

IT SERVICES

18 June 2020

Deep Dive 2: Telecom tech spends resilient – upgrade TECHM

Global 5G rollout is estimated to offer a mega US\$ 10bn business opportunity for Indian IT players. As against consensus apprehensions of widespread 5G delays post-pandemic, roadmaps for network rollout in the US and China are on course. Top US telco players with >95% market share have reaffirmed 5G investment commitments. We are upbeat on prospects for Tech Mahindra (TECHM) given its highest telecom exposure among large-cap IT at 42%, which leads us to raise FY21/ FY22 EPS by 5%/7%, increase our TP to Rs 690 and upgrade the stock to BUY.

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US, China on track in 5G race despite Covid-19: In our view, the street has overestimated Covid-led 5G capex delays and thus misjudged telecom tech spending trends. Telecom's status as an essential service has ensured uninterrupted 5G network building. Barring Europe which could see delays, the 5G roadmap in early mover countries is largely on track: (1) US – AT&T, Verizon and T-Mobile (+Sprint) who collectively account for 95%+ market share have indicated timely 5G network progress. (2) China has doubled down on national network deployments targets for CY20 backed by a forceful central government push.

Telecom sector resilient: Telecom is a relatively defensive sector in the current environment and hence telecom technology spends will be resilient, in our view. Operators across geographies have pointed to a benign impact on the low-margin handset business and on roaming charges. At the same time, the sudden shift to online sales channels and negligible customer churn due to the lockdown will aid operating margins. Our view of sustained technology spends in the sector is validated by Gartner who sees positive traction in telecom tech spending in the short and long term due to Covid-19.

Upgrade TECHM to BUY: TECHM has the highest telecom exposure among large-caps at 42% of revenue and hence would benefit the most from healthy 5G spends. We raise FY21/FY22 EPS for the company by 5%/7%, revise our Mar'21 TP to Rs 690 (Rs 570 earlier), and upgrade the stock from REDUCE to BUY on attractive valuations. Our FY22 EPS estimates are 10% above Bloomberg consensus. After correcting 29% in 2020 YTD, valuations at 12.6x/9.7x FY21E/ FY22E P/E factor in near-term operational weakness.

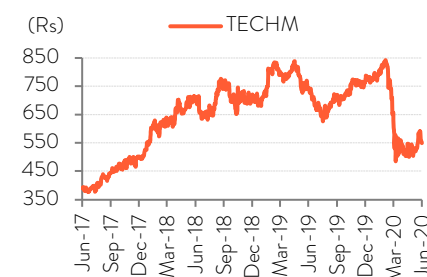
We revise USDINR assumptions for our coverage universe to Rs 76.5/Rs 78 for FY21/FY22 (from Rs 75/US\$ earlier) and accordingly adjust our EPS estimates by –6% to +12% and reset our target prices, but keep ratings unchanged.

RECOMMENDATION SNAPSHOT

Ticker	Price	Target	Rating
TCS IN	2,048	2,160	ADD
INFO IN	704	760	ADD
WPRO IN	218	170	SELL
HCLT IN	576	680	BUY
TECHM IN	535	690	BUY
LTI IN	1,880	2,230	BUY
MPHL IN	840	780	SELL
MTCL IN	906	880	REDUCE
HEXW IN	315	350	ADD
PSYS IN	594	590	REDUCE
NITEC IN	1,335	1,430	ADD
ECLX IN	434	420	REDUCE

Price & Target in Rupees

TECHM – STOCK PERFORMANCE

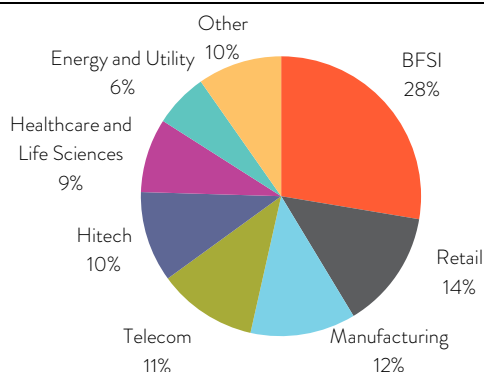


Source: NSE



Focus charts

FIG 1 – TELECOM CONTRIBUTES ~10% OF REVENUE FOR TOP 5 IT PLAYERS



Source: BOBCAPS Research

FIG 3 – US LARGE TELCOS WITH 95%+ MARKET SHARE WELL ON TRACK FOR 5G

	Market share by subscribers (%)	CY19 Capex (US\$bn)
AT&T	46	19.6
Verizon	23	17.9
T-Mobile (+ Sprint)	30	18.7
U.S. Cellular	1	0.7

Source: Company, BOBCAPS Research | ■ On Track ■ Delayed

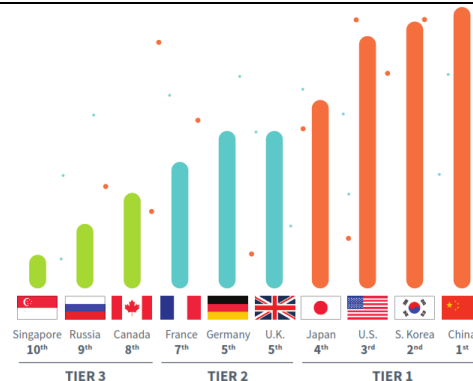
FIG 5 – GARTNER VALIDATES OUR VIEW OF LIMITED IMPACT ON TECH INVESTMENT IN TELECOM VERTICAL

TSP Industry Impacts on Technology Investment due to Covid-19

Industry	Short-term impact of tech investment	Long-term impact of tech investment
Banking and Securities	Negative ↓	Uncertain ↔
Communications	Positive ↑	Positive ↑
Education	Positive ↑	Positive ↑
Public Sector	Positive ↑	Positive ↑ Negative bias
Healthcare	Positive ↑	Positive ↑ Negative bias
Insurance	Negative ↓	Uncertain ↔
Manufacturing	Negative ↓	Uncertain ↔
Retail	Negative ↓	Uncertain ↔ Negative bias
Transportation	Negative ↓	Negative ↓

Source: BOBCAPS Research

FIG 2 – US AND CHINA FORERUNNERS FOR 5G



Source: CTIA, BOBCAPS Research | Note: Above chart ranks countries on 5G readiness efforts

FIG 4 – 5G CAPEX COMMENTARY OF LARGE US TELCOM OPERATORS INDICATES STEADY ROLLOUT

"Our 5G deployment continues. We now cover more than 120 million people in 190 markets, and we expect we'll be nationwide this summer. We will continue investing in our critical growth areas like 5G, broadband and HBO Max."

- Chairman & CEO, **AT&T Inc.** (Apr 20)

"We were a little bit ahead of plan when we ended the first quarter. And can I report that today, we are still on plan with the 5G and fibre. 5G is still very much the centre of our strategy. And as you heard me saying before, we're in the middle of the execution, and we're not halting that."

