October 4, 2022

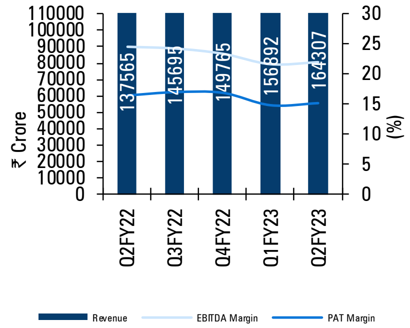
Growth momentum continues, high attrition restricts margin expansion…

The revenue growth of Indian IT companies is expected to continue in Q2, however margin expansion is likely to be restricted due to continued high attrition. Recent trends in Accenture's 4QFY22 (Aug ending company) earnings also indicates some near term encouraging trends especially in its outsourcing business which is proxy to Indian IT companies. Outsourcing business, 46% of the revenue mix in Q4, grew by 16% YoY in US$ and 23% YoY in local currency to US$7.1bn. for the same business, new bookings (net new order book) stands at US$10bn for the quarter, which grew by 41.1% YoY while that of FY22 stands at US$33.9 bn, up 18% YoY. For Indian IT companies' revenue performance expects to be strong in Q2, barring weakness in a few companies due to company specific events i.e seasonal weakness in P&P business for HCL Tech which will likely overshadow stable performance in other verticals while Tech M business is expected to be impacted by planned exit from some of the low margin portfolio (largely in BFSI space vertical wise and Asia region geography wise) which shall impact revenues by ~1% for the quarter). Revenue growth for the companies would be driven by continues strong deal execution. Margins are expected to expand on QoQ but margin expansion would be restricted to 20-50bps for majority of the companies due to continued supply side challenges which will keep attrition at the elevated levels and subsequently increase backfilling costs. The demand environment is expected to be strong in H1FY23/CY22 due to continued deal momentum led by sectors like BFSI, insurance, retail 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 to maintain its 14-16% CC revenue guidance for FY23E and we expect the company to maintain status quo as far guidance is concerned through the rest of the year. We also do not expect the company to change margin guidance of 21-23% as it already factored in cost pressures. Even for HCL Tech, we do not expect the company to change revenue/EBIT margin guidance from 12-14%/18-20% for FY23E.** Due to unfavourable currency movements i.e GBP and EUR depreciation against USD, there would be cross currency headwinds in the range of 100-150bps for the quarter, which is expected to impact dollar revenues. Rupee revenues for the quarter are expected to be aided by rupee depreciation against dollar.

We expect IT companies to post CC revenue growth between 3-5% for Q2FY23 with Infosys being at the higher end (5% CC revenue growth) in tier I IT companies while TCS, Wipro & HCL Tech (IT services) are expected to post constant currency (CC) revenue growth of 3%, 4% & 3.5% QoQ respectively. Among tier II IT companies we expect Mindtree to post a revenue growth of 5% QoQ in CC while TechM, LTI & Coforge are expected to post a growth of 2%, 3% & 4.5% respectively in CC terms. We expect cross currency headwinds in the range of 100-150 bps impacting the dollar revenues of the companies. We expect TCS, Infosys, Wipro & HCL Tech to post dollar revenue growth between 1.5-3.5% QoQ while TechM, LTI, Mindtree & Coforge are expected to post a revenue growth between 0.5-4% QoQ. We prefer Infosys, Mindtree, Coforge.

