

JUNE 23, 2017

UPDATE

BSE-30: 31,291

Accenture—tightens revenue growth guidance band. Accenture reported c/c revenue growth of 7% for May 2017 (3QFY17) quarter, at the upper-end of guidance band. However, the company tightened FY2017 revenue growth guidance band to 6-7% from 6-8% earlier with the tightening capturing slower-than-expected initiation of new projects due to continued uncertainty on healthcare legislation in the US. Outsourcing business outpaced consulting growth for the second consecutive quarter. The results do not lend any incremental insights into FY2018 demand potential for Indian IT.

Outsourcing growth outpaces consulting for the second consecutive quarter

Accenture reported c/c revenue growth of 7% yoy for May 2017 quarter (Accenture has August financial year-end). Revenue growth was at the upper end of the guidance band with acquisitions contributing ~2.5% to revenues. Revenue growth was robust in the Products vertical at 15% in c/c, while it was muted at 2% in Health and Public Services. New bookings grew 8% yoy to US\$9.8 bn, impressive overall. Contrary to management expectations, outsourcing business growth outpaced consulting growth for the second consecutive quarter.

FY2017 revenue growth guidance band tightened to 6-7% from 6-8% earlier

Accenture expects acquisitions to contribute ~2% to overall revenues in FY2017. Implied organic growth stands at 4-5% in c/c. The cut captures slower-than-expected growth in Health & Public Service vertical. This is largely on account of continuing uncertainty around healthcare legislation and state and federal budgets in the US. Management outlook for other parts of the business is robust and unchanged from earlier quarters

Applications growth accelerates while strategy & consulting growth moderates

An interesting aspect of Accenture's performance is acceleration in application services growth to high-single digits from mid-single digits in the previous year and deceleration in strategy and consulting growth. Do note that application service is a large portfolio of business for Indian IT that has seen perceptible slowdown in growth rate with fears of commoditization and secular decline in this business. Accenture management indicated that drivers for growth have been systems integration, application engineering and implementation of digital technologies. We would watch this dynamic closely as the strength of Indian IT is in the applications space, an area that has suffered due to reallocation of client spends towards consulting in the past two-three years. Any broader shift in the market towards implementation work can have positive impact on the growth of Indian IT.

Read through for Indian IT—no direct impact but some evidence of slowdown seen

While not directly evidenced from Accenture's results, the fact remains that growth rates have moderated for most IT services companies globally. Each company has a different pain point (healthcare, retail and materials and resources are the most cited ones) but at an aggregate level this has meant lower growth rate for services companies

We expect Indian IT growth challenges to continue in the near term, led by a combination of slow pace of deal closures, continuing captive shift, lack of much anticipated kicker to financial services spending and share gain by consulting firms in digital spending. These factors will impact FY2018E industry growth

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Per person metrics continue to be under pressure

Revenue/employee (ttm) declined 4% yoy to US\$86,895, while EBIT/ person was down 3.2% to US\$12,812. The decline is steeper at 12% and 9% for revenue/ employee and EBIT/ employee when compared to numbers two years back. The broader trend of shift of operations to low-cost locations and currency headwind is the larger reason over the past two years, but the decline should have been lesser noting—(1) faster growth in consulting and higher-realization in digital services and (2) benefits of automation in traditional services.

Sharp increase in non-GDN headcount

After a long time, the company has added aggressively to its non-GDN headcount. Non-GDN headcount increased by 4,232 in the quarter. GDN headcount's contribution declined 40 bps qoq to 74.8% of employees which could essentially be a quarterly blip.

Exhibit 1: Accenture interim results, August fiscal year-ends, US\$ mn

	3QFY16	2QFY17	3QFY17	% qoq	% yoy
Revenues	8,435	8,318	8,867	6.6	5.1
Cost of revenues	5,745	5,814	5,957	2.5	3.7
SG&A expenses	1,384	1,366	1,534	12.4	10.9
Pension settlement charge			510		
EBIT	1,306	1,139	865	(24.0)	(33.7)
Other income	(12)	(20)	9		
PBT	1,294	1,119	874	(21.8)	(32.4)
Provision for taxes	343	(231)	(117)		
PAT	950	1,350	991	(26.6)	4.3
Minority interest	53	48	35	(27.1)	(33.4)
PAT after minority interest	897	1,301	956	(26.5)	6.5
Margins (%)					
EBIT (recurring)	15.5	13.7	15.5		
Net income	11.3	16.2	11.2		

