

NOVEMBER 21, 2017

UPDATE

BSE-30: 33,478

**Visa regulations: risks and offsets—6.** As a follow-up to our recent note, we find Congressman Darrell Issa's bill even more draconian than our initial view as it seeks to (1) strengthen the non-displacement clause and make it mandatory for all applications for H-1B dependent employers and (2) increase investigations. If passed, this bill can have severe negative consequences. We expect this bill to face multiple roadblocks in the House and Senate and it may struggle to become a law. Nonetheless, the noise level will remain elevated.

#### Event—Judiciary committee of the US HOR approves Darrell Issa's (Republican) bill for vote

On November 15, 2017, the Judiciary committee of the US House of Representatives approved Congressman Darrell Issa's (Republican) 'Protect and Grow American Jobs' bill for a vote after a few amendments. This is just the first of many steps to becoming a law. Next, the bill will be tabled for vote in the HOR (say in early CY2018) and will then be sent to the Senate Judiciary Committee if it passes the HOR. Subsequently, it would be sent for vote in the full Senate if it passes in committee. And finally, it would go to the President if it passes both the chambers. It is reasonable to expect debates and amendments during the course of this journey.

On detailed read, the bill appears to be structured in a way to harm IT outsourcing companies

- ▶ **More stringent non-displacement clause and elimination of exemptions.** The extant law requires H-1B dependent employers to attest that they will not displace any US employee that is similarly situated as the H-1B worker for 90 days before and 90 days after the H-1B petition is filed. However, an exemption from this attestation is available if (a) H-1B employee receives a wage of US\$60K/year or higher; or (2) H-1B employee has a master's degree or its equivalent/higher degree. Indian IT companies normally pay >US\$60K and avail exemption.

Darrell Issa's bill proposes to strengthen the non-displacement clause on multiple fronts— (1) increasing the tenure applicability of attestation to 90 days before the H-1B petition is filed and during the entire period of an H-1B worker's employment, (2) ensuring primary and secondary non-displacement i.e. non-displacement at H-1B dependent employer's workplace as well as client worksites (this rule prevails in the extant law to some extent but is not relevant as most H-1B employers avail non-displacement attestation exemption), and (3) elimination of all exemptions, making attestations mandatory for H-1B dependent employers. Do note that no client would give such attestations in the normal course.

- ▶ **Required wages.** Darrell Issa's bill proposes that H-1B dependent employers pay a mean wage level for the occupational classification in the area of employment. It will likely result in some wage inflation for Indian IT companies especially in states such as California where the mean wage level is significantly higher. The impact is still manageable with some hit to earnings.
- ▶ **Exemption from the requirement that US workers be recruited first.** Darrell Issa's bill proposes that an exemption from the requirement that U.S. workers be recruited first, be available at a higher wage. During the first year beginning the date of enactment of this bill, the lesser of US\$90K and the mean wage level for occupational classification will be the minimum wage for an exempt H-1B non-immigrant. From the second year, the employer must pay the lower of US\$135,000—which is indexed for inflation—or the average wage for the occupation in the area of employment, but with a floor of US\$90,000. From the third year from the enactment of this bill and for every three years thereafter, salary amount mentioned above increases to the extent of increase in CPI during the intervening period.
- ▶ **Change in 'H-1B dependent employer' definition to an employer having more than 20% of US headcount on H-1B visas as against 15% at present.** Most Indian IT companies have more than 40% of US employees on visas.

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- ▶ **Periodic investigations.** The new bill also proposes higher scrutiny and audits for H-1B dependent employers. The bill proposes random investigations on at least 5% of H-1B dependent employers annually (or perhaps 5% of H-1B petitions filed) and clients of H-1B dependent employers would have an obligation to assist in investigations. To fund effective enforcement of this H-1B program, an additional initial fee of US\$495 (it is US\$495 per petition filed as per our understanding) will be imposed on H-1B dependent employers. This fee could be adjusted to ensure full costs of carrying out the enforcement programs and activities.
- ▶ **Report on H-1B dependent employers.** The Secretary of Labor and the Secretary of Homeland Security shall publish a joint report, annually, on the use of the H-1B program by H-1B dependent employers. This report will carry occupational classification details, required wages, worksites and outcome of investigations of all H-1B visa workers of H-1B dependent employers. We note that some of the information in this report will be competitive in nature and can hurt H-1B dependent employers and their clients' business.

