December 30, 2020

Healthy topline growth despite seasonally weak quarter

Normally, this quarter is seasonally weak due to furloughs. However, this year we believe there will be an aberration to this trend. We expect companies to report healthy revenue growth in this quarter led by lower furloughs, improvement in demand post Covid-19 and ramp up of deals won in the previous quarters. This, coupled with cross currency tailwind, will further boost revenue growth in the quarter. The companies are also seeing a demand tailwind in terms of cost takeout by clients (led by higher offshoring & automation), vendor consolidation opportunities, captive carve outs and traction in cloud & customer experience that could further propel demand in coming quarters. In terms of margins, we expect them to remain stable (barring TCS, HCL Tech & Coforge) mainly due to cross currency benefits, lower furloughs, offshoring partially offset by rupee appreciation.

We expect Tier-1 IT companies to see revenue growth in the range of ~2-3% in constant currency terms. This, coupled with cross currency tailwind of ~50-60 bps will further positively impact dollar revenue growth (in the range of 3-4%). Among tier 1, HCL Tech, Infosys are expected to see dollar revenue growth of 4.0%, 3.8%, respectively. Tata Consultancy Services (TCS), Wipro are expected to witness dollar revenue growth of 3.6%, 2.9%, respectively. Among Tier 2, LTI is expected to see a sharp rise in dollar revenues of 5.5% QoQ followed by Mindtree, which is expected to witness revenue growth of 3.8% QoQ. We prefer Infosys in tier-1 and LTI in midcap.

Margins to remain stable barring companies giving wage hikes

Infosys & Wipro are expected to register 2-18 bps improvement in EBIT margins due to lower travel cost, rationalisation and operational efficiencies partially offset by rupee appreciation. However, TCS & HCL Tech are expected to witness margin decline of ~100 bps mainly led by wage hikes.

In midcap, Mindtree to report healthy margins

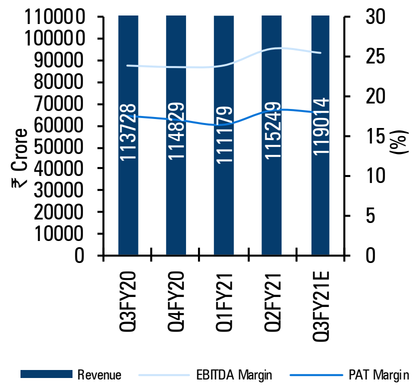
Midcap companies are expected to report 3-45 bps improvement in EBITDA margins, with Mindtree leading margin growth with 45 bps QoQ improvement. However, Coforge is expected to register 75 bps QoQ decline in EBITDA margins mainly due to negative operating leverage.

Exhibit 1: Estimate for Q3FY21E (₹ crore)

Company	Revenue	Change (%)		EBITDA	Change (%)		PAT	Change (%)	
	Q3FY21E	YoY	QoQ	Q3FY21E	YoY	QoQ	Q3FY21E	YoY	QoQ
HCL Tech	19,241.7	6.1	3.5	4,906.6	9.8	-0.9	3,097.6	2.0	-1.4
Infosys	25,371.4	9.9	3.3	7,290.2	25.7	2.9	5,125.9	15.0	5.7
InfoEdge *	296.8	-7.4	15.9	91.4	-13.7	77.4	80.4	-11.7	57.1
L&T Infotech	3,149.4	12.0	5.0	721.2	36.7	5.2	491.6	30.5	7.6
Mindtree	1,999.4	1.7	3.8	414.1	35.2	6.1	253.7	28.8	0.0
Coforge	1,181.6	10.1	2.4	200.9	3.5	-1.9	113.1	-8.3	-6.3
TCS	41,470.2	4.1	3.3	11,404.3	4.9	-0.9	8,578.4	5.7	-1.3
Teamlease	1,267.6	-6.2	12.3	29.2	6.1	26.8	23.0	-9.8	23.4
Tech Mahindra	9,525.4	-1.3	1.6	1,733.6	10.9	1.8	1,117.4	-2.5	5.0
Wipro	15,510.5	0.3	2.6	3,602.8	10.8	3.8	2,583.4	5.2	4.8
Total	**1,19,014.1**	**4.6**	**3.3**	**30,394.4**	**12.1**	**1.1**	**21,464.4**	**7.2**	**1.6**

Source: Company, ICICI Direct Research

Topline, Profitability (Coverage Universe)



