

Traction in topline growth

Tata Consultancy Services	
Rating	Hold
TP	4,147
PE	32x
Infosys Ltd	
Rating	Hold
TP	1,789
PE	26x
MindTree	
Rating	Neutral
TP	4,398
PE	40x
Coforge Limited	
Rating	Accumulate
TP	6,110
PE	35x
Persistent Systems	
Rating	Hold
TP	3,981
PE	34x
L&T Technology Services	
Rating	Hold
TP	4,990
PE	42

Source: Arihant Research

Q2 FY22 Preview- Expect a Good Quarter

We expect another good quarter of growth for IT services companies. Deal intake remains healthy across the industry, driven by a strong demand environment and steady deal closures. Deal signings will be robust, and the pipeline will stay healthy. Margin is likely to remain under pressure for few companies (MindTree, Infosys) due to wage revisions and attrition will be the key factor to watch. **Amongst the Tier I, TCS will be our preferred pick and Coforge & Persistent Systems in the Tier II techs.**

Revenue. Growth momentum to continue in Q2 FY22 on the back of broad-based demand, strong deal wins, continued traction in digital and cloud, ramp-up of large deals and demand recovery in highly impacted verticals (travel, hospitality and manufacturing). We expect Infosys to raise its FY22 revenue growth guidance to 15-17% CC YoY (current 14-16%). Tier- I companies on the back of healthy deal wins and pipeline, client mining, and consistent execution over tier- II companies are expected to maintain growth outperformance. The shortage of skilled resources remains a key challenge in the short term.

Attrition rate and wage: We expect uptick in attrition rates and higher subcontracting and recruitment costs. TCS is likely to report margin expansion on the back of normalization of wage hikes and revenue growth-led operating leverage.

While skill based cost has increased in the market, expect companies to try to better size their pyramids in order to balance the increase. Hiring across our IT coverage will continue to remain high as companies try to manage demand and backfill growing attrition, which will be a key focus area for investors.

PAT: We expect our IT coverage universe to deliver a strong PAT growth sequentially and on annual basis . TCS/Infosys is expected to report a PAT growth of 10%/3% YoY. PAT growth for MindTree would be slightly subdued on account of a YoY dip in margin.

View: Sector valuations remain on the higher side, we remain positive as the demand environment continues to stay strong. Double-digit topline growth should be sustainable in the near to medium term. Whereas higher recruitment costs as the war for talent intensifies, are likely to weigh in on margins. We expect healthy deal wins in Q2 FY22 backed by accelerated demand for digital transformation and cloud adoption and spending on higher technology. We have introduced FY24E and revised earnings estimates of IT companies within our coverage universe, factoring in recent acquisitions, continued demand momentum and currency movement in Q2 FY22.

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Q2 FY22 Earnings Estimates:

