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World-Class Financial Services

SECTOR OF  
THE MONTH

**Information  
Technology**



**PICKS OF  
THE MONTH**

**#INFOSYS LTD**

**#HCL TECH LTD**

## Sector of the Month: Information Technology

The IT-BPM industry stood at \$177 bn in 2019 and is expected to grow to \$350 bn by 2025. The IT-BPM industry is the largest contributor to the total exports of the country, with 43% of the IT-BPM services being exported in 2018. Total revenue from IT services & BPM for FY2019-20 accounts for \$135 bn. The sector is headed towards achieving \$1 tn digital economy by 2022. The country has become the global digital capabilities hub with around 75% of global digital talent present in the country.

India is the leading sourcing destination across the world, accounting for approximately 55 per cent market. Share of the US\$ 185-190 billion global services sourcing business in FY19. India acquired a share of around 38 per cent in the overall BPM sourcing market.

The computer software and hardware sector in India attracted cumulative foreign direct investment (FDI) inflow worth US\$ 43.58 billion between April 2000 and December 2019. It ranked second in FDI inflow as per the data released by the Department for Promotion of Industry and Internal Trade (DPIIT).

Moreover the total export revenue of the industry is expected to grow 8.3 per cent y-o-y to US\$ 136 billion in FY19. IT-BPM. Sector accounted for the largest share in the Indian services export at 45 per cent. Total number of employees grew to 1.02 million cumulatively for four Indian IT majors\* as on December 31,2019.

### SEGMENTS OF INDIA'S IT SECTOR

#### IT & ITeS sector

IT services	Business Process Management	Software products and engineering services	Hardware
<p>Market Size: US\$ 92.49 billion during FY19. Over 81 per cent of revenue comes from the export market. BFSI continues to be the major vertical for the IT sector. IT services accounted for almost 51 per cent share of IT industry's revenue in India in FY19.</p>	<p>Market size: US\$ 36.2 billion during FY19. Around 87 per cent of revenue comes from the export market. Market size of BPM industry to reach US\$ 54 billion by FY25. BPM had a 20 per cent share of IT industry's revenue in India in FY19.</p>	<p>Market size: US\$ 34.39 billion during FY19. Over 83.9 per cent of revenue comes from export. It had around 19 per cent revenue share in the Indian IT space in FY19</p>	<p>Market size: US\$ 14.48 billion in FY19. The domestic market accounts for a significant share. Hardware exports from India was estimated to grow at 7-8 per cent in FY19.^</p>

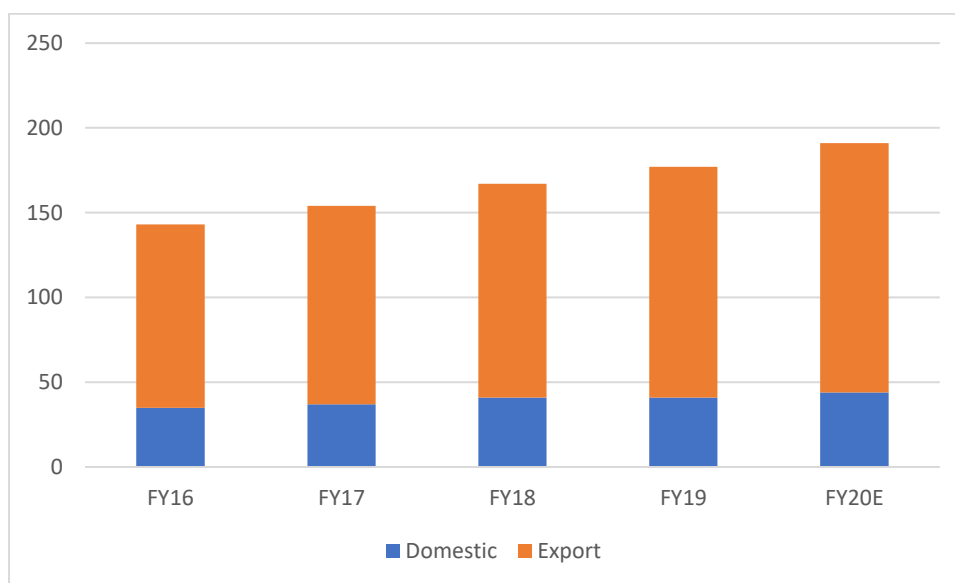
Source: Ace equity, IBEF, Dealmoney research