Dollar growth, QoQ

IT Services	Q3FY21E	Q2FY21	Growth (%)
TCS	5,619.3	5,424.0	3.6
Infosys	3,437.9	3,312.0	3.8
Wipro ^	2,050.2	1,992.4	2.9
HCL Tech	2,607.3	2,507.0	4.0
Tech M	1,290.7	1,265.4	2.0
LTI	426.7	404.5	5.5
Mindtree	270.9	261.0	3.8
Coforge	159.5	154.9	3.0
Internet & Staffing (in ₹)			
Info Edge	296.8	256.1	15.9
Teamlease	1,267.6	1,129.1	12.3

^ IT services

Top Picks

Infosys, LTI

Research Analysts

Devang Bhatt
devang.bhatt@icicisecurities.com

Annual guidance revision, commentary to be of key interest

During the quarter, many large cap IT companies like TCS, Infosys and Wipro won large deals (led by captive takeovers). Margins in these deals will be of key investor interest. In addition, with Brexit and many companies focus on Europe, commentary in this geography will be a key thing to watch. In addition, digital revenue growth, deal pipeline, vertical specific commentary, offshoring, margin trajectory, guidance revision and long-term IT trends become important from an investor's perspective.

Exhibit 2: Company Specific view

Company	Remarks
TCS	Lower furloughs, recovery in demand (impacted due to Covid-19) and cross currency benefits are expected to positively impact Q3FY21E revenues. TCS is also expected to register 3.0% QoQ growth in constant currency led by anticipated improvement in demand from BFSI, healthcare and retail, project ramp up and lower furloughs. Further, cross currency tailwind would lead to revenue growth of 3.6% QoQ in dollar terms. In rupee terms, revenue is expected to increase 3.3% QoQ (lower than dollar growth due to rupee appreciation). EBIT margins are expected to decline 111 bps led by wage hike & rupee appreciation partially offset by operational efficiencies. **Investor interest**: Trends in digital technologies, margins in captive takeover deals, changes in delivery model, commentary in deal pipeline, trend across verticals and key long term trends
Infosys	We expect Infosys to report 3.3% QoQ increase in revenues in constant currency terms mainly led by ramp up of Vanguard deal, acquisitions and ramp up of other large deals. The company is witnessing a healthy deal pipeline led by traction in cloud, customer experience and in large deals, which involve cost takeout. With cross currency tailwind, we expect Infosys' dollar revenues to increase 3.8% QoQ. In addition, despite headwind of rupee appreciation, we expect EBIT margins to remain stable at 25.3% mainly led by cost rationalisation and lower travel & facility cost. PAT is expected to increase 15% YoY due to healthy operating margins (led by Covid 19 related savings, operational efficiencies and rupee depreciation) and absence of investments made in the previous year. **Investor interest**: Upward revision in revenue and margin guidance, commentary on margins of captive takeover deals, wage hikes, traction in digital technologies, vertical wise commentary and pricing environment
Wipro	Ramp up of deals won in previous quarters (like John Lewis) and healthy volumes in small & medium deals is expected to drive revenues (up 2.4% QoQ in CC terms). Further, with cross currency tailwind, we expect dollar revenues to increase 2.9% QoQ. EBIT margins in global IT services are expected to increase 18 bps QoQ to 19.5% mainly led by simplification of organisation structure and operational efficiencies. In rupee terms, overall revenues are expected to increase 2.6% QoQ. Overall EBIT margins are expected to increase 40 bps QoQ to 19.0%. **Investor interest**: Progress of new strategy under the new CEO, wage hikes quantum, margin in captive takeover, deal pipeline and revival timeline of impacted verticals
HCL Tech	Strong growth in cloud adoption, improvement in mode 2 revenues and easing of stress in ER&D segment is expected to drive revenues (up 3.4% QoQ). Further, tailwind from cross currency revenues is expected to boost dollar revenues (up 4.0% QoQ). In rupee terms, revenues are expected to grow 3.5% QoQ (lower than dollar revenue growth due to rupee appreciation). However, EBIT margins are expected to decline 96 bps QoQ mainly led by partial wage hikes. Consequently, PAT is expected to decline 1.4% QoQ. **Investor interest**: Upward revision in margin and revenue guidance, outlook on IMS revenues, product revenues, vertical wise commentary and acquisition strategy
Tech Mahindra	Tech Mahindra is expected to witness 2.0% QoQ growth in dollar revenues led by healthy traction in communication and enterprise segment. However, due to rupee appreciation, rupee revenues are expected to grow 1.6% QoQ. Further, despite headwind of furloughs and rupee appreciation margins are expected to be flat led by rationalisation of sub-contracting cost and operational efficiencies. PAT is expected to decline 2.5% YoY mainly due to lower other income. **Investor interest**: Deal pipeline in telecommunication & enterprise segment, opportunities in 5G, margin improvement in portfolio companies and long term growth opportunity

