

IT

Muted quarter with margin expansion

India Equity Research | IT

Slower ramp ups, continued uncertainty in Europe coupled with softness in telecom and BFS verticals leads us to forecast a muted growth of 0-3% for Top 4 IT players in Q1FY13, further worsened by negative impact of cross currency (CC) movement. We also believe large cap players' margins will expand 10-110bps led by significant (~7.5%) INR depreciation in the previous quarter. While Street expects Infosys to cut its guidance from 8-10% to 6-8%, we believe the cut will be limited to 7-9%, primarily to adjust for unfavourable CC impact.

Slow ramp ups and CC movement to impact USD growth

We expect a muted June quarter due to slow ramp ups further impacted by CC impact of 0.5-1.0%. We forecast 0.0-3.0% QoQ growth in USD revenue for Indian large cap IT players with TCS and HCL Tech (HCLT) leading the pack with 3% sequential growth. Infosys is expected to post a muted growth of 0.6% in USD terms, in line with its guidance of 0-1%, slightly impacted by CC impact.

Currency to absorb wage hikes and visa costs; margins to expand

The INR has depreciated 7.5% versus the previous quarter (INR/USD from ~50.3 to ~54.0), which in our view will positively impact margins by ~225bps. This, in our view, will largely absorb the impact of both wage hikes (TCS full quarter impact and Wipro one month) and H1B visa costs. In fact, we expect a margin improvement of 10-110bps for large cap players with Wipro and Infosys leading the pack.

Infosys: USD guidance to reduce (7-9%), INR guidance to increase

While we admit that the current quarter will also be weak for Infosys and growth is likely to be ~0.6% in USD terms (-0.5% due to cross currency), we expect growth to ramp up from next quarter. We also expect the company to cut its USD full year FY13 guidance from 8-10% to 7-9% to adjust for CC impact, although we do not foresee any cut in constant currency guidance.

Outlook: Growth to be back ended

We expect past delays in decision making that had postponed project ramp ups to not only impact overall FY13 revenue growth, but also lead to back-ended growth. While we believe cost cutting pressures in the European geography will drive growth for Indian IT companies, we expect most of it to pick up only from H2FY13. We expect TCS' and HCLT's revenue growth to outperform both Infosys and Wipro in the current year due to past wins and relatively higher traction in growth verticals. We also expect Infosys' and Wipro's margins to improve in the current year even excluding currency impact.

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Infosys: USD guidance to reduce (7-9%), INR guidance to increase

While we admit that Q1FY13 will also be a weak quarter for Infosys and growth will be ~0.6% in USD terms (-0.5% due to cross currency), we expect growth to ramp up from next quarter. We also expect the company to cut its USD full year FY13 guidance from 8-10% to 7-9% to adjust for CC impact, although we do not foresee any cut in constant currency guidance. We also do not believe the above adjustment in CC will have any negative impact on the stock outlook as the company will also revise its revenue and earnings guidance upwards to adjust for sharp depreciation in INR QoQ. On the margin front, we expect EBITDA margins to expand 70bps led by currency benefits partly offset by visa costs. We also expect Infosys to announce wage hikes from the next quarter and issue a 4.5% USD growth guidance for next quarter, Q2 being the strongest quarter.

TCS: Expect 3% USD revenue growth and slight expansion in margin

We expect TCS to post another robust quarter (relatively) with a USD growth of 3% QoQ. We expect the company to post a margin expansion of 40bps in spite of a 8% wage hike announced effective April 1, 2012, and H1B visa cost in the current quarter primarily on back of ~7.5% INR depreciation. We also expect management commentary to be soft in BFS and telecom verticals. The key trigger to watch for would be forex loss as management has been mentioning adoption of different hedging policy of late and forex loss to be limited to the amount of premium paid for the options, although we are building in INR2.5bn forex loss for the current quarter.

Wipro: Flat revenue with margin expansion

We expect Wipro to post a flat revenue growth in USD terms in line with management's guidance of -1 to 1% , with CC marring the high end (1%) possibility. We also expect Wipro's margin to improve due to sharp fall in INR and limited impact of wage hike (just one month) in the current quarter. We expect the company to post USD1,536mn revenue for IT services and guide in the 3-5% range for the next quarter. EBITDA margin is likely to expand by 110bps largely helped by INR depreciation. The key thing to watch will be management's commentary on telecom vertical and India business.

HCL Technologies: Strong growth with high forex losses

We expect HCLT to post revenue growth of 3% QoQ helped largely by past deal closures. While the INR has depreciated ~7.5% QoQ, which should have a positive impact on margins, we believe large part of the benefit will be absorbed by lateral hiring and H1-B visa costs in the current quarter. Hence, we expect margin to improve by a meager 10bps QoQ.

