

IT SERVICES

04 December 2019

US elections – a potential cyclical risk for Indian IT

Our analysis of growth trends over the last 12 years indicates a risk of protracted near-term softness for India’s IT services industry in the runup to US presidential elections in Nov’20. Besides inherent immigration rhetoric, we find that slow, delayed decision-making by clients in election years (FY09, FY13, FY17) has translated into cyclical growth moderation for the IT services industry (ranging from 270bps to >10ppt vs. the respective prior financial year). Our study suggests **TECHM** and **WPRO** are the most vulnerable among tier-I players.

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US polls and IT services growth adversely correlated: Over the last 12 years (encompassing three US presidential elections), growth in the Indian IT industry has moderated in every poll year as compared to the respective previous financial year. Even excluding Nov’08 which had the global financial crisis impact, growth in Indian IT services moderated by 860bps and 270bps in the FY13 and FY17 election years respectively. This cyclical growth headwind arises largely due to delays in decision-making by clients in the absence of clarity regarding government spending, taxation and regulation.

Back-ended acknowledgement by IT leaders: The poll-related cyclical risk has seldom been flagged in advance by Indian IT companies, nor have managements alluded to potential implications of this event for IT services players. Post-elections, however, several company leaders have acknowledged the event as being one of the causes behind slower discretionary spending by clients (Fig 3).

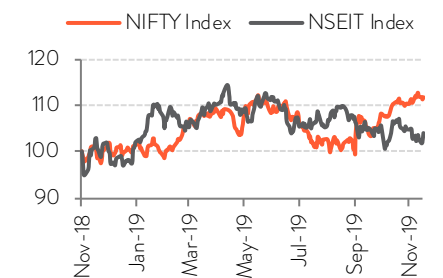
TECHM and WPRO face highest risk; HCLT the lowest: While we remain optimistic on the long-term growth prospects of IT services companies, we are cautious on the sector’s near-term outlook. Our scenario analysis shows that Tech Mahindra (TECHM) and Wipro (WPRO) are the most vulnerable in a scenario of sector-wide growth moderation ahead of US elections. HCL Tech (HCLT) faces the least risk. Overall, we prefer TCS and HCLT amongst large-caps; L&T Infotech (LTI) is our sole BUY among mid-caps.

KEY RECOMMENDATIONS

Ticker	Price	Target	Rating
TCS	2,079	2,230	ADD
INFO	709	860	ADD
WPRO	240	240	REDUCE
HCLT	1,126	1,260	BUY
TECHM	758	740	REDUCE
LTI	1,672	2,010	BUY
MPHL	869	1,020	ADD
MTCL	747	690	SELL
HEXW*	339	410	ADD
PSYS	686	650	REDUCE
NITEC	1,467	1,600	ADD
ECLX	505	450	REDUCE

Price & Target in Rupees

NSEIT INDEX PERFORMANCE



Source: Bloomberg

FIG 1 – SCENARIO ANALYSIS FOR ELECTION YEAR GROWTH

FY21E EPS chg (%)	(S1) Revenue growth flat EBIT margin flat	(S2) Revenue growth down 100bps EBIT margin down 30bps	(S3) Revenue growth down 200bps EBIT margin down 50bps
TCS	(3.0)	(4.9)	(6.4)
INFO	(5.5)	(7.5)	(9.0)
WPRO	(5.5)	(7.7)	(9.5)
HCLT	2.8	0.4	(1.5)
TECHM	(9.6)	(12.0)	(13.9)

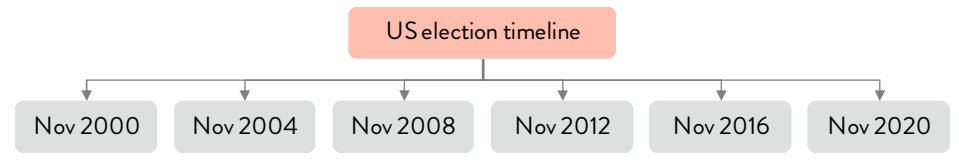
Source: BOBCAPS Research | Note: S1, S2 and S3 refer to our three scenario

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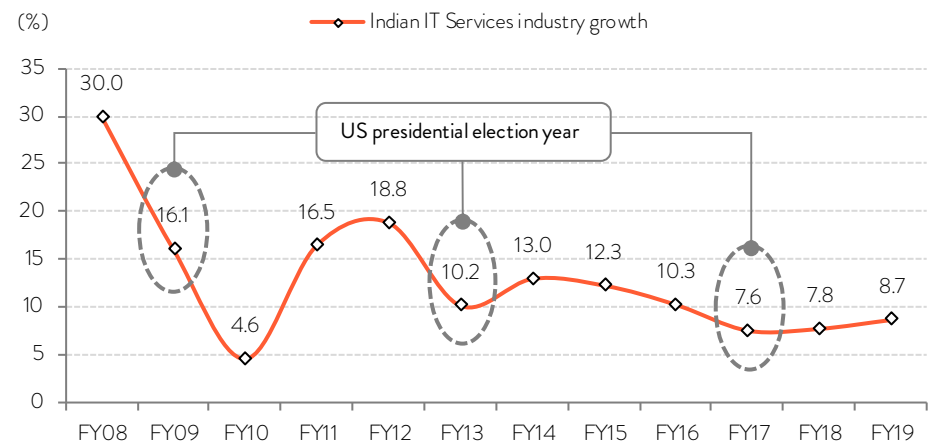


