

Oct 4, 2021

Market share gain for Indian IT companies to continue

IT stocks had a phenomenal rally in the last three months as well as the last one year. Large cap IT stocks in our coverage rallied from 64-210% in the last 12 months while the run up was from 6-38% in the last three months. Nifty IT index also rallied 73% in the last one year, surpassing major Nifty indices of banks, FMCG, auto, pharma as well as the Nifty 50 benchmark index. However, Nifty IT has seen some correction (8-10%) recently. Now the obvious question for investors is whether this dip is an opportunity to invest further in IT stocks. We tried to focus on some data points of global IT spending and trend of market share for IT companies, which suggests that IT spending will remain strong in the medium to long term on account of some structural changes happening on the ground. We suggest that investors use this temporary blip to invest further in Indian IT stocks.

Market share for Indian IT companies continues to grow...

As per Gartner, Global IT spending, is expected to grow at 6.9% CAGR in CY20-22E to US\$4.4 trillion. Growth is expected to be fuelled by IT services (29% of the mix). Global IT services revenues grew only at 2.5% CAGR in CY12-20 while Indian IT exports grew at 12% CAGR over the same period, which suggests market share gain. The market share of Indian IT companies has grown from 5.9% in CY12 to >12% in CY20. Global IT services are expected to see an acceleration in growth and are expected to grow at 9.2% CAGR in CY20-22E, which suggests that Indian IT companies will continue to gain market share.

...structural changes in business models may accelerate market share gain

Recent Accenture guidance suggests the demand environment for Indian IT companies continues to be strong. In our view, it is not a quarter phenomenon but there are some structural changes happening on the ground that may bring cheer for Indian IT companies in years to come. Covid-19 has made industries across the globe bring about changes to adapt to the Work from Home environment with minimal disruption to their business models. This also led businesses to change their model from captive to outsourcing, which is expected to benefit Indian IT companies. It has already started with Infosys' and TCS' recent deal wins of the captive units of some of the businesses.

...which could bring in pricing discipline

One of the major highlights of the quarterly earnings call was in regard to pricing where some managements do not rule out pricing discipline ahead. Not all the companies provide pricing data but whatever historical data is available suggests that revenue growth for Indian IT companies has been largely driven by volumes. This suggests that pricing growth has been largely stagnant. One rationale given by managements regarding pricing power is pressure on their margin in the medium term due to i) lower utilisation on account of elevated hiring of freshers to cater to the strong demand ii) higher subcontracting costs. ***We do not rule out margin pressure on Indian IT companies in the near term but in the long term, strong revenue growth may help to tide over these costs.***

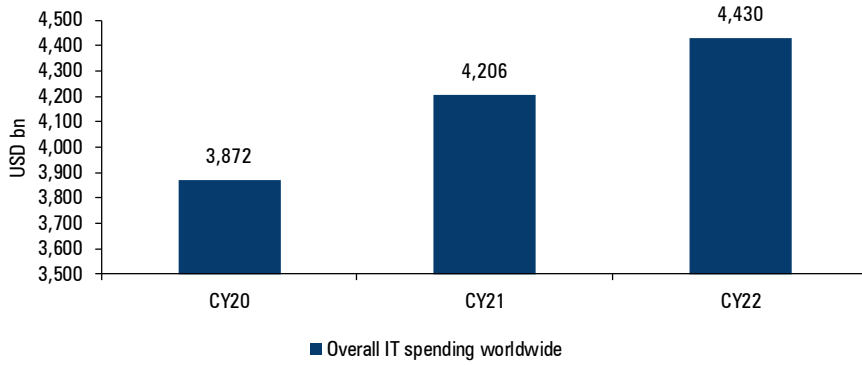
...which is key to valuation multiple re-rating

we believe the above factors would be key for valuation multiple re-rating. Hence, we are increasing target multiple for TCS, Infosys, TechM, LTI and Persistent and maintaining their **BUY** rating. We are also upgrading Wipro, HCL Tech, Mphasis and Coforge from **HOLD** to **BUY** by assigning higher target multiple. We now assign **HOLD** rating to MindTree, from **BUY** earlier, as we believe growth is largely factored in current market price (Exhibit 4).