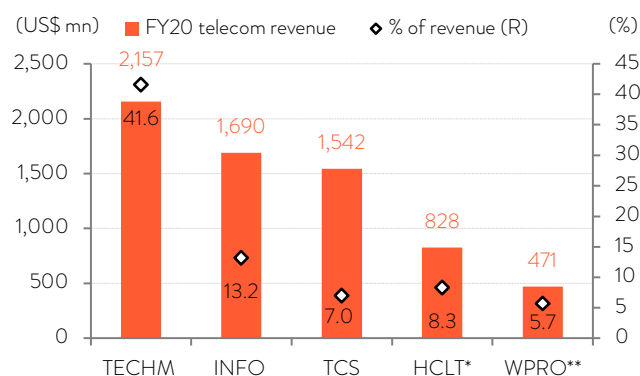
- Chairman & CEO, **Verizon Communications Inc.** (Apr 20)

"We're moving quickly (on the 5G roadmap). More importantly, as we look forward, we will launch and build out and lay 2.5-gigahertz spectrum across thousands of sites in 2020. The rollout of 2.5GHz is going to move super super-quick. So, we've managed through Covid..."

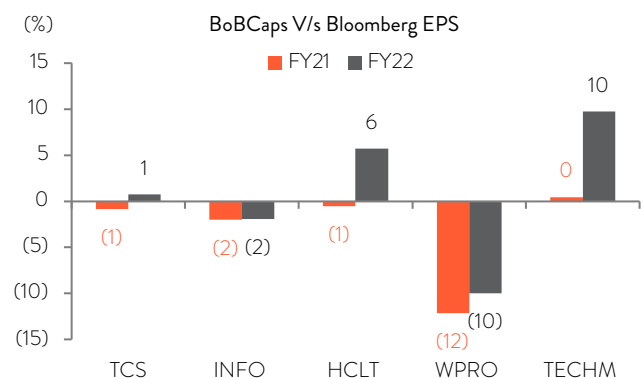
- President Technology, **T Mobile** (May 20)

Source: Company, BOBCAPS Research

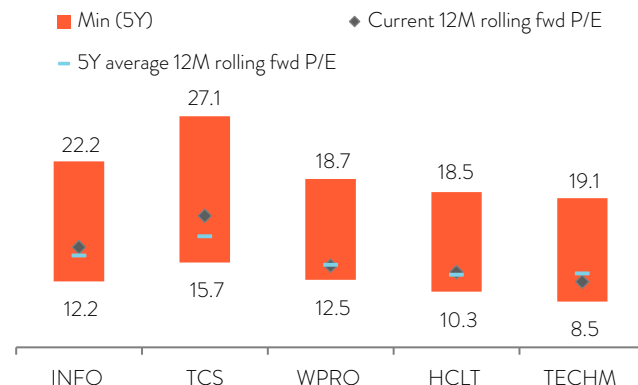
FIG 6 – TECHM HAS HIGHEST EXPOSURE TO TELECOM VERTICAL



Source: BOBCAPS Research | *HCLT = Telecommunications, Media, Publishing & Entertainment, **Wipro = Media and Telecom

FIG 7 – WE BAKE IN SWIFTER POST-COVID RECOVERY FOR TECHM


Source: Bloomberg, BOBCAPS Research

FIG 8 – TECHM ONLY TOP 5 COMPANY TRADING AT DISCOUNT TO 5Y AVERAGE P/E


Source: Bloomberg, Company, BOBCAPS Research

FIG 9 – PREFER HCLT AND TECHM AMONG LARGE CAPS AND LTI AMONG MID CAP IT PLAYERS

Company	CMP (Rs)	Mkt Cap (US\$ bn)	Rating	Target Price (Rs)	US\$ revenue CAGR FY20-22E (%)	EBIT CAGR (%) FY20-22E	EPS (Rs)		P/E (x)		ROE (%)	
							FY21E	FY22E	FY21E	FY22E	FY21E	FY22E
TCS	2,048	101.1	ADD	2,160	2.7	10.5	83.4	102.7	24.5	20.0	33.7	34.7
INFO	704	40.3	ADD	760	1.7	8.3	37.1	41.9	19.0	16.8	23.1	23.7
WPRO	218	16.4	SELL	170	(1.2)	0.1	13.6	15.3	16.0	14.2	13.6	13.6
HCLT	576	20.6	BUY	680	4.2	9.7	40.3	48.2	14.3	11.9	20.1	21.5
TECHM	535	6.1	BUY	690	2.4	17.7	42.5	55.3	12.6	9.7	16.1	19.0
LTI	1,880	4.4	BUY	2,230	8.3	15.9	93.1	109.3	20.2	17.2	27.8	27.8
MPHL	840	2.1	SELL	780	3.6	10.0	54.6	71.2	15.4	11.8	16.8	20.1
MTCL	906	2.0	REDUCE	880	3.3	23.9	43.7	53.9	20.7	16.8	21.4	23.2
HEXW*	315	1.3	ADD	350	5.3	4.7	19.8	22.1	15.9	14.3	20.2	19.5
PSYS	594	0.6	REDUCE	590	5.3	27.9	37.7	52.8	15.7	11.3	11.7	15.0
NITEC	1,335	1.1	ADD	1,430	5.7	16.8	82.5	106.2	16.2	12.6	18.1	20.5
ECLX	434	0.2	REDUCE	420	2.3	4.6	42.9	59.0	10.1	7.4	11.8	15.4

Source: BOBCAPS Research | Prices as on 17th Jun 2020 | *FY21 refers to CY20 for Hexaware and so on

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Telecom tech spends resilient

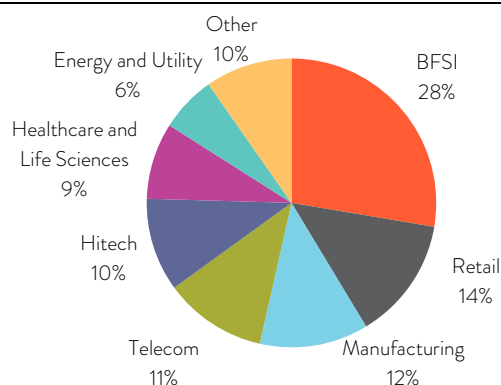
Following our analysis of [Retail IT spends amid the pandemic](#), the second report in our 'Deep Dive' series examines shifting trends in the global Telecom industry and the impact on technology budgets. For Indian IT players, 5G networks offer a mega US\$ 10bn business opportunity over the next six years. We take a closer look at 5G capex progress amid the Covid-19 crisis, the pandemic-led impact on telecom players, and 5G-driven growth opportunities for Indian IT players.

Among our key findings are that (1) global investments in 5G technology and infrastructure, especially in China and the US, remain uninterrupted despite the pandemic, and (2) in the current environment, tech spending in the telecom sector will fare better than other verticals.

