

## Growth surprise reinforces buoyant demand

- IT companies ex-TCS and HCLT outperformed optimistic growth expectations in Q1FY22
- BFSI vertical continued to shine; sharp uptrend in communications as well
- Healthy deal wins and upbeat guidance reinforce buoyant demand trends though supply has tightened; we stay optimistic on the sector

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**Q1 growth surpassed already-optimistic expectations:** IT services companies under our coverage saw broad-based QoQ dollar revenue growth in Q1FY22. All companies (except TCS and HCLT) outperformed consensus and our optimistic estimates that were premised on seasonal strength in Q1. Large-cap and mid-cap growth averaged at 4.2% and 7.6% QoQ USD respectively. Wipro (WPRO) performed well with 12.2% QoQ USD growth, driven by inorganic growth of 7.4% from the Capco acquisition. Persistent Systems (PSYS), Mindtree (MTCL) and Coforge also outperformed estimates, led by pickup across verticals, especially BFSI.

**Supply pressure intensifies:** EBIT margin fell 110-120bps QoQ on average across our coverage due to increased hiring and initiatives to combat attrition. Q1 saw record quarterly hiring, with large-cap players inducting ~53.6k employees and mid-caps ~17k. Most companies plan to ramp up recruitment throughout FY22. Subcontractor costs shot up as companies scrambled for talent amid a demand surge. MTCL/Tech Mahindra's (TECHM) subcontracting costs surged 340bps/210bps QoQ but other large-caps maintained costs in an acceptable range.

**Healthy deal wins, upbeat guidance signal buoyant demand:** LTM deal TCV was strong for all companies in Q1 (up by average ~30% YoY). TCS (US\$ 8.1bn TCV) and Coforge (US\$ 319mn) had record wins. Infosys (INFO) raised revenue guidance by 200bps to 14-16% YoY CC for FY22. Similarly, Coforge upped guidance to 'at least' 19% YoY CC organic growth vs. 17% earlier. WPRO's 3-4% QoQ CC organic growth guidance for Q2 looks robust on a strong base of Q1. Mid-cap players are racing to take the lead – Mphasis (MPHL) has guided for above-industry direct business growth and L&T Infotech (LTI) aims to be in the top industry quartile.

**Maintain positive view:** We remain optimistic on the sector's growth prospects on the back of a multiyear technology refresh cycle set in motion by the pandemic. The changing cloud footprint of enterprises is manifesting as a strong growth catalyst (see our report [IT Services: On cloud nine](#)). Prefer TECHM, TCS and INFO among large-caps and LTI and Coforge amongst mid-caps.

### Recommendation snapshot

Ticker	Price	Target	Rating
AFFLE IN	3,836	6,200	BUY
COFORGE IN	4,988	5,860	BUY
ECLX IN	2,159	2,880	BUY
HCLT IN	1,163	1,360	BUY
INFO IN	1,739	2,020	BUY
INFOE IN	5,489	6,530	BUY
INMART IN	7,057	7,200	HOLD
JUST IN	953	1,330	BUY
LTI IN	5,053	5,960	BUY
MPHL IN	2,867	3,020	HOLD
MTCL IN	3,501	2,400	SELL
PSYS IN	3,214	3,050	HOLD
TCS IN	3,637	4,270	BUY
TECHM IN	1,416	1,660	BUY
WPRO IN	629	620	HOLD

