January 5, 2023

Furloughs to impact revenues; supply side easing to aid margin expansion

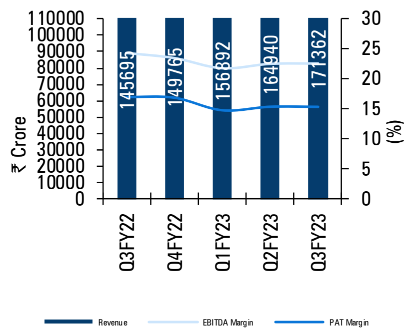
Q3 of last year saw IT companies report strong growth on healthy demand and lower furloughs, which was an aberration to the historical trends where Q3 is seasonally a weak quarter for them. For Q3FY23, we expect revenue growth to moderate sequentially (after strong growth reported in H1), on higher than normal furloughs, fewer working days, deferred spending from some clients and a high inflationary environment. Geography wise, the US market is expected to be impacted by high inflationary pressures while the Europe market is expected to be impacted by energy constraints that are likely to have an impact on the manufacturing vertical. Vertical wise, some companies have already indicated pain in a few pockets of BFSI (mortgage), retail, hi-tech and telecom, which is expected to continue in this quarter as well in our view.

Recent Accenture numbers for outsourcing business were strong wherein it reported 9.7% YoY growth in outsourcing bookings. We note that the numbers may look down QoQ but the historical trend suggests new bookings are generally lower in Q1 vs. Q4 as they form 20% of annual new bookings in the quarter and new bookings gradually pick up in subsequent quarters. Assuming similar build of new order bookings in CY23, our back of the envelope calculation suggests outsourcing bookings for CY23 are likely to be in the range of US$40.5-41 billion, which is a strong 19%+ growth and is likely to lead to strong high teen growth in outsourcing revenues for CY23. It suggests pain in H2 for Indian IT companies could be seasonal in nature and long term growth trends are likely to be intact.

EBIT margins are expected to expand on a QoQ basis albeit marginally except LTIMindtree where margin for the company is expected to be hit by integration costs. Margin expansion is expected to be in the range of 10-70 bps for a majority of companies due to easing of supply side pressure, rupee depreciation, moderation of attrition, etc. The deal momentum is expected to continue but there is expected to be some moderation on account of slower decision making on the client side. Cost take out deals are expected to form a major pie in the medium term compared to revenue enhancement deals historically due to nature of demand. Vendor consolidation is another theme, which is likely play out in the medium term. However, we believe it could be neutral for the industry as it would be gain for a few and loss for others. Companies with end to end capabilities, stable management and better execution track record, especially in large deals, are likely to be winners.

We expect Infosys to maintain its 15-16% CC revenue guidance for FY23E as the asking rate for H2 in terms of growth is not challenging. We expect the company to maintain status quo as far as guidance is concerned even in Q4. We also do not expect the company to change its margin guidance of 21-22% as it has already factored in cost pressures. **Even for HCL Tech, we do not expect the company to change revenue, EBIT margin guidance from 13.5%-14.5%, 18-19%, respectively, for FY23E as revenue, EBIT margin are largely factored in the pain points.** Due to marginal currency movements i.e. GBP and EUR depreciation against the US dollar, cross currency headwinds are expected to be in the range of 20-50 bps for the quarter, which is expected to impact dollar revenues. Rupee revenues for the quarter are expected to be aided by continued rupee depreciation against the dollar.

Topline, Profitability (Coverage Universe)



Dollar growth, QoQ

IT Services	Q3FY23E	Q2FY23	Growth (%)
TCS	6,959.5	6,877.0	1.2
Infosys	4,591.4	4,555.0	0.8
Wipro ^	2,817.3	2,797.7	0.7
HCL Tech	3,186.5	3,082.4	3.4
Tech M	1,643.1	1,638.1	0.3
LTIMindtree	1,050.7	1,023.1	2.7
Coforge	254.8	246.9	3.2
Staffing (in ₹)			
Teamlease	1,988.5	1,955.1	1.7
Info Edge	550.4	531.8	3.5