Telecom forms 10% of revenue for top 5 IT players

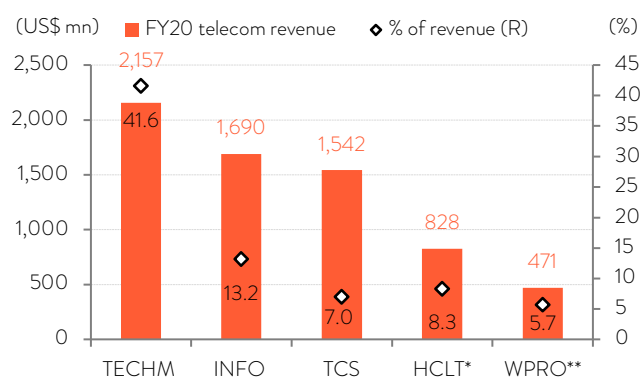
Telecom is the fourth largest vertical for Indian IT companies after BFSI, retail and manufacturing, and accounts for ~11% of revenue for the top 5 players (TCS, INFO, HCLT, WPRO and TECHM). Among large-caps, TECHM has the highest telecom exposure at 42% of revenue (FY20). INFO and TCS follow at 13% and 7% respectively. For mid-caps under our coverage, telecom is a relatively smaller revenue contributor – possibly due to the peculiarity of the telecom industry which is dominated by a few large service providers in a given country or region.

FIG 10 – TELECOM VERTICAL CONTRIBUTES 11% OF REVENUE FOR TOP 5 INDIAN IT COMPANIES



Source: Company, BOBCAPS Research

FIG 11 – TECHM HAS HIGHEST EXPOSURE AT 42%



Source: Company, BOBCAPS Research | *HCLT = Telecommunications, Media, Publishing & Entertainment, **Wipro = Media and Telecom

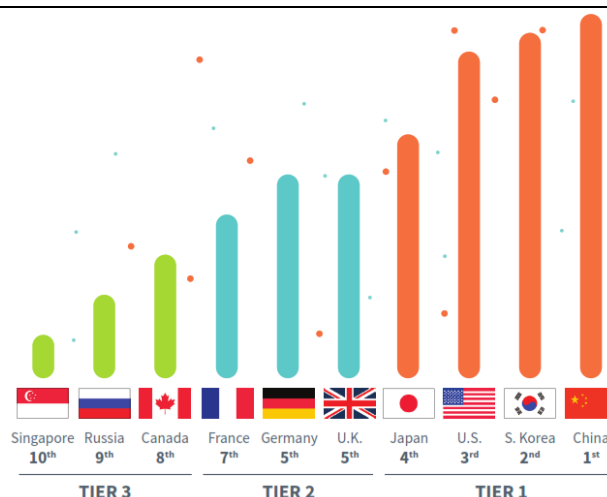
Global 5G capex progressing well despite Covid-19

Street overestimating 5G capex delays

Street overstating 5G capex delays and thus misjudging telecom tech spending trends

In our view, the street has overestimated delays in 5G capex across the globe from Covid-led lockdowns and logistical challenges, and thus misjudged telecom tech spending trends. We note that the 5G roadmap in early-mover countries remains largely on track even as telecom service providers have reworked strategies in response to the pandemic. The US, China, Japan, South Korea and Singapore are all seeing timely 5G adoption owing to their ahead-of-the-curve investments and the telecom sector's 'essential service' tag which minimises disruptions in times of lockdown.

FIG 12 – US AND CHINA ARE FORERUNNERS IN 5G RACE



Source: CTIA, BOBCAPS Research. Note: Above chart ranks countries with developed wireless markets across key factors to compare current 5G readiness efforts. Countries were evaluated based on spectrum and infrastructure policies, industry investment, and overall government support

5G rollouts resilient in the US

Top US telco players have reconfirmed 5G investment commitments

The 5G roadmap in the US remains on course despite the pandemic. Industry experts forecast CY20 to be a year of strong 5G spending in the country as service provider T-Mobile/Sprint capitalises on its spectrum leadership and AT&T and Verizon invest in mmWave capacity (for ultra-fast 5G speeds) and low-band 5G coverage. AT&T, Verizon and T Mobile (+Sprint) who collectively account for over 95% of market share in the US have indicated that they are largely on track with 5G network progress.

FIG 13 – US 5G CAPEX ON TRACK

	Market share by subscribers (%)	CY19 Capex (US\$bn)	5G capex status
AT&T	46	19.6	On track for 5G rollout
Verizon	23	17.9	On track for 5G rollout
T-Mobile (+ Sprint)	30	18.7	On track for 5G rollout
U.S. Cellular	1	0.7	Indicated some delays

Source: Company, BOBCAPS Research.

FIG 14 – 5G CAPEX COMMENTARY OF LARGE US TELCOM OPERATORS

“Our 5G deployment continues. We now cover more than 120 million people in 190 markets, and we expect we’ll be nationwide this summer. We will continue investing in our critical growth areas like 5G, broadband and HBO Max.”

- Chairman & CEO, **AT&T Inc.** (Apr 20)

“We were a little bit ahead of plan when we ended the first quarter. And can I report that today, we are still on plan with the 5G and fibre. 5G is still very much the centre of our strategy. And as you heard me saying before, we’re in the middle of the execution, and we’re not halting that.”

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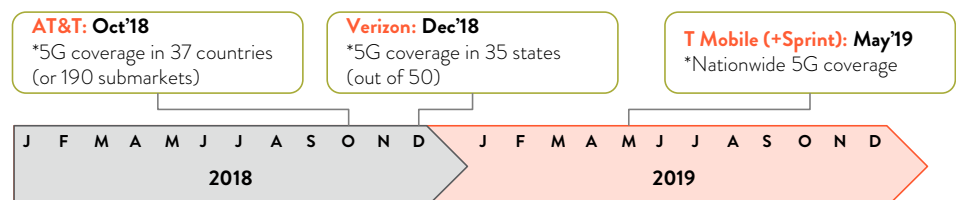
“We’re moving quickly (on the 5G roadmap). More importantly, as we look forward, we will launch and build out and lay 2.5-gigahertz spectrum across thousands of sites in 2020. The rollout of 2.5GHz is going to move super super-quick. So, we’ve managed through Covid...”

- President Technology, **T Mobile** (May 20)

Source: Company, BOBCAPS Research

In the race for technological supremacy against China, US telcos, the Federal Communications Commission (FCC) and the government began investing in 5G from 2016. That year, the FCC rolled out the 5G Fast Plan to accelerate deployment of high-speed broadband in rural America, which culminated in its third auction of 5G spectrum towards the end of 2019. The US government also paid ~US\$ 10bn to satellite providers to fast track the auction of 5G C-Band spectrum by 2023 which ensures superior download speeds.

