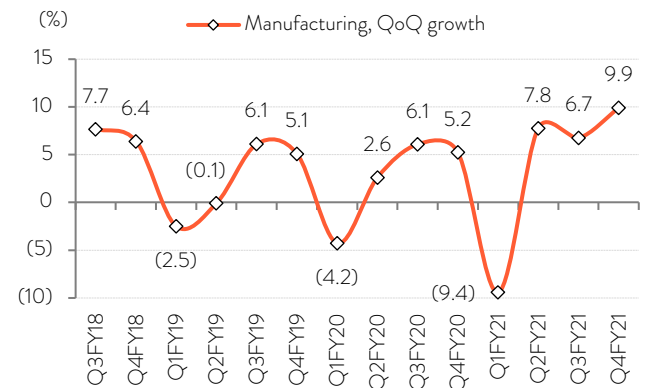
Manufacturing was the best performing vertical for INFO and MTCL in Q4 in terms of sequential growth, and the second best for TCS. HCLT bagged eight transformational deals during the quarter in this segment (including a large contract from UD Trucks, a Japanese automotive company.) TECHM has also seen two quarters (H2FY21) of steady growth in the manufacturing space. Overall, the automotive and industrial segments are picking up strongly as economies open up but aerospace recovery is some way off.

**FIG 10 – BROAD-BASED PICKUP IN MANUFACTURING VERTICAL REVENUE: TIER-I...**



Source: Company, BOBCAPS Research | Tier-I: TCS, INFO, HCLT, WPRO, TECHM

**FIG 11 – ...AND TIER-II**



Source: Company, BOBCAPS Research | Tier II: LTI, MTCL, Coforge - Manufacturing and Retail)

### BFSI has performed well; growth to continue

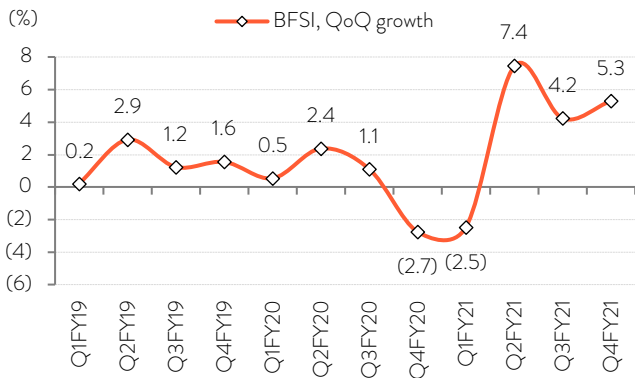
The BFSI vertical saw subdued sequential growth in Q3FY21 but only due to the seasonality impact. In Q4, however, BFSI has been at the forefront of digital transformation, attracting healthy demand in areas such as cloud adoption, core modernisation, cybersecurity, workspace modernisation, call centre modernisation, digital banking, insights and analytics (see our report: [Deep Dive 3 – Swift BFSI recovery ahead; raise TCS to BUY](#)). Other areas of strong demand include front-to-back digitisation, customer experience transformation, mortgage transformation and lending services.

For TCS, BFSI grew by a stellar 8.1% QoQ USD with a TCV of US\$ 3.9bn in Q4. INFO posted strong volume growth despite Q4 being a seasonally soft quarter and won six large deals in financial services. For WPRO, BFSI demand continues to be strong across subsegments. The Capco acquisition has also strengthened its position in the financial market globally. HCLT performed well in the vertical, winning four large deals. For TECHM, BFSI posted the highest QoQ growth among verticals.

Among tier-II companies as well, BFSI led the growth momentum. LTI bagged a large deal worth US\$ 45mn TCV for its Temenos T24 platform, with the new logo comprising one of the largest Islamic banks. PSYS' quarterly growth was led by BFSI and the company won a three-year core IT modernisation deal with a leading Fortune-25 financial services company.

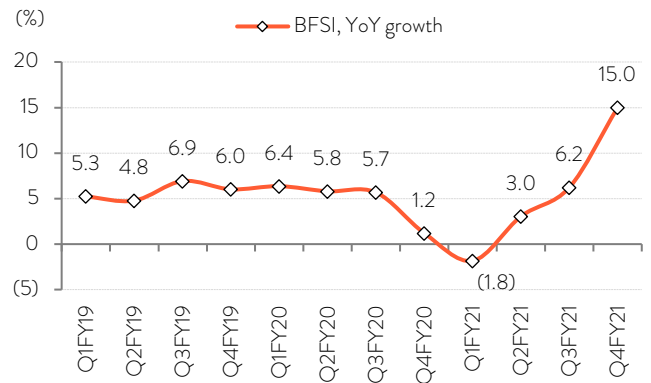
For Coforge, the financial services vertical now accounts for ~48% of revenue despite a 4.6% QoQ decline in Q4. Coforge expects BFS to rebound strongly in Q1FY22. MTCL was one of the few players to see muted growth in the space due to delayed closure of a few deals, though management has a positive outlook for upcoming quarters. MPHL saw QoQ contraction in its banking and capital markets segment (-4.3% QoQ USD).