^ IT services

Top Picks

Infosys, Coforge

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We expect IT companies to post QoQ CC revenue growth between 0.5% and 3.5% for Q3FY23. We expect HCL Tech (IT services) to grow 2.5% in CC terms leading the growth among Tier I IT companies while TCS, Infosys & Wipro are expected to report revenue growth of 1.5%, 1% & 1%, respectively. Among tier II IT companies, LTIMindtree is expected to report its first consolidated results after Mindtree's merger with LTI. We expect it to report growth of 3% QoQ in CC terms. Among other Tier II IT companies, we expect Coforge and Tech Mahindra to report revenue growth of 3.5% and 0.5%, respectively, in CC terms. We expect cross currency headwinds to continue impacting the revenue of companies and expect the impact to be in the range of 20-50 bps on dollar revenues. We expect TCS, Infosys, Wipro (IT services) and HCL Tech (IT services) to post moderate dollar revenue growth of 0.7-2% QoQ while TechM, LTIMindtree and Coforge are expected to post revenue growth of 0.5-3.2% QoQ. We prefer Infosys and Coforge.

For Teamlease, we expect muted growth at the company level with general staffing and specialised HR staffing expected to report sequential revenue growth of 2% while specialised staffing is expected to decline by 2% due to global macroeconomic factors impacting the hiring trend. At the company level, we expect revenues to grow 1.7% QoQ while on the margins front we expect margins to decline 20 bps QoQ to 1.4% due to the weak performance of high margin business. For Info Edge, we expect revenue growth to moderate to 3.5% at the company level due to revenue in recruitment business being impacted by slowdown in IT hiring. We expect the recruitment business to grow 5% QoQ while 99acres is expected to report growth of 3% QoQ. We expect Jeevansathi revenues to decline 5% due to the change in business strategy implemented by the company to grow users. On the margins front, we expect consolidated EBITDA margins to improve by 90 bps QoQ to 35.5% while PAT is expected to grow 2.7% sequentially with a corresponding margin of 31.4%.

Supply side ease to aid margin expansion albeit slightly

We expect most IT companies except LTIMindtree to report a marginal margin expansion on account of easing of supply side pressure, moderation of attrition, moderation of sub-contractor cost and rupee depreciation. LTIMindtree's EBITDA margin this quarter is expected to be impacted by merger related cost and on account of higher mix of pass-through (low margin arrangement). We expect LTIMindtree margins to decline 200 bps QoQ with 100 bps impact of integration cost and 100 bps impact on account of lower pass through revenue for LTI. We expect moderate margin expansion for other IT companies in our coverage with margin expansion in the range of 10-70 bps QoQ. We expect TCS, Infosys, Wipro (IT services) & HCL Tech to report margin expansion of 20 bps, ~20 bps, 10 bps & ~30 bps, respectively, while TechM and Coforge's EBITDA margins are expected to improve 30 bps & 40 bps QoQ, respectively.

Exhibit 1: Estimate for Q3FY23E (₹ crore)

Company	Revenue	Change (%)		EBITDA	Change (%)		PAT	Change (%)	
	Q3FY23E	YoY	QoQ	Q3FY23E	YoY	QoQ	Q3FY23E	YoY	QoQ
HCL Tech	26,203.5	17.3	6.1	5,817.2	11.0	7.2	3,753.7	9.0	7.6
Infosys	37,750.8	18.5	3.3	9,217.8	10.0	3.5	6,300.7	8.5	4.6
InfoEdge *	550.4	32.3	3.5	195.4	61.6	6.2	172.7	45.7	2.7
LTIMindtree	8,639.1	25.4	4.9	1,511.8	6.2	-6.0	1,067.9	1.7	-10.1
Coforge	2,095.0	26.3	6.9	377.1	24.9	9.3	212.6	15.7	5.5
TCS	57,221.2	17.1	3.5	15,049.2	12.0	3.7	10,723.4	9.8	2.8
Teamlease	1,988.5	12.9	1.7	28.0	-25.7	-11.5	28.3	-6.3	-10.4
Tech Mahindra	13,509.2	18.0	2.9	2,080.4	1.0	4.9	1,344.2	-1.8	4.6
Wipro	23,403.8	14.5	3.3	4,278.1	-0.6	5.8	2,789.6	-9.7	5.7
Total	**1,71,361.5**	**17.6**	**3.9**	**38,555.0**	**9.2**	**4.1**	**26,393.2**	**6.2**	**3.7**

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

CY23 IT budget of clients, revenue, margin guidance outlook key monitorable

In the current quarter, key thing to watch will be the IT budget of clients for CY23, commentary on growth outlook, impact of macros on the tech spending of some of its big clients and comments on the outlook for US and Europe regions. Also, key will be comments on hiring & attrition trends, margin outlook and deal momentum & conversion. We expect Infosys and HCL Tech to continue with their annual guidance on revenue and margins. Also comments on the progress of integration of LTIMindtree and expected timeline for full integration will be watched.