**Rapid growth in market size of Industry**

IT-BPM industry revenue was estimated at around US\$ 191 billion in FY20 at 7.7 per cent growth y-o-y. The domestic revenue^ of the IT industry is estimated at US\$ 44 billion and export revenue is estimated at US\$ 147 billion in FY20. The market size of India’s IT-BPM sector is expected to grow to US\$ 350 billion by 2025 and BPM is expected to account for US\$ 50-55 billion out of the total revenue.

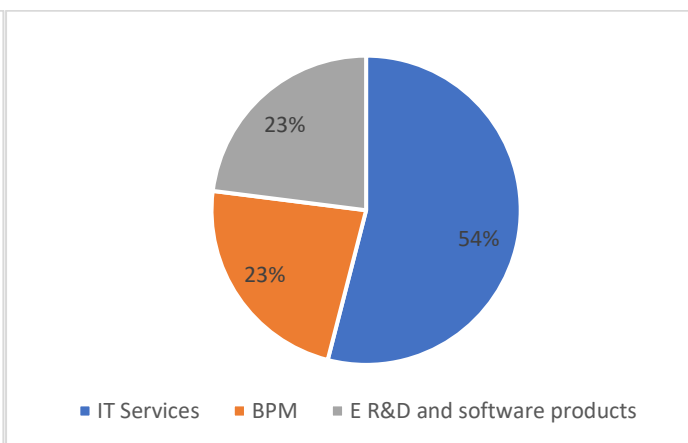
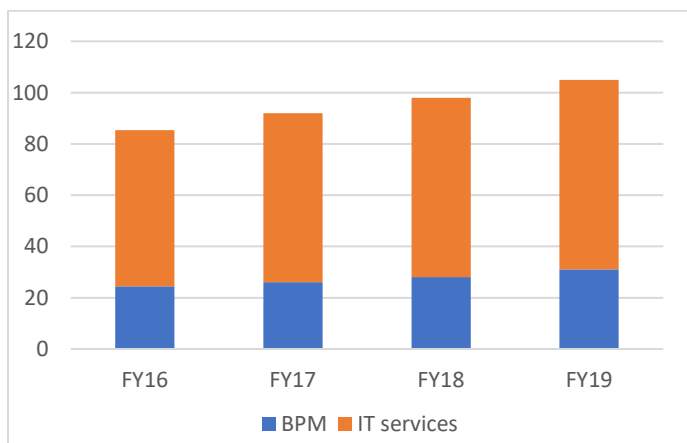
Spending on information technology in India is expected to reach US\$ 90 billion in 2019. Outsourcing of large technology contracts by clients is expected to accelerate the growth of the industry in FY20. The cloud market in India is expected to grow three-fold to US\$ 7.1 billion by 2022 with the help of growing adoption of Big Data, analytics, artificial intelligence and Internet of Things (IoT) according to Cloud Next Wave of Growth in India report. India’s digital economy is estimated to reach US\$ 1 trillion by 2025.

**Market size of IT industry in India (US\$ billion)**



**Growth in export revenue (US\$ billion)**

**Sector-wise breakup of export revenue (FY19)**



Source: Ace equity, IBEF, Dealmoney research

US is the major importer of IT services US has traditionally been the biggest importer of Indian IT exports as it absorbed over 62 per cent of Indian IT-BPM export during FY19. Non-US-UK countries accounted for just 21 per cent of the total Indian IT-BPM export during FY19.

