

Demand unhindered but margins to contract QoQ

- We expect most of our IT coverage to perform well in Q4, with 2.5-5% QoQ CC topline growth, and mid-tier players likely to outshine tier-I
- Margin pressure to persist due to supply-side issues – we estimate an average margin decline of 33bps QoQ (ex-COFORGE)
- Our top picks remain LTI and TECHM among IT companies and AFFLE in the internet space

Ruchi Burde | Seema Nayak
 researchreport@bobcaps.in

Expect good growth on the back of steady demand: We expect demand to hold firm in Q4FY22 despite disruptions due to the ongoing Russia-Ukraine war. Most IT companies under our coverage have limited exposure to these geographies, barring some delivery centres present there. Q4 demand is likely to be broad-based across verticals. For most companies, we expect growth to lie in the 2.5-5% QoQ CC range (higher for PSYS given a significant inorganic growth component). Deal pipelines should remain robust, as in Q3. Q4FY22 will experience some cross-currency headwinds due to appreciation of the GBP against the USD.

Margin headwinds to persist: We anticipate an EBIT margin impact in Q4 at 33bps on average across our coverage (ex-Coforge) due to higher employee cost (retention bonuses, salary hikes, higher attrition). Companies are using operational levers to minimise margin pressures, including offshoring, pyramid optimisation, fresher hires, and hiring in tier-2/3 cities (including setup of delivery centres in the interiors of India).

Pushing the inorganic peddle...: The Indian IT sector has seen a surge in M&A activity from Q3FY22, especially among the top-5 players. Post Q2FY22, our coverage companies have together made over 15 acquisitions, including 7 by TECHM alone. PSYS was among the few mid-sized companies in the fray with 3 acquisitions – Shree Partners, SCI and Data Glove. We thus model for an inorganic growth component of 2-2.5% QoQ for TECHM and PSYS in Q4FY22.

...to drive higher guidance: Companies are using the inorganic route to plug the gaps in terms of skill, geographical presence, and in-demand capabilities. Many Indian IT players have bought targets in Europe, besides the US, with M&A activity in this geography at its strongest since 2007. Most acquisitions help improve near-shore presence in the areas of digital and data engineering (both HCLT and TECHM have invested in digital engineering companies in Europe). This should lead to elevated growth guidance for FY23.

Top picks: Our top BUY-rated picks remain LTI (TP Rs 8,490) and TECHM (Rs 1,940) among IT companies and AFFLE (Rs 1,720) among internet companies.

Recommendation snapshot

Ticker	Price	Target	Rating
AFFLE IN	1,272	1,720	BUY
COFORGE IN	4,558	7,080	BUY
ECLX IN	2,416	3,790	BUY
HCLT IN	1,195	1,610	BUY
INFO IN	1,861	2,250	BUY
INFOE IN	4,746	6,780	BUY
INMART IN	5,069	7,660	BUY
JUST IN	782	990	BUY
LTI IN	6,338	8,490	BUY
MPHL IN	3,318	3,470	HOLD
MTCL IN	4,390	5,610	BUY
PSYS IN	4,916	4,580	HOLD
TCS IN	3,815	4,770	BUY
TECHM IN	1,489	1,940	BUY
WPRO IN	599	850	BUY

Price & Target in Rupees | Price as of 5 Apr 2022



IT Services: Q4 outlook

We expect 3-4% QoQ USD revenue growth for **TCS** and **INFO** in Q4FY22 with EBIT margin declines of 60-70bps QoQ due to increased hiring and talent retention measures. **WPRO** is projected to grow 2.7% and have a flat margin QoQ after a likely bottoming out in Q3. **TECHM** should see a 5% QoQ USD uptick in revenue split equally between the organic and inorganic segments, as well as the enterprise and communication verticals where demand remains strong. Q4 is usually a weak quarter for **HCLT's** products and platforms business – hence we model for ~2% QoQ USD growth and a flattish 19% EBIT margin.

For **LTI**, we believe the healthy demand climate will override unfavourable seasonality to drive robust 4.5% QoQ USD growth and a steady 17.9% EBIT margin. **PSYS** is expected to display the highest growth among our IT coverage at 7.7% QoQ USD, including ~2% from inorganic growth. For **MTCL**, we expect Q4 growth to be similar to Q3 at 4.7% because of momentum in the BFSI, hospitality (TTH) and communications, media & technology (CMT) verticals. Its EBITDA margin is likely to hold at 20%+ but could slip a bit QoQ (50bps) because of supply pressure.

For **COFORGE**, the growth outlook remains similar to Q3 (at 4% QoQ USD) and the company is likely to buck the trend with ~100bps QoQ EBITDA margin expansion given its large-deal ramp-up, pyramid rationalisation and offshore scale-up. **ECLX** is also forecast to perform well at 4.4% QoQ USD due to the absence of roll-offs, with 60bps QoQ EBIT margin expansion. For **MPHL**, we project a 5% QoQ USD uptick led by traction in the banking and capital markets vertical, with a 40bps dip in EBIT margin.