For Teamlease, we expect muted performance as hiring trends are not encouraging across its general & specialised staffing. Overall revenues are expected to improve 2.1% QoQ aided by 2% QoQ in general staffing while specialised staffing (except top IT companies) is also expected to post muted growth. We expect margins to improve sequentially by 10 bps QoQ to 1.4%. We expect Info Edge to post muted growth of 2% due to moderate

Topline, Profitability (Coverage Universe)



Dollar growth, QoQ

IT Services	Q2FY23E	Q1FY23	Growth (%)
TCS	6,881.7	6,780.0	1.5
Infosys	4,599.5	4,444.0	3.5
Wipro ^	2,803.9	2,735.5	2.5
HCL Tech	3,061.0	3,025.0	1.2
Tech M	1,640.7	1,632.5	0.5
LTI	591.8	580.2	2.0
Mindtree	415.3	399.3	4.0
Coforge	247.1	238.7	3.5
Staffing (in ₹)			
Teamlease	1,918.7	1,879.4	2.1
Info Edge	517.2	507.7	1.9

^ IT services

Top Picks

Infosys, Mindtree, Coforge

Research Analysts

Sameer Pardikar
sameer.pardikar@icicisecurities.com
Sujay Chavan
sujay.chavan@icicisecurities.com

growth in the recruitment & 99 acres business while we expect decline of 5% in Jeevansaathi (change in business strategy where it continue to offer few features complimentary for its users). We expect Info Edge's margins to decline by 50bps QoQ due to continued elevated marketing spend & increase in employee cost. We also expect the PAT to decline by 0.4% sequentially.

Margin expansion restricted due to continued high attrition

Despite wage hike for the companies like TCS, Infosys, LTI already factored in Q1, we expect margins expansion likely to be restricted in the range of 20-50bps QoQ for Top 4 companies due to continued high attrition which is expected to keep backfilling costs at elevated levels. This along with elevated travelling and facility costs likely to mitigate some of the tailwinds like pricing, utilisation improvement, pyramid optimisation etc. For Mindtree, margins are expected to decline 130bps QoQ due to wage hike (-230-240 bps impact which is likely to be mitigated by some of the costs already factored in Q1 (~60bps merger related costs and 50bps annual visa costs) resulting into margin contraction of 130bps QoQ. HCL Tech margins for the quarter would also be impacted by partial wage hike in Q2 (wage hikes normally spread between Q2 and Q3) which is likely to be mitigated by pricing benefits and moderation of subcontractor costs resulting modest 20bps QoQ EBIT margin expansion. Coforge margins are expected to improve by 155bps QoQ due to continued focus on offshoring, planned increase in utilisation and large part of fresher's absorbed earlier becoming billable.

Exhibit 1: Estimate for Q2FY23E (₹ crore)

Company	Revenue	Change (%)		EBITDA	Change (%)		PAT	Change (%)	
	Q2FY23E	YoY	QoQ	Q2FY23E	YoY	QoQ	Q2FY23E	YoY	QoQ
HCL Tech	24,428.3	18.3	4.1	5,178.8	7.0	4.1	3,464.3	6.1	5.5
Infosys	36,704.3	24.0	6.5	8,561.8	9.3	8.9	5,954.9	9.8	11.1
InfoEdge *	517.2	47.1	1.9	163.6	53.9	0.3	147.9	-115.8	-0.4
L&T Infotech	4,722.6	25.4	4.4	878.4	19.8	5.7	651.9	18.2	2.8
Mindtree	3,313.9	28.1	6.2	656.1	23.6	-0.3	459.0	15.1	-2.7
Coforge	1,971.5	25.6	7.8	345.0	26.1	18.2	182.3	24.2	21.7
TCS	54,916.0	17.2	4.1	14,223.2	8.5	6.0	10,062.3	4.6	6.2
Teamlease	1,918.7	25.9	2.1	26.9	-21.3	6.2	23.0	-146.6	-13.4
Tech Mahindra	13,092.5	20.3	3.0	1,977.0	-0.9	5.2	1,180.9	-11.8	4.4
Wipro	22,722.2	15.0	5.0	4,202.6	-1.5	5.9	2,803.7	-4.5	9.3
Total	**1,64,307.3**	**19.4**	**4.7**	**36,213.4**	**7.4**	**6.3**	**24,930.2**	**9.9**	**7.3**

*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.