Price & Target in Rupees | Price as of 23 Aug 2021

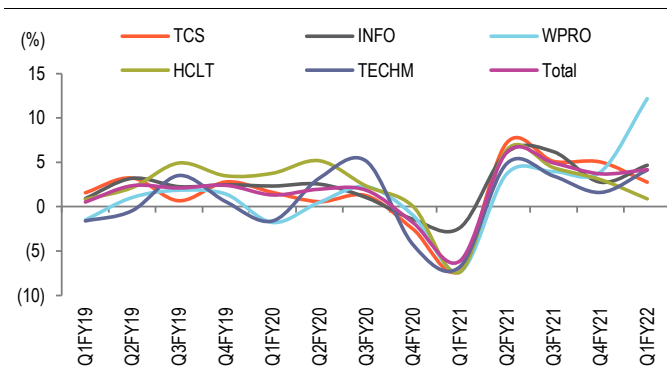


### Wipro, PSYS and Coforge outperform

Large-cap IT services players under our coverage grew 4.2% QoQ USD on average in Q1FY22. Mid-caps performed even better at 7.6% QoQ. WPRO among large-caps and Coforge among mid-caps outperformed peers. WPRO’s organic growth of 4.9% QoQ CC was its highest in the last 38 quarters, surpassing the guided range of 2-4%. Coforge also continued to surprise with revenue surging 16% QoQ USD (including two months of SLK Global contribution) and 7.6% organic growth.

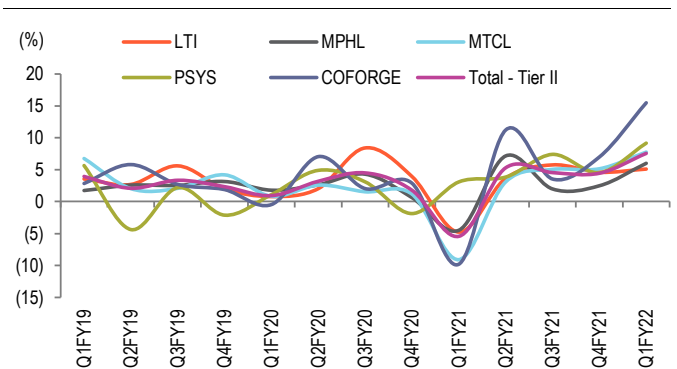
PSYS outperformed our and consensus estimates, growing 9.1% QoQ USD, albeit aided by the Capiot acquisition. INFO, LTI, MTCL and MPHL also bettered estimates in terms of sequential growth. However, muted sequential pickup at TCS, HCLT and TECHM weighed down overall large-cap performance.

**Fig 1 – Large-caps: QoQ USD growth**



Source: Company, BOBCAPS Research

**Fig 2 – Mid-caps: QoQ USD growth**



Source: Company, BOBCAPS Research

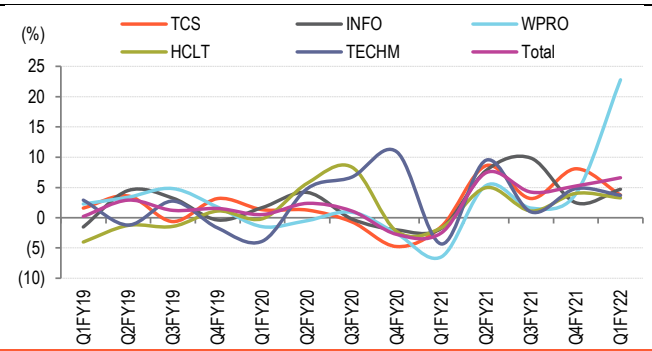
### BFSI vertical leads sequential growth

Demand for BFSI has remained strong for all service offerings in Q1 as spends have increased in the areas of customer experience, product innovation, cloud transformation and core optimisation. BFSI has remained relatively insulated from the Covid-19 impact, with consistent sequential growth across our coverage. Notably, in Q1FY22, the vertical accelerated beyond its Q4FY20 growth band (post onset of Covid).

TCS’s BFSI bookings were robust at US\$ 2.2bn TCV. WPRO’s 12.2% QoQ USD topline growth was also driven by traction in BFSI (+23% QoQ), albeit partly led by the Capco acquisition. WPRO has done well in the healthcare vertical as well, akin to many other players. For HCLT, BFSI clocked the second-best growth among verticals at 3.2% QoQ USD.