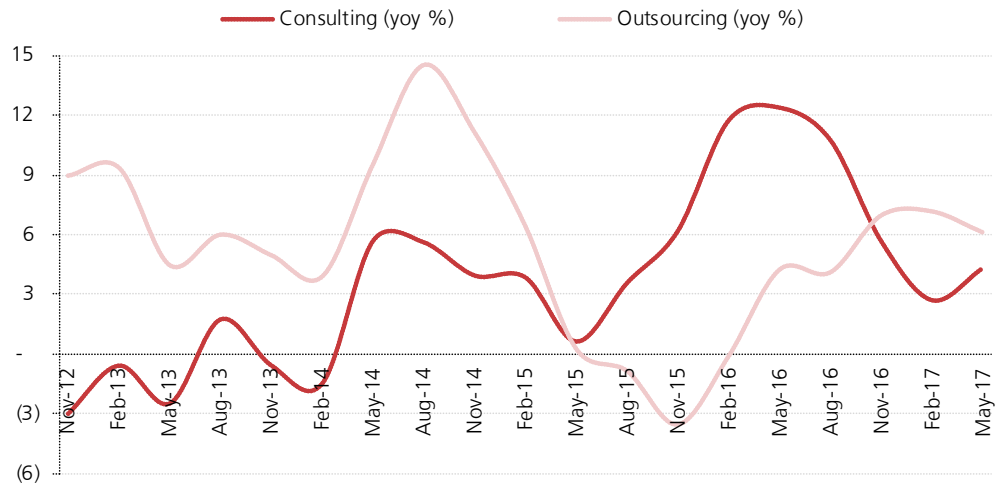
Source: Company, Kotak Institutional Equities

Exhibit 2: Revenue growth by segments and new bookings (May-17 quarter)

	Revenues	Growth (%)		% of total
	(US\$ mn)	(qoq)	(yoy)	
Total revenues	8,867	6.6	5.1	100.0
by geography				
Americas	4,123	4.2	2.6	46.5
EMEA	3,043	7.6	3.3	34.3
Asia Pacific	1,710	11.4	16.2	19.3
by verticals				
Communications & High Tech	1,755	8.3	2.7	19.8
Financial Services	1,865	5.4	3.3	21.0
Govt	1,554	2.8	1.0	17.5
Products	2,429	7.3	12.6	27.4
Resources	1,246	8.8	2.1	14.1
by service line				
Consulting	4,820	9.4	4.3	54.4
Outsourcing	4,047	3.4	6.1	45.6
New bookings (US\$ bn)				
Consulting	5.2	13.0	6.1	53.1
Outsourcing	4.6	—	9.5	46.9
Total	9.8	6.5	7.7	100.0

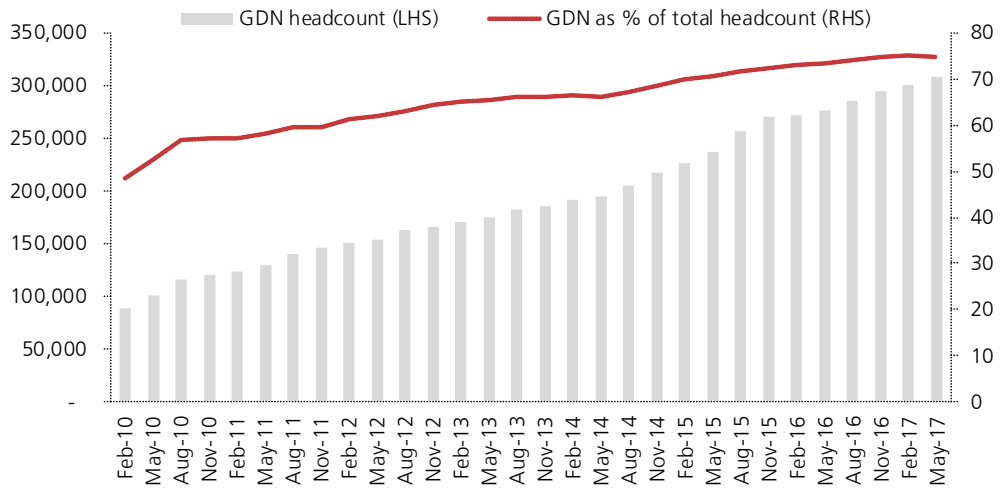
Source: Company, Kotak Institutional Equities