**FIG 12 – TIER-I: QOQ BFSI GROWTH UPTICK**



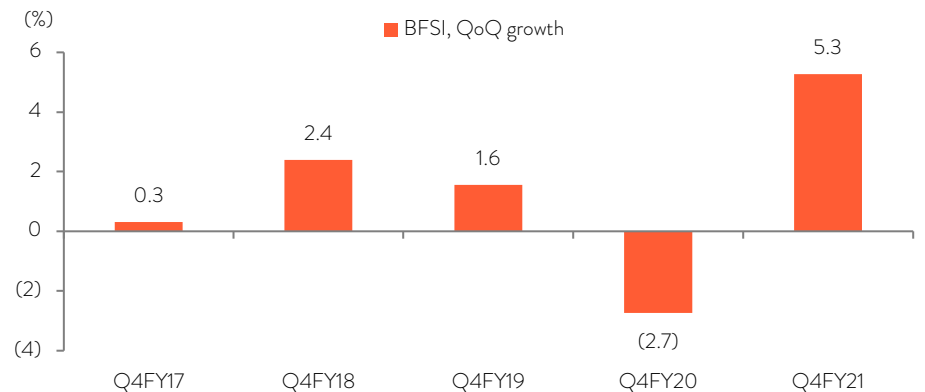
Source: Company, BOBCAPS Research

**FIG 13 – TIER-I: YOY BFSI GROWTH UPTICK**



Source: Company, BOBCAPS Research

**FIG 14 – IT SECTOR: SIGNIFICANT RISE IN Q4FY21 BFSI GROWTH QOQ**



Source: Company, BOBCAPS Research



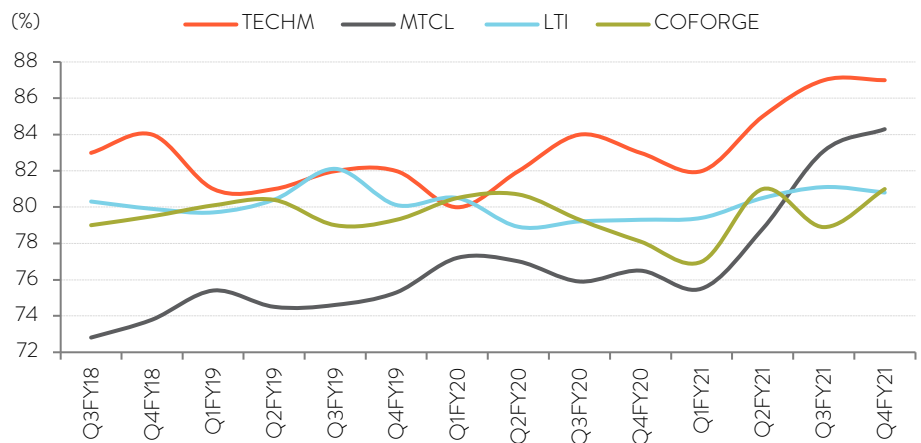
## Healthy margin levers

Besides good topline growth, the operational efficiencies that aided EBIT margins in Q4FY21 comprised improved utilisation, control over subcontracting costs, and lower travel and branding costs.

## Utilisation remains at peak levels

Utilisation has held at peak rates for most companies – these levels picked up in Q1 and Q2FY21 due to work-from-home trends, but in Q4 the uptick was mostly led by the demand surge. TECHM, MTCL and Coforge have surpassed their utilisation peaks of Q3FY21. Most managements are aware that current levels are unsustainable and have started to recruit ahead of the curve to backfill higher attrition and create capacity for future demand.