Exhibit 2: Company Specific view

Company	Remarks
TCS	This quarter is expected to be hit by furloughs, with furloughs expected to be higher than the last couple of years. However, margins are expected to improve QoQ due to easing of supply side pressure. We expect TCS to report CC QoQ growth of 1.5% for the quarter to be aided by continued deal execution albeit growth will be lower compared to strong H1 on lesser working days. A few pockets of BFSI, hi-tech, manufacturing may witness weakness in the quarter due to macro concerns as well as energy constraints in the Europe region. We expect dollar revenue growth of 1.2% QoQ accounting for 30 bps cross currency headwinds. Rupee revenue is expected to grow 3.5% QoQ aided by rupee depreciation. We expect margins to improve 20 bps QoQ aided by easing of supply side pressure, moderation of attrition and rupee depreciation. Deal momentum is expected to continue while mix of deals would be skewed towards cost-take out programs. **Key investor interests:** Deal momentum, macro impact on revenues, attrition trend, CY23 IT budget
Infosys	Q3 is seasonally a weak quarter for Infosys due to furloughs and furlough impact was higher this year. However, the asking rate for Infosys as per annual guidance is around 0.5-1.1% QoQ revenue growth in CC for the next couple of quarters, which is not an uphill task in our view. We expect Infosys to report 1% QoQ CC growth for Q3 as there would be continued impact of slowdown in few pockets of BFSI (mortgage), retail, hi-tech & telecom and Europe as a region. The company is expected to report rupee revenue growth of 3.3% QoQ, to be aided by rupee depreciation. EBIT margins are expected to improve ~20 bps QoQ led by cost optimisations on easing of supply side pressure, lower subcontractor costs and rupee depreciation. Deal momentum is expected to continue while mix of deals are expected to be skewed towards cost-take out programs. We do not expect Infosys to change revenue, EBIT margin guidance for FY23 as the asking rate to achieve those seem not stretched. **Key investor interests:** Revenue and margin guidance for FY23, deal momentum, macro impact on revenues, attrition trend, CY23 IT Budget
Wipro	The company had given 0.5-2% QoQ CC growth guidance for Q3. Due to higher furlough impact this year, we bake in revenue growth at the lower end. The company is expected to report 1% QoQ CC revenue growth in Q3 while dollar revenue growth is expected to be 0.7% QoQ, after factoring in 30 bps cross currency headwinds. Wipro's consulting business (led by Capco) is expected to continue to witness headwinds in Q3 while some verticals like retail, hi-tech, manufacturing are likely facing headwinds during the quarter. Some revenues for the quarter could also be impacted by certain leadership changes during the quarter in our view. Rupee revenue is expected to grow 3.6% QoQ to be aided by rupee depreciation. On EBIT margins, we expect IT services EBIT margins to expand moderately by 10 bps QoQ as there would some wage hike impact to hit in Q3 with tailwinds being moderation of attrition, pyramid optimisation and rupee depreciation. **Key investor interests:** deal momentum, macro impact on revenues, attrition trend, CY23 IT budget
HCL Tech	As indicated by the company in its investor day in December 2022, furloughs this year are expected to be higher than previous years and are likely to impact its revenue growth in IT services in Q3 as well as in H2. We expect HCL Tech to report 2.5% QoQ revenue growth in IT services in CC terms to be impacted by some pockets of weakness due to macro concerns while P&P business, which is seasonally strong in Q3 is likely to report 15% revenue growth in CC terms on a low base. We factor in 50 bps cross currency headwinds for IT services for the quarter. Hence, IT services are likely grow 2% for the quarter. In dollar terms, revenue is expected to grow 3.4% QoQ, aided by the P&P business. Rupee revenue is expected to grow 6.1% QoQ. On the margin front, we expect EBIT margins for the company to improve 30 bps QoQ to be aided by a rebound in P&P (high margin business), easing of supply side pressure and rupee depreciation while wage hike being headwind (wage hike is split between Q2 and Q3 for the company). Since the company already indicated that it would be at the lower end of the revenue guidance given for FY23 in CC terms, we do not expect the company to revise guidance downward. **Key investor interests:** Revenue and margin guidance for FY23, deal momentum, macro impact on revenues, attrition trend, CY23 IT budget
Tech Mahindra	Revenue growth in Q3 is likely to be impacted by higher furloughs, continued portfolio rationalisation, fewer working days. We expect the company to report 0.5% QoQ revenue growth in CC terms. Dollar revenue growth is expected to be at 0.3% QoQ factoring in 20 bps cross currency headwind. Rupee revenues are expected to grow 2.9% QoQ aided by rupee depreciation. Slower growth is expected to be across BFSI and hi-tech while there is expected to be a seasonal uptick in the retail and CME verticals. Deal wins for the quarter are likely to be at the lower end of the guided range of US$700-US$1 bn. Margins are expected to improve 30 bps QoQ to be aided by supply side easing. Some continued pricing benefit and rupee depreciation with higher subcontractor costs continue to be headwinds for the quarter. **Key investor interests:** Deal momentum, macro impact on revenues, attrition trend, CY23 IT budget

