

March 18, 2020

Covid-19, oil price dip to pose near term headwinds...

The spread of Covid-19 has led to lockdowns in many countries globally and could have adverse economic implications. In addition, the recent fall in crude prices could also have an adverse impact of fiscal health of oil producing countries. As a result, IT companies, which have considerable exposure to verticals such as oil, energy & utilities; banking & capital markets; manufacturing and travel & transport could see an adverse impact from the ongoing crisis. Companies like Wipro, Infosys in large cap and MindTree, NIIT Tech, Sonata software, Cyient, Accelya Solutions among midcaps could be impacted on most fronts due to their exposure to the impacted segments. In addition, the recent rate cut by the US Federal Reserve could impact BFSI revenue growth, especially in capital markets. Further, travel restrictions across the globe could also impact new client wins, large deal closure and ability of IT companies to ramp up projects.

With the situation surrounding Covid-19 spread and control still unclear, the managements of major companies are opting to wait for around 10-15 days to provide a clear indication of the impact of the virus outbreak on the business. We believe the real impact of this could be seen in H1FY21E, in terms of project ramp downs and decline in large deal wins.

Valuation & Outlook

It is difficult for us to accurately predict the slowdown in demand and its impact on the revenue & profitability of IT companies led by Covid-19, oil price fluctuation, banking & capital market, retail segment and restriction on movement of resources. Considering there are many moving parts, we conservatively downgrade our multiple and target price to factor in the uncertainty. However, the recent correction in stock prices of IT companies have made a few stocks attractively placed (based on FY20E FCF yield and valuation). Hence, we maintain **BUY** on a few stocks led by attractive FCF yield and upgrade the rating on a few stocks based on attractive valuation. The current valuation of Wipro, Sonata and Firstsource is factoring in zero growth till perpetuity making them lucrative buys at current levels.

***Recommend BUY** on few stocks led by attractive FCF yield and upgrade rating on few stocks based on attractive valuation. We have BUY on Wipro, Infosys, TechM, L&T Infotech, Sonata Software, Firstsource and Persistent*

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Exhibit 1: Large cap IT coverage universe summary

Large Cap	CMP	Target		Rating		% upside/downside	Remarks
		Old	New	Old	New		
TCS	1690	2120	1925	Hold	Hold	13.9%	The company witnessed a slowdown in revenue growth mainly led by weakness in certain pockets of banking, retail and manufacturing. Further, higher exposure to BFSI and retail segment could impact the company's revenue growth
Infosys	572	890	710	Buy	Buy	24.1%	The company has seen healthy growth in large deals and has witnessed industry leading growth led by a change in management. Infosys may face headwinds in the near term. However, we believe the company is on the right path to growth. This prompts us to maintain BUY rating on the stock with a revised target price of ₹ 710/share
Wipro	182	285	235	Buy	Buy	29.1%	Although the company has higher exposure to BFSI, energy & utility and Middle East, we believe the current valuation factors in most negatives. Hence, we continue to have a BUY rating on the stock
HCL Technologies	462	700	525	Buy	Hold	13.6%	Exposure mainly to BFSI, energy & utilities and manufacturing. Growth in these verticals could be impacted on account of the Fed rate cut, decline in crude oil prices and lockdown in Europe, respectively. In addition, uncertainty in the products division and travel restrictions could impact the company's revenue and profitability. Hence, we downgrade the stock from BUY to HOLD
Tech M	610	905	760	Buy	Buy	24.6%	TechM is expected to witness a limited impact as the company has comparatively less exposure to impacted verticals. In addition, the company is trading at an attractive valuation, which prompts us to maintain BUY rating on the stock. The downward revision in target price is mainly due to near term headwinds of travel restrictions, Europe and China exposure

