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Hexaware, Mphasis, Sonata highlight business impact of Covid-19...

On a consolidated basis, IT companies are expecting near term pain (at least in H1FY21E) led by a lockdown, pricing pressure, delay in deal signing and furloughs. Most of them expect a recovery to begin from H2FY21E and have assumed business as usual in new deal signing. However, we believe there will be a delay in new deal signings while recovery time can also stretch beyond H2FY21E. Further, in terms of margins, the company expects headwinds due to lockdown cost, pricing pressure, lower utilisation, cross currency headwinds and furloughs while tailwind is led by rupee depreciation, lower attrition, lower travel and utility cost. Below are the highlights cited by each company and their views on the current situation. Based on the company's view and our assumptions, we have made changes to our financials and arrived at a fair value of the companies.

Hexaware

Hexaware hosted a conference call and highlighted that:

- They have enabled work from home for 99% of offshore and 100% of onsite employees in IT services
- However, in terms of BPO (~8% of revenues), only 75% is working from home due to client specific challenges, which we believe will impact the company's near term revenues
- The company has seen the impact of Covid-19 on verticals like travel, education and healthcare i.e. in fitness. There could be a second level of impact on verticals like manufacturing and retail. Travel is ~10% of the company's revenues while fitness & education have a marginal contribution to revenues. One of the top 10 clients is in the travel vertical. BFSI, as of now, has not been impacted. The company highlighted that the pain in one of the BFSI top clients has receded. However, we believe issues in top 10 clients may hamper growth in the near term
- Hexaware has also highlighted that a few clients will get better credit terms based on the long term view of the client and also some pricing discount. We believe this will impact working capital and cash flows of the company in the near term
- In the near term, the company witnessed a delay in new deal signing. Hexaware believed the impact of Covid 19 will continue till May. New deal signing should pick up from Q2CY20E & Q3CY20E while affected verticals like travel should see a V-shaped recovery
- In the long run, the company sees acceleration to digital services specifically in automation, cloud and customer experience due to the disruption faced by clients led by Covid-19. Further, company expects to gain market share in the long run led by absence of legacy IMS and smooth transition for clients in work from home

We believe the management expectation in the near term is a bit on the optimistic side while the impact of Covid 19 could be longer than management expectation. Accordingly, we revise our revenue & EPS estimates downwards and also revise our target price downwards. We now assign a P/E of 12x to CY21E EPS of ₹ 20/share and arrive at a target price of ₹ 250/share. We maintain our **HOLD** rating on the stock.

Exhibit 1: Financials- Hexaware

Particular (Hexaware)	CY20E Previous Estimates	CY20E Revised Estimates	CY21E Previous Estimates	CY21E Revised Estimates
Revenue (in Rs crore)	6,569	5,957	7,226	6,552
EPS	22.8	17.3	25.9	20.0

Source: Company, ICICI Direct Research

This report highlights summary of business impact of Covid 19 as highlighted by Hexaware, Mphasis and Sonata Software. We continue to maintain HOLD rating on Mphasis and Hexaware while we have a BUY rating on Sonata Software

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Mphasis

Mphasis highlighted that:

- Work from home for BPM is complex while for the remaining 90% it is work from home
- As of now, the company is not witnessing a massive scale impact,
- Mphasis has converted most of the pipeline in March
- The company is witnessing revenue disruption in ramping up of deals as regular onboarding is being disrupted on account of background check, etc, taking a backseat
- Total 18 months of minimum commitment from DXC is still pending,
- Mphasis is focussing on expanding new clients
- The company will be able to give a clearer picture in two to three weeks
- We believe Q1 and Q2 will be challenging led by lockdown, challenges, ramp down in existing deals and impact on new deal pipeline. As a result, we expect FY21E to be a washout
- From a margin perspective, there could be headwinds in terms of utilisation led by delay in deal ramp ups, pricing pressure and tailwinds in terms of rupee depreciation, lower attrition and lower travel cost.

Considering the various challenges, our revised estimates are highlighted below. We assign 12x multiple to FY22E EPS of ₹ 59.4 and arrive at a target price of ₹ 735. We continue to maintain our **HOLD** rating on the stock.

Exhibit 2: Financials- Mphasis

Particulars (Mphasis)	FY21E	FY21E	FY22E	FY22E
	Previous Estimates	Revised Estimates	Previous Estimates	Revised Estimates
Net Sales (in Rs crore)	9,577.7	8,887.4	10,480.1	9,531.2
EPS	64.2	49.8	70.2	59.4

Source: Company, ICICI Direct Research

Sonata Software

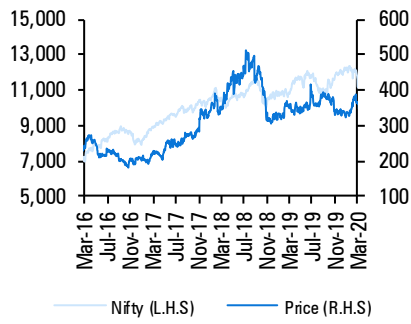
Sonata Software has given a profit warning that one of its large clients had to temporarily suspend their operations, thus affecting a majority of the company's ability to service them. The company believes this will have a significant negative impact on profits by up to 40% in the immediate future. Currently, Sonata expects this to affect its Q1FY21E and Q2FY21E performance. We believe this is a temporary aberration for the company's financials and the company should be able to recover in FY22E. Further, the company has a cash balance of ₹ 400 crore, which would also help Sonata to withstand the storm. In addition, the stock price has corrected significantly factoring in most of the negatives. Hence, we maintain our **BUY** rating on the stock with a target price of ₹ 230/share (10x P/E on FY21E EPS of ₹ 22.9/share).

Exhibit 3: Financials- Sonata Software

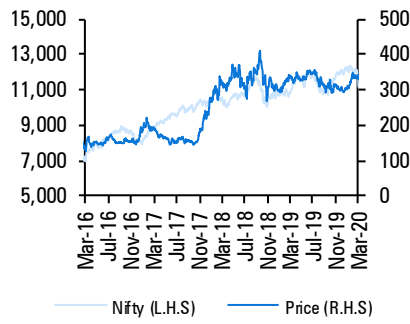
Particulars (Sonata Software)	FY21E	FY21E	FY21E	FY21E
	Previous Estimate	Revised Estimate	Previous Estimate	Revised Estimate
Revenue (in Rs crore)	3,821	3,109	4,116	3,341.6
EPS	31	17	34	22.9

Source: Company, ICICI Direct Research

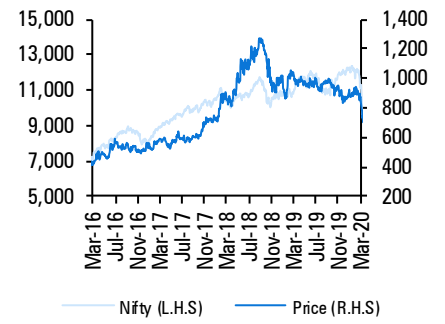
Hexaware price chart



Sonata Software price chart



Mphasis price chart



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