Early investments have ensured resilient network rollout despite pandemic effects. AT&T, Verizon and T-Mobile started deploying 5G in 2019. While Verizon and AT&T have dominated 5G auctions, T-Mobile has already rolled out 5G wireless coverage in all US states. Recently, T-Mobile and GCI have announced a historic partnership, bringing in a larger umbrella of customers for 5G services.

FIG 15 – TOP US TELCOS HAVE LAUNCHED COMMERCIAL 5G


Source: Company, BOBCAPS Research | *Current 5G status

China has advanced 5G targets

China has doubled down on national network deployments targets for CY20

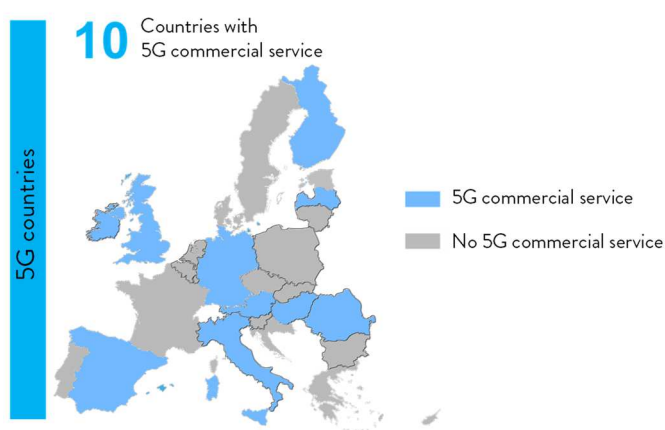
In a bid to leapfrog past the US and Europe, China has doubled down on its national 5G network deployments targets for CY20 backed by a central government push (and a potential Covid-19 stimulus package). Rapid network rollouts are also targeted at enabling industrial automation to help Chinese corporates cope with coronavirus restrictions and unlock new consumption-led opportunities.

As of March-end, China had ~198,000 5G base stations and 50mn 5G users. The three state-owned telecoms operators have already awarded nearly US\$ 10bn worth of 5G contracts and are projected to collectively spend US\$ 25.5bn on related equipment throughout 2020, installing half a million base stations that will provide coverage to every city in China.

Europe an outlier – will see spectrum auction delays

Before the onset of Covid-19, most operators in Europe had adopted a wait-and-watch approach for 5G adoption. Due to this, the pandemic has significantly affected 5G rollouts in Europe. Austria's TTK (Telecom Control Commission) has decided to postpone 5G spectrum auctions. Portugal's ANACOM and France's Arcep have also indicated that telecom operators are desirous of deferring auctions due to the pandemic. In the Czech Republic, the auction of 5G frequencies will now take place only post H1FY20.

FIG 16 – 5G COMMERCIAL LAUNCH IN SELECT CITIES OF JUST 10 EUROPEAN COUNTRIES



Source: IDATE Digiworld, European 5G Observatory (till Mar'20), BOBCAPS Research.

FIG 17 – 5G AUCTIONS DELAYED IN 17 EUROPEAN COUNTRIES

Sr. No.	Country	Sr. No.	Country
1	Austria	10	Greece
2	Belgium	11	Ireland
3	Bulgaria	12	Latvia
4	Croatia	13	Lithuania
5	Cyprus	14	Romania
6	Czech Republic	15	Slovenia
7	Denmark	16	Spain
8	Estonia	17	Russia
9	France		

Source: European 5G Observatory, BOBCAPS Research

OEM commentary confirms divergence of early movers vs. laggards

Commentary from large telecom/5G equipment manufacturers such as Nokia, Samsung, Ericsson and Qualcomm confirms the global 5G trends discussed above: (1) the US 5G roadmap remains largely on course, (2) China has accelerated 5G deployments post Covid-19, and (3) Europe rollouts could see delays.

FIG 18 – GLOBAL TELECOM OEM COMMENTARY ON 5G TRENDS

- As we look to the second half of calendar 2020, while there are a few regions with minor delays in 5G network deployments, overall 5G is progressing as planned and we continue to be well positioned to drive the rapid adoption of 5G globally.
- In the month of Mar'20, 30% of the devices that were sold into the channel were 5G devices. 71% of all models launching in China are 5G.

Qualcomm

- The Covid-19 impact is hard to assess. On the one hand, globally, we see a number of countries actually accelerating investments into 5G as well as 4G capacity in response to the pandemic. One of the cases is clearly China.
- But if you look at Europe, it's doing the opposite, slowing down adoption of 5G.

Ericsson

- In countries such as the US and India, especially due to the lockdown brought on by Covid-19, installation of 5G base stations as well as auctioning of 5G frequencies are being delayed.
- Europe is also seeing a delay in terms of the 5G frequency auctions and commercialisation schedules.
- Covid-19 has greatly increased market uncertainties and it is difficult to determine the timing or stable economic recovery.
- If the Covid-19 impact expands or becomes more prolonged, carriers both in Korea and overseas may decide to delay some of their 5G investments.

Samsung

- Coronavirus has led to a sales decline of 200mn euros in the first quarter.
- There could be 5G deployment delays in certain European countries as a result of the coronavirus.

Nokia

Source: Company, BOBCAPS Research

5G to unlock opportunities for Indian IT vendors but with a lag

5G and related services offer a trillion-dollar market opportunity globally, with investments expected to continue till 2035. For Indian IT players, 5G networks could translate into a US\$ 10bn incremental opportunity in the areas of infrastructure outsourcing, data centre management, switching and billing system operations. The biggest commercial use of 5G will be in the areas of manufacturing, IoT and smart/connected ecosystems.

Key 5G markets

- **Manufacturing:** Mobile 5G technology will allow for higher flexibility, lower cost, and shorter lead times for factory floor production reconfiguration, layout changes, and alterations. The technology's high-capacity, wireless flexibility and low-latency performance make it a natural choice to support manufacturers. Due to low latency (i.e. minimal delays in data processing offering near real-time information), 5G could allow manufacturers to scale up their robotic work forces.
- **IoT:** The 5G spectrum expands the frequencies on which digital cellular technologies transfer data and hence will play an important role in the Internet of Things, by offering faster networks with higher capacities that serve connectivity needs.
- **Smart devices:** In Industry 4.0, connected devices will be able to sense their environments and interoperate with each other, making decentralised decisions. Many expect this transformation to rely on the underlying capabilities of next-generation 5G networks.
- **Augmented/virtual reality:** With its low latency (~1ms) and high bandwidth, 5G will give a real push to augmented reality and virtual reality. These technologies will pave new ways of working in manufacturing, gaming, automotive and healthcare post-pandemic.

Changing nature of telecom outsourcing deals

The nature of telecom outsourcing deals has shifted to business enablement rather than just cost saving. IT services can help bring expertise around digital engagement for telcos with artificial intelligence and automation, enterprise modernisation and hybrid cloud services. With the onset of 5G, most telecom players will start efforts to move networks to the cloud, opening up a large market for IT players.