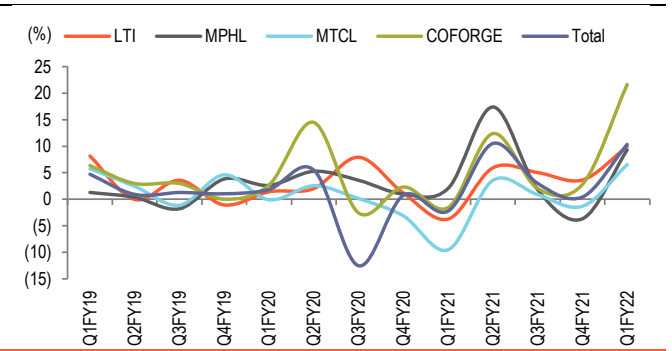
LTI posted stellar growth of 39.6% YoY USD in BFS (+9.9% QoQ USD) despite it being the company’s largest vertical. MTCL also saw a rebound in BFSI growth (+6.6% QoQ USD) after two quarters of weakness. PSYS posted a double-digit uptick in both the BFSI and health & life science verticals. Coforge saw tailwinds from the SLK Global acquisition. For MPHL, banking and capital markets delivered the second-best growth amongst its verticals, at 9.2% QoQ USD.

**Fig 3 – Large-caps: BFSI QoQ growth**



Source: Company, BOBCAPS Research

**Fig 4 – Mid-caps: BFSI QoQ growth**



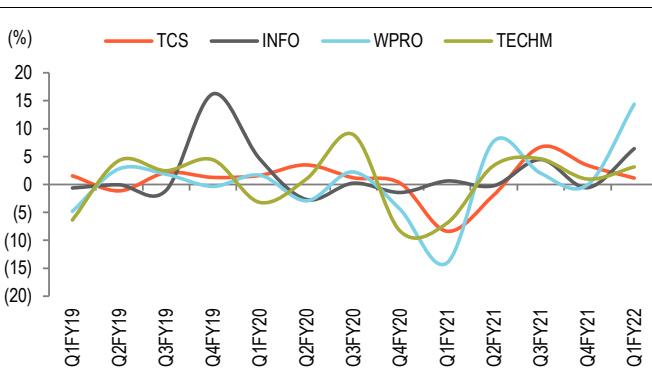
Source: Company, BOBCAPS Research

**Telecom shines; other verticals pick up as well**

All IT players under our coverage saw secular growth across verticals in Q1FY22. Apart from BFSI, the telecom and retail verticals have shown a QoQ pickup. Telecom growth YoY has started to improve after a lull of three quarters, reaching double digits for most companies. TECHM’s upbeat 5G commentary is indicative of upcoming robust demand in the communications vertical. About 60-70% of its communications TCV is centered around 5G. The company’s highest growing vertical during Q1 was technology, media and entertainment.

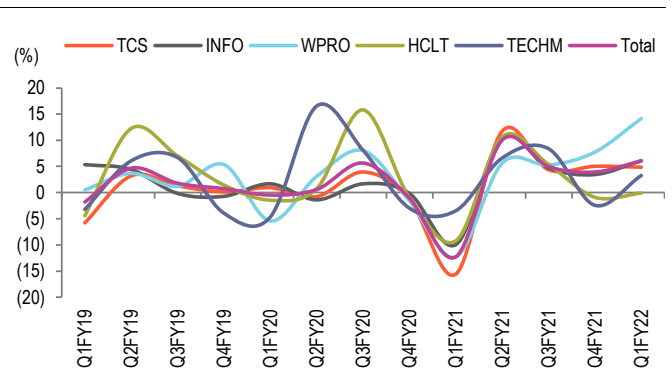
TCS, HCLT and PSYS reported their strongest QoQ growth from healthcare and life-sciences. For WPRO, telecom and retail ranked second among its verticals. Coforge’s transportation vertical recovered after a subdued showing in Q4FY21, with 15.3% QoQ INR growth. MTCL and MPHL also saw the travel vertical outperforming in Q1 (+12.8% and +11.5% QoQ USD respectively). Hi-tech, media and entertainment grew the most for LTI at 13.1%.