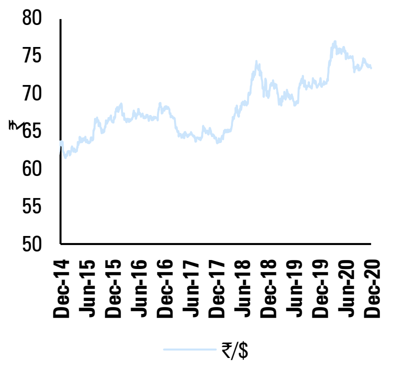
Source: Company, ICICI Direct Research

EBIT/EBITDA margin impact

EBIT margins	Q3FY21E	Q2FY21	Change (bps)
TCS	25.1	26.2	(111)
Infosys	25.4	25.3	2
Wipro ^	19.5	19.3	18
HCL Tech	20.6	21.6	(96)
EBITDA margins			
Tech M	18.2	18.2	3
LTI	22.9	22.9	3
Mindtree	20.7	20.3	45
Coforge	17.0	17.8	(75)
Internet & Staffing (in %)			
Info Edge	30.8	20.1	1,067
Teamlease	2.3	2.0	26

^ IT services

$/₹



$ vs. global currencies

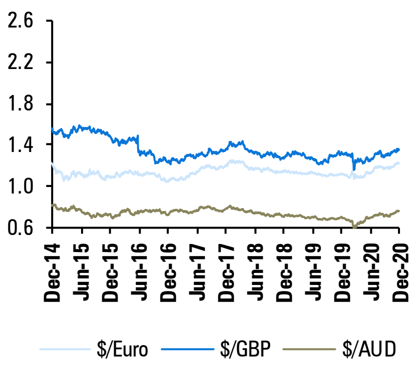


Exhibit 3: Company Specific views

Company	Remarks
Larsen & Toubro Infotech	The company is expected to outperform midcap companies in terms of revenue growth. LTI is expected to report robust growth in dollar revenues (up 5.5% QoQ & 8.2% YoY) mainly led by expected improvement in hi tech, media & entertainment, pharma, ramp up of large deals won, higher cloud adoption by clients and improving growth in top client. In rupee terms, revenue is expected to grow 5% QoQ. EBITDA margins are expected to remain flat QoQ to 22.9%. PAT is expected to increase 30% YoY mainly due to low base and higher operating margins. **Investor Interest**: Progress of large deal won in UAE, digital technology outlook, margin trajectory, deal conversion, new logo addition and PAT margin range
Info Edge	Billings in Naukri and 99 Acres declined 20.3% YoY and 22.8% YoY, respectively. We believe that in the near term, revenues will be under pressure and, hence, expect revenues to decline 7.4% YoY in Q3FY21E. In addition, we expect margins on a YoY basis to decline 225 bps YoY to 30.8%. However, on a QoQ basis we expect revenues to increase 15.9% QoQ mainly led by green shoots in economy and improving trend in IT, healthcare, education & telecom. Further, margins on a QoQ basis are expected to improve from 20.1% to 30.8% due to operating leverage benefits and low base in previous quarter. As a result, PAT is expected to increase 57.1% QoQ. **Investor interest**: Outlook on recovery of key verticals, acquisition via fund raising, update on venture fund and update on Zomato, PolicyBazaar & other new investments
MindTree	MindTree is expected to report revenue growth of 3.8% QoQ in dollar terms mainly led by improving growth in top client, improved traction across verticals and cross currency tailwind. In rupee terms, revenues are expected to increase 3.8% QoQ. Further, EBITDA margins are expected to increase 45 bps QoQ mainly led by pyramid rationalisation, SG&A optimisation and automation & productivity. PAT is expected to increase 28.8% YoY mainly due to low base in the previous year. **Investor interest**: Expansion in Europe, multi-year annuity deals, progress on rationalisation of tail accounts, mining of strategic accounts, margin outlook, travel vertical outlook, growth in top client and merger with LTI
Coforge	Coforge's revenue growth in the quarter is expected to be lower than some of its midcap peers due to higher base in the previous quarter (up 10.5% QoQ in Q2FY21). The company is expected to register revenue growth of 3.0% QoQ mainly led by improvement in banking, insurance and healthcare. In terms of rupee revenues, Coforge is expected to grow 2.4% QoQ (lower than dollar revenue growth due to rupee appreciation). However, EBITDA margins are expected to decline 75 bps QoQ due to negative operating leverage. PAT is expected to decline 6.3% QoQ and 8.3% YoY due to lower operating margins. **Investor interest**: Outlook on travel vertical, large deal pipeline in BFSI, insurance & healthcare and margin outlook
Teamlease Services	Although Teamlease's revenues are expected to decline YoY due to impact of Covid-19, we expect revenues to increase QoQ. The company is expected to report revenue growth of 12% QoQ mainly led by festive season and green shoots in economy. We expect general staffing to improve 13% QoQ and specialised staffing to improve 3.0% QoQ. Further, we expect EBIT margins to improve 26 bps QoQ & YoY to 2.3% mainly led by rationalisation of core employee headcount, reduction in losses in other HR services and improvement in specialised staffing margins. Consequently, we expect PAT to increase 23.4% QoQ. However, we expect PAT to decline 9.8% YoY mainly led by lower other income and higher tax expenses. **Investor interest**: Outlook on general staffing & specialised staffing, outlook on other HR services profitability and long term margin trajectory