Table 1: Hedge position as at Q4FY12 end

Companies	Total hedge position (USD mn equivalent)
TCS	4,831
Infosys	907
Wipro	1,573
HCLT	1,300
Infotech	127
Mphasis	482
Hexaware	215
eClerx	94

Source: Companies

Table 2: Quarterly average exchange rates for INR vis-à-vis global currencies

	Q4 FY11	Q1 FY12	Q2 FY12	Q3 FY12	Q4 FY12	Q1 FY13
USD	45.3	44.7	45.8	50.8	50.3	54.0
Q-o-Q change (%)	0.9	(1.2)	2.4	11.1	(1.1)	7.5
Y-o-Y change (%)	(1.5)	(2.0)	(1.5)	13.3	11.0	20.8
GBP	72.4	72.9	73.7	79.9	79.0	85.5
Q-o-Q change (%)	2.3	0.6	1.1	8.4	(1.1)	8.2
Y-o-Y change (%)	1.1	7.2	2.3	12.7	9.0	17.2
EURO	61.9	64.4	64.7	68.5	65.9	69.3
Q-o-Q change (%)	1.5	4.0	0.5	6.0	(3.9)	5.2
Y-o-Y change (%)	(2.6)	11.0	7.9	12.4	6.5	7.7

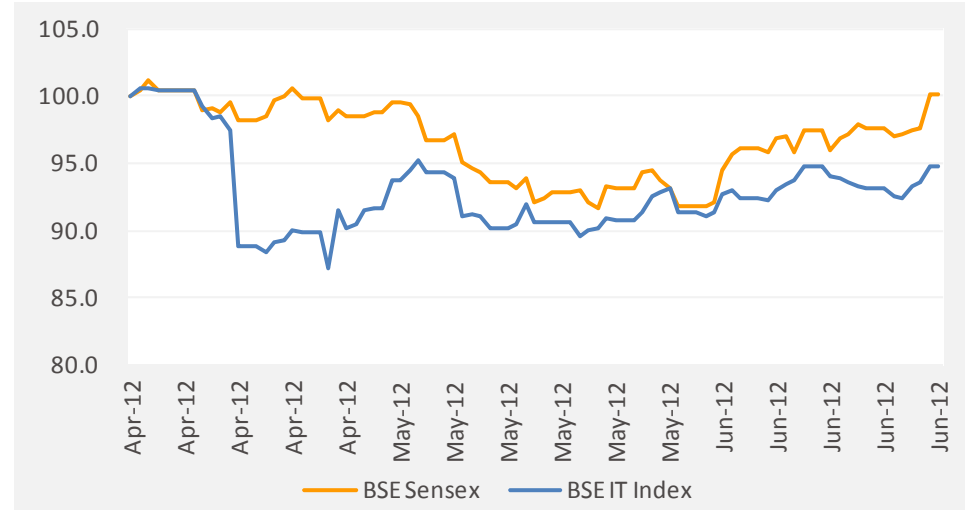
Source: Bloomberg, Edelweiss research

Table 3: Quarter end closing exchange rates for INR vis-à-vis major global currencies

	Q4 FY11	Q1 FY12	Q2 FY12	Q3 FY12	Q4 FY12	Q1 FY13
USD	44.6	44.7	49.0	53.1	50.9	55.6
Q-o-Q change (%)	(0.3)	0.3	9.6	8.4	(4.1)	9.4
Y-o-Y change (%)	(0.7)	(3.8)	9.0	18.7	14.1	24.5
GBP	71.5	71.6	76.3	82.4	81.5	86.9
Q-o-Q change (%)	2.5	0.2	6.6	8.0	(1.1)	6.6
Y-o-Y change (%)	5.0	3.2	9.0	18.3	14.1	21.3
EURO	63.4	64.7	66.6	68.7	67.9	70.1
Q-o-Q change (%)	6.0	2.0	3.0	3.2	(1.2)	3.2
Y-o-Y change (%)	4.7	13.9	9.5	14.9	7.1	8.4