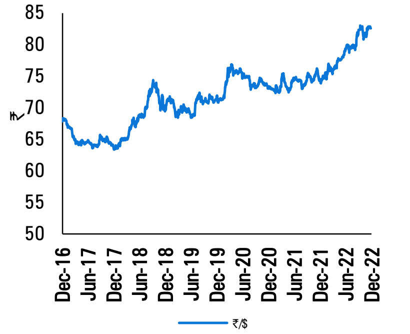
Source: Company, ICICI Direct Research

EBIT/EBITDA margin impact

EBIT margins	Q3FY23E	Q2FY23	Change (bps)
TCS	24.2	24.0	19
Infosys	21.7	21.5	13
Wipro ^	15.2	15.1	9
HCL Tech	18.2	17.9	26
EBITDA margins			
Tech M	15.4	15.1	29
LTIMindtree	17.5	19.5	(203)
Coforge	18.0	17.6	40
Internet & Staffing (in %)			
Teamlease	1.4	1.6	(21)
Info Edge	35.5	34.6	90

^ IT services

$/₹



$ vs. global currencies

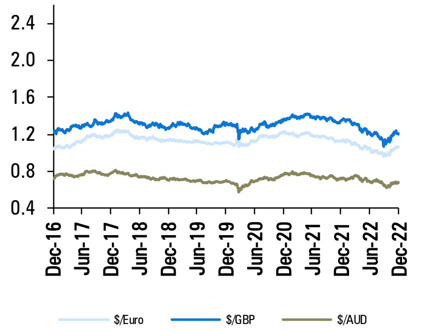


Exhibit 3: Company Specific views

Company	Remarks
LTIMindtree	LTI Mindtree would be reporting its numbers for the first time in Q3 as a combined entity. Q3 revenues will have some impact of furlough and lower working days. Hence, revenue growth is likely to decelerate from earlier levels. The company is expected to post revenue growth of 3% in CC terms while dollar revenue growth is expected to be 2.7% QoQ factoring in 30 bps cross currency headwinds. Revenue for Q3 is also expected to be lower by US$2-3 mn on elimination of inter segmental revenue when consolidating numbers of LTI and Mindtree. We expect EBITDA margins for the combined entity to decline 200 bps QoQ due to: 100 bps impact on the integration of the two entities and 100 bps impact on lower pass through revenue for LTI for the quarter. Growth for retail, hi-tech, manufacturing (ex-pass through) is expected to be muted while BFSI, travel are expected to continue to do well for the combined entity. Attrition is expected to see a downward trend for the entity. **Key investor interests:** Progress on integration of LTI and Mindtree, deal momentum, macro impact on revenues, attrition trend, CY23 IT budget
Info Edge	We expect revenues for the quarter to be impacted by moderation of hiring in the IT sector while some pick-up was visible in hiring in the non-IT sectors. 99 acres is expected to post steady revenues while revenues for Jeevansathi will continue to impact due to continued complimentary offering of some features. We also note that Q3 of last year was exceptionally high in revenues due to buoyancy in IT sector hiring. We expect revenues to improve 3.5% QoQ to ₹ 550.4 crore, mainly led by 5% QoQ growth in recruitment revenues. We factor in stable 3% QoQ growth in 99 acres revenues while revenues for Jeevansathi are expected to decline 5% QoQ. We expect consolidated margins to improve QoQ by 90 bps to be driven by margin expansion in recruitment business. PAT is expected to improve 2.7% QoQ. **Investor interest:** FY23 outlook of recruitment, real estate and matrimony business and investments in marketing and employees
