

Q3FY21 result preview

Top picks

Large caps

- Infosys
- HCLT

Mid-caps

- Mphasis
- Mindtree

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Technology

Preview Q3FY21 – fewer furloughs + residual comeback

In a seasonally soft quarter, we expect Indian IT to deliver strong sequential revenue growth led by (1) fewer-than-usual furloughs and (2) residual recovery from Covid-19 decline over H1CY20. Further, product-related seasonality / large deal ramp-ups too should help in some cases. Ex-TCS / HCLT (partly), wage hikes are still due hinting at stability / upward bias in margins. Q4FY21 / FY22 revenue outlook should be upped (vs Sep-20) given the recent trend of captive takeovers / large deal wins. (1) Margins in these deals, (2) client IT spends and (3) business confidence in Europe post Dec-20 lockdowns (~25% of revenue) will take center stage as focus shifts away from mere post Covid ‘comeback’ to ‘growth’. As balance sheet is becoming a key competitive advantage again, tier I vs tier II can re-emerge as a prominent debate. As highlighted in our recent note ([link](#)), we maintain a cautious stance given the disproportionate expectations and life-time high valuations of the sector. **INFO, HCLT, MPHL and MTCL** are our top picks.

- ▶ **Fewer-than-usual furloughs and residual recovery will help.** Barring a few cases (e.g. Mphasis, Co-forge), we expect furloughs to be less pronounced vs a typical December quarter as enterprises come out of lockdowns. Secondly, while Sep '20 witnessed a good demand recovery post revenue decline in H1CY20, revenue run-rate of many IT companies was still lower than Dec '19. To that extent, we expect the residual ‘come back’ to help growth in Dec '20. US\$ depreciation against GBP / Euro should add some cross-currency tailwinds. We expect HCLT / TechM to lead / lag the tier I and LTI / Co-forge to lead / lag the tier II on growth.
- ▶ **Margins should remain largely stable.** TCS / HCLT (partly) rolled out wage hikes for their employees with effect from Oct '20. For others, wage hikes are still due. Sequentially, we expect most of the cost elements to remain stable. INR appreciated marginally during Dec-20 (~0.7%), the impact of which should be more than offset by operational efficiencies. Except TCS / HCLT / Co-forge, we expect margin stability across most of our coverage companies with an upward bias.
- ▶ **Revenue outlook for Q4FY21 / FY22 should see an upgrade.** Over the previous 1-2 months, multiple tier-I firms announced IT captive takeover deals (e.g. Wipro - Metro AG, TCS - Deutsche bank / Pramerica, Infosys - Daimler). On the back of these, reported deal win TCV may be very strong and should also translate into an upgrade in the revenue outlook for Q4FY21 / FY22.

INFO should raise FY21 sales growth guidance to 3-4% (from 2-3%, YoY, CC). Wipro / HCLT may guide revenue growth of 0.5-2.5% / 1.5-2.5% (QoQ, CC) in Mar '20. FY21 EBIT margin guidance of INFO / HCLT will likely be upped to 24-24.5% (from 23-24%) / 20.5-21% (from 20-21%).

- ▶ **Investor focus may shift from mere ‘comeback’ to ‘growth.’** While resilience / adaptability in light of the ongoing pandemic were the key aspects of investor focus over H1CY20, ‘comeback’ from the Covid lows is the key theme playing out over H2CY20. Going forward, as investor focus shifts towards post Covid growth (acceleration?), conversations around (1) client IT spends, (2) business confidence in Europe (~25% of revenue, incl. UK) and (3) margins in captive takeover deals will likely take the center stage. As balance sheet is becoming a key competitive advantage again, tier I vs tier II can re-emerge as a prominent debate.

► **Disproportionate expectations + life time high valuations make us cautious.**

As highlighted in our recent sector outlook 2021 note ([link](#)), we expect 2021 to present an acid test for the lofty expectations around Covid-led (1) acceleration in cloud / digital adoption and (2) cost savings. Re-rating in Indian IT (up to ~45%, vs pre-Covid) hints at much taller and farther expectations vs even global tech (MSFT, Amazon, Alphabet, ~3-17%). As low base effect wears off, we expect these disproportionate / asymmetric expectations to correct in 2021.

In addition, rather than a pent-up demand, we are wary of the likelihood of IT spends actually turning out to be lower in 2021. Besides, potential margin drag due to captive take overs, resumption in travel / marketing events and weaker US\$ are the other foreseeable risks. Accordingly, we maintain a cautious stance on the sector. Prefer stocks with scope for idiosyncratic surprises and valuation comfort (INFO, HCLT, MPHL and MTCL).

