

IT Services

Sector Update

December 18, 2020

Demand environment remains intact, Strong acceleration in cloud adoption!

Quick Pointers:

- ACN's outsourcing order book stood at 6.3\$ Bn, grew 46.5% YoY in USD terms (quarterly average of 5.93\$ Bn in FY20). This mirrors well for demand for Tier-1 Indian IT companies.
- Consulting order book grew 9.3% YoY (+2.2% QoQ) indicating pickup in discretionary spends.

Accenture reported strong revenue growth, order bookings and raised guidance underscoring the accelerated demand for technology transformation. Most leading companies are simultaneously transforming multiple parts of their enterprises. Pre-COVID digital leaders are racing to widen the gap and digital laggards are racing to leap frog. This is driving force for broad based recovery across IT industry.

ACN's outsourcing order book stood at 6.3\$ Bn, grew 46.5% YoY in USD terms (quarterly average of 5.93\$ Bn in FY20). This mirrors well for demand for Tier-1 Indian IT companies. Consulting order book grew 9.3% YoY (+2.2% QoQ) indicating pickup in discretionary spend. ACN management stated that transition to cloud is a mega trend across the entire spectrum of low to highly impacted industries due to COVID. ACN's high double digit growth in cloud resonates well with commentary of accelerated demand for cloud migration by Indian IT companies. ACN's revenue growth and order book was broad based across verticals and markets. Strong rebound in BFSI for ACN can be seen as continued improvement in BFSI demand for Indian IT. ACN maintained their view of strong growth recovery in 2H of high single digit with nil impact of reimbursable travel costs. Accenture results reinforces our view of i) accelerated demand for cloud adoption ii) rising number of large transformation deals iii) broad based demand across all industry verticals

Post the run up of sector in last 6 months, Indian IT sector valuation may appear rich when compared to its long- term historical average. However, in our view Valuations should not be looked separately and should also factor key aspects such as 1) Sector has entered into Technology Upcycle, 2) Valuations has a strong co-Relation with sales & earnings growth, 3) Prolonged low interest rate environment, 4) Digital becoming mainstream, 5) Strong order book & deal pipeline. Considering these key aspects, we continue to believe that Valuations are still reasonable & we continue to remain bullish on Indian IT Sector. Our preference order in Large Caps, remains INFY, HCLT & TCS and in Tier-2 COFORGE, LTI, Mindtree & Mphasis.

- **Revenue beats guidance, strong momentum in outsourcing continues:** ACN's 1QFY21 revenue grew 2% YoY local currency to USD11.76bn, exceeding their guidance of USD11.55-11.95 by \$200mn. Outsourcing growth momentum continued with 8% YoY local currency growth in this quarter. Consulting revenues improved 11% QoQ USD terms indicating good pickup in discretionary spends.

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- **Upward revision of guidance:** ACN raised its full-year guidance band to 4%-6% vs 2-5% previously and management sounded confident of good order book. Inorganic initiatives would contribute 2% in FY21. ACN expects the operating margin for the full year to be in the range of 14.8-15% (vs 14.7% in FY20). Management guided for Q2 revenue of USD 11.55-11.95 bn, implying growth of 1-4% in local currency terms (including Fx impact: +3% QoQ).
- **Broad based growth across industry verticals and markets:** Growth was broad based with Health and public service, Financial services and Communications & HiTech growing at 11%, 5% and 3% YoY in local currency. Strong growth in Financial Services mirrors well for Indian IT services.
- **Cloud performed better than expected generating 12\$ Bn revenues in FY20 and accelerated in high double digit growth in 1Q21.** Cloud has become a mega trend across all industry verticals – including entire spectrum of low to highly impacted industries by pandemic
- **Strong order book momentum to continue:** Overall bookings grew 25% YoY at USD 12.9bn with book-to-bill ratio at 1.1x [FY20 average quarterly order book USD 12.4bn]. Consulting book-to-bill stood at 1.04x whereas outsourcing book-to-bill stood at 1.16x Consulting bookings increased 9.3% YoY as enterprises continued to reinvent their business to remain relevant to the client. Continued strong growth in outsourcing bookings 46.5% YoY bodes well for Indian IT companies.

