



Central and Eastern European (CEE) IT companies, EPAM Systems (EPAM) and Luxoft Holding (Luxoft), yet again reported strong set of numbers for Q2FY18. In tandem, we enumerative comparative performance of Indian IT sector: 1) While revenues of EPAM/Luxoft grew by a healthy 26.6%/16.1% YoY, the top-5 Indian IT companies logged 7.9% YoY growth; 2) Europe drove growth for Indian IT companies, while the Americas lent impetus to CEE companies; 3) Legacy platforms of financial services are being aggressively replaced following the digitisation wave; 4) Strong revenue growth in non top-10 clients - up 35.9%/23.9% YoY for EPAM/Luxoft, led by strong focus on diversification and scaling up by investing in high-potential clients; 5) Top clients - large global banks remained weak due to in-sourcing and cost optimisation. While we believe CEE companies possess technological expertise, innovative offerings and superior operational culture compared to Indian IT companies, much smaller scale (~5% of revenue of top-5 Indian companies) and limited services portfolio (software and platform development) curtail the impact on Indian players.

Financial services, automotives early adopters of digital

Commentary by EPAM and Luxoft suggested that financial services and automotive sectors are adopting newer technologies at faster pace. In financial services, while regulatory changes, simplification of operations and digital fintech are driving growth, revenue from high-proportion top-clients (UBS forms ~9% of EPAM's revenue; UBS, Deutsche Bank comprise >30% of Luxoft's revenue) continued to slip due to in-sourcing and cost rationalisation measures of global clients. Automotive industry outlook remains robust with increasing digitalisation, autonomous vehicles and connected mobility. Trends of transformation, digitisation and competitive disruption are also leading to strong traction in telecom, media & entertainment and travel & consumer industries.

North America driving growth

While Q2FY18 revenue growth of Indian companies was led by Europe (up 12.3% YoY), revenues of CEE companies was driven by the Americas. We believe America is adopting digital engagements at a faster pace than Europe, which is leading to higher growth in America for CEE companies, which derive majority of their revenues from digital services. European clients, post Brexit, are still engaging in higher legacy deals. CEE companies are also strategising to increase deliver-centre scale and expanding global footprint in high-growth regions like Asia-Pacific.

Outlook: Better times ahead for IT

Commentary by EPAM and Luxoft suggests better revenue growth for FY19 and FY20 versus FY18, led by higher digitisation. While we believe that location, operational culture, superior service portfolio and quality of talent pool will help CEE companies post revenue growth in excess of 20%, these companies still lack scale to compete with Indian companies. We reiterate that handsome growth in Indian IT will return as digital revenues start contributing significant proportion to revenues. We maintain **'BUY'** on Tech Mahindra and HCL Technologies and **'HOLD'** on Infosys, Tata Consultancy Services and Wipro.

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Not rated

Sandip Agarwal

+91 22 6623 3474

sandip.agarwal@edelweissfin.com

Pranav Kshatriya

+91 22 4040 7495

pranav.kshatriya@edelweissfin.com

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Table 1: Indian IT companies - Product engineering services growth

	Q2FY16	Q3FY16	Q4FY16	Q1FY17	Q2FY17	Q3FY17	Q4FY17	Q1FY18	Q2FY18	CQGR
EPAM	236.0	260.3	264.5	283.8	298.3	313.5	324.7	349.0	377.5	6.0
QoQ growth (%)	8.4	10.3	1.6	7.3	5.1	5.1	3.6	7.5	8.2	
Luxoft	161.5	171.9	169.2	178.0	196.5	206.9	204.1	209.2	228.0	4.4
QoQ growth (%)	9.1	6.4	(1.6)	5.2	10.3	5.3	(1.3)	2.5	9.0	
Product Engineering Services										
Infosys	78.9	81.8	83.2	87.5	95.7	99.5	102.8	108.7	111.8	4.5
QoQ growth (%)	(0.0)	3.7	1.6	5.3	9.3	3.9	3.3	5.8	2.9	
Wipro	144.7	147.1	150.6	137.0	139.9	137.0	138.8	138.0	138.9	(0.5)
QoQ growth (%)	4.8	1.6	2.4	(9.0)	2.1	(2.1)	1.3	(0.5)	0.7	