Rise of edge computing

With an exponential rise in download speed and lower latency, the amount of data generated from 5G networks will be massive. This will lead to the advent of edge computing which enables localisation of data and efficient data processing through distributed cloud systems. With edge computing architecture, complex event processing can take place in the device or a system close to the device, eliminating round-trip snags and enabling faster action.

Currently 10-15% of enterprise generated data is created and processed outside a traditional data centre or cloud. By 2022, Gartner expect this figure to reach 75%. This presents enormous opportunities for IT service providers in the areas of cloud deployment and securing cloud migration deals from telecom players. TECHM's cloud migration, network application and shared system modernisation deal worth US\$ 1.3bn with AT&T for the initial stage of 5G implementation is a benchmark in this respect.

Network virtualisation leading the way for Edge Cloud implementation

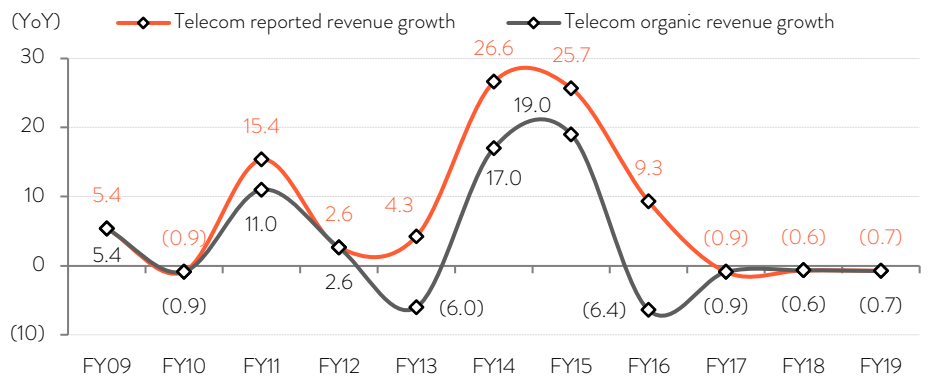
Network function virtualisation (NFV) helps network operators to manage and expand network capabilities on demand using virtual, software-based applications in place of physical boxes that once stood in the network architecture. Deploying NFV can help save capex costs by at least 10%.

For 5G telcos, the need will be to deploy virtualised infrastructure network running on edge computing, replacing dedicated hardware elements. Hence, for 5G rollout, network transformation and edge cloud distribution need to go hand in hand. NFV is currently being offered by OEMs and has already seen adoption by the likes of Verizon and AT&T. NFV will create more demand for cloud adoption, driving growth for cloud vendors and IT players.

Last cycle indicates growth lag for IT services players

Typically, we observe a lag of a couple of years between spectrum auction of a new generation technology and its outsourcing to IT players. Telcos first set up the requisite hardware and software, and thereafter turn to IT service providers to manage and run them. Hence, OEMs such as Nokia, Ericsson and Samsung usually have the opportunity to participate in the rollout phase early on. Later on, IT firms step in to offer IoT platforms, data analytics solution and cloud migration of data as a part of managing the network. This usually happens during the peak of technology adoption.

FIG 19 – TECHM SAW HIGHEST TELECOM REVENUE GROWTH DURING PEAK OF 4G CAPEX CYCLE



Source: BOBCAPS Research

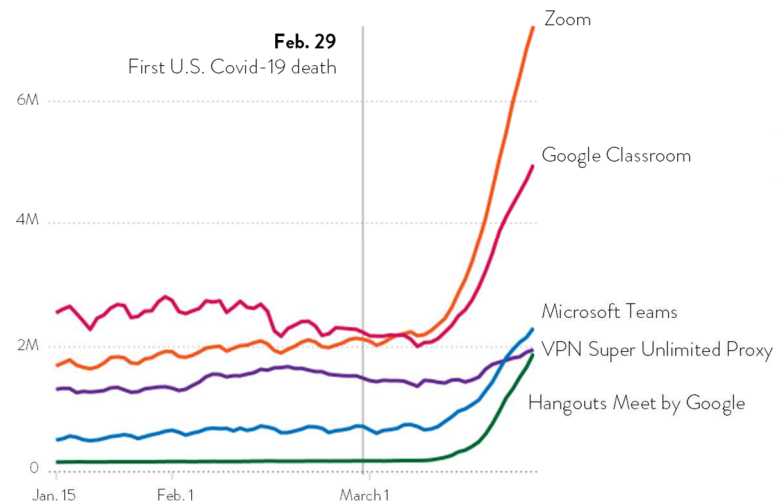
Telecom resilient in current challenging times

Covid-19 fuelling increased reliance on telecom sector

Telecom has been among the key industries enabling the successful shift of critical services to work-from-home for most companies in the pandemic-hit world. The increased use of collaborative apps has led to a surge in data usage. Streaming platforms have seen viewership increase by 20% post Covid across the world. As per Cellular Operators Association of India, there was a 30% jump in traffic towards March-end. Telcos in India have seen a 15-22% surge in demand for data after the lockdown.

FIG 20 – LOCKDOWN LED TO SUDDEN INCREASE IN REMOTE WORKING APP USAGE

Daily app sessions for popular remote work apps



Source: Apptopia, BOBCAPS Research

Telecom a resilient pocket – industry experts validate our view

Telcom is a relatively defensive sector in the current environment and accordingly telecom technology spends will be resilient, in our view. Operators across geographies have pointed to a benign impact on the low-margin handset business and on roaming charges. However, the sudden shift to online sales channels and negligible customer churn due to the lockdown will aid operating margins. Our view of sustained technology spends in the sector is validated by Gartner who sees positive traction in telcom tech spending in the short and long term due to Covid-19.

FIG 21 – GARTNER VALIDATE OUR THESIS OF RESILIENT TELECOM TECH SPENDING

TSP Industry Impacts on Technology Investment due to Covid-19		
Industry	Short-term impact of tech investment	Long-term impact of tech investment
Banking and Securities	Negative ↓	Uncertain ↔
Communications	Positive ↑	Positive ↑
Education	Positive ↑	Positive ↑
Public Sector	Positive ↑	Positive ↑ Negative Bias
Healthcare	Positive ↑	Positive ↑ Negative Bias
Insurance	Negative ↓	Uncertain ↔
Manufacturing	Negative ↓	Uncertain ↔
Retail	Negative ↓	Uncertain ↔ Negative Bias
Transportation	Negative ↓	Negative ↓

Source: Gartner, BOBCAPS Research

TECHM a key beneficiary – upgrade to BUY

In our view, the street has overestimated the contraction in 5G spends due to perceived Covid-induced delays in spectrum auctions and rollouts. We expect TECHM to benefit the most from resilient tech spends given its highest exposure to the telecom vertical among large-cap IT service vendors at 42% of revenue. We raise our FY21/FY22 EPS estimates for the company by 5% each, revise our Mar'21 TP to Rs 690 (vs. Rs 570 earlier), and upgrade TECHM from REDUCE to BUY on attractive valuations. Our EPS estimates are 1%/8% above Bloomberg consensus.