**FIG 15 – UTILISATION AT PEAK LEVELS**

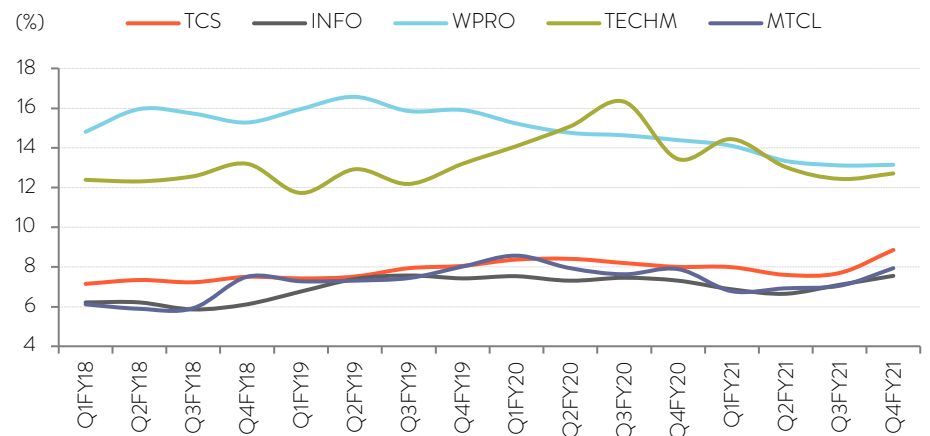


Source: Company, BOBCAPS Research

## Subcontracting costs inching up

Subcontracting costs as a percentage of sales have started moving up again after a lull of two quarters, mostly because of increased demand and a gradual buildup of supply-side pressures.

**FIG 16 – SUBCONTRACTING COST AS PERCENTAGE OF SALES RISING AS SUPPLY PRESSURE MOUNTS**

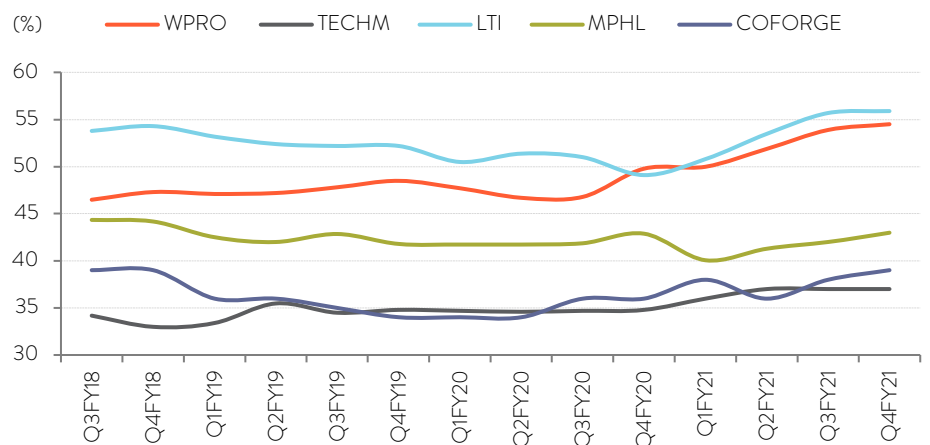


Source: Company, BOBCAPS Research

**Increase in offshoring**

Offshoring-led topline growth will remain a margin tailwind in the near future. Work-from-home has led to a larger portion of work being done offshore, with clients becoming more amenable to global delivery. Currently, companies are able to pitch up to 90-95% offshoring in deals, thereby making them sustainable. During to the pandemic stretching into FY22, offshoring is expected to continue and travel costs are likely to remain low as well.

**FIG 17 – PICKUP IN OFFSHORING POST PANDEMIC**



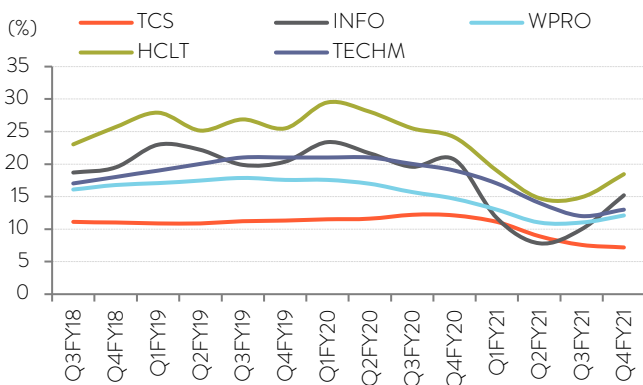
Source: Company, BOBCAPS Research

### Supply pressure building up

Most companies (except TCS, MTCL, LTI and Coforge) saw a sequential increase in attrition in Q4FY21. TCS continues to have the lowest attrition among all companies despite the ongoing talent war. This uptick was expected as demand surged and a multiyear technology upcycle ensued amid the pandemic. Stretched utilisation rates were also a contributing factor.

