July 5, 2022

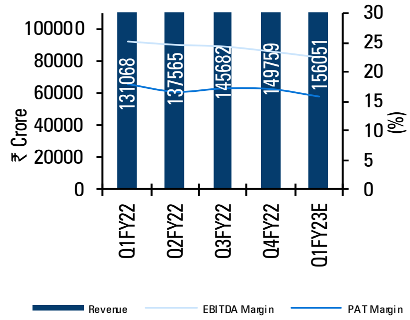
Deal execution picks up; wage hike, travel expenses to impact margins…

The growth of Indian IT companies is expected to pick up in Q1, barring weakness in a few companies due to company specific events. The deal execution normally picks up in Q1 as this is the first quarter of full execution after major/minor impact of furlough in Q3 and Q4, respectively. However, margins are expected to take a hit on a QoQ basis on account of annual wage hike cycle for a few while rationalisation of employee costs for others. Margin impact will also be on account of visa related costs as well as uptick in travel related expenses as the economy opens up. The demand environment is expected to be strong due to continued deal momentum led by sectors like BFSI, insurance, etc, but we need to be watchful on how macro as well as geopolitical risks play out, especially in H2FY23, which is expected to set tone for FY24 numbers. **We expect Infosys and HCL Tech to maintain their annual revenue and margin guidance**. Due to unfavourable currency movements, there would be cross currency headwinds, which are expected to impact dollar revenues for the quarter. Rupee revenues for the quarter are expected to be aided by rupee depreciation against dollar. Accenture's outsourcing business (proxy to Indian IT) reported strong numbers on revenues in Q3 but new deal bookings have witnessed some deceleration in the last two to three quarters (albeit on a high base). We believe new bookings number needs to pick up in subsequent quarters for better revenue visibility for Accenture. Continuous investments in newer technologies like cloud transformation (Accenture continues to maintain that ~30-40% of applications has been migrated to cloud, suggests long tail of cloud transformation ahead), AI/ML, block chain [as per CB insights, US$25 billion (bn) have been already invested by blockchain companies in CY21], which is expected to further propel demand in coming quarters.

We expect TCS, Infosys, Wipro to post constant currency (CC) revenue growth in range of 2.5-4.5% QoQ while HCL Tech is expected to post weak growth of 2.0% QoQ due to continued weakness in P&P business and also muted IT services business. TechM is also expected to post 2% QoQ revenue growth due to seasonal weakness in its Comviva business. LTI is expected to post 3% QoQ CC growth factoring in absence of pass through revenues (2- 2.5% impact) for the quarter. Mindtree is expected to report 5% CC growth to be aided by broad based growth across verticals of travel, BFSI, insurance except retail sector. There would be cross currency headwinds in range of 50-140 bps for companies mentioned above, which would impact dollar revenue growth negatively. TCS, Infosys & Wipro are expected to see dollar revenue growth of 1.5-3.5% QoQ, respectively. HCL Technologies (HCLT) is expected to witness dollar revenue growth of 1.4% QoQ. LTI, Mindtree, Tech M are expected to see dollar revenue growth in the range of 2%, 4.5%, 0.7%, respectively, QoQ. Coforge is expected to witness revenue growth of 3% QoQ. We prefer Infosys, Mindtree.

For Teamlease, we expect a relatively muted performance as overall revenues are expected to improve 3% QoQ aided by 3% QoQ in general staffing while specialised staffing (mainly led by traction in IT staffing) is expected to grow 2% QoQ. We expect margins to decline 20 bps QoQ to 2.1% due to higher employee cost. For Info Edge, Q1 is weak for Naukri business as subscription renewals of Naukri generally gets delayed. We expect revenues to improve 2.1% QoQ to ₹ 465 crore, mainly led by 3% QoQ growth in recruitment revenues. We expect 3%, 5% QoQ revenue growth, decline, respectively, in 99 Acres and other businesses (mainly pertains to Jeevansathi revenues due to paid to free conversion of some of the features (e.g. chat) albeit for limited period. We expect margins to fall

Topline, Profitability (Coverage Universe)



Dollar growth, QoQ

IT Services	Q1FY23E	Q4FY22	Growth (%)
TCS	6,803.1	6,696.0	1.6
Infosys	4,429.8	4,280.0	3.5
Wipro ^	2,762.5	2,721.7	1.5
HCL Tech	3,034.0	2,993.1	1.4
Tech M	1,619.4	1,608.1	0.7
LTI	581.8	570.4	2.0
Mindtree	401.1	383.8	4.5
Coforge	239.4	232.4	3.0
Staffing (in ₹)			
Teamlease	1,872.7	1,817.4	3.0
Info Edge	465.2	455.5	2.1

^ IT services

Top Picks

Infosys, Mindtree

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QoQ by 160 bps due to weaker revenues, continued marketing spend especially in 99 acres & Jeevansathi.