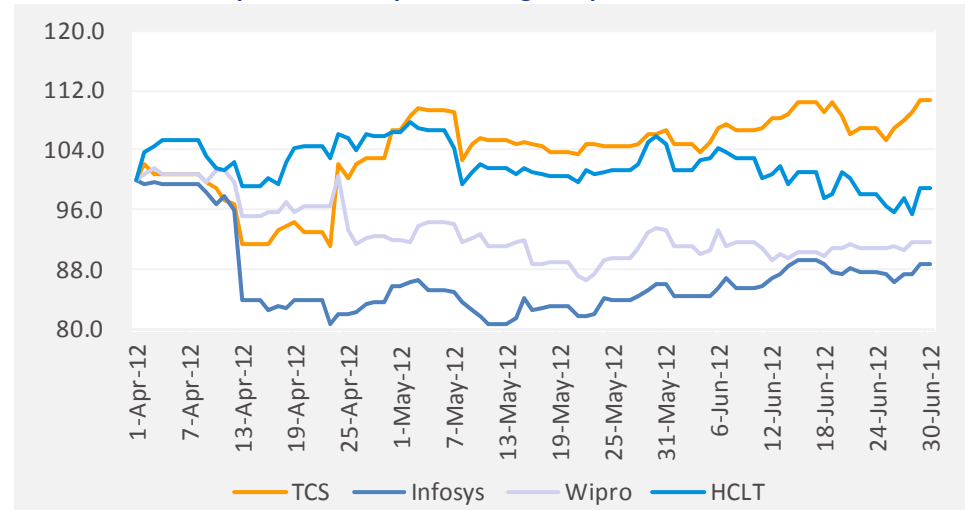
Source: Bloomberg, Edelweiss research

Chart 1: IT Index has underperformed the Sensex during the quarter



Source: Bloomberg

Chart 2: TCS has outperformed its peers during the quarter



Source: Bloomberg

Table 4: Quarterly estimates and comments

Stock		Q1FY13E (INR mn)	Q4FY12 (INR mn)	Q-o-Q growth (%)	Q1FY12 (INR mn)	Y-o-Y growth (%)	Key things to watch out for
Infosys	Revenues	97,108	88,520	9.7	74,850	29.7	Revenue growth of 0.6% QoQ impacted by cross currency. EBITDA margins to expand by 70bps led by currency benefits partly offset by visa costs. Expect FY13 revenue guidance to be reduced from earlier 8-10% to 7-9% to adjust for CC impact. Key thing to watch out would be Q2FY13E guidance for revenues, margin and gross hires.
	Revenues (USD mn)	1,782	1,771	0.6	1,671	6.6	
	EBITDA	32,288	28,870	11.8	21,740	48.5	
	EBITDA margin (%)	33.3	32.6		29.0		
	PAT	23,931	23,160	3.3	17,220	39.0	
TCS	Revenues	148,634	132,593	12.1	107,971	37.7	Revenue growth of 3.0% QoQ and EBITDA margin expansion of 40bps in spite of a 8% wage hike and visa cost impact. Expect management commentary to be soft in BFS and Telecom vertical.
	Revenues (USD mn)	2,727	2,648	3.0	2,412	13.1	
	EBITDA	44,424	39,117	13.6	30,311	46.6	
	EBITDA margin (%)	29.9	29.5		28.1		
	PAT	32,100	29,324	9.5	23,805	34.8	
Wipro	Revenues	107,697	98,164	9.7	84,929	26.8	Wipro to post a flat revenue growth in USD terms in line with guidance of -1 to 1% , as cross currency impacts growth. Margins to improve due to sharp fall in INR and limited impact of wage hike (just 1 month) in the current quarter. Q2FY13 revenue guidance expected to be in the range of 3-5%. Commentary on telecom vertical and India business to be tracked.
	Global IT rev (USD mn)	1,536	1,536	0.0	1,408	9.1	
	EBITDA	22,066	19,084	15.6	16,579	33.1	
	EBITDA margin (%)	20.5	19.4		19.5		
	PAT	15,364	14,809	3.7	13,349	15.1	
HCL Tech	Revenues	58,805	52,156	12.7	42,995	36.8	Expect it to post a revenue growth of 3% on a QoQ basis helped largely by past deal closures. Margin to be flat as currency benefits are offset by wage hike and visa cost. Management commentary on the demand environment and margin outlook for next year to watch out for.
	Revenues (USD mn)	1,079	1,048	3.0	963	12.1	
	EBITDA	10,884	9,591	13.5	7,942	37.0	
	EBITDA margin (%)	18.5	18.4		18.5		
	PAT	5,378	5,817	(7.6)	4,908	9.6	
Mphasis	Revenues	14,113	13,289	6.2	12,617	11.9	HP channel revenues to continue its slide. Direct channel to provide cushion to revenue growth, margins to be flat as wage hike is offset by currency benefits. Ramp-up of HP non-ES revenues key monitorable.
	EBITDA	2,752	2,614	5.3	1,931	42.5	
	EBITDA margin (%)	19.5	19.7		15.3		
	Adjusted PAT	2,019	1,894	6.6	1,363	48.1	
InfoEdge	Revenues	1,075	1,059	1.5	867	24.1	Muted growth due to seasonally weak quarter in the recruitment segment. Ad spending to impact the margins. Commentary on matrimonial portal and traction in real estate segment key monitorable.
	EBITDA	387	421	(8.0)	316	22.4	
	EBITDA margin (%)	36.0	39.7		36.5		
	PAT	378	399	(5.2)	256	47.7	
Infotech	Revenues	4,701	4,174	12.6	3,467	35.6	Revenue growth of 4% QoQ in USD terms. Margin to be flat despite wage hikes as currency benefits offset the same. Demand outlook and margin commentary especially in N&CE to be watched.
	EBITDA	921	827	11.3	435	111.7	
	EBITDA margin (%)	19.6	19.8		12.5		
	PAT	605	714	(15.4)	269	125.0	