Exhibit 2: Company Specific view

Company	Remarks
TCS	Revenue growth momentum is expected to continue on strong deal execution while margins are expected to improve sequentially as wage hike is behind now. 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 150 bps would lead to revenue growth of 1.5% QoQ in dollar terms. In rupee terms, revenue is expected to increase 4.1% QoQ aided by rupee depreciation. EBIT margins are expected to improve by only 50 bps QoQ to 23.6% despite wage hike impact already factored in Q1 on continued in high attrition pushing higher backfilling expenses as well as higher subcontractors costs. PAT is expected to improve by 6.2% QoQ. **Investor Interest** : i) Demand outlook in key verticals of BFSI, Retail CPG ii) Margin outlook for FY23
Infosys	Revenue growth momentum is expected to continue on strong deal execution while margins are expected to improve sequentially as wage hike is behind now. Infosys is expected to register 5% QoQ growth in CC led by continued momentum from financial services, retail, communication, energy and manufacturing, despite it is witnessing weakness in some pockets of BFSI and Retail. Cross currency headwinds of 150 bps would lead to 3.5% QoQ growth in dollar term. Rupee revenues are expected to increase 6.5% QoQ aided by rupee depreciation. We factor in EBIT margin expansion of only 40 bps QoQ despite wage hike impact already taken in Q1, due to continued high attrition which is expected to increase backfilling costs and continued higher subcontractor costs which likely mitigate few of the tailwinds in terms utilisation improvement, pyramid optimisation etc. We expect PAT to increase ~11.1% QoQ. **Investor interest**: Any change in revenue growth guidance of 14-16% in CC for FY23E and 21-23% EBIT margin band
Wipro	Wipro had guided for 3-5% CC growth in Q2 for IT services. We expect the company to report 4% QoQ CC growth in revenues in IT services (including full quarter revenue from Rizing, we are factoring 150bps contribution). We expect dollar revenue growth of 2.5% QoQ, factoring in 150 bps cross currency headwinds. The growth is expected to be broad based across sectors. The company is expected to report 5% QoQ rupee growth aided by rupee depreciation. EBIT margins in global IT services are expected to improve by 30 bps QoQ despite wage hike in Q2 on account of some tailwinds such as pricing, moderation of subcontractor costs, utilisation improvement, pyramid rationalisation and some const control on variable payout. Overall EBIT margins are expected to improve by ~40 bps QoQ. Consequently, PAT is expected to improve by 9.5% QoQ. **Investor interest**: commentary on recent M&A, Deal wins, vertical commentary, commentary of client's IT Budget and revenue guidance for Q3
HCL Tech	HCL Tech is expected to report weak numbers on seasonally weak numbers for P&P business which will overshadow decent performance in IT & ER&D business. Company's IT services to report 3.5% QoQ growth in CC given continued strong deal momentum, while Dollar revenue is expected to grow by 2% QoQ factoring 150bps cross currency headwinds. In dollar terms; ER&D is expected to grow by 2.5% QoQ while P&P business is expected to decline by 10% QoQ. At company level, it is expected to post 1.2% QoQ growth in USD terms. In rupee terms, we expect the company to report 4.1% QoQ growth aided by rupee depreciation. EBIT margins for the quarter are expected to grow by 20 bps QoQ despite wage hike in the quarter as well as planned on boarding of 10,000 freshers in the quarter,to be mitigated by pricing benefits as well as moderation of sub-contractor costs . PAT is expected to improve by 7.5% QoQ. **Investor interest**: Any change in revenue growth guidance of 12-14% in CC for FY23E and 18-20% EBIT margin band
Tech Mahindra	Revenue growth of Q2 is expected to be impacted by exiting some of its portfolio, while margins are expected to be flat QoQ despite wage hike for the quarter. The company is expected to report 2% QoQ growth in CC revenues (1% impact on portfolio exits in BFSI vertical and largely to Asia region as per strategy to exit low margin businesses). However, dollar revenue is expected to grow 0.5% QoQ due to 150 bps cross currency headwinds. Rupee revenues are expected to grow 3% QoQ aided by rupee depreciation. We expect EBIT margin to improve by ~10 bps QoQ despite wage hike (70-80bps impact) which is expected to be mitigated by price hikes, benefit of exiting some of the low margin businesses, rupee depreciation etc. PAT is expected to improve 4.4% QoQ. **Investor interest**: Outlook on margin, large deals and incremental order flow from 5G services