Exhibit 3: Outsourcing growth outpaces consulting growth for second consecutive quarter



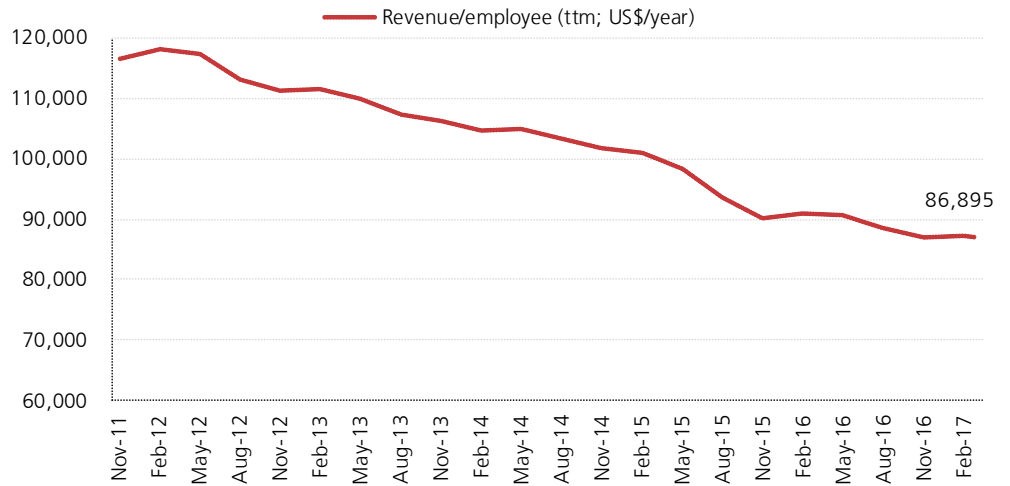
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Exhibit 4: Accenture's GDN accounts for 75% of employee base; onsite (high-cost location):offshore (low-cost location) employee mix is comparable to Indian IT (20:80)



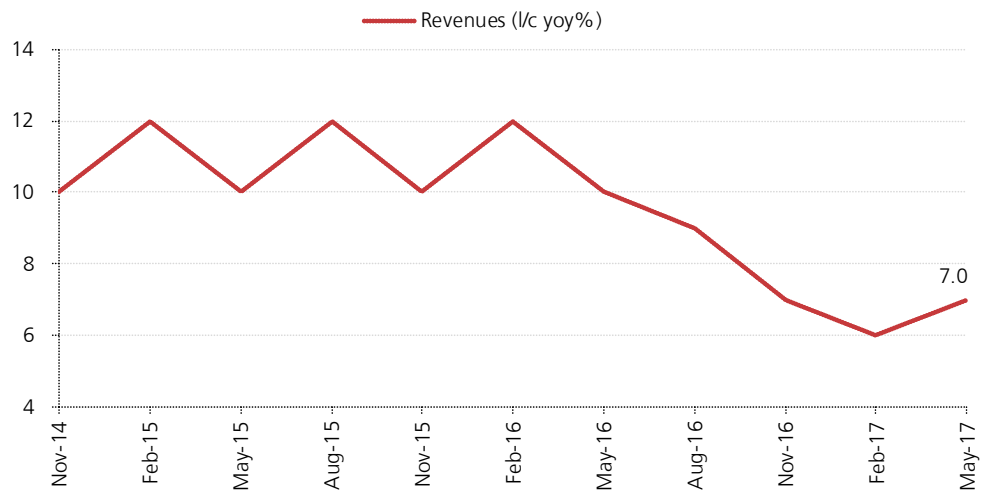
Source: Company, Kotak Institutional Equities

Exhibit 5: Revenue productivity (trailing 12 months) of Accenture (US\$/year)