Source: Company, ICICI Direct Research

Exhibit 4: ICICI Direct Coverage universe IT

Company	Cmp (₹)	TP (₹)	Rating	Mcap (₹ Cr)	EPS (₹)				P/E (x)				RoCE (%)				RoE (%)			
					FY20	FY21E	FY22E	FY23E	FY20	FY21E	FY22E	FY23E	FY20	FY21E	FY22E	FY23E	FY20	FY21E	FY22E	FY23E
HCL Tech (HCLTEC)	944	1,105	Buy	2,56,142	40.8	45.6	53.2	61	23	21	18	15	23.0	23.8	24.9	25.3	21.6	20.7	21.0	20.9
Infosys (INFTEC)	1,252	1,450	Buy	5,33,300	38.9	46.3	49.8	57	32	27	25	22	30.8	33.7	33.6	35.6	25.2	27.4	27.2	28.7
TCS (TCS)	2,934	3,410	Buy	11,01,137	86.2	87.5	104.0	118	34	34	28	25	43.5	44.6	49.0	53.0	37.5	37.2	42.4	45.7
Tech M (TECMAH)	978	1,105	Buy	94,672	45.9	50.0	58.8	69	21	20	17	14	19.1	18.7	19.8	20.9	18.5	18.3	18.9	19.5
Wipro (WIPRO)	385	435	Hold	2,19,611	16.6	18.1	19.7	22	23	21	20	17	19.3	21.0	22.3	24.4	17.4	18.6	19.9	21.8
Mindtree (MINCON)	1,629	1,680	Buy	26,841	38.3	60.9	69.6	79	43	27	23	21	23.0	30.6	30.5	30.3	20.0	26.3	25.8	25.2
LTI (LTINFC)	3,605	3,850	Buy	62,967	86.6	105.9	126.5	149	42	34	29	24	30.7	31.8	31.6	31.3	28.1	28.3	28.3	28.0
Coforge (NIITEC)	2,691	2,690	Hold	16,303	71.4	75.7	94.4	110	38	36	29	24	23.0	25.5	27.0	27.6	18.5	20.1	22.0	22.6
Infoedge (INFEDG)	4,769	4,090	Buy	61,328	26.8	24.9	33.1	39	178	192	144	122	18.0	9.5	11.9	13.2	13.5	7.1	9.0	10.0
Teamlease (TEASER)	2,530	2,840	Buy	4,325	20.5	57.5	67.7	86	124	44	37	30	15.0	15.4	15.8	17.0	6.5	15.0	14.8	16.0

Source: Company, ICICI Direct Research

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Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%

Pankaj Pandey **Head – Research** **pankaj.pandey@icicisecurities.com**

ICICI Direct Research Desk,
ICICI Securities Limited,
1st Floor, Akruti Trade Centre,
Road No 7, MIDC,
Andheri (East)
Mumbai – 400 093
research@icicidirect.com

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