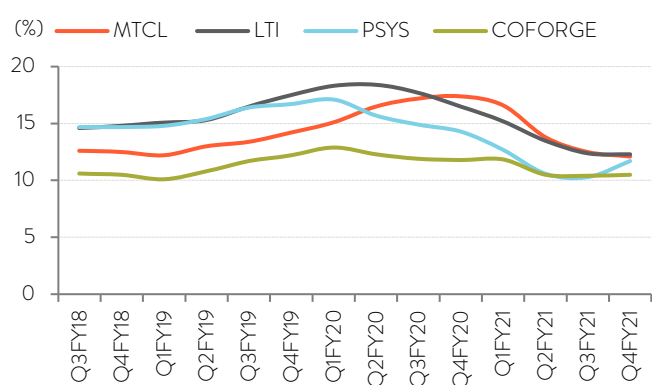
To combat this, many firms such as INFO (second wage hike in Jul'21) have announced another round of salary hikes in FY22 on top of the increments given in Q4. A majority of IT players are giving out wage hikes over a three-quarter duration. Coforge gave one-time bonuses in Q4 on top of hikes in Q3. TECHM has reinstated variable pay from Q4 and started skill-based allowances to stem attrition.

**FIG 18 – QOQ ATTRITION CLIMBING FOR TIER-I...**



Source: Company, BOBCAPS Research

**FIG 19 – ... AND TIER-II PLAYERS**



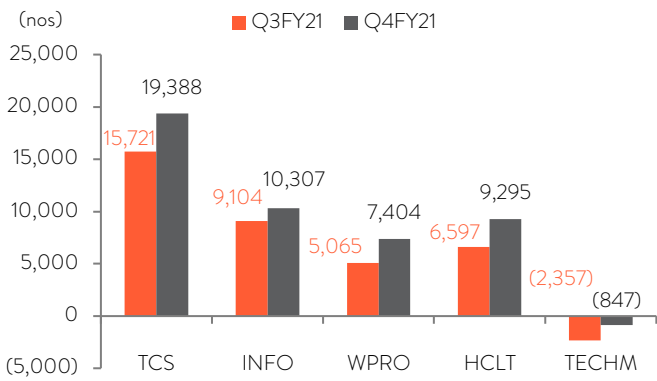
Source: Company, BOBCAPS Research

### Record hiring amid talent crunch

Barring TECHM, all companies have ramped up hiring QoQ, whether they saw an increase in attrition or not, in order to safeguard against employee shortage and backfill for potential departures. TCS, WPRO, HCLT, PSYS, MTCL, LTI and Coforge all had their highest QoQ net headcount additions ever in Q4. LTI is planning for significant hiring in the next quarter too while HCLT is recruiting in additional locations such as Vietnam, Sri Lanka and the Philippines.

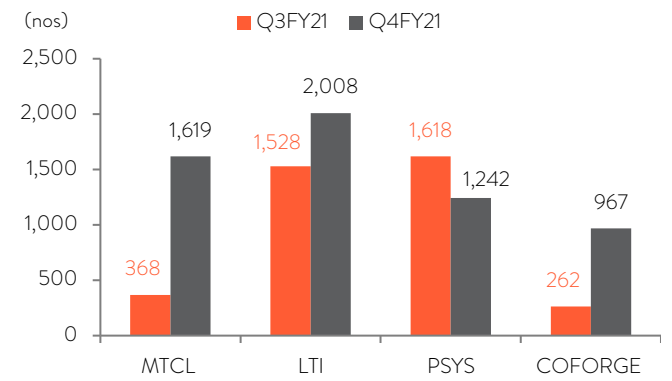
Most companies concur that the net additions are in alignment with their order booking and deal momentum and not in excess of requirement. TECHM is the only company to have pared its headcount in Q4.