**Fig 5 – Large-caps: Telecom QoQ growth**



Source: Company, BOBCAPS Research

**Fig 6 – Large-caps: Retail QoQ growth**



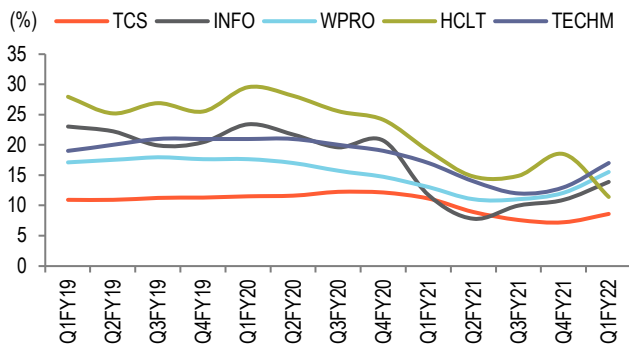
Source: Company, BOBCAPS Research | TCS: Retail & CPG; WPRO: Retail & transportation; TECHM: Retail, Transport and Logistics

### Mid-cap IT facing higher supply pressure

A surge in demand for IT services during the pandemic has caused an acute shortage of digital talent. Attrition has started inching up for all players given a tight supply-side environment. The rise in attrition has been sharper for mid-cap players at 290bps QoQ on average with large-caps at 95bps QoQ. HCLT was the only company to see improvement in attrition figures.

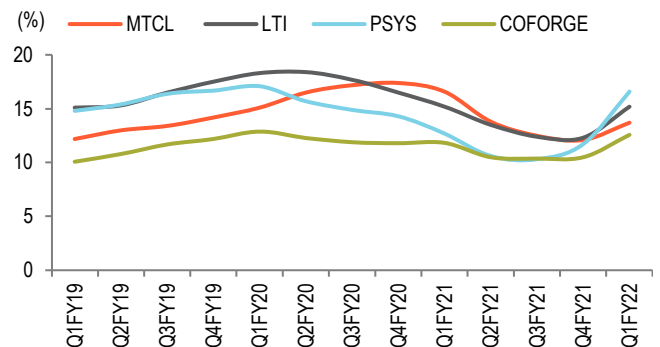
Companies have announced several measures to curb employee churn including multiple rounds of salary hikes. TCS, INFO and LTI had a negative EBIT margin impact of 130bps, 80bps and 340bps respectively from wage hikes in Q1. TECHM's margins also suffered due to hikes. WPRO has announced increments for 80% of employees effective September. MTCL will initiate another round of hikes till the mid-management level. PSYS has also announced salary hikes and measures such as flexible working hours to curb attrition.

**Fig 7 – Large-caps: Attrition inching up**



Source: Company, BOBCAPS Research

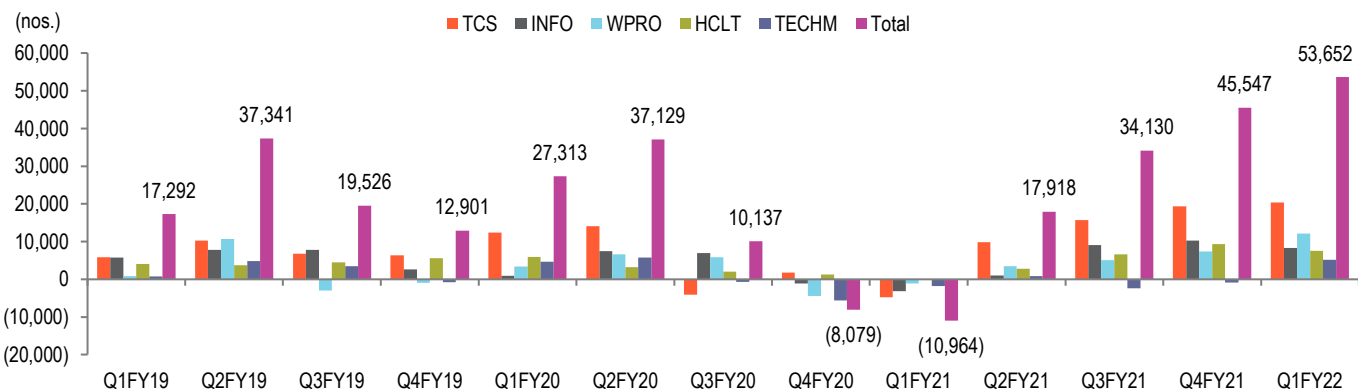
**Fig 8 – Mid-caps: Attrition inching up**