As of FY19, US and UK were the leading customer markets with a combined share of nearly 80 per cent. However, there is a growing demand from APAC, Latin America and Middle East Asia regions. Being the low-cost exporter of IT services, India is going to attract more markets in other regions in the same manner it tapped the US market.

### Effect of Covid-19

The Mar'20 quarter continued the trend of moderation in YoY revenue growth in the sector that has been in play through FY20 in general. 3% YoY revenue growth for TCS was the lowest since the GFC levels. Order bookings were strong, aided by strength in the 1st half of the quarter, but may weaken as weak macro slowed down the decision making and curtailed discretionary spending. Companies abstained from providing guidance along expected lines. Most companies expect the June'20 quarter to reflect the severe impact of Covid-19 and expect recovery from the Sep'20 quarter onward. US-listed peers expect sharper hits in the June'20 quarter in comparison to India-listed peers.

Companies took swift cost-saving actions - freezing lateral hiring, deferring annual hikes/ promotions - as they prepare to address challenges arising from revenue pressure/lower utilization and likely price cuts (as of now in most troubled verticals like Travel/Hospitality and Retail).

### Drivers for Growth

#### Exports to provide the tailwind for growth

Export revenue from the industry grew at a CAGR of 8.01 per cent to US\$ 147 billion in FY20E from US\$ 108 billion in FY16. In FY20, IT-BPM industry export revenue crossed US\$ 147 billion at a growth of 8.1 per cent. In FY19, export from IT and IT Enabled Services (ITeS) registered a growth of 17 per cent to reach Rs 1.09 lakh crore (US\$ 15.63 billion) in Telangana.

#### Digital Exports to provide major growth opportunity

Global digital spend is expected to increase from US\$ 180 billion in 2017 to US\$ 310 billion by 2020. India's IT industry is increasingly focusing on digital opportunities as digital is poised to be a major segment in the next few years. It is also currently the fastest growing segment, growing over 30 per cent annually. In India, domestic market of computer services is growing faster than their export, which is fueled by the government's Digital India programme. Export revenue from digital segment already forms about 20 per cent of the industry's total export revenue. The figure was estimated at US\$ 33 billion in FY19.

#### Availability of talent pool

Availability of skilled English-speaking workforce has been a major reason behind India's emergence as a global outsourcing hub. The number of engineering graduates is expected to reach 8.02 lakh by 2020. India BPO promotion scheme was approved under Digital India programme. It aims to create employment opportunities for the youth and promote investments in the IT&ITeS industry. Under the scheme, employment has already been created for more than 10,000 individuals. Indian IT industry had 884,000 digitally skilled talent in 2019.

Source: Ace equity, IBEF, Dealmoney research

### **SEZ's together with Tier II cities to drive IT sector**

IT-SEZs have been initiated with an aim to create zones that lead to infrastructural development, exports and employment. As of February 2020, there were 421 approved SEZs across the country, and of these, 276 are from IT & ITeS and 145 are exporting SEZs. Over 50 cities already have basic infrastructure and human resource to support the global sourcing and business services industry. Some cities are expected to emerge as regional hubs supporting domestic companies. Software Technology Parks of India (STPI) has set up 57 centres across the country to provide single window clearance and infrastructure facilities. STPI units can avail Excise Duty exemptions on procurement of indigenously manufactured goods.

Source: Ace equity, IBEF, Dealmoney research



**Pick of the Month (Infosys Ltd.):**

**CMP: 736**

**Target: 840**

Infosys Limited was started in 1981 and is a global leader in the 'next generation' of IT and consulting with revenues of \$6.35 billion. Infosys defines, designs and delivers technology-enabled business solutions that help Global 2000 companies win in a Flat World. Infosys also provides a complete range of services by leveraging their domain and business expertise and strategic alliances with leading technology providers. Infosys' offerings span business and technology consulting, application services, systems integration, product engineering, custom software development, maintenance, re-engineering, independent testing and validation services, IT infrastructure services and business process outsourcing.

