

2QFY15 results for the IT Services sector have demonstrated the **high volatility and expectations** that have now become an integral part of the sector. **TCS and HCL Tech stocks fell by ~10%** on the day of results – on the back of **marginal miss on the revenue and EBITDA** front. All this, notwithstanding robust management guidance for the future!

The case of **TCS** was particularly appalling. The company **fell short of the consensus revenue expectations by 0.5% (\$25-30mn)**. The margins were marginally lower than expectation, but along the lines of management's earlier guidance. **Yet, the stock tanked by 10% after the results – all for a miss of \$30mn – an insignificant 0.2% of the full year revenue base of \$16bn.**

Over the last seven quarters, the stock prices of the Top-4 IT Services companies **have been highly volatile**, particularly on the day of the results. Our analysis reveals that **on thirteen occasions, the stocks reacted by more than 5% on the day of the returns**. And in only three of those occasions, were the results off the expectations, by more than 5% (*details on page 2*).

We believe that this high volatility and short-term focus is highly detrimental for the sector. **Excessive focus on quarterly results will inhibit the management of these companies, from focusing on long-term growth**, and force them to 'deliver' results, inline with expectations, quarter after quarter. The managements will be forced to take decision which will deliver short-term investor gratification, rather than long-term value creation.

We also believe that these sharp stock price reactions **might deter the managements, from providing the true on-the-ground picture to the investor community**, and encourage the practice of '**expectations management**' – where the companies will try to **under-promise and over-deliver**. And as the last twelve months stock price performance of one of the Top-4 companies has depicted – this practice only ends up increasing the stock price volatility.

We would like to highlight that the **IT Services sector has the highest level of corporate governance and investor disclosures** in the market – where, as Infosys's management regularly puts it, '*the bad news travels by elevators and the good news by stairs*'.

Notwithstanding the sharp price reactions on result days, we note the **IT Services sector has delivered superior returns** over the medium and long term, and has consistently **outperformed the broader index** (*comparison on page 2*). The sector companies have withstood the burden of high quarterly expectations and have created sustainable value and wealth for the investors.

We maintain our positive stance on the sector, and expect the sector to deliver robust earnings growth, on the back of expected revival in US discretionary spending, European companies opening-up to outsourcing and the Indian companies capturing market share from global peers. We maintain **BUY rating on Tech Mahindra, TCS and HCL Tech** and remain **NEUTRAL on Infosys and Wipro**.

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Stock price reactions and results – Top-4 IT Services companies – Last 7 quarters

Company	Quarter	Absolute Stock Returns (%)			Deviation from consensus estimates		Possible Explanation
		-1w	1d	+1w	Revenue	EBITDA	
Infosys	Q4FY13	3.0%	-21.3%	0.0%	-2.0%	-7.2%	Earnings miss, Failure to meet its guidance
	Q1FY14	2.2%	10.9%	1.5%	1.7%	2.7%	Revenue beat, low expectations
	Q2FY14	3.5%	4.8%	1.3%	0.8%	-8.1%	Revenue beat, Narrowing of guidance
	Q3FY14	-1.8%	2.8%	5.0%	-0.6%	4.5%	-
	Q4FY14	-1.7%	0.8%	-2.2%	-0.2%	1.1%	-
	Q1FY15	-1.5%	1.0%	-2.2%	-0.7%	2.7%	-
	Q2FY15	-4.8%	6.7%	-2.3%	0.1%	3.4%	Low expectations, underperformance leading upto results
TCS	Q4FY13	-4.6%	-0.6%	-1.5%	0.0%	-0.4%	-
	Q1FY14	6.4%	4.9%	1.8%	0.4%	4.3%	Robust margin expansion
	Q2FY14	7.5%	-5.0%	-4.7%	0.0%	3.1%	High expectations
	Q3FY14	4.8%	-5.8%	1.5%	-0.4%	-0.4%	High expectations
	Q4FY14	2.8%	1.0%	-0.7%	-0.2%	-0.4%	-
	Q1FY15	1.4%	2.6%	6.6%	0.2%	1.3%	-
	Q2FY15	-2.0%	-8.7%	0.8%	-0.8%	-2.6%	High expectations, Marginal miss
HCL Tech*	Q3FY13	-0.4%	-1.5%	-2.5%	-0.7%	3.4%	-
	Q4FY13	0.7%	3.5%	-3.4%	-2.9%	0.6%	-
	Q1FY14	3.9%	-6.7%	-2.7%	1.3%	6.6%	Concerns of lopsided growth driven by IMS
	Q2FY14	3.9%	4.2%	1.4%	0.9%	4.5%	-
	Q3FY14	3.8%	1.1%	1.3%	1.1%	6.4%	-
	Q4FY14	1.1%	-2.7%	-2.2%	-1.8%	0.4%	-
	Q1FY15	-4.8%	-9.1%	1.3%	-0.5%	0.3%	High expectations
Wipro	Q4FY13	-8.4%	-7.9%	-2.7%	1.6%	0.4%	Muted guidance for Q1
	Q1FY14	-2.0%	6.7%	7.4%	1.3%	3.4%	Strong guidance for Q2
	Q2FY14	0.9%	-4.4%	-1.2%	-0.5%	9.7%	-
	Q3FY14	-0.4%	3.8%	0.0%	0.8%	4.4%	-
	Q4FY14	4.5%	-6.7%	-4.0%	0.2%	3.7%	Disappointing guidance for Q1
	Q1FY15	7.2%	-4.6%	-2.6%	-0.5%	1.4%	-
	Q2FY15	1.7%	-3.6%	-1.1%	-1.5%	-3.1%	-