Table 4: Quarterly estimates and comments (contd.)

Stock		Q1FY13E (INR mn)	Q4FY12 (INR mn)	Q-o-Q growth (%)	Q1FY12 (INR mn)	Y-o-Y growth (%)	Key things to watch out for
Hexaware	Revenues	5,021	4,383	14.6	3,341	50.3	Incremental revenues from deals won in the past to aid sustained revenue growth of 4.7% in USD terms. Margins expected to be flat as currency benefits absorb the wage hike impact. Deals in pipeline, any new large wins and progress in account mangement beyond top 10 to be tracked.
	EBITDA	1,130	982	15.0	511	121.1	
	EBITDA margin (%)	22.5	22.4		15.3		
	PAT	834	884	(5.7)	603	38.3	
eClerx	Revenues	1,510	1,276	18.4	996	51.6	Organic growth to be flattish, Agilyst consolidation to aid growth. Growth of Top 5 clients to be watched. Commentary on organic growth, margin profile of Agilyst and demand outlook key monitorable.
	EBITDA	561	468	19.9	391	43.6	
	EBITDA margin (%)	37.1	36.6		39.2		
	PAT	360	304	18.4	352	2.5	

Source: Company, Edelweiss research

Table 5: Valuation and recommendation snapshot

Company	Absolute	Relative	CMP (INR)	Mcap (USD mn)	Diluted EPS (INR)		P/E (x)		EV/EBITDA(x)		Mcap/Revenue	
	Reco	Reco			FY13E	FY14E	FY13E	FY14E	FY13E	FY14E	FY13E	FY14E
eClerx	BUY	SO	627	330	63.1	73.5	9.9	8.5	6.4	5.5	3.1	2.6
HCL Tech	HOLD	SP	484	6,058	38.0	40.5	12.7	12.0	7.1	6.7	1.4	1.3
Hexaware	BUY	SO	127	677	11.0	13.3	11.5	9.6	8.0	6.0	2.0	1.7
Info Edge	REDUCE	SU	358	705	12.2	15.4	29.3	23.2	18.5	13.9	8.5	7.2
Infosys	BUY	SO	2,499	25,894	172.5	192.2	14.5	13.0	8.8	7.9	3.6	3.3
Infotech	BUY	SO	167	336	19.3	20.8	8.7	8.0	3.8	3.4	1.0	0.9
Mphasis	HOLD	SP	371	1,405	35.5	39.9	10.4	9.3	5.2	4.3	1.4	1.3
TCS	HOLD	SP	1,259	44,473	66.8	75.2	18.9	16.7	13.5	12.0	4.1	3.7
Wipro	HOLD	SP	400	17,761	27.9	29.5	14.4	13.6	7.0	9.3	7.0	2.0

Source: Company, Edelweiss research

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Coverage group(s) of stocks by primary analyst(s): IT

ECLERX SERVICES, HCL Technologies, Hexaware Technologies, Infosys, Info Edge, Infotech Enterprises, Mphasis, Tata Consultancy Services, Wipro

Recent Research

Date	Company	Title	Price (INR)	Recos
29-Jun-12	Accenture	In line results; outsourcing sees traction; <i>Global Pulse</i>		Not Rated
19-Jun-12	Persistent Systems	IP business to boost growth; <i>Visit Note</i>	352	Not Rated
19-Jun-12	Info Edge	Macro uncertainty to impact growth; <i>Visit Note</i>	736	Reduce

Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	104	60	18	183
* 1 stocks under review				
	> 50bn	Between 10bn and 50 bn	< 10bn	
Market Cap (INR)	114	58	11	

Rating Interpretation

Rating	Expected to
Buy	appreciate more than 15% over a 12-month period
Hold	appreciate up to 15% over a 12-month period
Reduce	depreciate more than 5% over a 12-month period

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