Source: Companies, Edelweiss research

Table 2: Vertical-wise growth - Indian companies versus CEE players

Top-4 Indian IT companies	Q2FY18	Q1FY18	QoQ Growth (%)	Q2FY17	YoY growth (%)
Financial Services	3,680	3,552	3.6	3,353	9.7
Manf. & Technology	2,776	2,684	3.4	2,505	10.8
Retail & CPG	1,525	1,504	1.4	1,507	1.2
Energy & utilities	825	795	3.9	721	14.5
Telecommunications, Media & Entertainment	1,429	1,408	1.5	1,383	3.4
Travel & Transportation	235	211	11.2	193	21.3
Healthcare & Lifesciences	1,028	1,015	1.3	1,003	2.5
Others	1,089	1,067	2.1	1,005	8.3
Total	12,588	12,236	2.9	11,671	7.9

EPAM	Q2FY18	Q1FY18	QoQ Growth (%)	Q2FY17	YoY growth (%)
Financial Services	88.8	79.0	12.4	77.1	15.2
Software & Hi-Tech	73.4	69.7	5.3	60.3	21.7
Media & Entertainment	64.3	63.1	1.9	45.3	41.9
Travel and Consumer	82.9	77.6	6.8	69.4	19.5
Life sciences and Healthcare	31.8	28.9	10.0	25.7	23.7
Emerging Verticals	36.3	30.7	18.2	20.4	77.9
Total	377.5	349.0	8.2	298.2	26.6

Luxoft	Q2FY18	Q1FY18	QoQ Growth (%)	Q2FY17	YoY growth (%)
Financial Services	129.2	113.5	13.8	123.1	4.9
Automotive and Transport	40.8	35.1	16.1	23.2	75.6
Telecom	24.0	25.5	-6.0	19.1	26.0
Healthcare & Lifesciences	7.7	8.7	(12.0)	8.6	(10.3)
Digital (Tech+Travel+Energy)	26.1	25.8	0.9	22.1	18.1
Other	0.3	0.5	(42.7)	0.4	(22.6)
Total	228.0	209.2	9.0	196.5	16.1

Source: Companies, Edelweiss research

Table 3: Top 10 revenue bifurcation

Company	YoY growth		Avg annualised size of top-10 client (USD mn)
	Top 10 client	Beyond top-10 client	
Infosys	-5.7%	8.6%	212.8
Wipro	8.1%	4.4%	145.0
HCL Technologies	18.7%	10.1%	176.6
EPAM	11.2%	35.9%	50.3
Luxoft	-2.9%	23.9%	52.4

Source: Companies, Edelweiss research

Table 4: Geography-wise growth

Top-5 Indian IT companies	Q2FY18	Q1FY18	QoQ Growth (%)	Q2FY17	YoY growth (%)
Americas	7,033	6,917	1.7	6,675	5.4
Europe	3,352	3,138	6.8	2,985	12.3
RoW	2,203	2,181	1.0	2,012	9.4
EPAM	Q2FY18	Q1FY18	QoQ	Q2FY17	YoY growth
Americas	218	206	5.9	170	28.4
Europe	136	121	11.8	110	22.8
RoW	24	22	10.1	18	31.9
Luxoft	Q2FY18	Q1FY18	QoQ	Q2FY17	YoY growth
EPAM	79	80	(1.2)	67	17.1
Americas	120	114	5.8	113	6.1
Europe	29	16	83.7	16	83.8