Source: Bloomberg, Company PhillipCapital India Research (*June year end)

IT Sector – Long term outperformance

Stocks	Absolute returns			Earnings CAGR %		
	1 Yr	3 Yr	5 Yr	1 Yr	3 Yr	5 Yr
TCS	23.0%	132.9%	324.5%	37.1%	30.1%	29.9%
Infosys	22.6%	41.7%	87.9%	13.0%	16.0%	12.2%
HCL Tech	46.2%	273.3%	469.2%	58.6%	58.6%	39.6%
Wipro	17.0%	69.6%	81.5%	17.5%	14.0%	15.0%
Average Top-4	26.1%	86.3%	162.6%	29.1%	25.2%	22.0%
CNX-IT	27.7%	80.2%	123.9%	20.9%	20.2%	17.2%
NIFTY	31.3%	54.3%	75.5%	10.6%	8.7%	15.2%

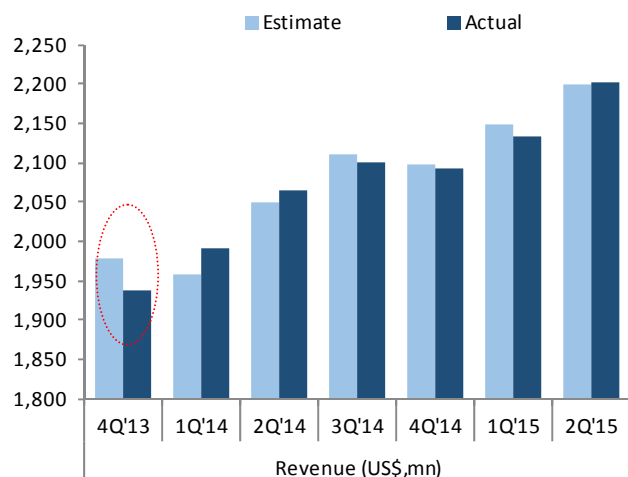
Source: PhillipCapital India Research, Bloomberg