Source: Company, ICICI Direct Research

Exhibit 2: Mid cap IT coverage universe summary

Mid Cap	CMP	Target		Rating		% upside/downside	Remarks
		Old	New	Old	New		
Zensar	100	205	110	Buy	Hold	10.0%	The company has faced client ramp downs in the retail vertical over the past two quarters. With the slowdown in the economy, we expect the concerns for the company to get accelerated. This could also lead to a delay in deal closures and new client acquisitions mainly driven by travel restrictions
Sonata	232	410	290	Buy	Buy	25.0%	Although the company has higher exposure to the retail and travel vertical, we believe the current valuation factors in all the negatives. Hence, we continue to have a BUY rating on the stock
Majesco	261	450	310	Hold	Buy	18.8%	The company has healthy annuity revenues of ~33%. Further, Majesco could be a beneficiary of the improvement in insurance segment over the long term. Hence, we upgrade the stock from HOLD to BUY
Firstsource	34	53	43	Buy	Buy	26.5%	We revise the target price downwards due to uncertainty in the UK (~35%). However, we maintain BUY rating on the stock due to better FCF yield (10% in FY19)
Hexaware	290	410	320	Hold	Hold	10.3%	The company has faced supply side issues, which has hampered its revenue growth. With travel restrictions, we believe this can accelerate. Further, the company has exposure in BFSI (~38%), manufacturing & consumer (~17%) and travel & transport (10%), which could be impacted on account of the Fed rate cut, lockdown in Europe and travel restrictions, respectively
Mphasis	661	1050	735	Hold	Hold	11.2%	The company has the largest exposure to the banking & capital markets (~45%). The recent Fed rate cut could impact the segment numbers. In addition, challenges in DXC (accounts for 30% of revenues) could further impact the company's revenue growth potential
Cyient	333	510	370	Hold	Hold	11.1%	With high exposure to the transport and energy & utilities vertical, the company's growth could face an impact driven by travel restrictions and decline in crude oil prices. In general, technology companies could see an impact due to a delay in deal closures and new client acquisitions mainly driven by travel restrictions
L&T Infotech	1479	2150	1795	Hold	Buy	21.4%	The company has healthy exposure to BFS (capital markets), energy & utilities and manufacturing. Growth in these verticals could be impacted. However, the company has good end-to-end capability, better execution and marketing team making it the preferred pick among midcap companies. Hence, we revise the rating on the stock
eClerx	404	590	455	Reduce	Hold	12.6%	The recent correction in the stock has made the company's valuation attractive. Hence, we upgrade the stock from REDUCE to HOLD

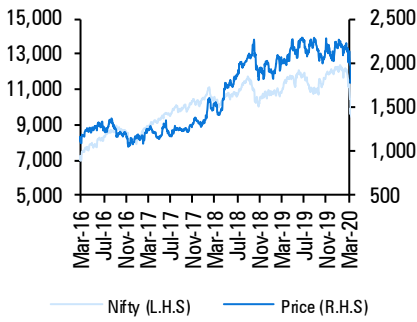
Source: Company, ICICI Direct Research

Exhibit 3: Mid cap IT coverage universe summary

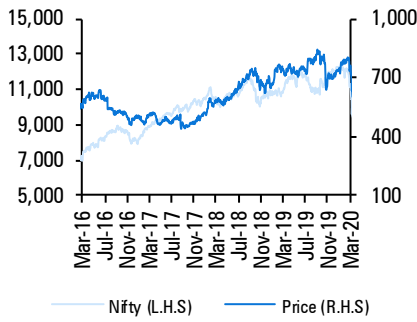
Mid Cap	CMP	Target		Rating		% upside/downside	Remarks
		Old	New	Old	New		
Persistent	591	780	735	Buy	Buy	24.4%	The change in management and exposure to impacted verticals are key positives. However, travel related restrictions lead us to revise our target price downwards while maintaining BUY rating
Mastek	263	385	240	Reduce	Reduce	-8.7%	Has high exposure to UK (~75%), which has been impacted by Brexit and now Covid -19. In addition, the recent acquisition by the company has high exposure to the Middle East. Hence, we maintain our REDUCE rating on the stock
Accelya	915	1300	980	Hold	Hold	7.1%	Being a focused IT player in the aviation industry, the company is expected to face headwinds in its numbers in H1
InfoEdge	2145	3000	2450	Hold	Hold	14.2%	Slowdown in economy could impact hiring activity (Naukri business) and real estate business (99 acres)
NIIT Tech	1232	1750	1390	Reduce	Hold	12.8%	With high exposure to the travel, transport and banking vertical, the company's growth could be impacted. However, recent correction in price factors in most of the negatives. This, coupled with change in promoters, is expected to lead to healthy capital allocation. As a result, we revise our rating upwards from REDUCE to HOLD
Mindtree	850	945	945	Hold	Hold	11.2%	The company has exposure in BFSI (~22%), retail, CPG & manufacturing (~22%) and travel & transport (~16%). Growth in these verticals could be impacted on account of Fed rate cut, lockdown in Europe and travel restrictions, respectively. In general, technology companies could see an impact due to a delay in deal closures and new client acquisitions mainly driven by travel restrictions
Teamlease	2121	2800	2405	Hold	Hold	13.4%	Slowdown in economy could impact addition in associate headcount number in the staffing business