Comprehensive telecom tech services portfolio

TECHM is a niche player that's ahead in the 5G game compared to other Indian IT players. Its OSS (Operations Support Systems) application services portfolio provides end-to-end services across the domains of network inventory, service provisioning, network configuration and fault management. The company is focused on '5G for Enterprise', offering a range of services that enable enterprises to establish their own private wireless networks.

FIG 22 – GARTNER RANKS TECHM AHEAD OF INDIAN PEERS IN TELECOM SERVICES OFFERINGS



Source: Company, Gartner, BOBCAPS Research

5G-oriented investments

TECHM has been investing in developing capabilities and partnerships addressing multiple facets of 5G rollout. Its investments in Altiostar and Rakuten's 5G testing lab are testament to this. It further acquired K-Vision, a Japan-based network solutions firm that helps communications service providers transition from 4G to 5G. The company has also launched 5G-enabled solutions to build future factories along with Cisco.

Beaten down valuations provide attractive opportunity

In contrast to the street's view of significant 5G capex delay due to Covid-19, we note that early movers US, China and Japan are well on track for 5G rollout. Moreover, telecom is a relatively resilient industry in the current environment. While we do expect TECHM to experience near-term weakness related to the pandemic (supply-side issues in BPO, slowdown in manufacturing/retail and delays in new deal execution), we believe 5G-driven traction will boost the communications vertical which forms 42% of revenues.

We raise our FY21/FY22 earnings estimates for TECHM by 5%/7%, taking them 0%/10% above Bloomberg consensus as we bake in relatively faster post Covid-19 recovery for the company. Following a 29% correction in stock price during 2020 YTD vs. an 7.5% correction in the Nifty IT index, TECHM's valuations at 12.6x/9.7x FY21E/FY22E P/E are beaten down and adequately factor in near-term operational weakness.

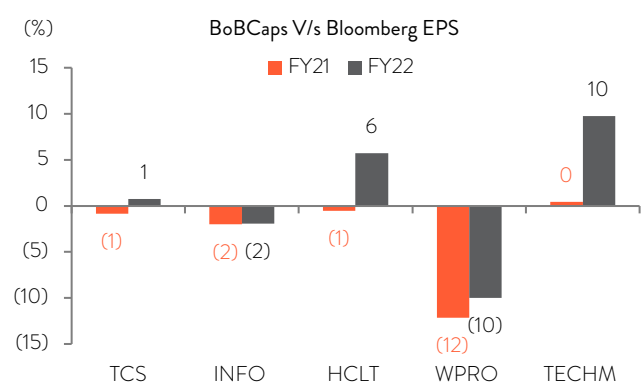
We raise our target FY22E P/E multiple to 12.5x (vs. 11x earlier), a 10% discount to the five-year rolling forward average, and upgrade the stock from REDUCE to BUY with a revised Mar'21 target price of Rs 690 (vs. Rs 570 earlier).

FIG 23 – REVISED ESTIMATES

(Rs mn)	FY21E			FY22E		
	Old	New	Change (%)	Old	New	Change (%)
US\$ Revenues (US\$ mn)	4,914	4,935	0.4	5,392	5,437	0.8
YoY growth (%)	(5.2)	(4.8)		9.7	10.2	
Revenues	3,68,578	3,77,550	2.4	4,04,408	4,24,104	4.9
EBITDA (Rs mn)	58,237	60,626	4.1	71,811	76,691	6.8
EBITDA margins (%)	15.8	16.1		17.8	18.1	
EBIT margins (%)	11.7	12.0		13.7	14.0	
Net Profits	35,646	37,414	5.0	45,614	48,648	6.7
EPS (Rs)	40.5	42.5	5.0	51.9	55.3	6.7

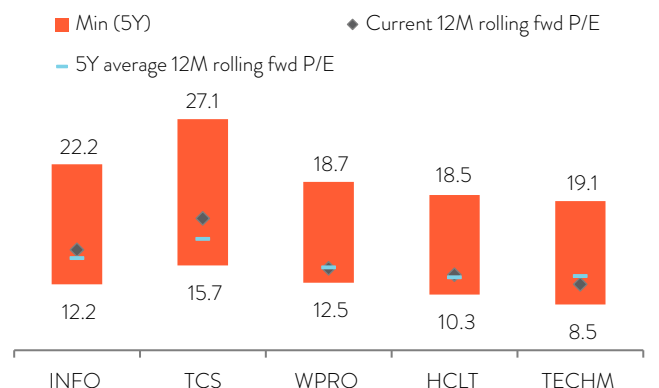
Source: BOBCAPS Research

FIG 24 – WE BAKE IN SWIFTER POST-COVID RECOVERY FOR TECHM



Source: Bloomberg, BOBCAPS Research

FIG 25 – TECHM ONLY TOP 5 COMPANY TRADING AT DISCOUNT TO 5Y AVERAGE P/E



Source: Bloomberg, Company, BOBCAPS Research

USDINR and target prices revised for IT universe

On account of sharp rupee depreciation against the dollar, we incorporate new USDINR estimates of Rs 76.5/Rs 78 for FY21/FY22 (vs. Rs 75 earlier) for our IT coverage universe, leading to increases in EPS and target price. Our ratings remain unchanged.

- We reiterate our positive stance on TCS, Infosys, HCL Tech and L&T Infotech owing to their bellwether status and robust performances in Q4.
- Maintain SELL on Wipro and Mphasis given a retail-heavy portfolio and DXC's ending revenue commitment respectively.
- Reiterate REDUCE on Persistent Systems, Mindtree (MTCL) and eClerx due to their less diversified revenue mix. We have incorporated MTCL's sharply lower Q1FY21 outlook.
- Maintain ADD on Hexaware in light of potential upside from the delisting process, and also on NIIT Technologies for its positive FY21 growth outlook despite Covid-19.