Valuation Table

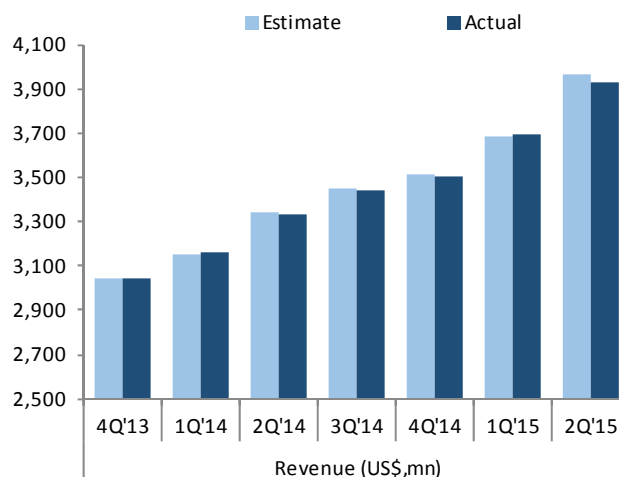
Companies	CMP	M-Cap	Target	Target	Upside	Rating	P/E (x)		ROE (%)	
	Rs	Rs bn	Multiple*	Price (Rs)	%		FY16E	FY17E	FY16E	FY17E
TCS	2,590	5,073	20.0	2,950	14%	BUY	19.3	16.1	38.0	36.7
Infosys	4,015	2,294	15.0	3,700	-8%	NEUTRAL	17.4	15.3	21.5	21.4
Wipro	564	1,391	14.0	608	8%	NEUTRAL	14.0	12.2	25.6	25.3
HCL Tech	1,615	1,140	15.0	1,820	13%	BUY	14.3	12.4	27.1	26.0

Source: PhillipCapital India Research (*Average FY16-17 P/E)

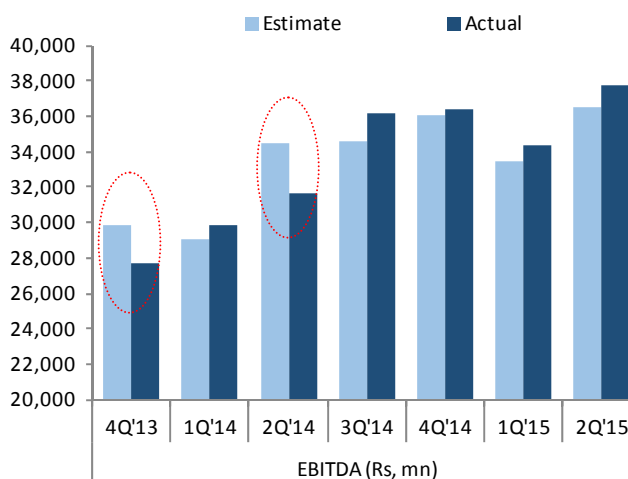
Infosys – Revenue (Results vs Estimates)



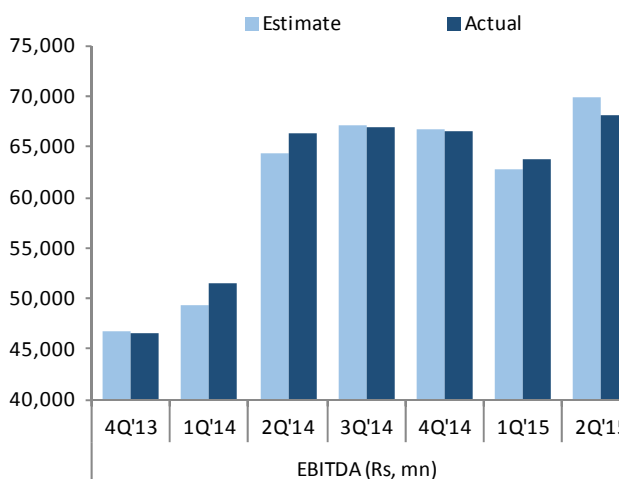
TCS – Revenue (Results vs Estimates)



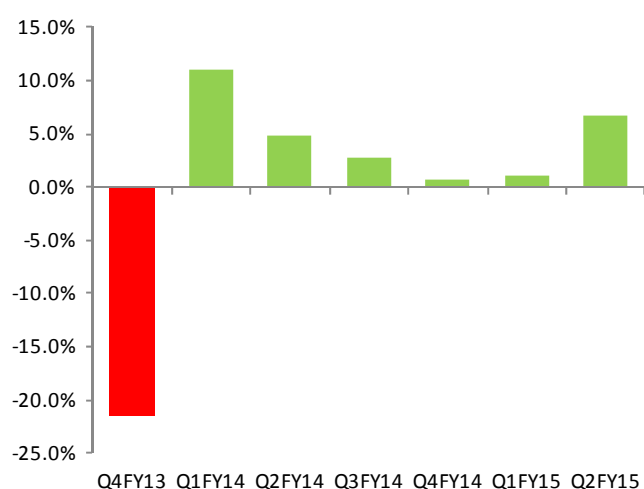
Infosys – EBITDA (Results vs Estimates)