**FIG 20 – QOQ NET HEADCOUNT ADD FOR TIER-I...**



Source: Company, BOBCAPS Research

**FIG 21 – ...AND TIER-II**



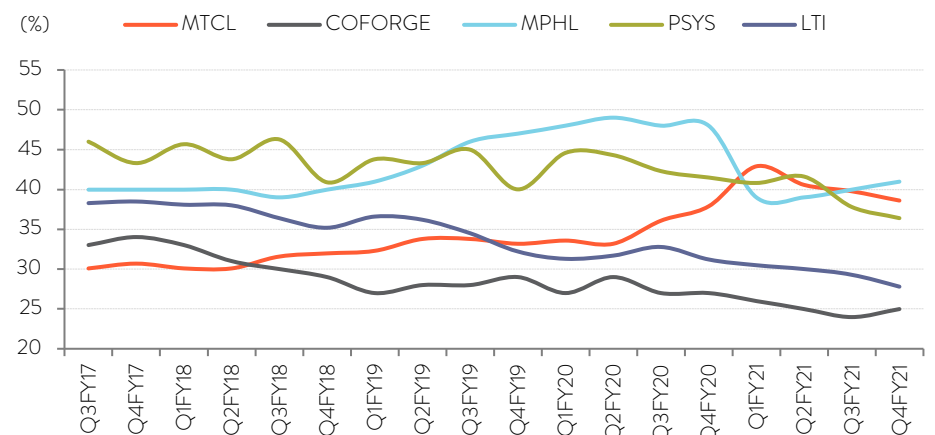
Source: Company, BOBCAPS Research

### Improvement in other key metrics

#### Derisking the client base

Most mid-caps have seen a derisking of the revenue mix. Coforge has been reducing client concentration since Q2FY20. Its top accounts now have fewer travel clients and the travel vertical formed just 19% of Q4FY21 revenue vs. 27% in Q4FY20 at the start of the pandemic. Following a spike in top-5 client concentration in Q1FY21 because of increased work on collaborative tools from its top account, MTCL has been able to rein this risk in over the last three quarters. LTI and PSYS have also consistently pared their client concentration levels.

**FIG 22 – CLIENT CONCENTRATION (TOP-5) COMING DOWN**

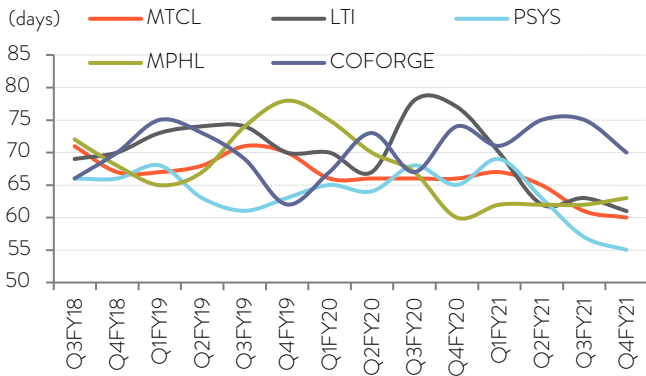


Source: Company, BOBCAPS Research

### Improved DSO levels

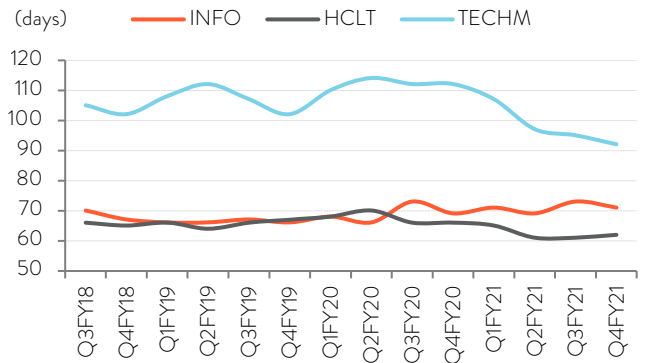
Post Covid-19, better cash conversion has resulted in improved DSOs across the sector. Some of this was due to reduced working capital needs. Even TECHM, which usually has one of the highest DSOs, posted its lowest levels in 17 quarters at 92 days in Q4.

**FIG 23 – DSO FOR SMALL-CAPS**



Source: Company, BOBCAPS Research

**FIG 24 – DSO FOR LARGE-CAPS**



Source: Company, BOBCAPS Research

## Annexure A: Peer comparison

**FIG 25 – PEER COMPARISON**

Company	Rating	Target Price (Rs)	US\$ revenue CAGR FY21-23E (%)	EPS (Rs)		ROE (%)		Target P/E (x)
				FY22E	FY23E	FY22E	FY23E	
TCS	BUY	3,780	17.2	118	135	44.2	40.7	28
INFO	ADD	1,540	13.1	56	59	30.4	30.3	26
HCLT	BUY	1,190	11.9	55	63	22.6	23.1	19
TECHM	BUY	1,190	15.0	64	76	21.1	22.3	16
LTI	BUY	4,710	17.5	132	155	29.1	28.8	30
MPHL	SELL	1,580	12.9	80	94	22.0	23.8	17
PSYS	SELL	1,340	15.0	63	70	17.1	16.9	19
COFORGE	BUY	4,080	23.2	132	163	25.2	26.2	25

Source: BOBCAPS Research

## Disclaimer

### Recommendation scale: 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)

Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

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