Table 1: Q3FY21 expectations

Company	Rev growth (CC) % Q3FY21	Rev growth (US\$) %			Rev growth (INR) %			EBIT Margin (INR) %			Net Margin (INR) %		
		Q3FY21	Q2FY21	Q3FY20	Q3FY21	Q2FY21	Q3FY20	Q3FY21	Q2FY21	Q3FY20	Q3FY21	Q2FY21	Q3FY20
TCS	3.0	3.6	7.2	1.3	3.3	4.7	2.3	25.0	26.2	25.0	20.1	21.0	20.4
Infosys	3.3	3.8	6.1	1.0	3.3	3.8	2.0	25.3	25.3	21.9	20.1	19.7	19.3
Wipro	2.4	3.0	3.7	2.2	3.1	0.8	2.4	19.0	18.7	17.5	16.6	16.3	15.8
HCLT	3.4	4.0	6.4	2.3	3.5	4.2	3.5	20.7	21.6	20.2	16.7	16.9	16.7
Tech Mahindra	1.7	2.0	4.8	5.1	1.7	2.9	6.4	14.2	14.2	12.2	12.0	11.4	11.9
Mphasis	2.5	2.7	7.2	4.3	2.3	6.4	5.5	16.4	16.1	16.2	12.5	12.3	12.9
Persistent	4.0	4.5	3.9	3.1	4.1	1.7	4.3	12.8	12.1	8.7	11.7	10.1	9.5
LTI	5.0	5.5	3.6	8.4	5.1	1.7	9.4	19.9	19.9	16.2	15.6	15.2	13.4
Mindtree	3.5	4.0	3.1	1.5	4.0	0.9	2.7	17.3	16.7	12.0	13.6	13.2	10.0
Coforge	2.2	2.5	9.9	2.1	1.9	9.1	3.4	13.1	13.8	13.9	10.0	10.5	11.5

Company	Revenues (US\$ mn)			EBIT (Rs mn)			PBT (Rs mn)			PAT (Rs mn)			EPS (Rs)		
	Q3FY21	Q2FY21	Q3FY20	Q3FY21	Q2FY21	Q3FY20	Q3FY21	Q2FY21	Q3FY20	Q3FY21	Q2FY21	Q3FY20	Q3FY21	Q2FY21	Q3FY20
TCS	5,619	5,425	5,586	1,03,725	1,05,150	99,740	1,11,325	1,12,550	1,05,690	83,203	84,330	81,180	22.2	22.5	21.6
Infosys	3,438	3,312	3,243	64,200	62,280	50,640	69,550	67,500	58,490	51,119	48,450	44,570	12.0	11.4	10.5
Wipro	2,052	1,992	2,095	29,665	28,303	27,233	33,665	32,061	30,793	25,889	24,646	24,558	4.5	4.3	4.3
HCLT	2,607	2,507	2,543	39,822	40,160	36,700	41,228	41,520	37,360	32,047	31,420	30,370	11.8	11.6	11.2
Tech Mahindra	1,291	1,265	1,353	13,533	13,313	11,785	15,224	14,093	14,736	11,433	10,646	11,459	13.0	12.1	13.0
Mphasis	336	327	318	4,083	3,924	3,694	4,216	4,038	3,865	3,120	2,992	2,936	16.7	15.9	15.6
Persistent	142	136	129	1,343	1,218	806	1,653	1,375	1,140	1,232	1,020	879	16.1	13.3	11.5
LTI	427	405	394	6,258	5,956	4,568	6,331	6,131	4,998	4,923	4,556	3,773	28.0	26.0	21.5
Mindtree	271	261	275	3,476	3,215	2,364	3,704	3,447	2,579	2,726	2,537	1,970	16.5	15.4	12.0
Coforge	158	155	150	1,539	1,588	1,491	1,549	1,525	1,621	1,178	1,207	1,233	19.1	19.6	19.7

Source: Company data, I-Sec research

Table 2: Relative valuation table

	P/E (x)				Revenue growth (US\$, %)				EBIT (%)			
	FY20	FY21E	FY22E	FY23E	FY20	FY21E	FY22E	FY23E	FY20	FY21E	FY22E	FY23E
TCS	33.8	34.8	28.6	25.1	5.4	-0.9	10.4	9.8	24.6	24.9	26.0	26.5
Infosys	31.7	27.1	23.6	20.4	8.2	5.0	10.0	11.5	24.5	27.8	27.9	28.5
Wipro	23.0	21.8	19.6	18.0	1.7	-2.6	7.7	7.7	17.1	18.4	18.7	18.7
HCLT	22.6	19.8	17.1	14.6	15.1	1.9	11.6	11.4	19.6	20.9	21.1	21.5
TechM	20.6	18.9	16.1	13.8	4.3	-1.6	6.0	7.5	11.6	13.4	14.5	15.5
Mphasis	24.6	24.3	19.8	16.9	10.8	6.1	11.3	12.4	16.0	15.9	17.3	17.7
Persistent	32.7	26.6	20.3	17.1	4.3	9.5	9.6	9.7	9.2	11.3	13.0	14.0
LTI	41.8	34.6	28.9	22.6	13.0	9.0	17.6	21.3	16.1	18.9	18.6	19.2
Mindtree	41.7	25.8	21.1	17.5	8.7	-2.0	15.2	12.0	10.5	16.6	16.7	17.5
Coforge	36.8	35.4	28.4	24.4	11.1	4.8	11.8	10.1	13.1	13.0	14.1	14.7