Source: Company, ICICI Direct Research

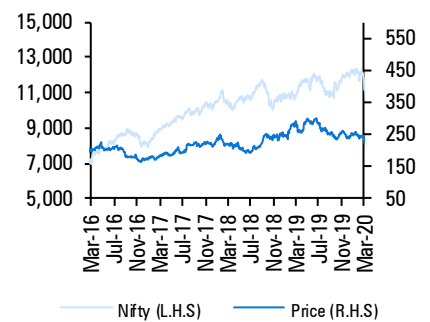
Tata Consultancy Services price chart



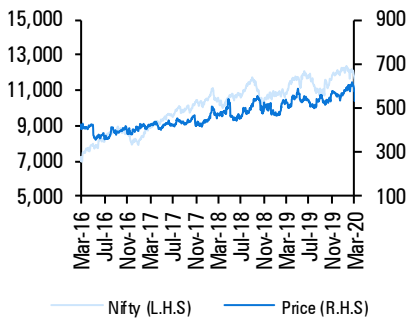
Infosys price chart



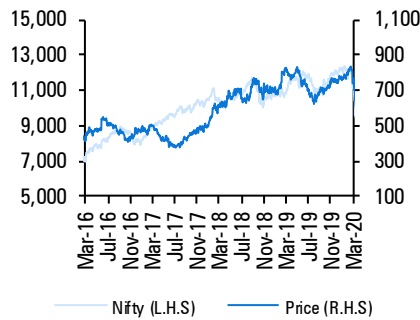
Wipro price chart



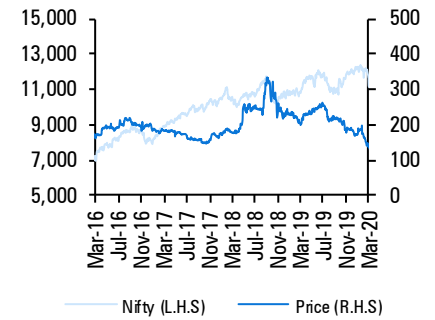
HCL Tech price chart



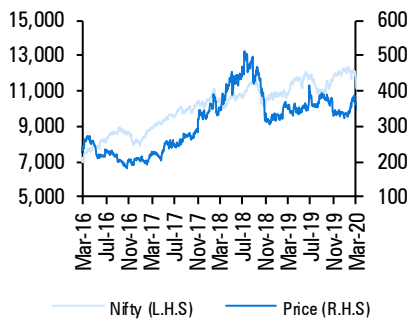
Tech Mahindra price chart



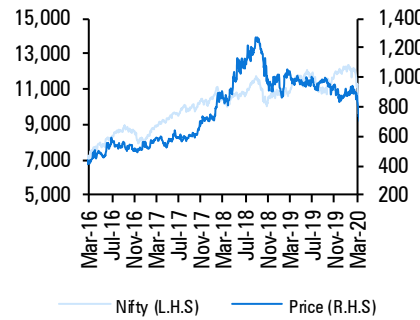
Zensar price chart



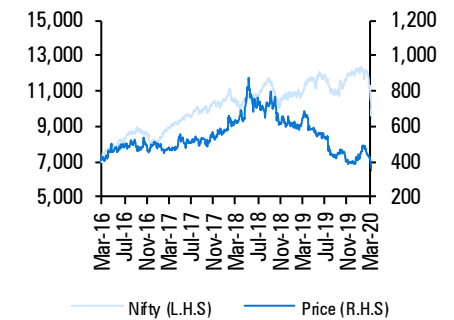
Hexaware price chart



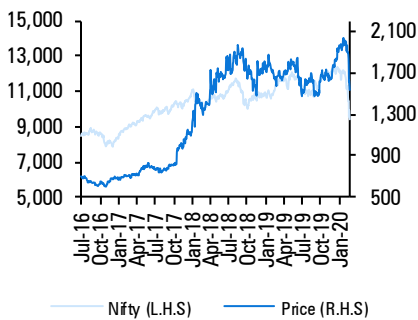
Mphasis price chart



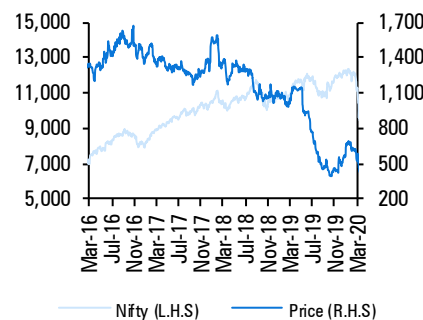
Cyient price chart



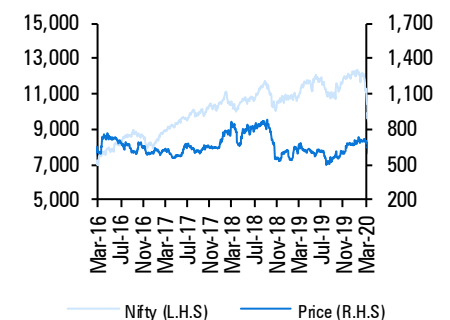
L&T Infotech price chart (Limited history)



