IT SERVICES

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Stellar outsourcing show- a positive readthrough for Indian IT

Accenture's (ACN) Q4FY20 dollar revenue was in line with the guided range of US$ 10.6bn-11bn, posting a decline of 1.4% QoQ and 1% CC. The guidance of 2-5% CC growth for FY21 was lower than street's estimates but aligned with the current economic climate. Positive takeaways were record bookings of US$ 14bn buoyed by high outsourcing bookings and impressive recovery in outsourcing revenue – this in turn heralds better times for Indian counterparts. We maintain a positive sector outlook and prefer TCS, HCLT and TECHM among large-caps.

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Performance meets guidance but below consensus: ACN's Q4 revenue of US$ 10.8bn declined by 1.4% QoQ and 1% in CC terms – weaker than Q3 when revenue grew 1.3% CC. The decline was led by a 5% QoQ dip in Europe and flattish growth in the US. As in the last quarter, health and public services was the only vertical showing growth, rising 4% QoQ and 11% YoY. Resources declined the most, by 6% QoQ and 11% YoY. BFSI fell by low single digits. Pressure continued in the troubled verticals of travel, transportation, energy and utilities, which form 20% of revenues (these saw mid-teen declines YoY).

Stellar outsourcing performance – positive for Indian IT: Demand erosion due to the pandemic led to a decline of 8.2% YoY in consulting revenues (vs. a 3.8% YoY decline the previous quarter). However, the healthy performance from the outsourcing business was a surprise and contrasted with the consulting business. Outsourcing revenue grew 5.9% YoY, marking a notable acceleration over the previous quarter (+2.7% YoY). Given the skew towards outsourcing for Indian IT players, ACN's stellar performance suggests a positive readthrough for them.

Record high outsourcing bookings: ACN registered one of its highest ever new order bookings of US$ 14bn in Q4, after a dip to US$ 11bn in Q3. Outsourcing bookings at US$ 7.5bn (+10.5% YoY) marked a historical high. The company's FY21 (Aug-ending) guidance of 2-5% YoY CC growth bakes in a strong recovery in H2 (high-single-digit to low-double-digit growth) and hints at a robust FY22 (Mar-ending) for Indian IT players.

Covid- a tipping point for cloud: Management believes that Covid-19 will accelerate cloud adoption and digital transformation, with the 20:80 rule for cloud vs. on-premise mix in enterprises likely to reverse. ACN's US$ 3bn investment in 'Accenture Cloud First' is a testament to soaring cloud demand.

RECOMMENDATION SNAPSHOT

Ticker	Price	Target	Rating
TCS IN	2,332	2,620	BUY
INFO IN	975	1,020	ADD
WPRO IN	305	246	SELL
HCLT IN	788	920	BUY
TECHM IN	752	910	BUY
LTI IN	2,414	3,290	BUY
MPHL IN	1,265	950	SELL
MTCL IN	1,248	1,220	ADD
HEXW IN	467	500	BUY
PSYS IN	1,181	840	SELL
NITEC IN	2,114	2,110	ADD

Price & Target in Rupees

Other highlights

- Q1FY21 revenue is guided to lie between US$ 11.15bn and US$ 11.55bn, i.e. –3% to 0% YoY CC growth. Management expects FY21 operating margins in the range of 14.8-15% and operating cash flow within US$ 6.35bn-6.85bn.
- Q4FY20 operating margin declined 130bps QoQ to 14.3% due to increased general and administrative costs.
- Book-to-bill ratios stood strong at 1.1x for consulting and 1.5x for outsourcing during the quarter.
- Free cash flow was robust at US$ 3bn in Q4 and US$ 7.6bn in FY20.
- A sum of US$ 1.5bn was spent on inorganic growth in FY20, reflecting ACN's commitment towards enhancing digital capabilities through acquisitions.
- FY21 revenue guidance bakes in ~200bps contribution from inorganic revenue, similar to the previous year.
- The company announced that starting FY21, the share of 'the new' (Digital, Cloud and Security services) will not be reported as 'the new' becomes 'the core'.
- ACN has increased quarterly cash dividend by 10% to US$ 0.88/sh.

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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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