### Implication, the next steps and our view

In our view, this bill is particularly harsh and can potentially limit the ability of IT companies to recruit H-1B workers, even as non-H-1B dependent firms in the US can continue to recruit H-1B workers without any major ramifications. At a broad level, this bill may be protecting interests of several US tech companies (amendment points #3 and #4 on page 1).

This bill could be tabled for a vote in the HOR in early CY2018. There is a possibility that it hits a roadblock and undergoes amendments for adequate support. Thereafter, it has to go through the Senate Judiciary committee, full Senate and finally to the President.

We are of the view that the bill may not receive adequate support in the current form.

### Legislative process—how a bill becomes a Law

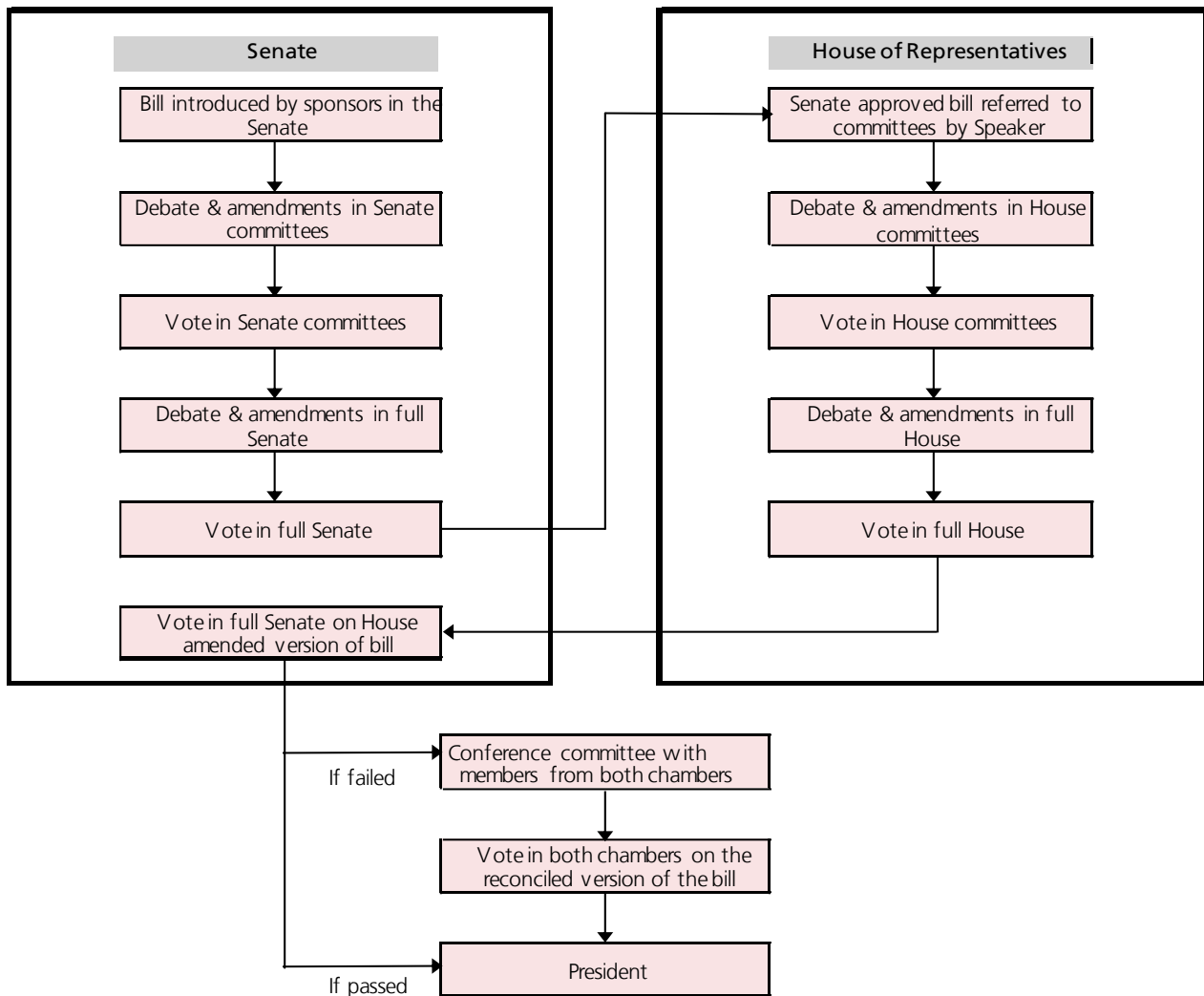
- ▶ **Bills introduced in the House of Representatives.** First, a representative sponsors a bill. The bill is then assigned to a Judiciary committee for study. If released by the committee, the bill is put on a calendar to be voted on, debated or amended. If the bill passes by simple majority (218 of 435), the bill moves to the Senate. In the Senate, the bill is assigned to another committee and, if released, debated and voted on. Again, a simple majority (51 of 100) passes the bill. Finally, a conference committee made of House and Senate members works out any differences between the House and Senate versions of the bill. The resulting bill returns to the House and Senate for final approval. The Government Printing Office prints the revised bill in a process called enrolling. The President has 10 days to sign or veto the enrolled bill.
- ▶ **Bills introduced in the Senate.** The process is very similar to that detailed above. In this case the bill is introduced by a Senator and it goes through voting in the Senate first. If passed in the Senate, it is forwarded to the House where it goes through the same process. The rest of the process is the same as above (Exhibit 1).