Coforge	We expect revenue growth for Q3 to be moderate due to higher furloughs and fewer working days in the quarter. Deal momentum is expected to continue and Coforge does not foresee any impact there. Furloughs are higher in BFS specific to mortgage businesses and insurance business while travel vertical is expected to continue its strong momentum in the quarter. We expect Coforge to report 3.5% QoQ CC revenue growth for the quarter. Dollar revenue growth is expected at 3.2% QoQ factoring in 30 bps cross currency headwinds. Rupee revenue is likely to grow 6.9% QoQ for the quarter to be aided by rupee depreciation. EBITDA margins are expected to improve 40 bps QoQ due to operating efficiencies and rupee depreciation. We expect Coforge to keep revenue as well as margin guidance intact for FY23. **Key investor interests:** Deal momentum, macro impact on revenues, attrition trend, CY23 IT budget
Teamlease Services	As indicated by the company in Q2, Q3 is expected to be another weak quarter for it in terms of margins as margins are expected to decline sequentially at the company level. Hiring trends across BFSI and consumers were steady but retail, telecom, e-commerce sectors continue to show sluggish demand. Historical trend suggests the e-commerce sector hiring generally picks up during the festive season but this time the growth was muted. We expect general staffing revenue growth of 2% QoQ. On specialised staffing, clients have slowed down their hiring and continue to look to optimise their resources rather than adding headcounts. Hence, we are baking in 2% QoQ decline in revenues. Specialised HR is expected to witness some uptick sequentially. We estimate 2% sequential revenue increase there. Overall revenues are expected to grow 1.7% QoQ. We expect EBITDA margins at the company level to decline 20 bps QoQ due to weak margin performance from high margin businesses of specialised and other HR services for the quarter. **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)	1,044	1,115	BUY	2,83,307	49.8	52.8	58.3	20.9	19.8	17.9	24.2	25.8	27.4	21.8	21.9	23.0
Infosys (INFTEC)	1,475	1,670	BUY	6,20,624	52.1	59.7	68.7	28.3	24.7	21.5	36.0	35.8	38.3	29.2	29.7	31.6
TCS (TCS)	3,310	3,630	BUY	12,11,146	104.7	115.7	130.3	31.6	28.6	25.4	51.4	49.3	48.7	43.0	42.0	41.0
Tech M (TECMAH)	1,013	1,240	BUY	98,547	63.1	65.2	80.0	16.1	15.5	12.7	22.5	21.5	23.2	20.7	19.1	20.8
Wipro (WIPRO)	387	420	HOLD	2,12,126	23.5	23.1	26.1	16.5	16.8	14.8	18.8	18.7	20.3	19.6	18.5	20.1
LTIM (LTINFO)	4,256	UR	UR	1,25,891	130.8	155.9*	186.2*	32.5	27.3*	22.9*	32.3	-	-	26.1	-	-
Coforge (NIITEC)	3,913	4,570	BUY	23,832	106.5	147.8	170.8	36.7	26.5	22.9	25.6	31.6	31.2	24.2	28.4	27.8
TeamLease (TEASER)	2,520	2,540	HOLD	4,308	22.5	72.9	88.0	112.1	34.6	28.6	15.4	15.4	16.0	(4.7)	15.1	15.6
Infoedge (INFEDG)	3,727	4,590	HOLD	46,838	35.8	45.5	51.7	104.2	82.0	72.1	4.2	5.4	6.0	3.2	4.1	4.5

*Source: Company, ICICI Direct Research, * merged entity figures as per our calculations*

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