Exhibit 1: Quick View of Accenture results

(USD mn)	1QFY20	4QFY20	1QFY21	QoQ gr.	YoY gr.
Revenues	11,358	10,836	11,762	8.54%	3.5%
EBIT	1,767	1,545	1891	22.4%	7.0%
<i>EBIT Margins (%)</i>	<i>15.5</i>	<i>14.3</i>	<i>16.2</i>		
PBT	1,800	1,783	1986		
Provision for taxes	425	478	464		
Net income	1375	1305	1522	16.6%	10.6%
<i>Net income margins (%)</i>	<i>12.1</i>	<i>12.0</i>	<i>12.9</i>	<i>0.75%</i>	<i>6.6%</i>

Source: Company, PL

Key Takeaways from management commentary

- **Accelerated demand for transition to cloud:** Transition to cloud is a mega trend across all industries – including entire spectrum of low to highly impacted industries by pandemic. Factors driving this trend of movement to cloud are i) Immediate savings ii) resilience iii) security iv) cloud enables data driven transformation and reap early business value. 4 out of 10 acquisitions in this quarter have been in this cloud space.
- **Speed of technology transformation has increased manifold:** Management indicated that organizations are going through broad compressed transformation i.e. simultaneously addressing digital transformation of all functions such as finance, supply chain, operations, movement to cloud etc. The speed of transformation matters the most as enterprises are in a race to gain edge over others.

- Management expects high single digit to low double digit growth in 2H21 driven by – i) improvement in macro-environment, ii) transformational deals won last year, iii) Growth in S&C to come back to pre-COVID levels iv) reimbursable travel costs won't be headwind in 2H.
- **Acquisition:** Accenture closed 10 strategic acquisitions this quarter in strategic areas such as Cloud, Intelligent Operations and Industry X. Management expects to invest at least 1.7Bn \$ in acquisition this fiscal year.
- **Highest utilization reported in last 10 years:** Higher utilization of 93% in 1Q was driven by higher revenue growth. Management stated that this is not a structural change and utilization will come back to normal range in next quarter. ACN reported 16.1% i.e. +50bps YoY increase in operating margin driven by lower travel cost and higher utilization.
- Accenture launched new brand campaign around their new purpose and growth strategy - To deliver 360-degree value to their clients

Accenture Trends

Exhibit 2: Broad based revenue growth

Segments	Revenue (USD mn)	YoY Gr.	Local currency
Communications, Media & Technology	2,333	4%	3%
Financial Services	2,346	7%	5%
Health & Public	2,212	12%	11%
Products	3,206	0%	-3%
Resources	1,664	-4%	-5%

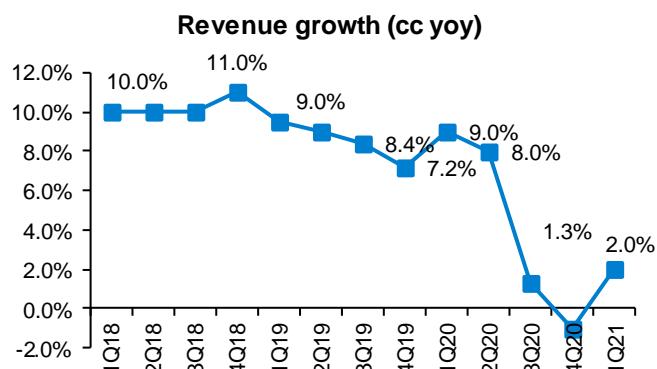
Source: Company, PL

Exhibit 3: Continued strong growth in outsourcing, pickup in consulting

Segments	Revenue (USD mn)	YoY Gr.	Local currency terms
Consulting	6,333	-1%	-2%
Outsourcing	5,430	9%	8%