Margins to take hit due to supply side pressure

We expect margins to contract QoQ due to wage hike and continued rationalisation of employee costs amid high attrition despite the industry continuing to add record freshers. The attrition across companies would continue to be high and, hence, cost to backfill attrition (at higher costs) and costs related to retention, bonus, rationalisation of compensations are expected to put pressure on margins. This quarter margins also would be impacted due to uptick in travel expenses as the economy opens up and visa related costs. We expect all IT companies to report a decline in EBIT margins sequentially in the range of 55-240 bps.

Exhibit 1: Estimate for Q1FY23E (₹ crore)

Company	Revenue	Change (%)		EBITDA	Change (%)		PAT	Change (%)	
	Q1FY23E	YoY	QoQ	Q1FY23E	YoY	QoQ	Q1FY23E	YoY	QoQ
HCL Tech	23,422.7	16.7	3.7	5,012.5	2.1	-0.8	3,310.7	3.0	-7.9
Infosys	34,198.1	22.6	6.0	8,033.7	8.1	2.4	5,638.5	8.5	-0.8
InfoEdge *	465.2	45.5	2.1	123.3	23.7	-3.7	112.3	11.3	-6.9
L&T Infotech	4,491.6	29.7	4.4	817.5	26.2	-3.4	593.4	19.4	-6.9
Mindtree	3,096.3	35.1	6.9	626.9	35.0	3.1	481.3	40.2	1.7
Coforge	1,848.0	26.4	6.0	314.2	49.3	-4.6	199.3	61.2	-4.0
TCS	52,533.8	15.7	3.8	13,816.4	9.1	-0.2	9,842.4	9.3	-0.8
Teamlease	1,872.7	36.0	3.0	39.3	33.3	-4.2	29.0	7.7	-8.3
Tech Mahindra	12,501.7	22.6	3.2	1,875.3	-0.1	-10.2	1,236.4	-8.6	-17.9
Wipro	21,621.4	16.3	3.1	4,268.4	-5.7	0.4	3,030.8	-12.1	-5.2
Total	**1,56,051.4**			**34,927.4**			**24,474.1**		

*Source: Company, ICICI Direct Research, * standalone business*

Revenue, margin guidance outlook key monitorable

In the current quarter, key thing to watch will be commentary on growth outlook and impact of macros on the tech spending of some of its big clients. Also, comments on hiring & attrition trends, margin outlook. We expect Infosys and HCL to continue with their annual guidance on revenue and margins. We do not expect Infosys to increase guidance for FY23 in this as well as subsequent quarters in FY23 which it used to do historically.