**Leadership position and global presence:** Infosys is a global leader in the 'next generation' of IT and consulting. Infosys has global presence through its 50 offices and development centers spread across India, China, Australia, the Czech Republic, Poland, the UK, Canada and Japan. Infosys' Finacle is Universal banking solution that caters to core banking, e-banking, Islamic banking, treasury, wealth management and CRM requirements of retail, corporate and global banks. It is used by over 106 banks across 61 countries, namely UK US, China, Taiwan, Hong Kong, India, Zimbabwe, Saudi Arabia, Maldives, Nepal, etc

**Lower discretionary spending:** Discretionary spending is one of the sizeable parts of the expense as IT industry is supported by employee and thus they are the real asset to the company. This expenses form roughly 25%-30% of the total expense. In the period of lockdown, it is likely to lower down by 15%-20%. This expense also includes cost incurred during meeting new clients which will be brought down drastically during the lockdown period.

**Q4FY20 Quarter result:** The company reported decent number during the march quarter. The topline registered 19% growth on YoY basis to Rs. 21,539 crore. Margins contracted from 26.6% in Q4FY19 from 23.9% in Q4FY20 owing to rise in expenditure by 24% on YoY basis. On the profitability front, Infosys marked 11% growth during the quarter ended march to Rs. 4,078 crores. The company had Rs 27,300 crore cash as of March 31, while it signed a \$1.65 billion of large deals in January-March period.

**Valuation:** Apparently, the company is trading at the PE of 20x EPS FY20 which is quite reasonable compared it with the TCS. We expect there is a room for further growth from here as well. We recommend a buy at the CMP Rs. 736 with the price target of Rs.840

NSE/BSE Code	INFY/ 500209
Sector	IT
Industry	IT - Software
Face value/Book Value (Rs.per share)	5 / 145.4
Dividend yield(%)	2.4
52H/L(Rs.)	847 / 511
Market Cap.(Rs.mn)	3,109,183
Shares Outstanding (mn)	4,259.0

(InRs.Cr)	FY16	FY17	FY18	FY19
Net Sales	6,84,840	7,05,220	8,26,750	9,07,910
Sales Growth	9.70%	3.00%	17.20%	9.80%
EBITDA	1,82,450	1,88,930	2,01,700	2,17,560
EBITDA Margin	26.60%	26.80%	24.40%	24.00%
PAT	1,43,830	1,61,000	1,54,100	1,66,390
NPM%	21.00%	22.80%	18.60%	18.30%
Adj.EPS(Rs.)	31.4	36.8	35.5	39.1

	FY16	FY17	FY18	FY19
P/E(x)	21.6	19.3	20.2	18.7
P/B(x)	4.5	4.8	4.8	4.8
EV/Sales(x)	4.1	3.9	3.4	3.1
EV/EBITDA(x)	15.2	14.7	13.8	12.8
ROCE(%)	30.60%	30.40%	32.40%	34.00%
ROE(%)	22.00%	24.10%	23.80%	25.60%

Quarterly Earnings	Q4FY20	Q3FY20	Q-o-Q %	Q4FY19
Net Sales	23,267.0	23,092.0	0.8	21,539.0
Total Expenditure	17,591.0	17,291.0	1.7	16,390.0
PBIDT (Excl OI)	5,676.0	5,801.0	-2.2	5,149.0
PAT	4,335.0	4,466.0	-2.9	4,078.0
PBIDTM% (Excl OI)	24.4	25.1	-2.9	23.9
PBIDTM%	27.0	28.7	-5.8	27.0
PATM%	18.6	19.3	-3.7	18.9
Adj. EPS(Rs)	10.2	10.5	-3.1	9.4

Source: Ace equity, IBEF, Dealmoney research

**Pick of the Month (HCL Technologies Ltd.):**

**CMP: 557**

**Target: 630**

HCL Technologies Limited is engaged in providing a range of software development services, business process outsourcing services and information technology (IT) infrastructure services. The Company delivers its solutions across select verticals, including financial services, manufacturing, retail and consumer products, media, publishing and entertainment, public services, energy and utility, healthcare, and travel, transport and logistics.