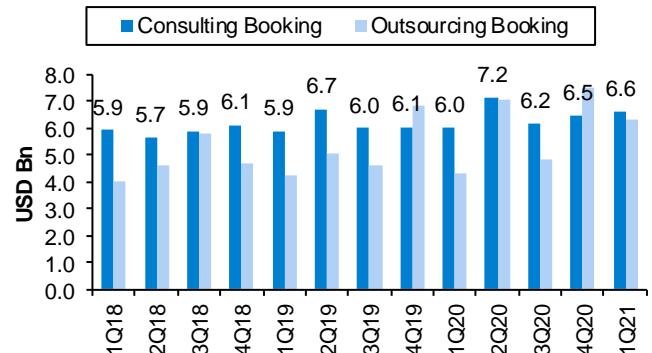
Source: Company, PL

Exhibit 4: Revenue growth of ACN

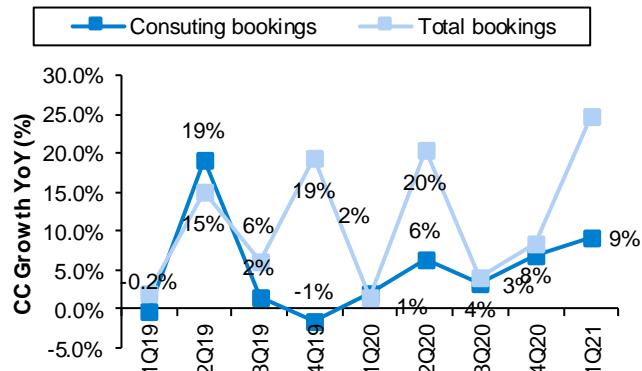


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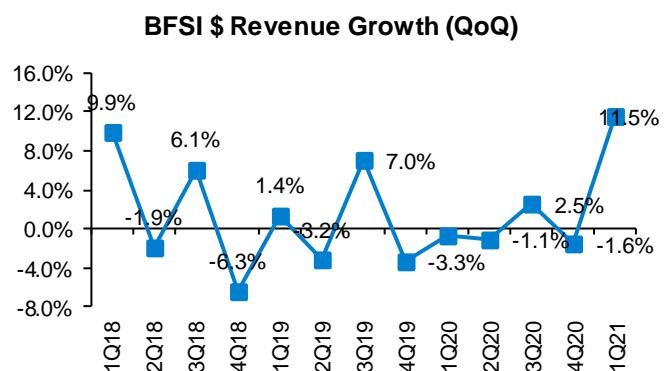
Exhibit 5: Outsourcing momentum continues, consulting