Exhibit 2: Company Specific view

Company	Remarks
TCS	Revenue growth momentum should pick up on account of acceleration in deal execution but margins are expected to be impacted by annual salary wage revision effective from April 2022 . TCS is expected to register 3% QoQ growth in constant currency led by continued improvement in demand from BFSI, healthcare and retail, acceleration in digital technologies, ramp up of deals. Further, cross currency headwinds of 140 bps would lead to revenue growth of 1.6% QoQ in dollar terms. In rupee terms, revenue is expected to increase 3.8% QoQ aided by rupee depreciation. EBIT margins are expected to decline 110 bps QoQ to 23.9% due to i) wage revision in both onsite & offshore ii) increase in retention costs iii) some increase in travel costs while we expect some tailwind in margins on rupee depreciation. PAT is expected to decline 0.8% QoQ. Investor Interest : i) Demand outlook in key verticals of BFSI, Retail CPG ii) Margin outlook for FY23
Infosys	Infosys is expected to register 4.5% QoQ growth in CC led by momentum from financial services, retail, communication, energy and manufacturing. Cross currency headwinds of 100 bps would lead to 3.5% QoQ growth in dollar term. Rupee revenues are expected to increase 6.0% QoQ aided by rupee depreciation. EBIT margins are expected to contract 75 bps QoQ due to increase in employee cost, retention costs while there would be reversal of contractual provisions made in Q4 and rupee depreciation would help margins to some extent for the quarter. PAT is expected to decline ~0.8% QoQ. Investor interest: Any change in revenue growth guidance of 13-15% in CC for FY23E and 21-23% EBIT margin band
Wipro	Wipro had guided for 1-3% CC growth in Q1 for IT services. We expect the company to report 2.5% QoQ CC growth in revenues in IT services (including one month revenue from Rizing). We expect dollar revenue growth of 1.5% QoQ, factoring in 100 bps cross currency headwind. The company is expected to report 3.1% QoQ rupee growth aided by rupee depreciation. EBIT margins in global IT services are expected to decline 50 bps QoQ, due to impact of higher employee costs amid higher attrition. Overall EBIT margins are expected to decline 60 bps QoQ due to weak performance in IT services. Consequently, PAT is expected to decline 5.2% QoQ. Investor interest: commentary on recent M&A, Deal wins, vertical commentary, commentary of client's IT Budget and revenue guidance and annual wage hike in Q2 and its impact on margins
HCL Tech	We expect muted performance from HCL Tech in a seasonally weak quarter. We expect P&P business to report single digit decline while IT services and ER&D to report modest 2-2.5% QoQ CC growth. On account of ~60 bps cross currency headwinds, we expect the company to report 1.4% QoQ growth in dollar term. Rupee revenues are expected to report revenue growth of 3.7% QoQ. EBIT margins for the quarter are expected to contract 90 bps QoQ due to increase in retention costs as well as increase in travel costs. PAT is expected to decline 7.9% QoQ. Investor interest: Any change in revenue growth guidance of 12-14% in CC for FY23E and 18-20% EBIT margin band
Tech Mahindra	Q1 is a seasonally weak quarter for TechM on account of seasonal weakness in its mobility business (Comviva). Tech Mahindra is expected to witness 2% QoQ growth in CC revenues. However, dollar revenue is expected to grow 0.7% QoQ due to 130 bps cross currency headwinds. Rupee revenues are expected to grow 3.2% QoQ. We expect EBIT margin to decline 180 bps QoQ due to lower revenues, wage hike impact, visa and uptick in travel costs. PAT is expected to decline 17.9% QoQ due to weak operating performance (also due to tax related one-time benefit in Q4). Investor interest: Outlook on margin, large deals and incremental order flow from 5G services

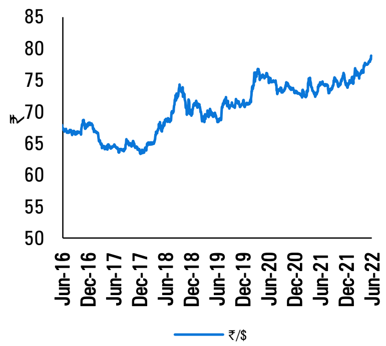
Source: Company, ICICI Direct Research

EBIT/EBITDA margin impact

EBIT margins	Q1FY23E	Q4FY22	Change (bps)
TCS	23.9	25.0	(106)
Infosys	20.8	21.6	(80)
Wipro ^	16.5	17.0	(50)
HCL Tech	17.1	18.0	(90)
EBITDA margins			
Tech M	15.0	17.2	(220)
LTI	18.2	19.7	(150)
Mindtree	20.2	21.0	(80)
Coforge	17.0	18.9	(190)
Internet & Staffing (in %)			
Teamlease	2.1	2.3	(20)
Info Edge	26.5	28.1	(160)