**Posted a strong revenue in Q4FY20:** Its growth in revenue was led by growth in IT & Business Services / Americas. Its revenues grew (+0.8% qoq in CC terms, led by Mode 2 business) and margins (+64bps qoq led by better Mode 2-3 margins). Cash conversion at 112% (OCF/ NI) for FY20 was also robust.

**Improving margins:** EBITM improved 64bps qoq/187bps yoy to 20.9% led by forex gains (53bps qoq impact) and higher productivity in IT&BS segment (22bps) partly offset by higher amortization from P&P (12bps). Margins for IT business services expanded 124bps qoq and for ER&D/ products declined 177bps/28bps qoq. Margins for Mode 2 improved by 290bps (few one-offs aided) and for Mode 3 by 260bps.

To acquire Cisco's Self-Optimizing Network (SON) technology: HCL Technologies has announced the acquisition of Cisco's Self-Optimizing Network (SON) technology for a cash consideration of \$50 million. SON is a multi-vendor multi-technology solution that optimises Radio Access Networks (RAN) for 2G-5G. The acquisition should strengthen HCLT's telecommunication offerings as SON has become a major component in 5G upgrades. The acquisition is expected to be completed by January'21.

**Outlook:** The companies valuation are attractive on the basis of strong growth in revenue and improving margins, strong clientele, continuous procurement of large deals provide traction to the company. The stock is trading at a valuations of 16.55x TTM P/E FY21. We recommend buy on HCL Tech Limited with a price target of Rs. 630.

NSE / BSE Code	HCLTECH / 532281
Sector	IT
Industry	IT - Software
Face value / Book Value (Rs per share)	2 / 143.6
Dividend yield (%)	1
52 H/L (Rs.)	624 / 376
Market Cap. (Rs. mn)	14,08,392
Shares Outstanding (Cr)	2,713.70

(In Rs.Mn)	FY17	FY18	FY19	FY20
Net Sales	3,11,359	4,75,680	5,05,690	6,04,270
Sales Growth	-3.10%	52.80%	6.30%	19.50%
EBITDA	66,536	1,03,840	1,12,460	1,39,260
EBITDA Margin	21.40%	21.80%	22.20%	23.00%
PAT	55,969	86,040	87,090	1,01,200
NPM%	18.00%	18.10%	17.20%	16.70%
Adj. EPS (Rs.)	19.9	30.2	31.4	37.3

	FY17	FY18	FY19	FY20
P/E (x)	25.2	16.4	16.2	13.9
P/B (x)	5.1	4.3	3.9	3.4
EV/Sales(x)	4.2	2.8	2.6	2.2
EV/EBITDA(x)	19.9	12.7	11.7	9.5
ROCE(%)	27.00%	34.30%	31.40%	31.00%
ROE(%)	22.10%	28.60%	25.10%	26.00%

Quarterly Earnings	Q4FY20	Q3FY20	Q-o-Q %	Q4FY19
Net Sales	18,587.00	18,135.00	2.5	15,990.00
Total Expenditure	13,729.00	13,506.00	1.7	12,396.00
PBIDT (Excl OI)	4,858.00	4,629.00	5	3,594.00
PAT	3,172.00	2,944.00	7.7	2,550.00
PBIDTM% (Excl OI)	26.1	25.5	2.4	22.5
PBIDTM%	26.9	26.4	2.1	23.7
PATM%	17.1	16.2	5.2	16
Adj. EPS(Rs)	11.7	10.9	7.7	9.4

Source: Ace equity, IBEF, Dealmoney research

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