Source: Company, BOBCAPS Research

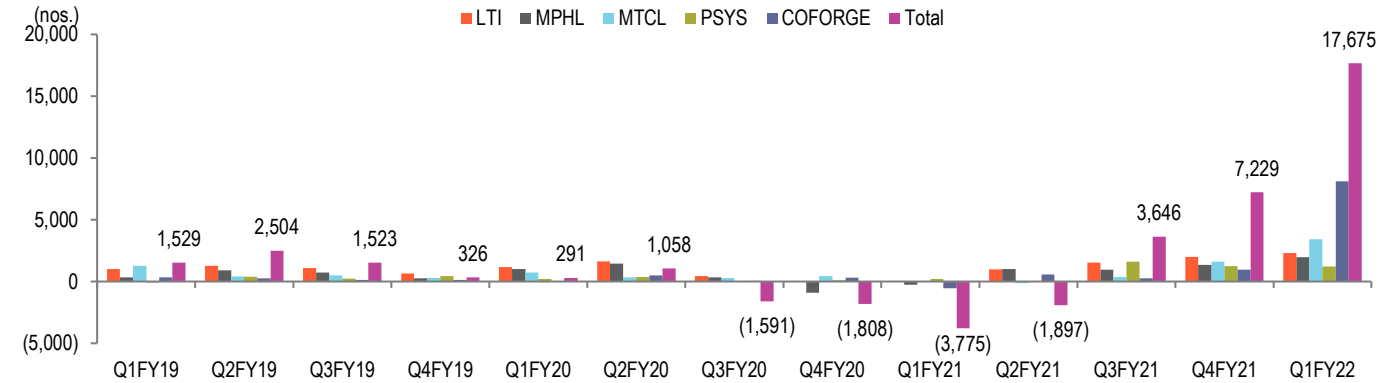
Companies have ramped up hiring at breakneck speed to backfill the attrition and build capacity for upcoming demand. Q1FY22 saw large-caps hire a record ~53.6k employees and mid-caps hire ~17k. TCS alone recruited more than 20k freshers in Q1. INFO has also raised its hiring target for FY22 from 25k to 35k while WPRO added a record ~12k employees in Q1 and plans to hire at least 6k more in Q2. PSYS aims to hire 2k more freshers in FY22. In Q1, HCLT hired 7.5k employees, TECHM 5.2k, PSYS 1.2k and Coforge 8.1k.

**Fig 9 – Large-caps: QoQ growth in hiring at all-time high**



Source: Company, BOBCAPS Research

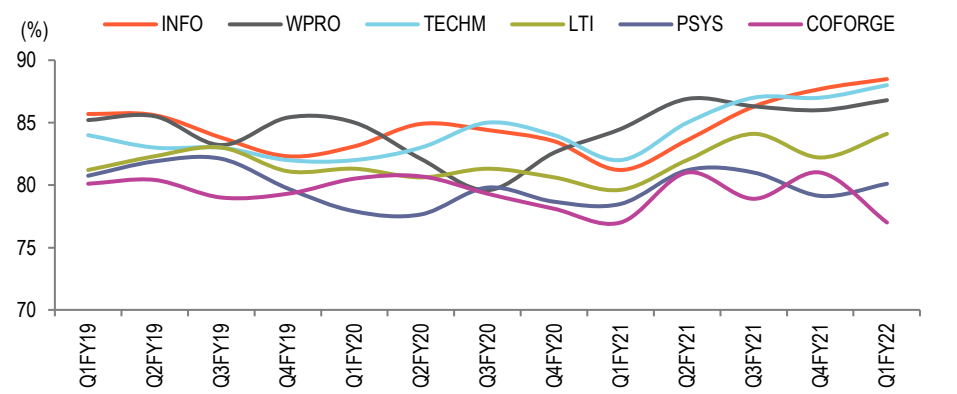
**Fig 10 – Mid-caps: QoQ growth in hiring at all-time high**



Source: Company, BOBCAPS Research

Utilisation remained at record highs for most large-caps with INFO in the lead at 88.5%. However, utilisation stabilised for mid-caps due to the ramp-up in hiring which made up for laggardly recruitment in previous quarters.