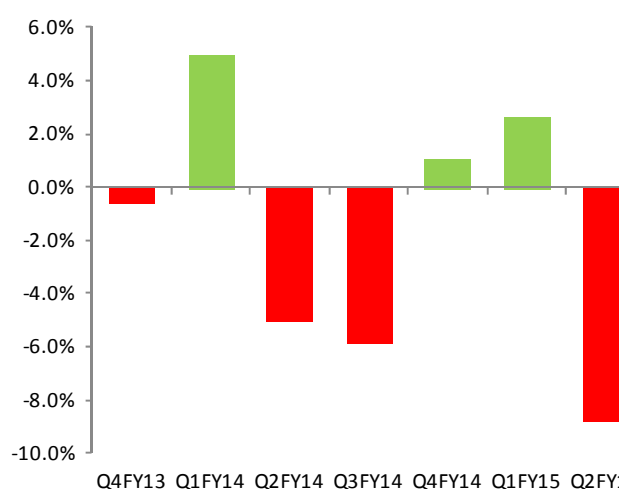
TCS – EBITDA (Results vs Estimates)



Infosys – Results day stock price reaction

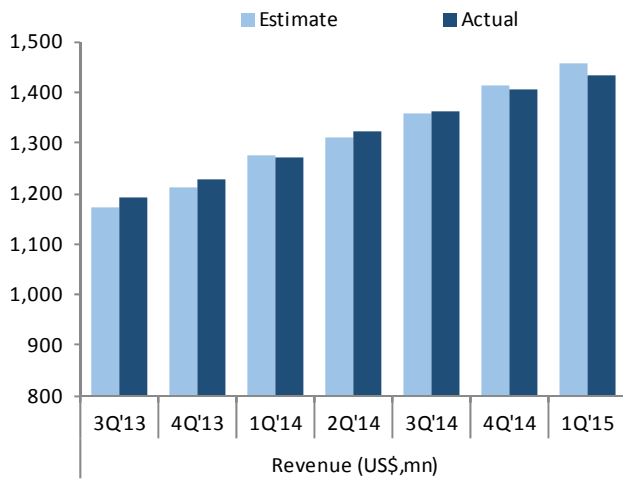


TCS – Results day stock price reaction

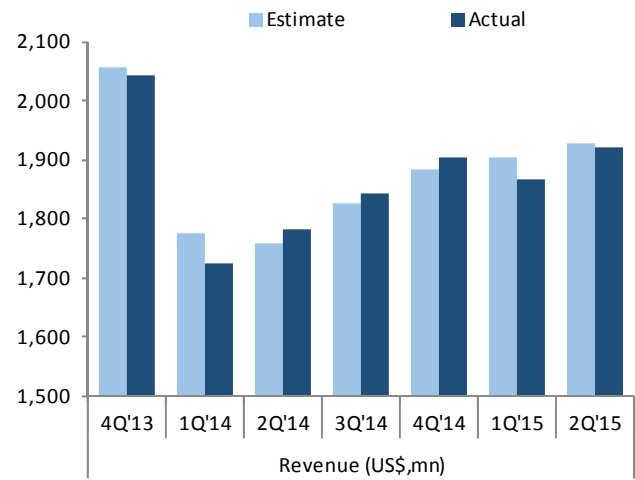


Source: Bloomberg, Company PhillipCapital India Research

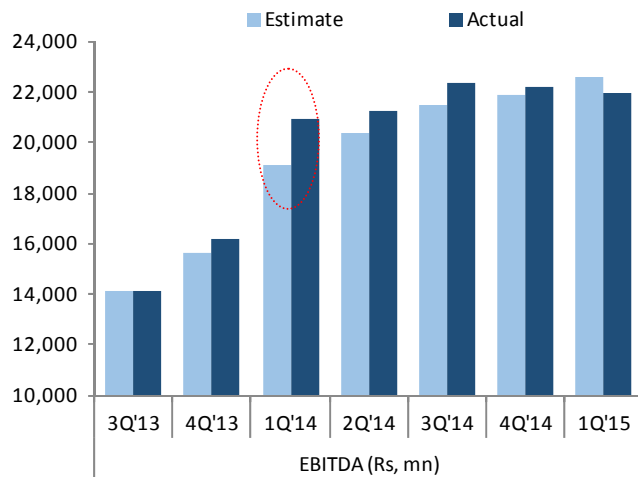
HCL Tech – Revenue (Results vs Estimates)