FIG 26 – EPS AND TARGET PRICE CHANGES

Company	Old	New	Change (%)	Old	New	Change (%)	Old TP	New TP
	FY21E EPS	FY21E EPS		FY22E EPS	FY22E EPS			
TCS	80.9	83.4	3	93.0	102.7	10	1,860	2,160
Infosys	36.3	37.1	2	40.3	41.9	4	730	760
Wipro	13.4	13.6	2	14.8	15.3	4	160	170
HCL Tech	39.3	40.3	2	46.0	48.2	5	650	680
Tech Mahindra	40.5	42.5	5	51.9	55.3	7	570	690
LTI Infotech	92.8	93.1	0	105.5	109.3	4	2,110	2,190
Mindtree	45.9	43.7	(5)	52.8	53.9	2	810	880
Mphasis	52.8	54.6	3	67.8	71.2	5	750	780
NIIT Technologies	80.8	82.5	2	98.7	106.2	8	1,330	1,430
Hexaware	19.6	19.8	1	21.8	22.1	1	320	350
Persistent Systems	37.3	37.7	1	47.2	52.8	12	530	590
eClerx	45.6	42.9	(6)	61.1	59.0	(4)	440	420

Source: BOBCAPS Research

FIG 27 – PREFER HCLT AND TECHM AMONG LARGE CAPS AND LTI AMONG MID CAP IT PLAYERS

Company	CMP (Rs)	Mkt Cap (US\$ bn)	Rating	Target Price (Rs)	US\$ revenue CAGR FY20-22E (%)	EBIT CAGR (%) FY20-22E	EPS (Rs)		P/E (x)		ROE (%)	
							FY21E	FY22E	FY21E	FY22E	FY21E	FY22E
TCS	2,048	101.1	ADD	2,160	2.7	10.5	83.4	102.7	24.5	20.0	33.7	34.7
INFO	704	40.3	ADD	760	1.7	8.3	37.1	41.9	19.0	16.8	23.1	23.7
WPRO	218	16.4	SELL	170	(1.2)	0.1	13.6	15.3	16.0	14.2	13.6	13.6
HCLT	576	20.6	BUY	680	4.2	9.7	40.3	48.2	14.3	11.9	20.1	21.5
TECHM	535	6.1	BUY	690	2.4	17.7	42.5	55.3	12.6	9.7	16.1	19.0
LTI	1,880	4.4	BUY	2,230	8.3	15.9	93.1	109.3	20.2	17.2	27.8	27.8
MPHL	840	2.1	SELL	780	3.6	10.0	54.6	71.2	15.4	11.8	16.8	20.1
MTCL	906	2.0	REDUCE	880	3.3	23.9	43.7	53.9	20.7	16.8	21.4	23.2
HEXW*	315	1.3	ADD	350	5.3	4.7	19.8	22.1	15.9	14.3	20.2	19.5
PSYS	594	0.6	REDUCE	590	5.3	27.9	37.7	52.8	15.7	11.3	11.7	15.0
NITEC	1,335	1.1	ADD	1,430	5.7	16.8	82.5	106.2	16.2	12.6	18.1	20.5
ECLX	434	0.2	REDUCE	420	2.3	4.6	42.9	59.0	10.1	7.4	11.8	15.4

Source: BOBCAPS Research | Prices as on 17th Jun 2020 | *FY21 refers to CY20 for Hexaware and so on

Stock performance

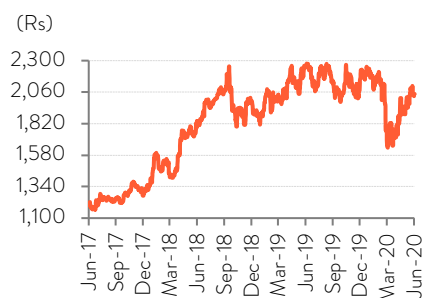
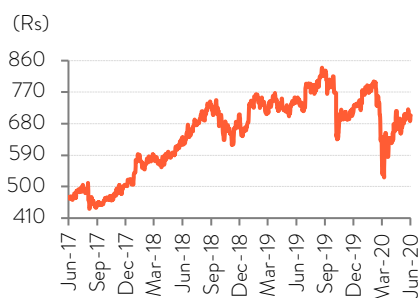
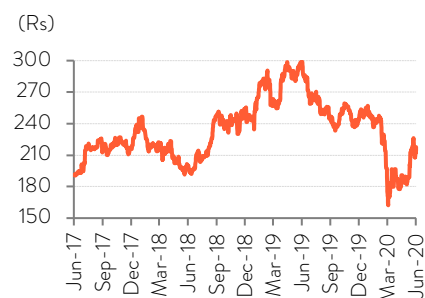
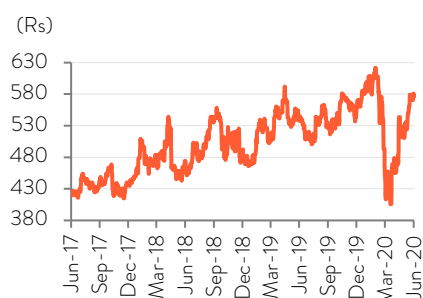
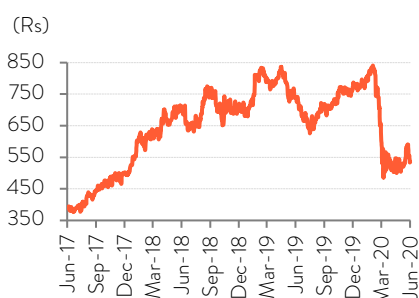
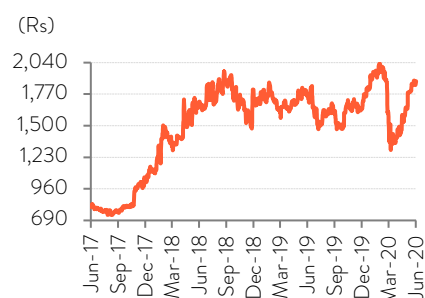
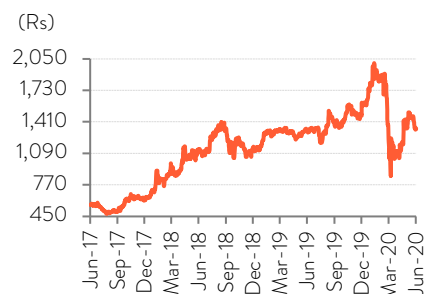
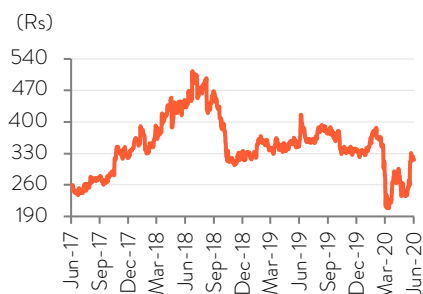
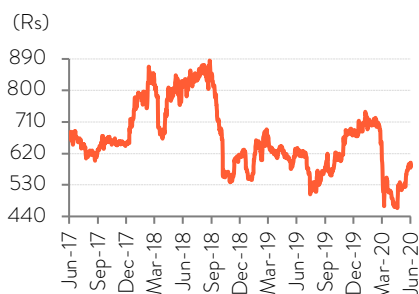
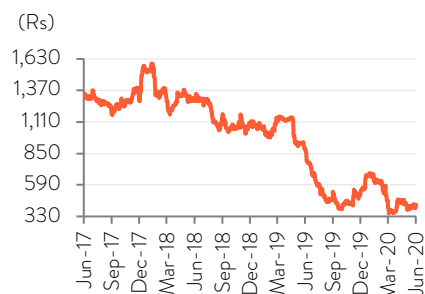
FIG 28 – TCS