^ *IT services*

$/₹



$ vs. global currencies

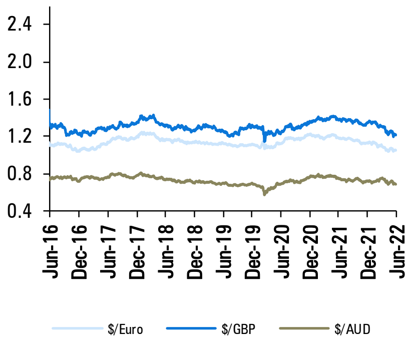


Exhibit 3: Company Specific views

Company	Remarks
Larsen & Toubro Infotech	Q1 revenue is affected by absence of pass through revenues. The impact is roughly in the range of 2-2.5%. In this context, LTI is expected to report 3.0% QoQ CC growth, growth would be broad based and led by ramp up of deals & improvement in discretionary spend. In dollar term, the growth is expected to be 2.0% QoQ as we expect 100 bps cross currency impact for the quarter. In rupee terms we expect revenues to increase 4.4% QoQ aided by rupee depreciation. We expect LTI's EBIT margin to decline 150 bps QoQ at 15.8% due to wage hikes for majority of the employees as well as visa & travel related costs. PAT is expected to decline 6.9% QoQ. Investor Interest: outlook on 14-15% net profit margin for FY23, deal pipeline
Info Edge	We expect Info Edge's revenues for the quarter expected to be weak. We expect revenues to improve only by 2.1% QoQ to ₹ 465.2 crore due to seasonality in recruitment business. recruitment business is expected to grow by 3% QoQ growth as seasonally renewals in subscription of Naukri has been weak in Q1. We expect 3% QoQ growth in 99 Acres as home search activity has seen some hit due to home loan interest rate increase. We expect other business (including Jeevansathi) to report decline QoQ on account of some feature have been moved from paid to free for the limited period. We expect margins to decline QoQ by 160 bps due to continued increase in employee as well as marketing spend especially in Jeevansathi business. PAT is expected to decline 6.9% QoQ. Investor interest: FY23 outlook of recruitment, real estate and matrimony business and investments in marketing and employees
MindTree	The company is expected to register 5.0% QoQ growth in CC terms mainly led by ramp up of deals in BFSI, improvement in travel vertical and healthy growth in top client but there would be some impact in retail sector. In dollar terms, revenue is expected to be up 4.5% QoQ due to 50 bps cross currency headwinds. Rupee terms revenues are expected to increase 6.9% QoQ aided by rupee depreciation. EBIT margins are expected to decline 90 bps QoQ due to merger related costs, visa costs and one off expenses related to an event in the quarter etc. Investor interest: progress on merger with LTI
Coforge	Q1 is typically a weak quarter for Coforge in terms of margin. Coforge is expected to register 3.5% QoQ growth in revenues of in CC terms, largely to be driven by BFSI, insurance and travel vertical. In dollar terms, we expect 3% QoQ growth due to 50 bps QoQ impact on cross currency headwinds. In terms of rupee, we expect the company to post 6% QoQ growth aided by rupee depreciation. EBIT margins are expected to decline 200 bps QoQ on visa costs, absence of product business license revenues, higher employee costs. PAT is expected to decline 4% QoQ. Investor interest: Outlook on travel vertical, large deal pipeline in BFSI, insurance & healthcare, margin and demand outlook
Teamlease Services	Q1 is seasonally a weak quarter for the company. We expect overall revenues to improve 3.0% QoQ led by 3% QoQ in general staffing while specialised staffing (mainly led by traction in IT staffing) is expected grow by 2% QoQ. We expect EBITDA margins to marginally decline by 20 bps QoQ to 2.1% due to higher employee cost. We expect PAT to decline 8.3% QoQ. Investor interest: PF trust related commentary

Source: Company, ICICI Direct Research

Exhibit 4: ICICI Direct Coverage universe (IT)

					EPS (₹)			P/E			RoCE (x)			RoE(x)		
Company Name	CMP	TP (₹)	Rating	Mcap (₹)	FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E
HCL Tech (HCLTEC)	976	1,090	HOLD	2,64,949	49.8	50.8	54.6	19.6	19.2	17.9	24.2	24.9	25.7	21.8	21.1	21.7
Infosys (INFTEC)	1,478	1,745	BUY	6,21,907	52.1	58.2	67.1	28.4	25.4	22.0	36.0	35.2	37.7	29.2	29.2	31.2
TCS (TCS)	3,316	3,835	BUY	12,26,661	104.7	117.7	131.3	31.7	28.2	25.2	51.4	50.2	48.9	43.0	42.7	41.2
Tech M (TECMAH)	1,011	1,190	BUY	98,273	63.1	68.5	79.5	16.0	14.8	12.7	22.5	22.5	23.0	20.7	20.0	20.6
Wipro (WIPRO)	422	465	HOLD	2,31,201	23.5	24.5	27.4	18.0	17.2	15.4	18.8	19.8	21.2	19.6	19.6	21.1
LTI (LTINFC)	4,000	4,480	HOLD	70,084	130.8	140.3	165.9	30.6	28.5	24.1	32.3	29.0	29.6	26.1	24.1	24.4
Mindtree (MINCON)	2,882	3,195	HOLD	47,494	100.3	109.8	127.9	28.7	26.3	22.5	38.0	35.4	34.5	30.2	27.4	26.6
Coforge (NIITEC)	3,486	4,550	BUY	21,229	106.5	147.8	175.0	32.7	23.6	19.9	25.6	31.5	31.8	24.2	28.4	28.3
TeamLease (TEASER)	3,295	4,025	BUY	5,634	22.5	95.0	125.4	146.6	34.7	26.3	15.4	19.2	20.7	(4.7)	18.9	20.2
Infoedge (INFEDG)	3,727	4,575	BUY	46,842	35.8	41.6	45.5	104.2	89.5	81.9	4.2	5.0	5.3	3.2	3.8	4.0

Source: Company, ICICI Direct Research

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