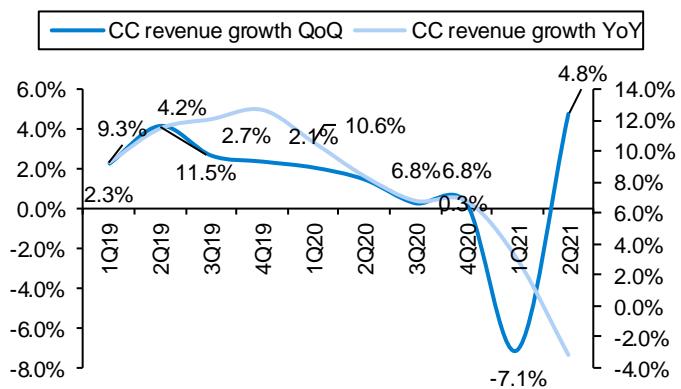
Source: Company, PL

Exhibit 6: Improved bookings

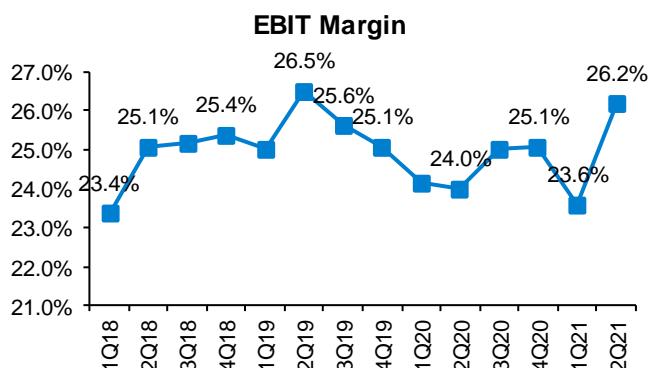
Source: Company, PL

Exhibit 7: Volatility in performance of BFSI vertical

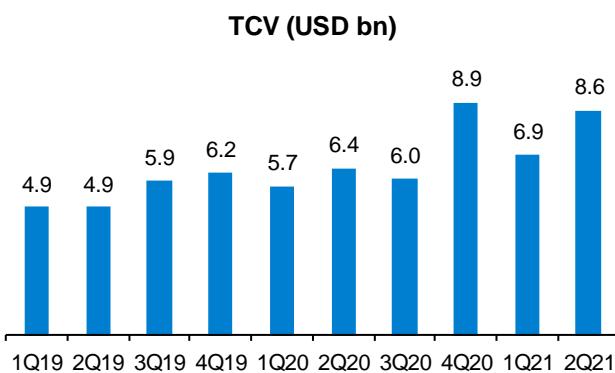
Source: Company, PL

TCS Trends**Exhibit 8: Revenue Momentum to remain**

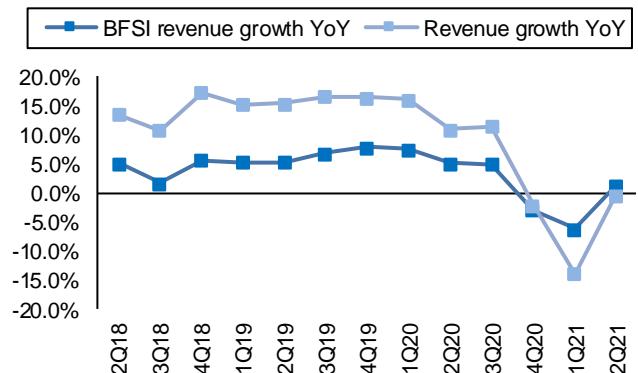
Source: Company, PL

Exhibit 9: Superior margins to sustain

Source: Company, PL

Exhibit 10: Strong Deal pipeline

Source: Company, PL

Exhibit 11: Expect BFSI to grow in FY21E

Source: Company, PL

Analyst Coverage Universe

Sr. No.	Company Name	Rating	TP (Rs)	Share Price (Rs)
1	Coforge	BUY	2,784	2,457
2	Cyient	BUY	492	485
3	HCL Technologies	BUY	1,101	830
4	Infosys	BUY	1,436	1,137
5	L&T Technology Services	Accumulate	1,860	1,754
6	Larsen & Toubro Infotech	BUY	3,465	3,259
7	Mindtree	BUY	1,625	1,441
8	Mphasis	BUY	1,711	1,382
9	Persistent Systems	BUY	1,368	1,189
10	Redington (India)	BUY	138	138
11	Sonata Software	BUY	427	339
12	Tata Consultancy Services	BUY	3,200	2,736
13	TeamLease Services	BUY	2,677	2,724
14	Tech Mahindra	BUY	1,042	848
15	Wipro	BUY	415	345
16	Zensar Technologies	BUY	215	225

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Buy	: > 15%
Accumulate	: 5% to 15%
Hold	: +5% to -5%
Reduce	: -5% to -15%
Sell	: < -15%
Not Rated (NR)	: No specific call on the stock
Under Review (UR)	: Rating likely to change shortly

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