Source: Companies, Edelweiss research

Chart 1: EPAM—Vertical-wise revenue break-up

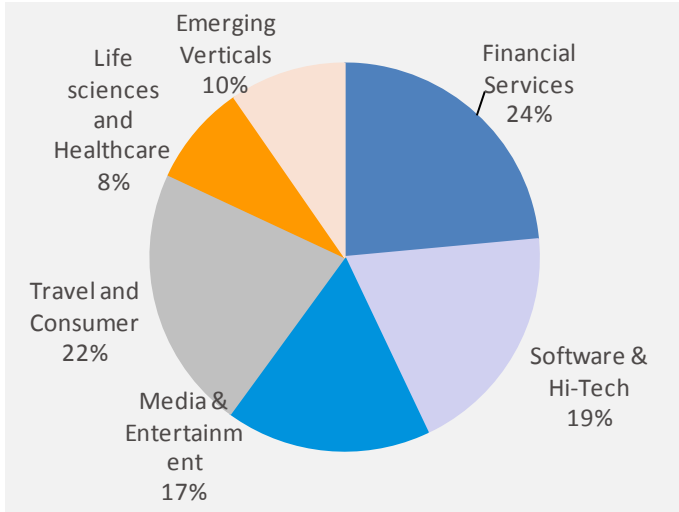


Chart 2: Luxoft—Vertical-wise revenue break-up

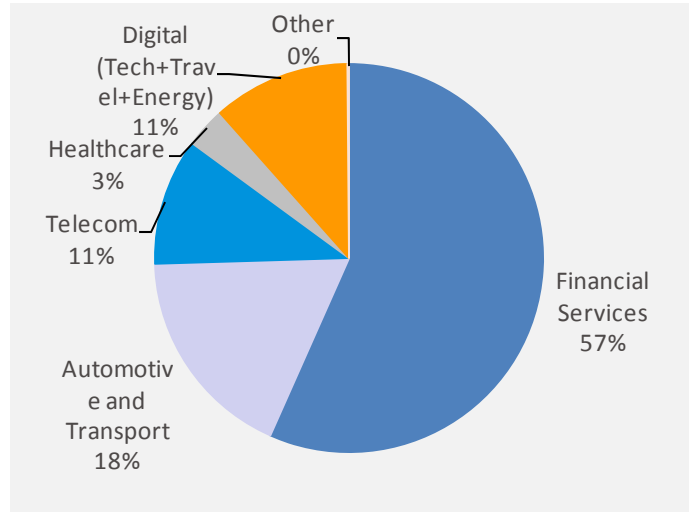


Chart 3: EPAM—Geography-wise revenue break-up

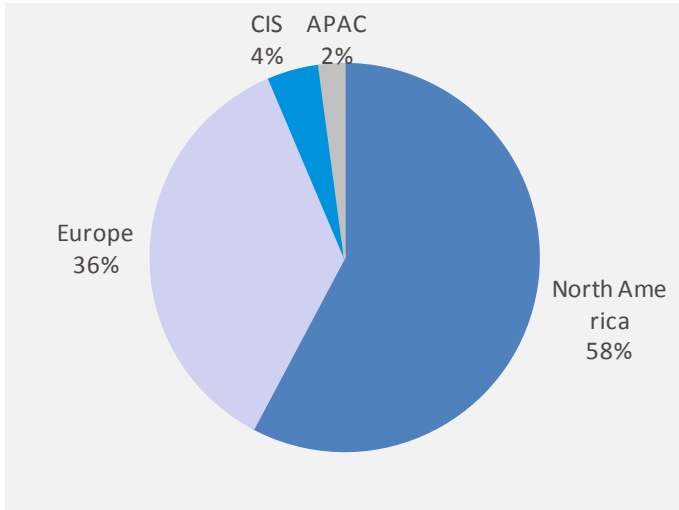


Chart 4: Luxoft—Geography-wise revenue break-up

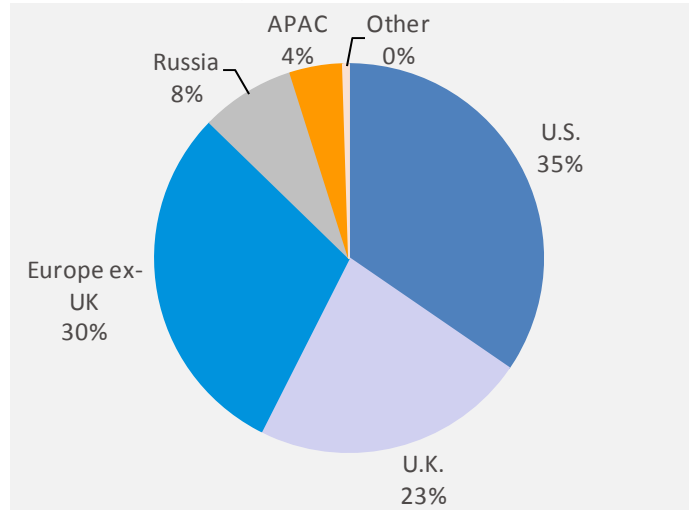


Chart 5: EPAM—Location of delivery professionals

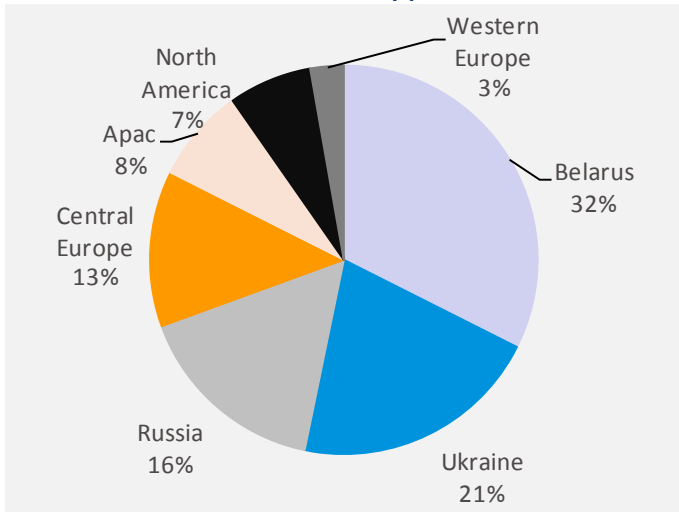
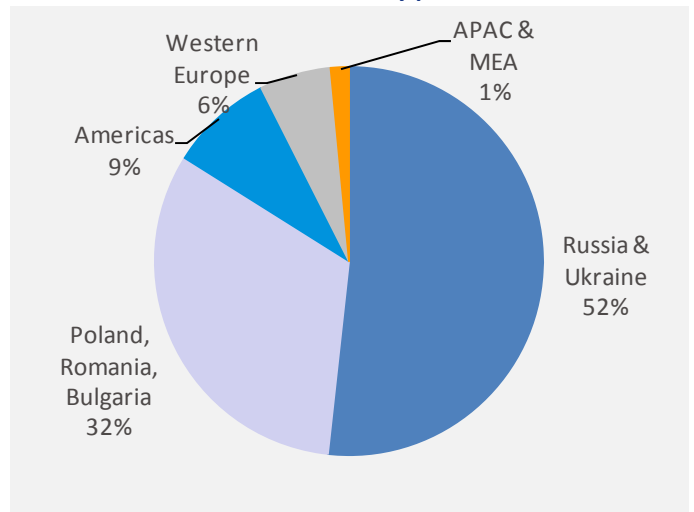


Chart 6: Luxoft—Location of delivery professionals



Source: Companies

Company Description

EPAM Systems

EPAM Systems (EPAM) is a provider of high-end outsourced software and application development services from its base in CEE region. EPAM's business model leverages the relatively lower wages for software engineering talent in CEE compared with those of its clients, mainly based in developed economies, such as, USA, UK, Europe, etc. EPAM has demonstrated strong, consistent growth - exemplified by >20% YoY growth for 26 consecutive quarters. Revenues grew at 27.9% CAGR over CY12-16 by expanding its service offerings to software development, platform engineering, cloud services and backend optimisation. Its industry exposure is diversified across various sectors such as financial services, software and hi-tech, media & entertainment, travel & consumer and healthcare & life sciences. The company posted TTM revenue of USD1,365mn growing at CAGR of 27.9% during CY12-16.

The company was founded by Belarus natives, Arkadiy Dobkin and Leo Lozner, in 1993 and incorporated as EPAM Systems on December 18, 2002. On January 24, 2012, it announced launch of an IPO on the New York Stock Exchange.