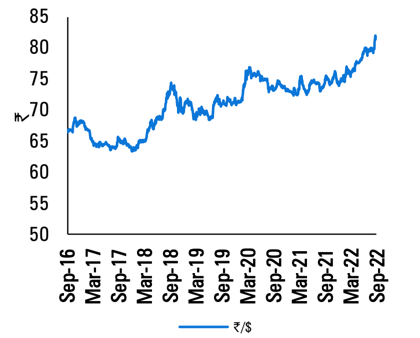
Source: Company, ICICI Direct Research

EBIT/EBITDA margin impact

EBIT margins	Q2FY23E	Q1FY23	Change (bps)
TCS	23.6	23.1	50
Infosys	20.5	20.1	42
Wipro ^	15.3	15.0	35
HCL Tech	17.2	17.0	19
EBITDA margins			
Tech M	15.1	14.8	31
LTI	18.6	18.4	23
Mindtree	19.8	21.1	(129)
Coforge	17.5	16.0	155
Internet & Staffing (in %)			
Teamlease	1.4	1.3	5
Info Edge	31.6	32.1	(51)

^ *IT services*

$/₹



$ vs. global currencies

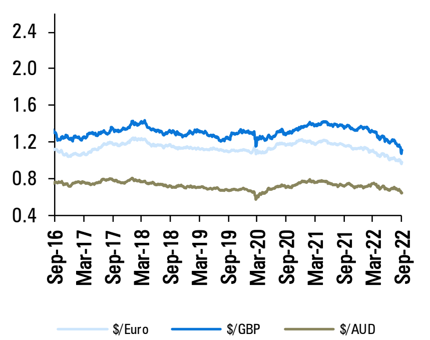


Exhibit 3: Company Specific views

Company	Remarks
Larsen & Toubro Infotech	LTI is expected to report moderate growth while margins are expected be largely flattish for the quarter. We expect it to report 3.0% QoQ CC growth, growth would be broad based and led by ramp up of deals. 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 improve by only 20 bps QoQ at 16.2% despite wage hike impact taken in Q1 due to continued high attrition resulting into higher backfilling costs and elevated travel and facility expenses. PAT is expected to improve by 2.8% QoQ. Investor Interest: Outlook on 14-15% net profit margin for FY23, deal pipeline, progress on Mindtree merger with LTI
Info Edge	We expect Info Edge's revenues for the quarter to be impacted by some slowdown in hiring in IT sector while revenue for Jeevansathi will impact due to continuation of some free features in the business. We expect the company's revenues to improve by 2% QoQ to ₹ 517 crore mainly led by 3% QoQ growth in recruitment revenues, with some impact of IT hiring slowdown while hiring in other sectors of BFS, Insurance, Retail and Travel & Tourism continue to be steady. We are factoring in moderate growth in 99 acres while revenues for Jeevansathi are expected to decline by 5% QoQ. We expect consolidated margins to decline QoQ by 50 bps due to continued increase in employee as well as marketing spend. PAT is expected to decline by 0.4% 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 BFS and continued growth in top client. RCM will continue to be weak while other verticals are expected to keep the growth momentum. US is expected report healthy growth while Europe region would be impacted by i) it is RCM heavy and moderation in RCM would impact ii) it would also have currency impact in the quarter due to GBP depreciating against USD. In dollar terms, revenue is expected to be up 4.0% QoQ due to ~100 bps cross currency headwinds. Rupee terms revenues are expected to increase 6.2% QoQ aided by rupee depreciation. EBIT margins are expected to decline 130 bps QoQ, due to i) wage hike impact for the quarter ii) while there would be some benefits in terms of absence of one- time merger related costs and visa costs, impact of the same has already been factored in Q1 and won't be repeated in Q2. PAT is expected to decline by 2.7% QoQ.
Coforge	Coforge is expected to register 4.5% QoQ growth in revenues of in CC terms, largely to be driven by continued momentum in BFS, travel verticals while insurance vertical is expected to return back to growth after decline in last quarter . In dollar terms, we expect 3.5% QoQ growth due to 100 bps QoQ cross currency headwinds. In terms of rupee, we expect the company to post 7.8% QoQ growth aided by rupee depreciation. EBIT margins are expected to improve 140 bps QoQ on continued increase in offshoring, planned improvement in utilisation as large tranche of freshers which were taken in earlier quarters are excepted to become billable. PAT is expected to improve by 21.7% QoQ on strong operating performance. Investor interest: Outlook on travel vertical, large deal pipeline in BFSI, insurance & healthcare, margin and demand outlook
Teamlease Services	We expect muted performance from Teamlease as hiring trends across sectors are not encouraging . We expect general staffing revenue growth of 2% QoQ as hiring trends are better in BFSI and Retail while in other sectors such as manufacturing, ecommerce are expected to be muted. Even on specialised staffing except for top IT player, hiring trends across other IT players has been muted and hence we anticipate 3% QoQ growth in revenue. Revenue for other HR services are expected to be impacted by pushing of admission cycle for some of the universities to Oct instead of Jul. Overall revenues to expected to report 2.1% QoQ growth. We expect EBITDA margins to improve marginally by 10bps QoQ due to continued higher employee cost. We expect PAT to decline by 13.4% QoQ also impacted by normalisation of other income which was aided by one-offs in Q1. Investor interest: Hiring trends across key sectors