FIG 29 – INFOSYS

FIG 30 – WIPRO

FIG 31 – HCL TECH

FIG 32 – TECH MAHINDRA

FIG 33 – LTI INFOTECH

FIG 34 – MINDTREE

FIG 35 – MPHASIS

FIG 36 – NIIT TECHNOLOGIES

FIG 37 – HEXAWARE

FIG 38 – PERSISTENT SYSTEMS

FIG 39 – ECLERX


Source: NSE

Financials – TECHM

Income Statement

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20P	FY21E	FY22E
Total revenue	3,07,729	3,47,421	3,68,677	3,77,550	4,24,104
EBITDA	47,169	63,368	57,261	60,626	76,691
Depreciation	10,849	11,292	14,458	15,486	17,398
EBIT	36,320	52,076	42,803	45,139	59,293
Net interest income/(expenses)	(1,624)	(1,332)	(1,919)	(1,250)	(1,550)
Other income/(expenses)	14,093	5,342	11,924	4,143	5,368
Exceptional items	0	0	0	0	0
EBT	48,789	55,431	52,753	48,073	63,151
Income taxes	10,925	12,544	11,604	12,258	16,104
Extraordinary items	0	0	0	0	0
Min. int./Inc. from associates	137	(567)	1,301	1,640	1,640
Reported net profit	38,001	42,975	42,505	37,414	48,648
Adjustments	0	0	0	0	0
Adjusted net profit	38,001	42,975	42,505	37,414	48,648

Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20P	FY21E	FY22E
Accounts payables	0	0	0	0	0
Other current liabilities	71,708	90,744	1,03,830	98,266	1,10,383
Provisions	9,581	9,753	11,055	10,344	11,619
Debt funds	17,260	14,047	24,282	24,282	24,282
Other liabilities	12,304	12,304	12,304	12,304	12,304
Equity capital	4,417	4,437	4,359	4,359	4,359
Reserves & surplus	1,89,102	2,03,184	2,17,705	2,37,753	2,64,300
Shareholders' fund	1,93,519	2,07,621	2,22,064	2,42,112	2,68,659
Total liabilities and equities	3,04,372	3,34,469	3,73,535	3,87,308	4,27,248
Cash and cash eq.	19,661	20,427	30,167	57,723	91,449
Accounts receivables	65,117	69,586	75,772	74,476	83,659
Inventories	659	752	358	358	358
Other current assets	76,857	88,020	1,21,702	1,15,263	1,19,090
Investments	59,595	77,926	61,046	61,046	61,046
Net fixed assets	76,717	71,667	76,047	69,999	63,204
CWIP	2,399	2,763	501	501	501
Intangible assets	27,727	28,163	33,877	33,877	33,877
Deferred tax assets, net	5,766	6,091	8,443	8,443	8,443
Other assets	0	0	0	0	0
Total assets	3,04,372	3,34,469	3,73,535	3,87,308	4,27,248

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20P	FY21E	FY22E
Net income + Depreciation	44,374	50,112	55,607	51,301	64,446
Interest expenses	169	(745)	(13,843)	(5,393)	(6,918)
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(7,832)	(10,574)	(13,356)	1,460	383
Other operating cash flows	(1,176)	5,527	17,667	0	0
Cash flow from operations	35,535	44,320	46,075	47,367	57,910
Capital expenditures	(7,902)	(7,793)	(15,386)	(9,439)	(10,603)
Change in investments	(20,701)	(23,216)	(16,880)	0	0
Other investing cash flows	(4,590)	9,967	13,843	5,393	6,918
Cash flow from investing	(33,193)	(21,042)	(18,423)	(4,045)	(3,684)
Equities issued/Others	251	(1,747)	0	0	0
Debt raised/repaid	7,486	(4,504)	0	0	0
Interest expenses	(993)	(1,354)	0	0	0
Dividends paid	(9,438)	(14,907)	(17,912)	(15,766)	(20,500)
Other financing cash flows	0	0	0	0	0
Cash flow from financing	(2,694)	(22,512)	(17,912)	(15,766)	(20,500)
Changes in cash and cash eq.	(352)	766	9,740	27,556	33,726
Closing cash and cash eq.	19,661	20,427	30,167	57,723	91,449

Per Share

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20P	FY21E	FY22E
Reported EPS	42.7	47.7	48.3	42.5	55.3
Adjusted EPS	42.7	47.7	48.3	42.5	55.3
Dividend per share	14.0	14.0	16.9	14.9	19.4
Book value per share	217.3	230.6	252.5	275.3	305.5

Valuations Ratios

Y/E 31 Mar (x)	FY18A	FY19A	FY20P	FY21E	FY22E
EV/Sales	1.5	1.3	1.3	1.2	1.1
EV/EBITDA	9.5	7.3	8.1	7.6	5.8
Adjusted P/E	12.6	11.2	11.1	12.6	9.7
P/BV	2.5	2.3	2.1	1.9	1.8

DuPont Analysis

Y/E 31 Mar (%)	FY18A	FY19A	FY20P	FY21E	FY22E
Tax burden (Net profit/PBT)	77.9	77.5	80.6	77.8	77.0
Interest burden (PBT/EBIT)	134.3	106.4	123.2	106.5	106.5
EBIT margin (EBIT/Revenue)	11.8	15.0	11.6	12.0	14.0
Asset turnover (Revenue/Avg TA)	108.9	108.8	104.1	99.2	104.1
Leverage (Avg TA/Avg Equity)	1.6	1.6	1.6	1.6	1.6
Adjusted ROAE	21.0	21.4	19.8	16.1	19.0

Source: Company, BOBCAPS Research | Note: TA = Total Assets

Ratio Analysis

Y/E 31 Mar	FY18A	FY19A	FY20P	FY21E	FY22E
YoY growth (%)					
Revenue	5.6	12.9	6.1	2.4	12.3
EBITDA	12.7	34.3	(9.6)	5.9	26.5
Adjusted EPS	33.6	11.9	1.2	(12.0)	30.0
Profitability & Return ratios (%)					
EBITDA margin	15.3	18.2	15.5	16.1	18.1
EBIT margin	11.8	15.0	11.6	12.0	14.0
Adjusted profit margin	12.3	12.4	11.5	9.9	11.5
Adjusted ROAE	21.0	21.4	19.8	16.1	19.0
ROCE	15.0	19.3	15.1	15.0	20.3
Working capital days (days)					
Receivables	70	71	72	73	68
Inventory	1	1	1	0	0
Payables	90	104	114	116	110
Ratios (x)					
Gross asset turnover	4.3	4.7	5.0	5.2	6.4
Current ratio	2.0	1.8	2.0	2.3	2.4
Net interest coverage ratio	(22.4)	(39.1)	(22.3)	(36.1)	(38.3)
Adjusted debt/equity	0.0	0.0	0.0	(0.1)	(0.3)

Source: Company, BOBCAPS Research

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Recommendations and Absolute returns (%) over 12 months

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

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

SELL – Expected return <-5%

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