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Q3FY18 RESULT REVIEW

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Bottoming out of margin and increasing Digital deal size, key growth driver for FY19

Revenue growth for 3QFY18 saw a mixed performance for IT sector . Revenue Growth for TCS and Infosys saw a soft performance of 1% QoQ due to weak performance in BSFI whereas HCL TECH, WIPRO and Persistentshowed a strong revenue performance in 3QFY18. TCS revenue grew 1.2%QOQ in 3QFY18 mainly due to turns around in the Retail verticals and Strength in Digital . BFSI in the US remains subdued which led to soft revenue performance by Infosys. Digital and Enterprise Service businesses of Persistent grew by 9% and 7% QoQ which led to good performance in 3QFY18. Cyient 3QFY18 revenues increased due to Aerospace & Defense, communications, transportation, Medical Technology and Healthcare business unit . Revenue of HCL Tech was driven by growth in ERD unit, revenue from acquisition and IP partnerships

Strong improvement in EBITDA margin : Overall IT sector saw a resilient margin performance in 3QFY18 despite a furloughs and lower working days . Margin expansion was merely seen due to better operational efficiencies , higher utilization and increasing digital revenue and automation process. Infosys OPM improved by 10bps to 24.3% despite partial wage hike impact, improvement in levers such as utilization now at 85%, delivery mix and SG&A efficiency . Tech Mahindra continued to report better operating profit margin (OPM) with an improvement of 169bps QoQ mainly driven by operating efficiencies. EBIT margin of TCS in 3QFY18 remain flattish at 25.2% in QFY18 . Persistent EBITDA margin increased in 3QFY18 led by declined in attrition rate by 80bps QoQ to 14.7% and improved in utilization rate by 130bps QoQ to 79.9%.

Q3FY2018 Results Snapshot

(in cr)

Company	Revenue	QoQ%	YoY%	EBITDA	EBITDA%	QoQ%	YoY%	PAT	QoQ%	YoY%
INFY	17794	1%	3%	4817	27%	1%	2%	5129	38%	38%
TCS	30,904	1%	4%	8288	27%	2%	1%	6531	1%	-4%
WIPRO	13669	1%	-1%	2487	18%	-12%	-13%	1929	-12%	-9%
HCLTECH	12809	3%	8%	2789	22%	2%	7%	2075	-6%	1%
TECHM	7776	2%	3%	1265	16%	14%	7%	924	10%	9%
PERSISTENT	792	4%	6%	138	17%	19%	16%	92%	11%	12%
CYIENT	983	2%	7%	141	14%	1%	16%	87	-22%	-7%

9MFY18 Results Snapshot

(in cr)

Company	Revenue	YoY%	EBITDA	EBITDA%	YoY%	PAT	YoY%
INFY	52439	2%	14080	27%	1%	12338	15%
TCS	91029	3%	23864	26%	-1%	18955	-5%
WIPRO	40799	-1%	8015	20%	-5%	6197	-1%
HCLTECH	37391	8%	8224	22%	7%	6492	6%
TECHM	22718	5%	3305	15%	1%	2555	12%
PERSISTENT	2281	6%	358	16%	7%	249	9%
CYIENT	2856	7%	394	14%	10%	286	8%

Segment performance

During 3QFY18 ,Financial service saw a mixed revenue performance . Revenue growth remained flat for Infosys with a growth of 0.1% QoQ and saw weak performance for TCS down by 1.5% QoQ and strong for Wipro with growth of 4.4% QoQ and HCL Tech grew by 1.4% QoQ .Europe continued to positively grow at the rate of 1.7-6.2% QoQ across the IT companies, as European clients are looking for outsourcing opportunities from Indian IT companies to optimize cost and deploy digital technologies.

BFS weak throughout for FY18, BFS recovery positive set-up for FY2019: BFS, which contributes a good amount in total revenue of the IT companies showed a weak performance in CY17. It contributed about 29% to total revenue of the top five IT companies in Q3FY2018. Majority of the IT companies expect bonus back of BFS in FY19 except TCS. Infosys management was optimistic for strong growth in BFS in FY2019 on account of uptick in spending on digital technologies while TCS management remained cautious on the BFS space and expects to continue to face problems for next few more quarters. Wipro and Tech Mahindra continued to report strong growth in the BFS vertical because of large exposure to capital markets and improvement in account-specific issues. Even the HCL tech and Persistent management expect a positive growth going forward.

Also on the retail segment , different management guidance was seen for 4QFY18,TCS management expect to get double digit growth in FY19 while Infosys still see less clarity on revival of retail .But other than BFS and Retail segment , all the other verticals are expect to continue to performance positive in FY19 on account of healthy deal pipelines and strong deal wins in the insurance vertical.