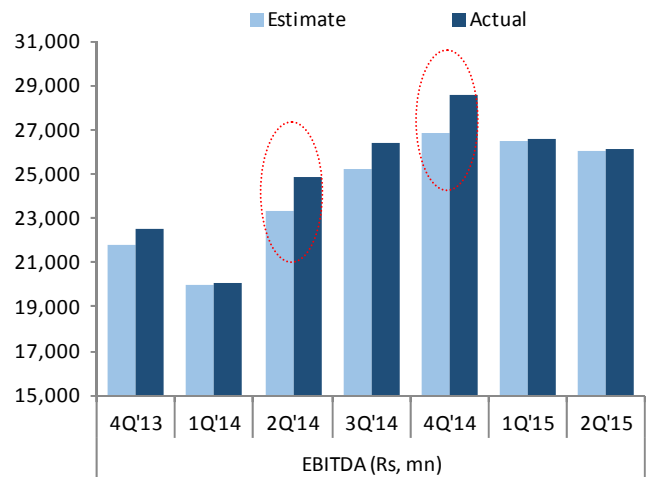
Wipro – Revenue (Results vs Estimates)



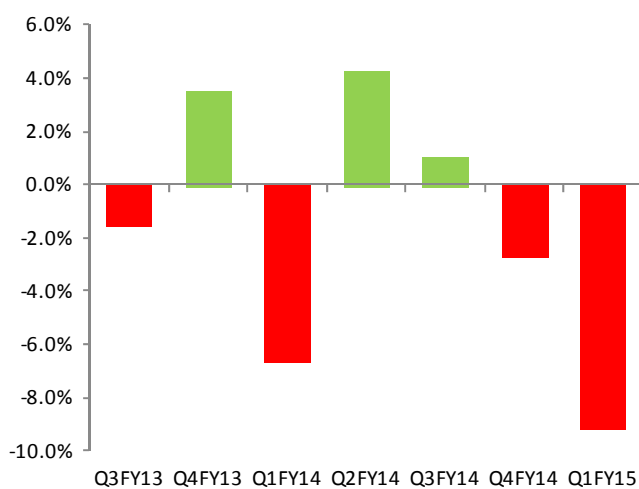
HCL Tech – EBITDA (Results vs Estimates)



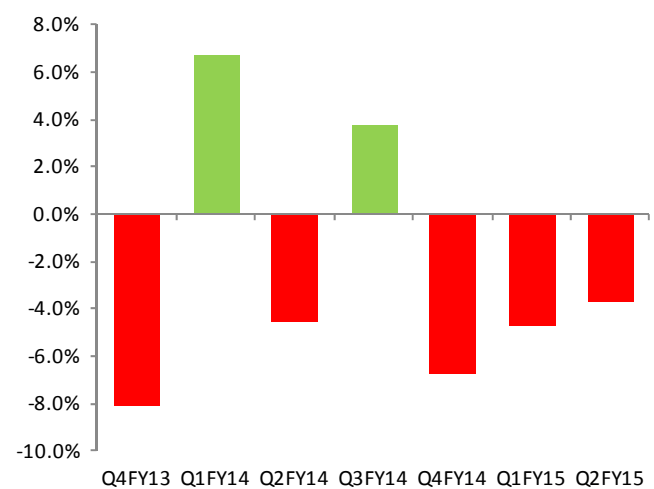
Wipro – EBITDA (Results vs Estimates)



HCL Tech – Results day stock price reaction



Wipro – Results day stock price reaction



Source: Bloomberg, Company PhillipCapital India Research

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