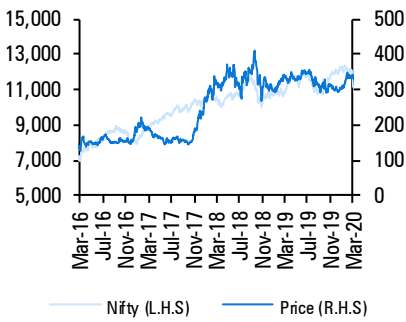
eClerx Services price chart



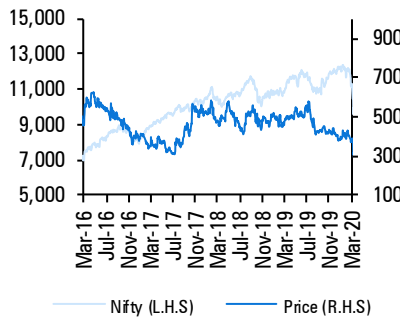
Persistent price chart



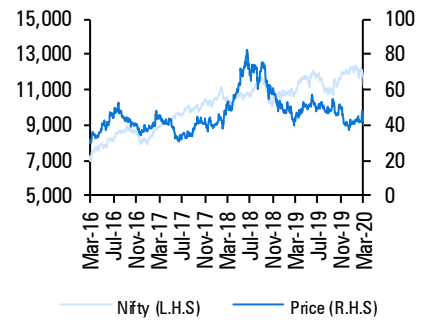
Sonata Software price chart



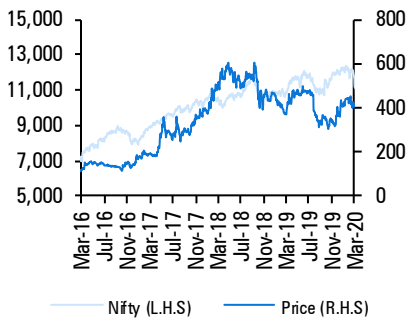
Majesco price chart



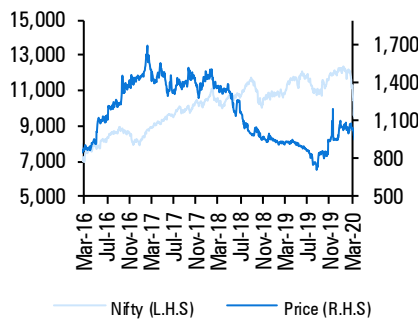
Firstsource price chart



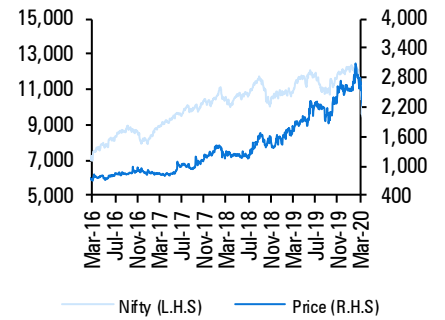
Mastek price chart



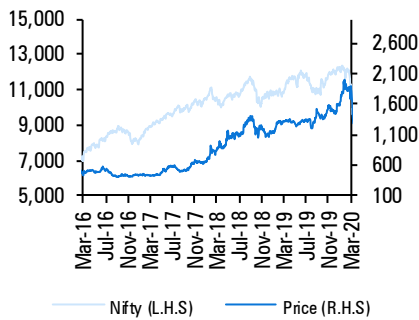
Accelya price chart



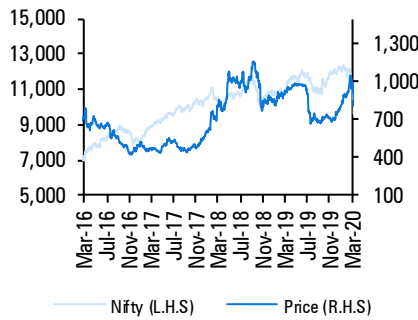
InfoEdge price chart



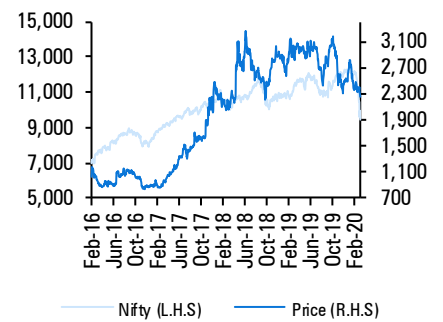
NIIT Tech price chart



Mindtree price chart



Teamlease price chart (Limited history)



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Buy: >15%;

Hold: -5% to 15%;

Reduce: -5% to -15%;

Sell: <-15%



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