Research Analysts

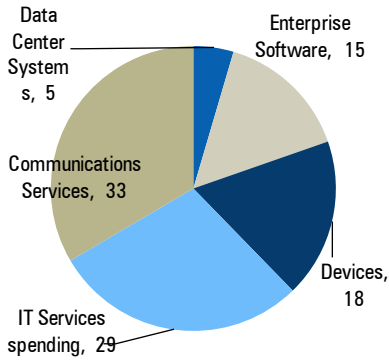
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Exhibit 1: Global IT spending to reach US\$4 trillion



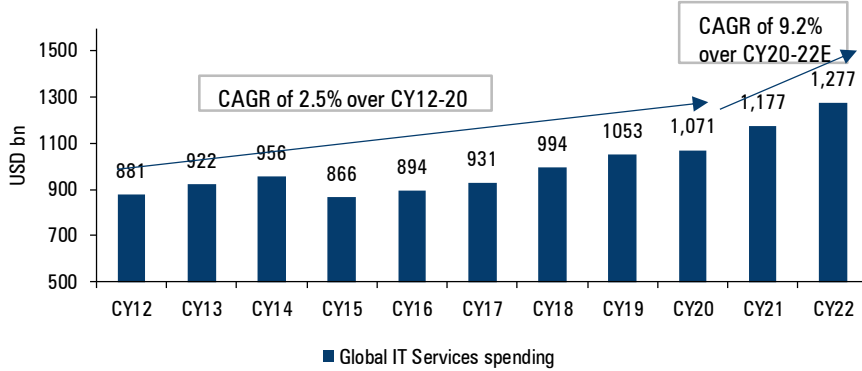
Source: Gartner, ICICI Direct Research

Exhibit 1: IT services form 29% of Global IT spending



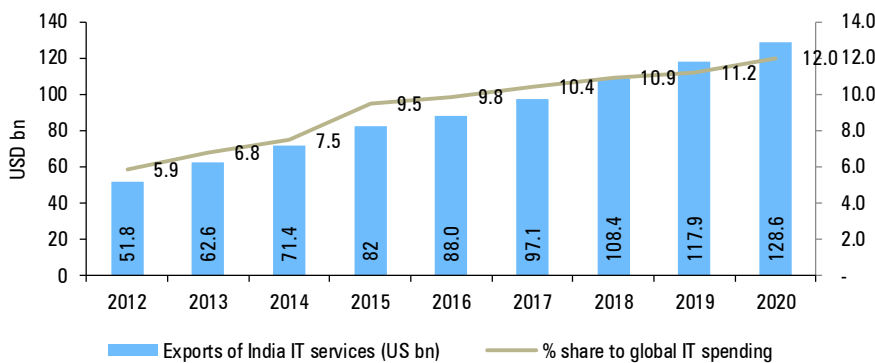
Source: Gartner, ICICI Direct Research

Exhibit 2: Global IT services grew only 2.5% CAGR over CY12-20



Source: Gartner, ICICI Direct Research

Exhibit 3: Which means Indian IT companies gained market share



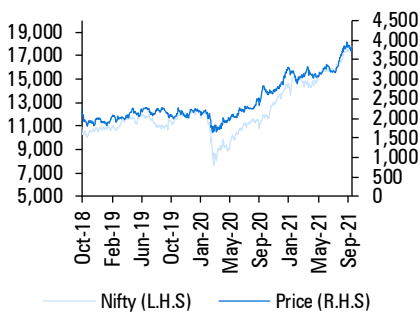
Source: RBI, Gartner, ICICI Direct Research

Exhibit 4: Target price, rating and P/E multiple change

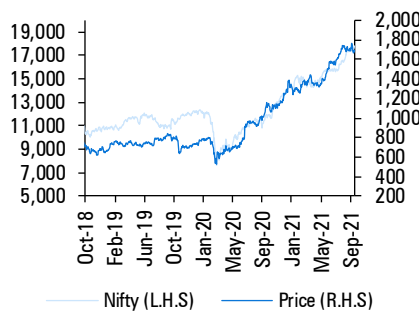
Company	Earlier TP (Rs)	Earlier Target P/E multiple	New TP (Rs)	New Target P/E multiple	Old rating	New rating	CMP	Upside (%)	
TCS	3,800	30	4,341		34	BUY	BUY	3,771	15.1
Infosys	1,825	28	1,930		30	BUY	BUY	1,679	15.0
Wipro	670	26	743		28	HOLD	BUY	640	16.0
HCL Tech	1,110	18	1,475		24	HOLD	BUY	1,278	15.4
Tech M	1,375	18	1,611		24	BUY	BUY	1,399	15.2
LTI	5,065	35	6,599		45	BUY	BUY	5,731	15.1
Mindtree	3,065	32	4,314		45	BUY	HOLD	4,184	3.1
Mphasis	2,725	29	3,555		38	HOLD	BUY	3,088	15.1
Coforge	5,500	40	6,139		43	HOLD	BUY	5,336	15.0
Persistent systems	3,535	35	4,267		42	BUY	BUY	3,712	15.0