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)	929	1,050	HOLD	2,52,099	49.8	50.5	55.2	18.6	18.4	16.8	24.2	24.8	26.0	21.8	21.0	21.9
Infosys (INFTEC)	1,394	1,760	BUY	5,86,542	52.1	58.1	67.5	26.7	24.0	20.7	36.0	35.0	37.7	29.2	29.1	31.1
TCS (TCS)	2,989	3,785	BUY	10,93,690	104.7	115.1	130.4	28.5	26.0	22.9	51.4	49.2	48.7	43.0	41.9	41.0
Tech M (TECMAH)	1,005	1,170	BUY	97,768	63.1	66.2	77.9	15.9	15.2	12.9	22.5	21.8	22.7	20.7	19.4	20.3
Wipro (WIPRO)	394	460	HOLD	2,15,963	22.3	23.3	27.1	17.7	16.9	14.6	18.8	18.9	21.0	19.6	18.7	20.8
LTI (LTINFC)	4,447	4,480	HOLD	77,922	130.8	140.3	165.9	34.0	31.7	26.8	32.3	29.0	29.6	26.1	24.1	24.4
Mindtree (MINCON)	3,124	3,320	BUY	51,485	100.3	109.8	127.9	31.2	28.5	24.4	38.0	35.4	34.5	30.2	27.4	26.6
Coforge (NIITEC)	3,332	4,375	BUY	20,293	106.5	147.8	175.0	31.3	22.5	19.0	25.6	31.5	31.8	24.2	28.4	28.3
TeamLease (TEASER)	3,054	4,240	BUY	5,221	22.5	85.6	124.6	135.9	35.7	24.5	15.4	17.6	20.8	(4.7)	17.4	20.4
Infoedge (INFEDG)	3,804	5,230	BUY	47,806	35.8	47.8	54.2	106.3	79.6	70.2	4.2	5.7	6.3	3.2	4.3	4.7

Source: Company, ICICI Direct Research

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Pankaj Pandey **Head – Research** **pankaj.pandey@icicisecurities.com**

ICICI Direct Research Desk,
ICICI Securities Limited,
1st Floor, Akruti Trade Centre,
Road No 7, MIDC,
Andheri (East)
Mumbai – 400 093
research@icicidirect.com

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