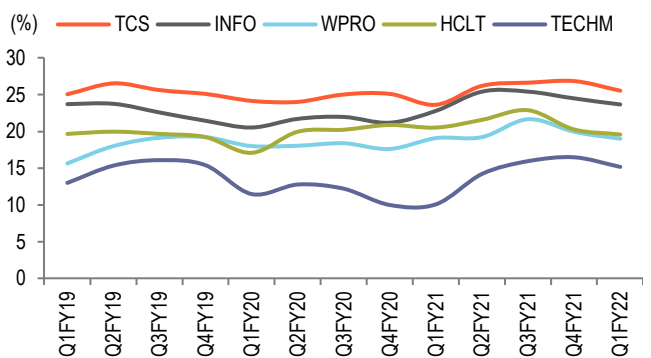
**Fig 11 – Utilisation stable**



Source: Company, BOBCAPS Research

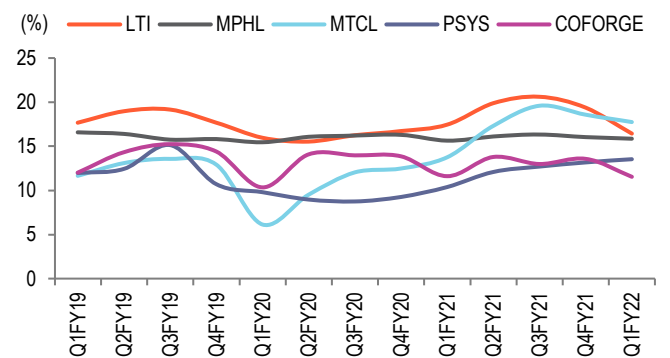
Owing to increased hiring and salary hikes to combat attrition, Q1 EBIT margin declined 110bps/120bps on average QoQ for mid-caps/large caps under over coverage. However, all players are confident that the buoyant demand will help sustain their current margin levels for the full year despite rising supply pressures.

**Fig 12 – Large-caps: EBIT margin**



Source: Company, BOBCAPS Research

**Fig 13 – Mid-caps: EBIT margin**



Source: Company, BOBCAPS Research

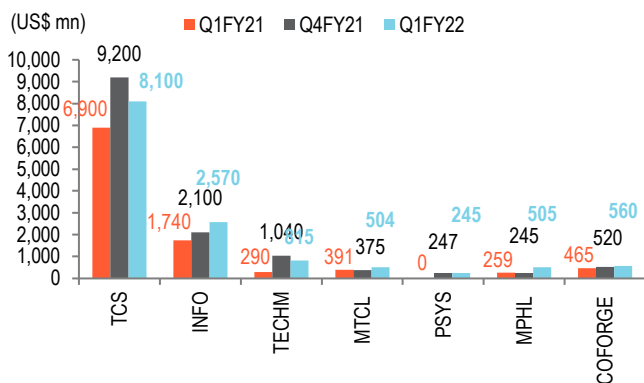
### Robust outlook especially for WPRO and Coforge

Most of our coverage companies have guided for accelerated growth in Q2 and FY22 as the demand climate looks much stronger than that in Q4FY21. Deal pricing also appears stable. Most client enterprises are raising their technology spends, especially in the areas of BFSI, health, life sciences, travel and ER&D. Increased hiring and attrition at IT players also signal robust demand and deal pipelines for FY22-FY23. The deal pipeline for most companies is a mix of midsized as well as large projects.