Revenue Growth guidance better than FY2018: Persistent's management expects the double-digit revenue growth for FY19 on account of healthy traction in digital business especially in Healthcare and BFSI. Cyient had guided for double-digit growth in the Services business similar to what was achieved in FY17. TECHM sees double-digit revenue growth for the full year fiscal 2018. Management of Wipro has guided in-line revenue growth guidance for Q4FY2018 and expects to catch up industry average growth rate on a YoY basis from FY2019. But Infosys has toned down its revenue guidance from 6.5-8.5% to 5.5-6.5% for FY18 in CC terms. Thus, we expect revenue growth in Q4FY18 and FY19 will be better as compared to FY17.

Overall outlook for the industry

According to the National Association of Software and Solutions Companies (Nasscom) ,a growth rate of 7-9 per cent for the IT and BPO industry is expected in 2018-19 as against 7.8 per cent in 2017-18 . Nasscom believes that a strong macroeconomic environment in developed markets will translate into better growth but with a lag. The industry body expects upswing in growth to start towards 2HFY19 after a gradual build-up over the next two quarters. The improvement in the macro environment in the US, like low unemployment, rising interest rate ,Tax rebate , increased retail spending, push toward digital and higher outsourcing from European clients will lead to positive outlook for the IT sector as an whole. Even recent US tax reform will spur discretionary spending in IT industry. Additionally on the technology segment side change in artificial intelligence and newer technology is creating lot of opportunities for IT sector specially companies like persistent who are working on newer technology to help their client to provide better solutions. Even Global Digital spend is expected to increase from USD 180 Bn in 2017 to USD 310 Bn in 2020, a growth over 20% YoY which will a key .

Also, bottoming up of Margins of the IT sector will aid to better growth going forward.

But an evolving tech labor market will continue to be a challenges present challenges, as well as opportunities for SECTOR: With employer demand for tech talent routinely outstripping supply, the year ahead will force more organizations to rethink their approaches to recruiting, training, and talent management.

However with AI and Block Chain which is the fastest growing tech and increasing Digital spend will define the next phase of Industry growth

View and VALUATIONS

For the past few years, IT sector struggled for growth due to series of event that occurred in macro environment like slump in oil prices, the impact of Brexit, the results from US elections and effects of demonetization. Even banks and financial institutions slowed down their spending and decision making worldwide which resulted in slow growth in several emerging economies. But with the improvement in macro environment in the US, like low unemployment, rising interest rate ,Tax rebate , increased retail spending, push toward digital and higher outsourcing from European clients will lead to positive outlook for the IT sector as an whole. Even recent US tax reform will spur discretionary spending in IT industry.

Even as per NASSCOM IT and BPO industry is expected to grow at the rate of 7-9 per cent in 2018-19 and it believes that a strong macroeconomic environment in developed markets will translate into better growth in FY19.

Therefore we believe positive outlook for IT sector on back of revival of BFS , Turnaround of retail segment , continued spending in newer technology like cloud computing, flexible consumption, cognitive computing,IOT , artificial intelligence, block chain etc., incremental spends in energy and utilities owing to hardening of oil prices; and turnaround of capex cycle in the telecom sector due to 5G roll-out, all of which will led to positive growth FY19.

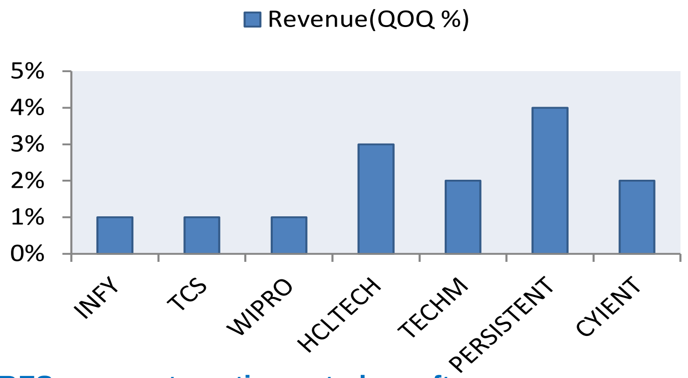
Thus we recommend BUY on Infosys, Persistent and Cyient with target price of Rs 1233(infy),Rs932(persistent) and Rs700(cyient) respectively.