Overall, we expect deal wins to remain on the uptrend and deal pricing to remain favourable across the board.

Internet: Q4 outlook

INFOE is likely to deliver robust 40% YoY growth in Q4FY22 aided by strength in jobs platform Naukri. Its property portal 99acres is likely to remain soft and hence we model for only a 20bps QoQ rise in EBITDA margin to 30%. We expect **JUST's** growth to remain soft (-0.7% YoY) given the lack of new initiatives post RRVL acquisition and estimate a muted EBITDA margin of 7.3% due to higher advertisement expenses.

AFFLE is forecast to grow 86% YoY but decline 22% QoQ due to seasonal weakness in Q4 (Q3 is a very strong quarter due to traction from the retail segment). We have pegged the EBITDA margin at 19% for the quarter, flattish QoQ. For **INMART**, we pencil in revenue growth of 10% YoY and EBITDA margin contraction of 6ppt YoY to 41.2% due to rising hiring costs.

Fig 1 – Q4FY22 estimates – IT Services

Company	Revenues (US\$ mn)	US\$ Revenue growth (%)		CC growth (QoQ)	EBIT margin (%)	EBIT (Rs mn)	EBIT growth (%)		EBIT margin (bps)		Net profit (Rs mn)	Net profit growth (%)		Cross currency impact (bps)
		QoQ	YoY				QoQ	YoY	QoQ	YoY		QoQ	YoY	
TCS	6,765	3.7	13.0	4.0	24.3	124,051	1.4	5.7	(70)	(250)	98,014	0.0	5.6	(30)
INFO	4,424	4.1	22.5	4.5	22.8	76,214	1.8	18.3	(64)	(163)	62,294	7.2	22.7	(38)
WPRO*	2,710	2.7	25.6	3.0	17.5	36,808	3.7	8.9	0	(240)	32,120	9.8	7.9	(35)
HCLT	3,034	1.9	12.5	2.5	18.9	43,120	1.4	8.3	(10)	(130)	33,323	(3.6)	11.9	(60)
TECHM	1,595	5.0	23.6	5.4	14.0	16,840	(0.8)	5.0	(80)	(250)	13,787	0.7	27.5	(40)
LTI	578	4.5	29.2	5.0	17.9	7,655	3.1	20.9	0	(150)	6,377	4.1	16.9	(50)
MPHL	439	5.0	27.2	5.4	14.7	4,864	3.4	20.0	(40)	(140)	3,696	3.3	16.6	(40)
MTCL	384	4.7	33.1	4.9	18.7	5,410	2.3	38.3	(50)	20	4,165	(4.8)	31.3	(20)
PSYS	214	7.7	40.3	8.0	13.3	2,142	2.8	46.3	(71)	10	1,709	(3.1)	24.0	(30)
COFORGE	231	4.0	33.9	4.9	17.8	3,094	16.3	80.0	180	417	2,439	30.6	87.4	(84)
ECLX	77	4.4	20.1	4.7	32.1	1,619	6.8	23.9	60	10	1,201	11.9	22.1	(30)

Source: BOBCAPS Research | *Refers to IT Services (excluding ISRE) | CC – Constant Currency

Fig 2 – Q4FY22 estimates – Internet

Company	Revenues (Rs mn)	Revenue growth YoY (%)	EBITDA margins (%)	EBITDA (Rs mn)	EBITDA growth YoY (%)	EBITDA margin YoY (bps)	Net profit (Rs mn)	Net profit growth YoY (%)
INFOE	4,060	40.0	30.0	1,218	130.2	1,176	1,156	74
INMART	1,977	10.0	41.2	814	(6.0)	(705)	795	45
JUST	1,745	(0.7)	7.3	127	(63.1)	(1,236)	178	(47)
AFFLE	2,636	86.2	19.0	501	45.2	(540)	375	(36)

Source: BOBCAPS Research

Fig 3 – Currency movement

Exchange rate	Mar'21	Dec'21	Mar'22	QoQ (%)	YoY (%)
USD/INR					
Average	72.9	74.7	75.4	0.9	3.5
Close	72.6	74.3	75.8	2.0	4.4
Euro/USD					
Average	1.20	1.14	1.12	(2.3)	(7.2)
Close	1.18	1.14	1.12	(2.3)	(5.5)
GBP/USD					
Average	1.38	1.35	1.33	(1.7)	(3.4)
Close	1.37	1.35	1.12	(17.3)	(18.4)

Source: RBI, BOBCAPS Research

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Recommendation scale: Recommendations and Absolute returns (%) over 12 months

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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