Luxoft

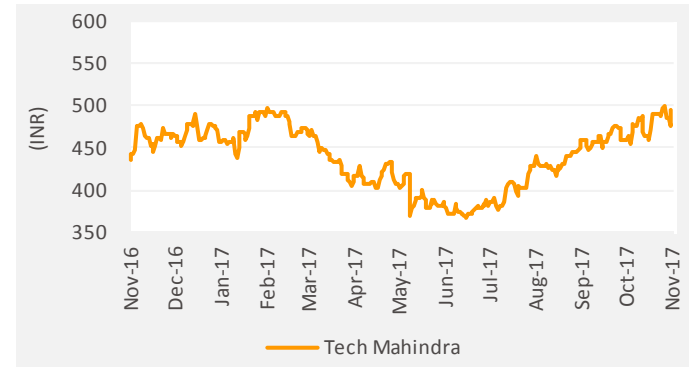
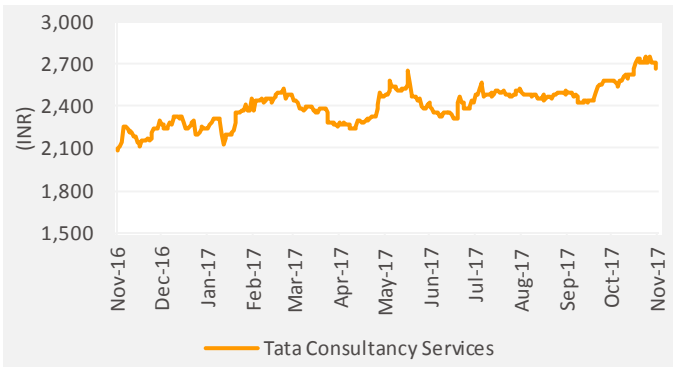
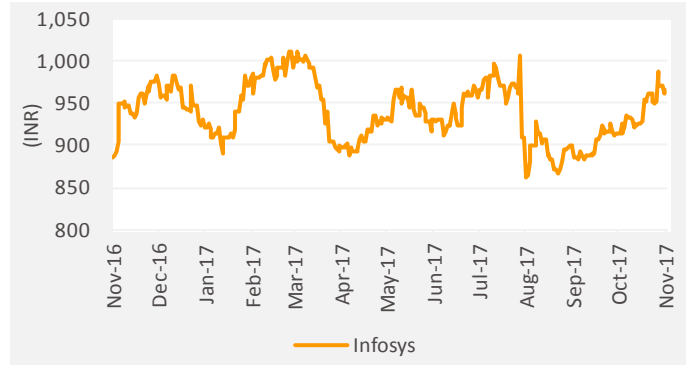
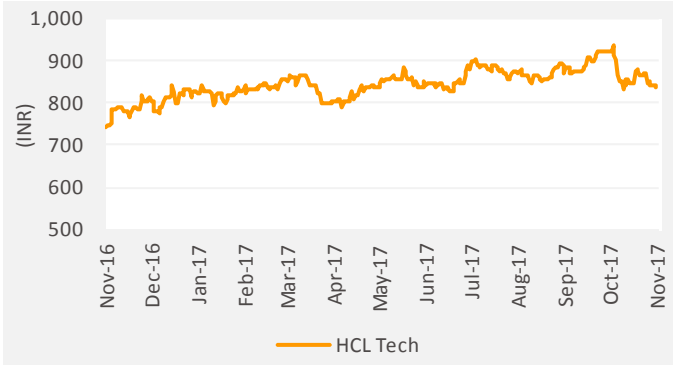
Luxoft is a provider of complex software development services and IT solutions to its global client base (such as, Deutsche Bank, UBS, Avaya, Harman and Boeing), leveraging talent pool from Central and Eastern European (CEE) region. Luxoft's business model focuses on high-end software development by outsourcing programming talent from technology-centric CEE region. The company's software development services consist of custom software development and support, product engineering and testing, and technology consulting. The company develops its solutions and delivers its services from 34 cities with dedicated delivery centres worldwide employing ~13,000 personnel at 39 cities across 19 countries. Luxoft posted TTM revenue of USD848mn growing at 25.7% CAGR over FY13-17.

In April 2000, Luxoft was established in Moscow as a subsidiary of IBS Group, a major Russian developer of complex IT solutions. Then, Luxoft was spun-off from IBS with the motive to unlock value for shareholders who were not interested in the Russian part of the business. In June 2013, Luxoft was listed on NYSE. Due to pro-Russian unrest in Ukraine in 2014, Luxoft relocated its senior management from Russia and Ukraine to Switzerland.

Edelweiss Securities Limited, Edelweiss House, off C.S.T. Road, Kalina, Mumbai – 400 098.
 Board: (91-22) 4009 4400, Email: research@edelweissfin.com

Aditya Narain
 Head of Research
aditya.narain@edelweissfin.com

One year price chart



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