3QFY18 Management Commentary

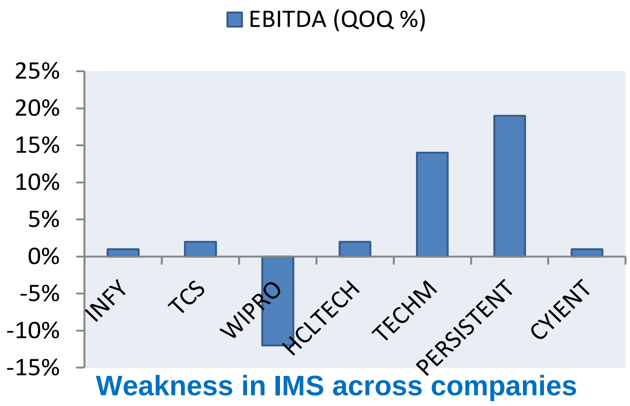
PERFORMANCE	MARGIN	DEAL WINS	VERTICALS	GUIDANCE
INFY	Infosys has reiterated it's near term EBIT margin range of 23-25%. Management is counting on onsite/offshore role mix optimization as OPM lever, as current Utilization (extrainees) rate of 84.9% leaves limited headroom.	The company announced 8 large deal wins in Q3FY18 with TCV of deal wins at US$779mn. The TCV of deal wins in 9MFY18 was US$2,167mn, down 19% yoy	Management indicated that the soft performance in Q3FY18 was impacted by more than expected furloughs, budget cuts at some clients and slow ramp-up of deals. However, management is confident of better revenue growth in BFSI in CY18 V/s CY17 on the back of deal wins as well as expectation of improving client spending	Management retained its annual guidance of 5.5-6.5% yoy CC revenue growth for FY18E.
TCS	N/A	Continuing investments by clients in Digital initiatives resulted in over 150+ wins and strong growth across all service practices.	Growth was led by Energy & Utilities (8.5% QOQ), Travel & Hospitality (2.9% QOQ) and Life Sciences & Healthcare (2.5% QOQ).Retail & CPG vertical saw Turnaround which a growth of (3% YOY) and (6.4% QOQ in CC). Robust demand pick up in Retail is expected in coming quarters.Retail & CPG vertical saw Turnaround which a growth of (3% YOY) and (6.4% QOQ in CC). Robust demand pick up in Retail is expected in coming quarters.	
HCLTECH	In terms of operating profit (EBIT) guidance, HCL reiterated its guidance at 19.5%- 20.5%on constant currency basis for FY18E. Margins in the quarter were largely in-line with our estimates and declined 10 bps QoQ due to cross currency impact.	Signed 20 transformational deals during the quarter, well-balanced across Mode 1, Mode 2, Mode 3, with several of them representing next gen offerings	Positive on ER&D and application services- Engineering and R&D services (24.2% of revenue) continue to lead the growth for the 5th straight quarter and grew strongly at 13.6% on QoQ basis. Application services (35.3% of revenue) grew 1.6% QoQ while barring the impact of IP partnership with DXC, application services grew 2.6% QoQ. Management indicated its positive outlook on the ER&D and application services space.	Management has maintained its constant currency revenue growth guidance to be in the range of 10.5-12.5% translating into 12.1-14.1% in US$ terms (based on Dec 31, 2017 end rates). Management has maintained its stance of meeting lower end of revenue guidance for FY18E. Management stated that its strategy on niche acquisitions and partnerships will continue
PERSISTENT	On the EBITDA margins, the EBITDA margin improved to 17.4% this quarter as against 15.2% in the previous quarter on account of wage hike which was primarily offset by improved utilization and other operational efficiencies. The utilization for the quarter was one of the highest in the recent quarters at 79.9% as against	N/A	The management has indicated that Persistent will go for M&As which can help it expand itself to unexplored geographies, verticals and technology (analytics)	Management expects the double-digit revenue growth for FY19E on account of healthy traction in digital business especially in Healthcare and BFSI.

STORY IN CHARTS

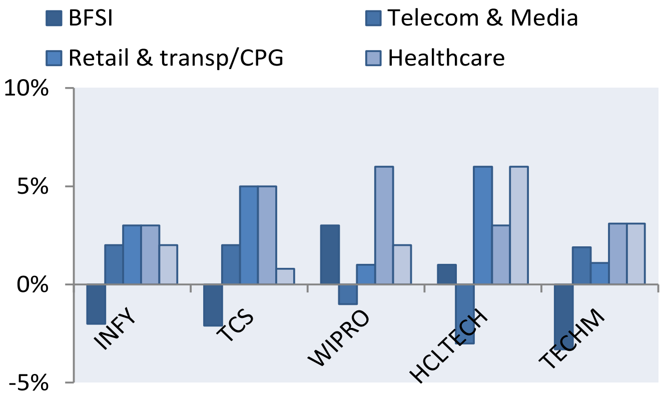
HCLtech , Persistent &TechM outperformance in 3QFY18



