

## IT

## Sector Update

## Britain says Adieu to EU; currency headwinds to play spoilsport in near term

## Key points

- ◆ **'Brexit'; Indian IT sector to be hit by cross-currency headwinds:** The people of UK have voted to leave the European Union (EU) through a referendum held on June 24, 2016. The so-called 'Brexit' turned out to be a nightmare for the currency markets, with the GBP touching a low of \$1.32 and the Euro touched \$1.09 after the verdict was announced. The GBP and the Euro managed to recover to \$1.39 and \$1.11, respectively. Overall, compared to FY2016 average, GBP was lower by 8%, while the Euro remains flat. The top five Indian IT companies have an exposure of 23-29% to Europe, on a reported basis. As far as the UK is concerned, TCS has an exposure of 15.8%, Infosys 6.6%, Wipro 11% and Tech Mahindra 10.8%. The current depreciation of 8% in GBP translates broadly into a revenue impact of 1.1% for TCS, Infosys (0.55%), Wipro (1%), HCL Tech (1.2%) and Tech Mahindra (1%). Additionally, any further depreciation in the Euro will have an adverse impact on these companies' USD revenues. In our Mid-cap universe, Firstsource Solution (FSL) has 37% revenue exposure to the UK, which will have cross-currency impact of close to 3.5% for the company.
- ◆ **Margins to also get impacted, but will be negated by INR fall:** GBP's depreciation against USD will also have a negative impact on the operating margins of around 30-60BPS. TCS will see the highest impact of around 60BPS. But, the INR depreciation of 3.8% vs USD compared to FY2016 average rate will offset the negative impact on margins.
- ◆ **Business impact seems minimal in near term, but could delay decision making:** The Indian IT sector has an exposure to the UK markets through the key verticals of BFSI, Telecom and Utilities among others. We believe that there could be some impact on the decision-making cycle as far as the new deals are concerned. But, the extent of impact on the overall business will be difficult to ascertain in the near term.
- ◆ **Valuation:** Brexit has resulted in a steep correction across the IT sector stocks, owing to fears of negative impact on business and the consequent earnings downgrades. We believe that there could be some impact on the earnings in FY2017/2018E from the event, but largely due to currency headwinds and not on account of business. We will wait for more clarity from the IT companies' management in the coming days to gauge the business impact from Brexit.

## Valuation

Company	Reco	Price target (Rs)	CMP (Rs)	EPS (Rs)			P/E (x)		
				FY16	FY17E	FY18E	FY16	FY17E	FY18E
Infosys	Buy	1,430.0	1,194.5	59.0	67.5	75.3	20.3	17.7	15.9
TCS	Buy	2,750.0	2,570.7	123.6	135.9	151.6	20.8	18.9	17.0
Wipro	Hold	650.0	555.0	36.2	40.5	45.1	15.3	13.7	12.3
HCL Technologies*	Buy	950.0	742.0	40.3	56.9	65.4	18.4	13.0	11.3
Tech Mahindra**	Neutral	NA	506.9	36.3	36.4	43.1	13.9	13.9	11.8
Persistent Systems	Buy	820.0	710.0	37.2	42.2	49.9	19.1	16.8	14.2
Firstsource Solutions	Hold	44.0	44.2	3.9	4.9	5.7	11.2	9.1	7.7

\* Changed its financial year ending from June-end to March-end during March 2016-ending quarterly results; hence, FY2016 consists of only 9-month period

\*\* EPS of Tech Mahindra excludes treasury shares

Source: Company, Sharekhan Research

Currencies	Average in FY16	As of June 24, 2016	Fluctuations
GBP-USD	1.51	1.39	-7.9
EUR-USD	1.10	1.11	0.7
INR-USD	0.015	0.015	-3.8

Source: Bloomberg

**Revenues contributed from Europe (incl UK) and UK in FY16**

Companies	Europe (Including UK) (%)	UK (%)
Infosys	23.0	-
TCS	26.8	15.8
Wipro	25.3	-
HCL Tech	30.1	-
Tech Mahindra	29.0	-
Persistent Systems	6.5	-
Firstsource Solutions	-	37.4

Source: Company, Sharekhan

**Currency exposure to GBP & EUR (FY16)**

Companies	GBP (%)	EUR (%)	GBP impact (%)
Infosys	6.6	9.4	(0.5)
TCS	14.0	7.7	(1.1)
Wipro	12.5	8.0	(1.0)
HCL Tech	15.0	15.0	(1.2)
Tech Mahindra	12.0	11.5	(1.0)
Persistent Systems	-	6.5	-
Firstsource Solutions	37.4	-	(3.0)

Source: Company, Sharekhan

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