Source: ICICI Direct Research

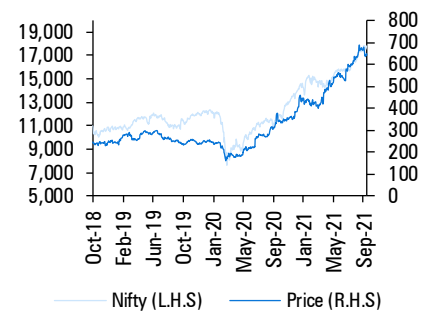
TCS Price Performance (done)



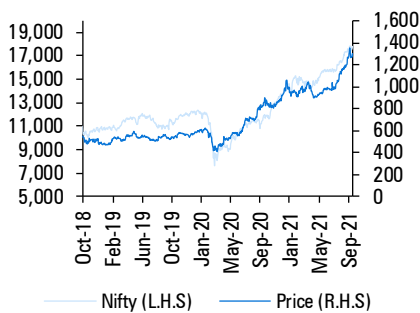
Infosys Price Performance



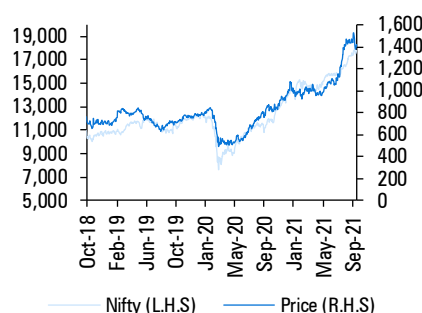
Wipro Price Performance



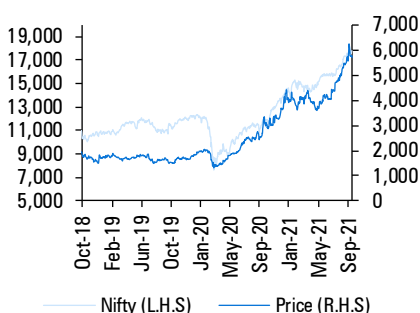
HCL Tech Price Performance



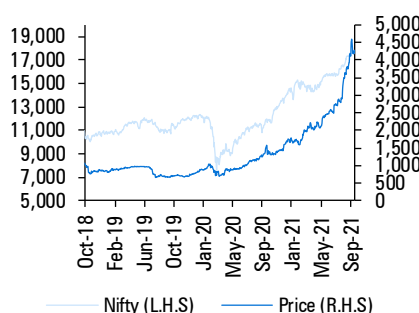
Tech M Price Performance



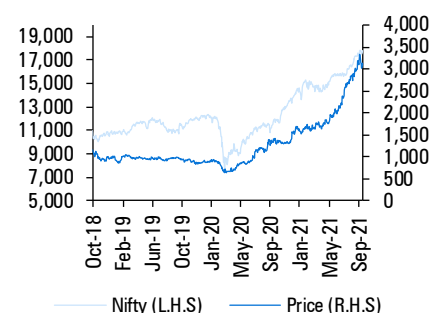
LTI Price Performance



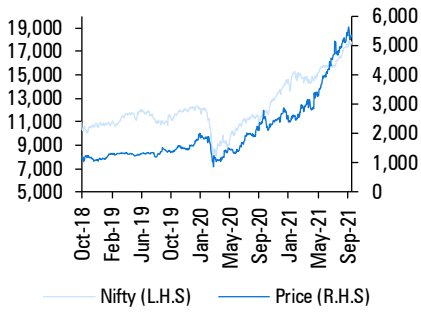
Mindtree Price Performance



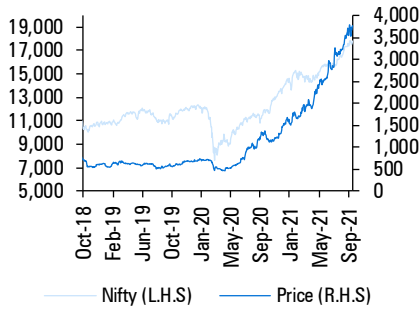
Mphasis Price Performance



Coforge Price Performance



Persistent Systems Price Performance



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Buy: >15%;

Hold: -5% to 15%;

Reduce: -5% to -15%;

Sell: <-15%



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