TCS's order pipeline increased 17% YoY in Q1, pointing to a robust start to the year. WPRO has guided for 5-7% QoQ CC revenue growth in Q2FY22 (including 2-3% growth from Capco) on a strong base of Q1. We believe its recent US\$ 1bn investment in cloud solutions is a step in the right direction and will help fuel growth. The company closed eight large deals in Q1 carrying cumulative TCV of US\$ 715mn. TECHM's outlook is buoyed by increased activity around 5G and pre-5G projects.

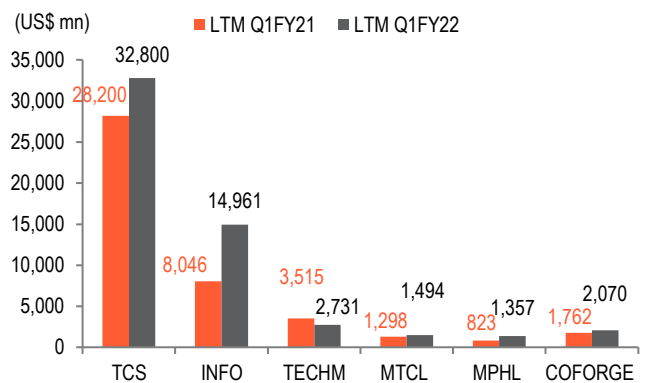
For Coforge, the 12-month executable order book as at end-Q1 was at a record US\$ 560mn (+8% QoQ, +20% YoY) plus US\$ 80mn from SLK Global. The company signed a total of 11 new logos in Q1. LTI has guided for attaining top industry quartile growth in FY22. MTCL's outlook is also robust with record deal wins (TCV of US\$ 504mn) in Q1 and growth beyond the top client.

**Fig 14 – Deal pipeline robust**



Source: Company, BOBCAPS Research

**Fig 15 – TTM order book has grown for most YoY**

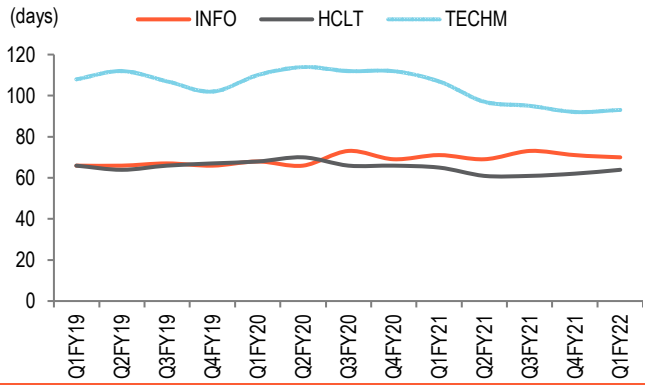


Source: Company, BOBCAPS Research

### Improved DSO levels

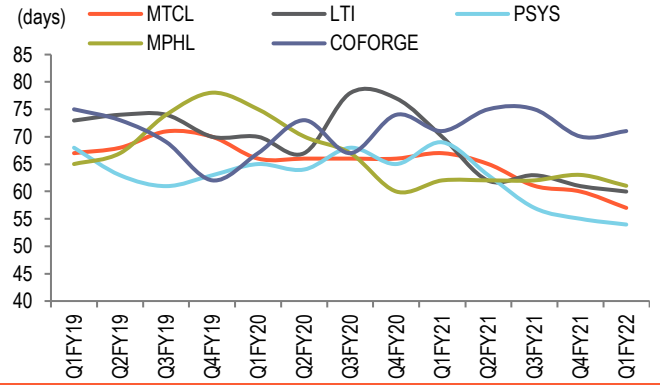
Post Covid-19, better cash conversion has resulted in improved days sales outstanding (DSO) across the sector. Some of this was due to reduced working capital needs. Even TECHM, which usually has one of the highest DSOs, posted its lowest levels in 16 quarters at 93 days in Q1.

**Fig 16 – Large-caps: DSO**



Source: Company, BOBCAPS Research

**Fig 17 – Mid-caps: DSO**



Source: Company, BOBCAPS Research

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**BUY** – Expected return >+15%

**HOLD** – Expected return from -6% to +15%

**SELL** – Expected return <-6%

**Note:** Recommendation structure changed with effect from 21 June 2021

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