FIG 2 – US PRESIDENTIAL ELECTION TIMELINE



Source: BOBCAPS Research

FIG 3 – INDIAN IT SERVICES SECTOR GROWTH HAS MODERATED IN EACH OF THE LAST 3 ELECTION YEARS



Source: NASSCOM, BOBCAPS Research

FIG 4 – BACKENDED ACKNOWLEDGMENT OF POLL-LED GROWTH HEADWINDS BY IT SERVICES COMPANIES

Company	Timeline	Comment
TCS	Q3FY16 Jan-16	"Don't think noise around immigration will impact customer's vendor choice."
	Q1FY17 Jul-16	"We need to watch out how Brexit and elections will play out going into subsequent quarters of the year."
	Q2FY17 Oct-19	Before elections "I am not accounting for any macro situations because I can't link a situation like a US election or a Brexit directly to revenue impact or a margin impact."
	Q2FY17 Oct-19	"On a secular basis, we see demand for our services only rising and I have no doubt in my mind that we will be back on the upward growth trajectory once we overcome the current cyclical headwinds."
	FY17 Annual Report May-17	After elections Uncertainties arising from key political events such as Brexit and US elections led to holding back of discretionary spending – especially by large global banks – on account of which revenue growth in FY17 was lower than that in FY16.
	FY17 Annual Report May-17	Elections mentioned as a risk factor.
INFO	Citi Conference Jun-16	Before elections "We don't anticipate any impact irrespective of who the President is. As in the past, in the runup to election, we have seen a lot of noise, but end of the day we have not seen any dramatic impact."
	Citi Conference Jun-16	Before elections "We are not seeing any signs or any influence of this (US elections) on client behaviour. Whereas in some of the previous elections, we have seen that much closer to the election; but here so far, we have not seen anything."

Company	Timeline			Comment
	Wells Fargo Tech Conference	Nov-16	After elections	"We have to see how, in light of the elections, things change from a banking point of view, from a regulatory point of view, and so forth. Over the next few months, we have to wait and watch what happens to the overall climate."
	CLSA India Forum	Nov-16	After elections	Answer in response to question on impact of political events such as US elections, Brexit: "At the beginning of the year, we were extremely optimistic on the back of our performance in the last year.... We had an industry-leading performance last year. Quarter four was extremely good for us after a few years of a poor Q4. Our growth in top 10 and top 20 accounts was pretty good. So on the back of this, we were very optimistic getting into this year. But unfortunately, as the year played out, we've started seeing some softness, some cautiousness from a client spending perspective."
WPRO	Q2FY17	Oct-16	Close to elections	"The US elections have led to uncertainties on spend, especially for Wipro."
	Q2FY17	Oct-16	Close to elections	"HPS has had a little bit of current uncertainty, again, given the US elections."
TECHM	Q1FY17	Aug-16	Close to elections	"A new uncertainty pertaining to the US election is there, but we'll work out the impact of that depending upon the results we see in November. And as far as we are concerned, overall, the deal pipeline and the outlook remains promising, but we'll have to strive harder to keep the growth momentum."

Source: Company, BOBCAPS Research

FIG 5 – BOBCAPS IT SERVICES UNIVERSE: VALUATION SUMMARY

Company	CMP (Rs)	Mkt Cap (US\$ bn)	Rating	Target Price (Rs)	US\$ revenue CAGR (%)		EBIT CAGR (%) FY19-FY21E	EPS (Rs)		P/E (x)		ROE (%)	
					FY17-FY19	FY19-FY21E		FY20E	FY21E	FY20E	FY21E	FY20E	FY21E
TCS	2,079	108.8	ADD	2,230	9.1	7.3	5.7	85.7	94.3	24.3	22.1	32.7	30.5
INFO	709	42.7	ADD	860	7.5	8.8	8.5	37.7	42.0	18.8	16.9	25.5	25.6
WPRO	240	19.9	REDUCE	240	3.4	4.7	4.8	15.4	16.7	15.6	14.4	16.4	16.8
HCLT	1,126	21.3	BUY	1,260	11.2	11.7	8.6	75.0	83.6	15.0	13.5	22.9	22.7
TECHM	758	9.3	REDUCE	740	7.0	7.1	3.6	48.9	54.8	15.5	13.8	19.6	19.6
LTI	1,672	4.1	BUY	2,010	17.9	10.3	6.6	85.9	100.3	19.5	16.7	28.3	28.1
MPHL	869	2.3	ADD	1,020	10.7	12.0	13.7	58.4	66.4	14.9	13.1	19.8	20.5
MTCL	747	1.7	SELL	690	13.3	10.0	5.8	33.1	46.6	22.6	16.0	15.7	20.0
HEXW*	339	1.4	ADD	410	13.6	16.2	11.2	22.3	23.6	15.2	14.4	25.7	22.9
PSYS	686	0.8	REDUCE	650	5.7	9.2	6.0	45.6	50.3	15.0	13.6	15.0	15.3
NITEC	1,467	1.3	ADD	1,600	13.0	12.0	13.3	72.3	87.3	20.3	16.8	20.2	21.3
ECLX	505	0.3	REDUCE	450	8.9	6.2	2.1	46.4	59.5	10.9	8.5	16.1	19.2

Source: Bloomberg, BOBCAPS Research | Prices as on 4th Dec 2019 | *FY20 refers to CY19 for Hexaware and so on

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Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

ADD – Expected return from >+5% to +15%

REDUCE – Expected return from -5% to +5%

SELL – Expected return <-5%

Note: Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

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