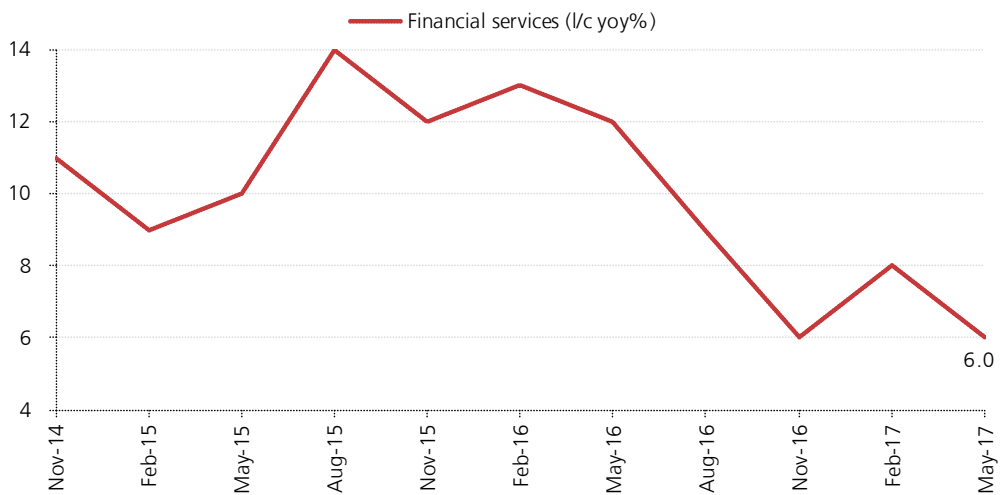
Source: Company, Kotak Institutional Equities

Exhibit 6: Revenue growth of Accenture (local currency yoy %)



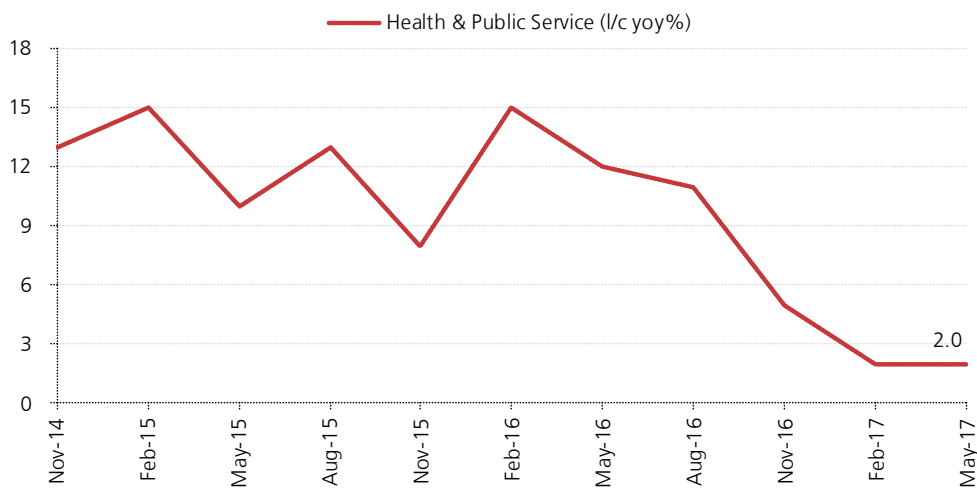
Source: Company, Kotak Institutional Equities