INR (Mn.)	Q2FY22E	Q1FY22A	Q2FY21A	QoQ	YoY	Remarks
Tata Consultancy Services						
Revenue (CC Terms) (Mn USD)	6357	6154	5424	3%	17%	We expect USD revenue to grow 3% QoQ, factoring in ~70 bps cross currency headwinds. EBIT margin is expected to expand 28 bps YoY due to normalization of wage hikes and revenue growth led operating leverage. we are expecting strong growth led by recovery in the India business and momentum of deal wins in the 1QFY22. Expect reporting of robust TCV due to continued momentum in deal wins.
Net Revenue	473,590	454,110	401,350	4%	18%	
EBIT	125,410	115,880	105,150	8%	19.3%	
EBIT Margin	26.5%	25.5%	26.2%	96bps	28bps	
PAT	98,690	90,080	74,750	10%	32%	
Infosys						
Revenue (CC Terms) (Mn USD)	3941	3782	3312	4%	19%	We expect Net revenue is likely to grow at 6% QoQ. EBIT margin may fall by 162bps YoY due to salary hikes, supply-side challenges, high subcontracting costs and Daimler deal transition costs. Key things to watch: steps taken to manage supply-side challenges and available levers to defend margins and demand environment in BFSI, Manufacturing, Retail, and Communications, pricing environment. Deals pipeline and deal closure momentum.
Net Revenue	294,790	278,960	245,700	6%	20%	
EBIT	69,960	66,030	62,280	6%	12%	
EBIT Margin	23.7%	23.7%	25.3%	6bps	-162bps	
PAT	53,520	51,950	48,450	3%	10.5%	
Coforge Limited						
Revenue (CC Terms) (Mn USD)	210	200	157	5%	33.8%	We expect EBITDA margins to expand by 213bps QoQ on the back of the revenue growth momentum lower visa costs, higher offshoring, better utilization and uptick in Advantage Go license revenue. We expect net revenue to grow 10% sequentially and Key things to watch out in Q2FY22 are Deal intake during the quarter and growth in deal pipeline, Top client and progress on scaling other major clients, margin outlook.
Net Revenue	16036	14616	11537	10%	39.0%	
EBITDA	2661	2114	2531	26%	5%	
EBITDA Margin	16.6%	14.5%	21.9%	213bps	-534bps	
PAT	1698	1312	1768	29%	-4.0%	
MindTree						
Revenue (CC Terms) (Mn USD)	334	311	261	7%	28%	Net revenue to grow 7% on QoQ as expect strong growth across all verticals led by RCM and CMT. Expect growth momentum in BFSI and Travel to continue. Expect deal wins to increase on an annual basis. Expect growth in 2-20 client groups. Expect top clients to continue to grow as well. Outlook on current deal wins, top client, and margin.
Net Revenue	24845	22917	19260	8%	29%	
EBITDA	4173	4063	3334	3%	25%	
EBITDA Margin	16.8%	17.7%	17.3%	-93bps	-51bps	
PAT	3362	3434	2537	-2%	33%	
Persistent Systems						
Revenue (CC Terms) (Mn USD)	179	167	136	7.4%	32%	We expect 7.4% QoQ CC revenue growth backed by healthy growth in the healthcare segment. Expect EBIT margins to decline marginally by 39 bps sequentially due to salary hikes, partly negated by revenue growth momentum, lower visa cost and higher utilization. Expect reporting of robust TCV compare to last quarter (\$246) due to continued momentum in deal wins. We expect lower other income due to recent acquisition in the BFSI segment.
Net Revenue	13302	12299	10077	8%	32%	
EBITDA	2128	2015	1664.0	6%	28%	
EBITDA Margin(%)	16.0%	16.4%	16.5%	-39bps	-52bps	
PAT	1567	1535	1020	2%	54%	
L&T Technology Services						
Revenue (CC Terms) (Mn USD)	214	206	178	4%	20.2%	We expect 4% QoQ CC revenue growth. Expect growth momentum across verticals. key things to watch in Q2FY22 are Deal intake, pipeline and industry Outlook. Demand trends in key sectors outlook. We Expect strong demand commentary.
Net Revenue	15897	15184	13138	5%	21.0%	
EBITDA	2686	2623	1801	2%	49.2%	
EBITDA Margin	16.9%	17.3%	13.7%	-38bps	319bps	
PAT	2230	2162	1655.0	3%	34.7%	

Source: Aриhant Research

Recent Deal Wins:

TCS: Current deal wins by; 1) As part of the expanded partnership, TCS will work collaboratively with Royal London. TCS will leverage its Machine First™ Delivery Model (MFDM™) and Location Independent Agile™ model to help the company achieve its digital strategy, gain business agility, and drive deeper customer relationships. 2) TCS designed a new user interface that simplified the shopping experience and enabled hassle-free checkouts without any lags. This and the improved resilience to traffic spikes, enhanced the customer experience and resulted in an 11% increase in the conversion rate and 40% reduction in bounce rate.

Infosys: Recent deal wins by Infosys ;1) Select Portfolio Servicing: As SPS' strategic partner, Infosys will leverage its Cobalt portfolio to design, build, operate, and automate a robust and resilient private cloud infrastructure as a service with on-demand flexibility and scalability. Additionally, Infosys intends to implement hybrid cloud to maximize data center flexibility underpinned by enhanced disaster recovery and security posture. 2) Infosys Finacle, part of EdgeVerve Systems, a wholly owned subsidiary of Infosys, and UnionBank of the Philippines (UBP), a leading bank in the Philippines, announced that the bank will migrate from an on-premise deployment to the state-of-the-art Finacle Digital Banking Solution Suite on Cloud.

TCS: SonyLIV; The company will help enhance its core OTT platform to leverage AI and machine learning to provide personalized experiences to subscribers across devices. It will also help SonyLIV use data and insights to monetize content and create new revenue streams.

Neptune Energy: Neptune chose TCS as its strategic partner for its transformation journey to become an insights-driven, cloud-first organization. It looked to leverage TCS' deep contextual knowledge, expertise in the oil and gas domain and vast experience in driving digital transformations to realize these objectives.

Wabtec Corporation: TCS conducted design thinking workshops with stakeholders across 13 countries, to map out to create a detailed blueprint covering more than 100 business functions, for integrating GE Transportation's operations and systems into Wabtec's ecosystem.

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Stock Rating Scale	Absolute Return
BUY	>20%
ACCUMULATE	12% to 20%
HOLD	5% to 12%
NEUTRAL	-5% to 5%
REDUCE	-5% to -12%
SELL	<-12%

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