### Background of Darrell Issa's bill (HOR 170)

'Protect and Grow American Jobs Act' was introduced on January 3, 2017 in the House by Congressman Darrell Issa (Republican) and co-sponsored by six other congressmen (Democrats + Republicans). Key demands at that point in time were (1) raise minimum H-1B wages to US\$100K from US\$60K and make provisions for inflation adjustments thereafter, and (2) eliminate exemption on attestations if an H-1B employee holds a master's or equivalent/higher degree. We note that around the same time, Democrat Congresswoman Zoe Lofgren introduced a bill seeking an increase in minimum wages to US\$130K/year and elimination of exemption from attestation if an H-1B employee holds a master's or equivalent/higher degree.

We note that Darrell Issa's bill, approved (marked up) by the Judiciary committee, has gone through a few amendments based on inputs of Democrat Congresswoman Lofgren (bipartisan effort) and the Chairman of the Judiciary committee. The amended bill which has received endorsement of the Judiciary committee is more adverse for Indian IT than the original version of the bill and may be favorable to US-based tech companies, on the margin.

Exhibit 1: Legislative process of how a bill introduced in the US Senate becomes a law



Source: Kotak Institutional Equities

Exhibit 2: Kotak Institutional Equities: valuation summary of key Indian technology companies

	21-Nov-17		Mkt cap.		EPS (Rs)			P/E (X)			EV/EBITDA (X)			RoE (%)		
Company	Price (Rs)	Rating	(Rs m)	(US\$ m)	2017	2018E	2019E	2017	2018E	2019E	2017	2018E	2019E	2017	2018E	2019E
HCL Technologies	837	REDUCE	1,194,960	18,400	59.2	63.6	66.5	14.2	13.2	12.6	10.4	9.6	8.6	27.2	24.9	23.4
Hexaware Technologies	335	REDUCE	101,431	1,562	13.7	16.6	17.9	24.5	20.2	18.8	16.9	14.2	12.5	26.5	27.8	26.5
Infosys	966	NR	2,219,470	34,176	62.7	64.4	67.2	15.4	15.0	14.4	10.7	10.9	10.1	22.6	22.0	22.7
L&T Infotech	984	BUY	169,004	2,602	55.8	62.6	65.6	17.6	15.7	15.0	12.7	12.3	10.3	37.6	31.5	27.7
Mindtree	508	ADD	85,390	1,315	25.1	28.8	34.5	20.3	17.6	14.7	10.9	11.7	8.5	17.0	18.1	20.1
Mphasis	726	SELL	152,836	2,353	38.3	41.1	44.0	18.9	17.7	16.5	12.9	13.3	11.8	13.0	13.8	15.3
TCS	2,673	REDUCE	5,116,795	78,790	133.4	135.8	145.6	20.0	19.7	18.4	14.4	14.2	12.8	32.6	31.1	33.9
Tech Mahindra	494	ADD	430,582	6,630	32.1	35.1	38.6	15.4	14.1	12.8	9.3	8.5	6.9	18.3	17.7	17.3
Wipro	294	REDUCE	1,430,807	22,032	17.5	18.2	19.7	16.8	16.2	14.9	10.3	10.6	9.3	17.2	16.8	16.7
Technology			10,901,274	167,862				17.3	17.1	16.2	12.1	11.9	10.7	23.0	24.6	23.3
KIE universe			104,096,876	1,601,507				23.9	22.2	17.6	12.9	11.9	10.0	13.1	12.7	14.5