Exhibit 7: Revenue growth from financial services vertical



Source: Company, Kotak Institutional Equities

Exhibit 8: Health and Public Service vertical growth was muted



Source: Company, Kotak Institutional Equities

Exhibit 9: Valuation summary of key Indian technology companies

Company	22-Jun-17		Mkt cap.		EPS (Rs)			P/E (X)			EV/EBITDA (X)			RoE (%)		
	Price (Rs)	Rating	(Rs m)	(US\$ m)	2017E	2018E	2019E	2017E	2018E	2019E	2017E	2018E	2019E	2017E	2018E	2019E
HCL Technologies	849	REDUCE	1,211,727	18,772	59.2	60.9	65.4	14.4	13.9	13.0	10.5	9.7	8.7	27.2	23.6	23.6
Hexaware Technologies	252	REDUCE	76,167	1,180	13.7	14.5	16.5	18.4	17.3	15.3	12.5	11.1	9.5	26.5	24.8	24.8
Infosys	940	ADD	2,159,817	33,461	62.8	63.7	70.4	15.0	14.8	13.4	10.4	10.6	9.3	22.6	21.3	21.3
L&T Infotech	818	BUY	139,550	2,162	55.8	59.7	65.2	14.7	13.7	12.6	10.3	9.1	7.8	37.6	30.5	30.5
Mindtree	521	REDUCE	87,541	1,356	26.4	30.8	36.0	19.7	16.9	14.5	11.2	9.3	7.7	17.9	18.8	18.8
Mphasis	597	SELL	125,545	1,945	38.3	38.1	39.6	15.6	15.7	15.1	10.1	11.2	10.5	13.0	12.8	12.8
TCS	2,395	REDUCE	4,718,879	73,107	133.4	136.8	149.3	17.9	17.5	16.0	13.1	12.6	11.3	32.6	31.3	31.3
Tech Mahindra	387	ADD	337,430	5,228	32.3	31.1	36.5	12.0	12.5	10.6	7.1	6.6	5.3	18.3	15.6	15.6
Wipro	255	REDUCE	1,241,111	19,228	17.5	17.5	18.6	14.6	14.6	13.7	8.7	8.6	7.7	17.2	15.4	15.4
Technology			10,097,769	156,438				16.0	16.2	14.9	11.1	10.8	9.6	23.0	23.4	23.4
KIE universe			92,833,645	1,436,866				21.5	19.4	15.9	11.8	10.6	9.0	13.1	13.4	13.4
Company	Target	O/S shares	EPS CAGR (%)	EPS growth (%)			Net Profit (Rs mn)			EBITDA (Rs mn)			Sales (Rs mn)			
	Price (Rs)	(mn)	2017-19E	2017E	2018E	2019E	2017E	2018E	2019E	2017E	2018E	2019E	2017E	2018E	2019E	
HCL Technologies	840	1,397	5.2	13.8	3.0	7.4	84,560	85,056	91,507	103,087	111,499	120,967	467,220	514,849	570,491	
Hexaware Technologies	230	304	9.7	5.9	6.1	13.3	4,170	4,425	5,015	5,746	6,319	7,254	35,348	38,912	44,125	
Infosys	1,015	2,168	5.9	6.4	1.4	10.6	143,530	139,791	152,578	186,050	191,536	212,895	684,850	727,400	809,423	
L&T Infotech	800	174	8.1	13.3	7.0	9.2	9,707	10,414	11,368	12,302	13,454	15,178	65,009	71,772	80,095	
Mindtree	460	168	16.8	(26.3)	16.4	17.2	4,442	5,173	6,060	7,181	8,199	9,460	52,364	56,442	63,255	
Mphasis	435	193	1.7	11.3	(0.7)	4.1	8,067	7,351	7,651	9,690	9,489	9,958	60,763	62,661	67,262	
TCS	2,405	1,914	5.8	8.6	2.5	9.1	262,890	261,867	285,757	323,110	345,361	381,968	1,179,660	1,255,338	1,391,563	
Tech Mahindra	450	872	6.3	(9.8)	(3.7)	17.5	28,128	27,077	31,809	41,843	42,293	49,405	291,408	308,838	339,367	
Wipro	228	4,734	3.2	(3.0)	(0.2)	6.6	84,893	82,651	88,109	119,123	115,176	121,841	558,261	551,915	586,673	
Technology				(1.0)	(1.0)	9.0	630,388	623,804	679,853	808,133	843,325	928,926	3,394,884	3,588,125	3,952,254	
KIE universe				20.3	10.8	22.0										

Notes:

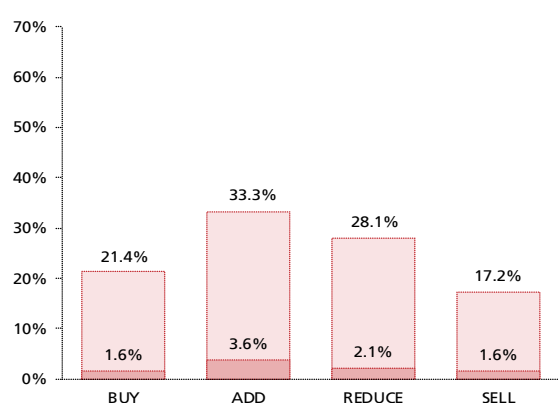
(a) Hexaware Technologies is December year-ending.

Source: Companies, Kotak Institutional Equities estimates

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Source: Kotak Institutional Equities

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