

RESEARCH
IT Services | Q2FY22 Preview

On a roll

SUMMARY
IT Services: Q2FY22 Preview

- Expect a robust Q2FY22 for our IT services coverage marked by dollar revenue growth of 3-8% QoQ and 14-40% YoY
- Key monitorables this quarter include attrition and operating margin defense amid supply challenges
- Pandemic-induced technology refresh cycle underpins our optimistic sector view – prefer TCS, HCLT, TECHM, COFORGE

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Daily macro indicators

Indicator	Current	2D (%)	1M (%)	12M (%)
US 10Y yield (%)	1.46	(3bps)	17bps	76bps
India 10Y yield (%)	6.25	2bps	5bps	25bps
USD/INR	74.13	0.2	(1.4)	(1.3)
Brent Crude (US\$/bbl)	79.28	1.0	10.7	101.9
Dow	34,326	1.4	(2.8)	24.0
Shanghai	3,568	0.9	0.0	10.9
Sensex	58,766	(0.6)	2.5	51.9
India FII (US\$ mn)	30-Sep	MTD	CYTD	FYTD
FII-D	(33.1)	1,488.9	75.0	2,102.3
FII-E	(268.3)	1,139.4	8,529.9	1,203.6

Source: Bloomberg

BOBCAPS Research

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Expect a strong Q2: We expect robust growth for most of our IT coverage in Q2FY22, similar to that in Q1, as the demand environment remains buoyant. Accenture's (Y/E Aug, Not Rated) Q4FY21 revenue growth came in at the upper end of guidance and its FY22 outlook was upbeat at 12-15% (our [23Sep report](#) has details), hinting at a strong Q2 earnings season for Indian IT. For the top 5, we expect revenue growth in the range of 4-6% QoQ CC. Midsized tech players are likely to grow faster at 5.4-7.9% QoQ CC. USD appreciation against the GBP, EUR and AUD will translate into cross-currency headwinds for Indian players in Q2.

Supply challenges persist: Despite elevated growth, most companies saw margin headwinds in Q1FY22 due to increased supply pressure, with EBIT margin declining 110-120bps on average across our coverage. The sector continued to face persistent supply challenges in Q2 and hence hiring is likely to have ramped up. We forecast a mixed operating margin performance marked by sequential contraction for select companies due to wage hikes, and modest improvement for others. Coforge is projected to be an outlier with 250bps QoQ margin expansion.

Revenue guidance upgrades on the cards: We believe Infosys (INFO) could hike its FY22 revenue growth guidance to 15-17% from 14-16%. Coforge is likely to put out a stronger revenue outlook as well. Wipro (WPRO) could guide for 2-4% QoQ revenue growth for Q3. We do not anticipate any change in FY22 margin guidance.

Key factors to watch: (1) Attrition and operating margin defense amid supply challenges, (2) large deal wins, (3) indications of seasonality in H2FY22, (4) subcontracting expenses, and (5) demand commentary.

Maintain optimistic stance on Indian IT sector: We remain optimistic on the IT sector backed by broad-based demand. We tweak FY22-FY24 EPS estimates by -3% to +4% for our IT services coverage, bake in higher target multiples to account for an improved growth outlook over the next 3-4 years and accordingly revise our target prices by 0-35%. Tech Mahindra (TECHM, TP Rs 1,660) among large-caps and Coforge (TP Rs 6,930) among mid-caps are our preferred picks.

Recommendation snapshot

Ticker	Price	Target	Rating
COFORGE IN	5,338	6,930	BUY
ECLX IN	2,213	2,880	BUY
HCLT IN	1,279	1,530	BUY
INFO IN	1,679	2,020	BUY
LTI IN	5,738	6,780	BUY
MPHL IN	3,089	3,530	HOLD
MTCL IN	4,253	3,210	SELL
PSYS IN	3,714	3,560	HOLD
TCS IN	3,773	4,800	BUY
TECHM IN	1,399	1,660	BUY
WPRO IN	641	630	HOLD

Price & Target in Rupees | Price as of 4 Oct 2021



Disclaimer

Recommendation scale: Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

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