	Target	O/S shares	EPS CAGR (%)	EPS growth (%)			Net Profit (Rs mn)			EBITDA (Rs mn)			Sales (Rs mn)		
Company	Price (Rs)	(mn)	2017-19E	2017	2018E	2019E	2017	2018E	2019E	2017	2018E	2019E	2017	2018E	2019E
HCL Technologies	900	1,407	6.0	13.8	7.6	4.5	84,560	89,514	93,197	103,087	112,081	121,821	467,220	509,100	566,882
Hexaware Technologies	270	304	14.2	5.9	21.4	7.5	4,170	5,061	5,439	5,746	6,686	7,461	35,348	39,442	44,284
Infosys	0	2,175	3.5	6.3	2.7	4.3	143,530	143,729	146,089	186,050	191,114	202,825	684,850	710,705	764,897
L&T Infotech	925	175	8.5	13.3	12.2	4.8	9,707	10,952	11,485	12,302	12,396	14,207	65,009	71,244	80,390
Mindtree	525	164	17.3	(30.1)	14.9	19.8	4,214	4,717	5,651	7,181	6,636	8,710	52,364	54,479	62,000
Mphasis	560	193	7.2	11.3	7.2	7.1	8,067	7,936	8,498	9,690	9,980	11,036	60,763	64,494	71,022
TCS	2,500	1,914	4.5	8.6	1.8	7.2	262,890	260,017	278,658	323,110	334,967	366,999	1,179,660	1,239,457	1,362,814
Tech Mahindra	545	883	9.7	(10.4)	9.5	9.9	28,128	30,970	34,217	41,843	44,174	51,927	291,408	310,377	341,386
Wipro	275	4,507	6.1	(3.0)	3.8	8.5	84,893	84,708	88,735	119,123	117,867	125,903	558,261	553,650	590,304
Technology				9.0	1.2	5.4	630,160	637,604	671,969	808,133	835,900	910,889	3,394,884	3,552,949	3,883,979
KIE universe				20.2	7.3	26.3									

Notes:

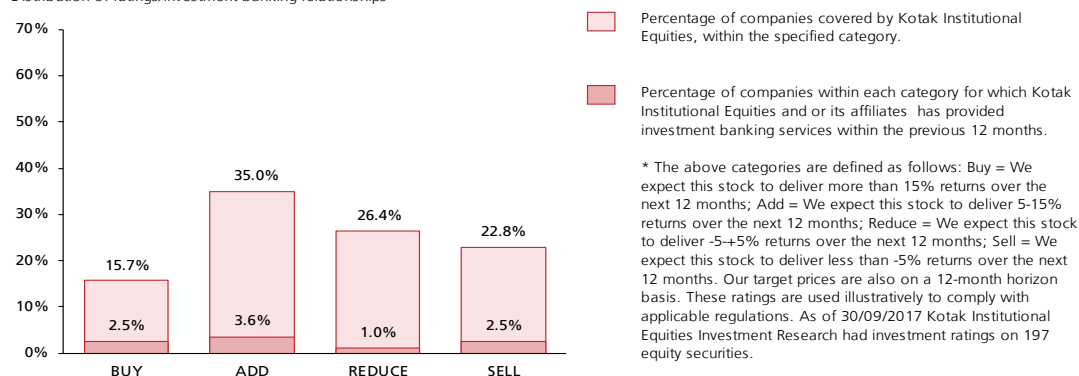
(a) Hexaware Technologies is December year-ending.

Source: Company, Kotak Institutional Equities estimates

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As of September 30, 2017

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