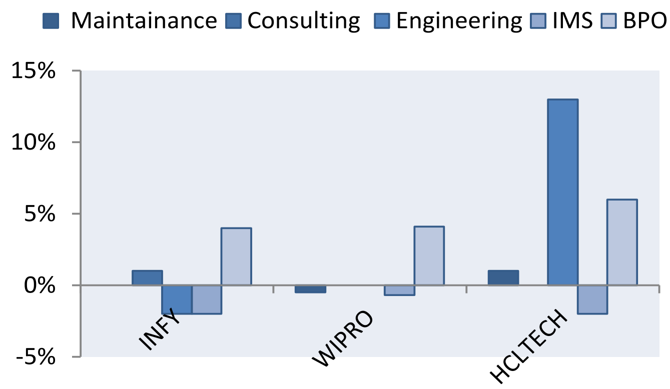
Improvement in ebitda across companies



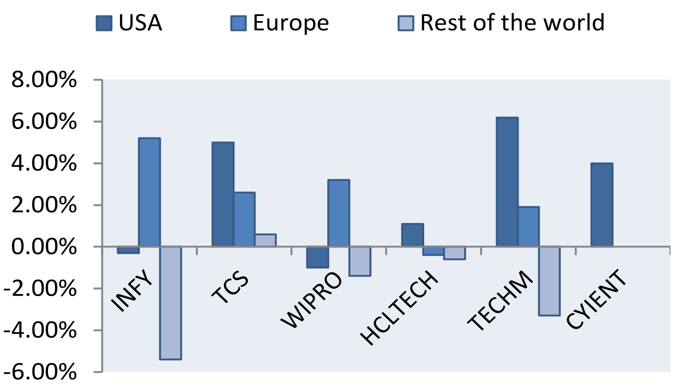
BFS segment continues to be soft



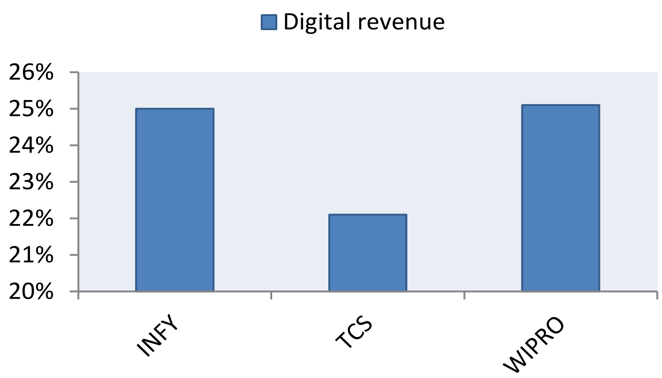
Weakness in IMS across companies



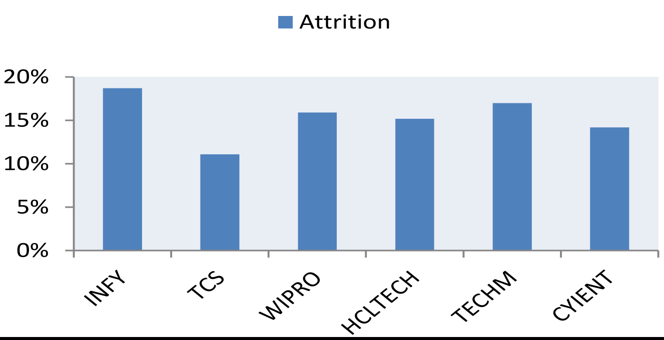
Continued momentum in Europe



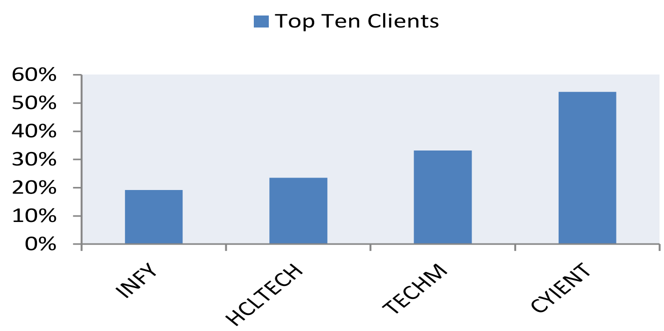
Strong digital performance



Declining Attrition rate



Improvement in top 10 client contribution



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