	EPS (Rs)				RoE (%)			
	FY20	FY21E	FY22E	FY23E	FY20	FY21E	FY22E	FY23E
TCS	86.2	83.5	101.6	115.9	36.4	36.5	40.4	38.5
Infosys	38.9	45.6	52.3	60.6	25.2	26.6	26.4	26.4
Wipro	16.6	17.5	19.5	21.2	17.3	18.8	19.7	18.3
HCLT	40.7	46.5	53.7	62.8	24.3	22.6	21.2	21.0
TechM	45.9	50.1	59.0	68.8	18.5	17.9	18.7	19.4
Mphasis	63.1	64.0	78.5	92.0	21.4	20.6	23.9	24.7
Persistent	44.4	54.4	71.3	84.9	14.3	15.7	18.3	19.3
LTI	86.7	104.6	125.5	160.7	31.1	30.8	30.2	31.6
Mindtree	38.3	62.0	75.6	91.5	20.0	25.8	25.8	25.4
Coforge	72.1	75.0	93.5	108.9	18.8	19.8	21.7	21.8

Source: Company data, Bloomberg, I-Sec Research

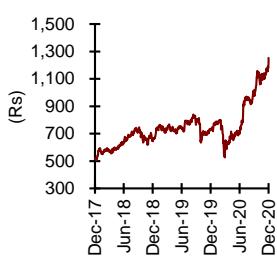
Table 3: Exchange rates

	Closing rate for the quarter ending:			Average rate for the quarter ending:		
	Sep'20	Dec'20	Chg (%)	Sep'20	Dec'20	Chg (%)
USD/GBP	1.29	1.34	4.0	1.29	1.32	2.0
USD/EUR	1.17	1.22	4.2	1.17	1.19	1.8
USD/AUD	0.72	0.76	5.5	0.72	0.73	1.8
INR/USD	73.77	73.90	0.2	74.37	73.81	(0.8)

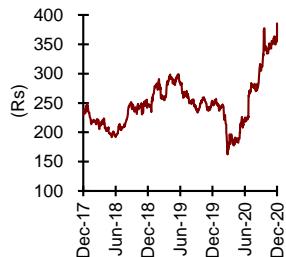
Source: Bloomberg, Exchange rates considered till December 22, 2020.

Price charts

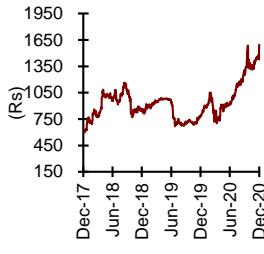
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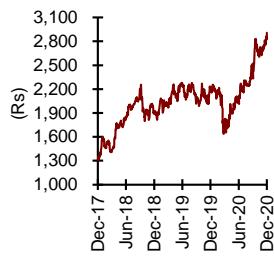
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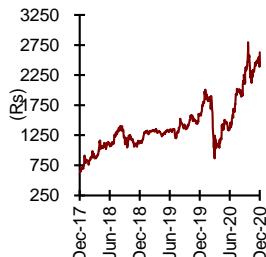
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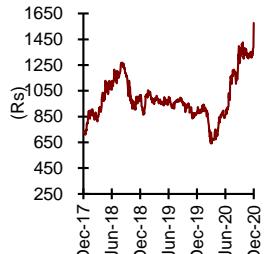
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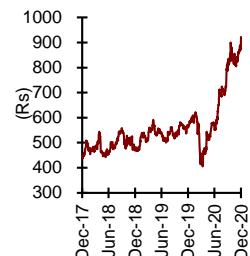
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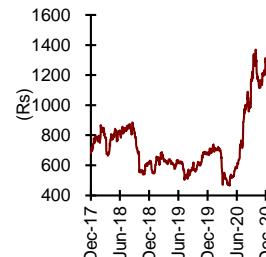
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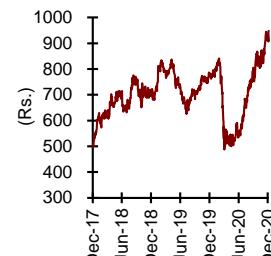
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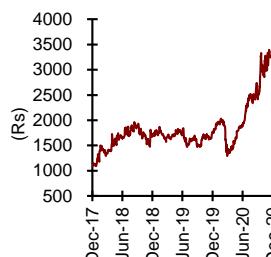
Persistent Systems



Tech Mahindra



L&T Infotech



Source: Bloomberg

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