ICICI direct Research

Result Preview

ICICI Securities – Retail Equity Research

April 5, 2023

Muted performance due to seasonality; Tier II likely to post better numbers…

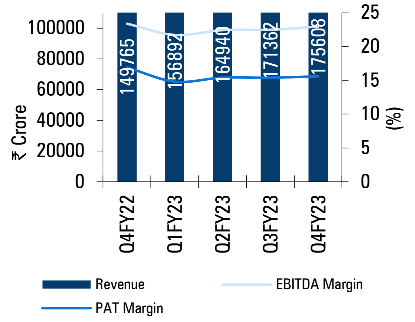
Q4 is seasonally weak for IT companies on account of fewer working days, some additional furloughs in January. Q4 this year has been eventful for the IT sector wherein on the one hand global IT giant Accenture continued to report strong bookings in the outsourcing business (proxy to Indian IT companies) while, on the other hand, we witnessed fast paced events unfolding in the global BFSI space (30-38% revenue mix for top three IT players). Some IT players have clarified that they do not have meaningful exposure to regional US banks, which are in financial trouble. Hence, the impact is expected to be minimal. We do not have the exact break-up of BFSI vertical revenue region wise (i.e. US, Europe, etc), but we do understand that US BFSI contributes ~19-20% of its revenue while the further break-up in terms of insurance, banks, etc, is not available. Consolidation of two large Swiss banks was another big event wherein IT deals at the two companies will likely consolidate in the medium term and may shrink further deal sizes of this account. The macro environment remains challenging for IT companies as decision making has been on the slower side that could be an additional headwind for Q4 revenues and beyond. Clients continue to spend on cloud transformation, which is a multi-year opportunity while cost take out deals continue to form a bigger pie in the deals.

Recent Accenture numbers for the outsourcing business were strong wherein it reported 31.8% YoY growth in outsourcing bookings. Historically, we have observed that new bookings for outsourcing in H2 are always better than H1. If we assume a similar trend for FY23, then we are looking at almost US$40 bn+ of new bookings for the outsourcing business in the year, which is likely to translate to mid-teen growth in FY24. This growth looks quite strong as it is coming on the back of strong growth coming in FY23.

EBIT margins of most companies are expected to decline QoQ as except TCS, LTIMindtree & Coforge, other are expected to report a sequential decline. Major headwinds for the same would-be muted revenues for the quarter. The deal momentum is strong but as explained above conversion may be in a slower lane. 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 achieve its guided revenue growth of 16-16.5% for FY23 while for FY24 we expect the company to guide for mid to high single digit revenue growth in CC terms. We also expect margins of the company to improve in FY24 as easing of supply side challenges, declining attrition, lower sub-contractor cost and other cost optimisation actions will continue to aid in margin improvement.

Topline, Profitability (Coverage Universe)



Dollar growth, QoQ

IT Services	Q4FY23E	Q3FY23	Growth (%)
TCS	7,216.5	7,075.0	2.0
Infosys	4,728.9	4,659.0	1.5
Wipro ^	2,817.5	2,803.5	0.5
HCL Tech	3,222.0	3,244.5	(0.7)
Tech M	1,668.3	1,668.3	-
LTIMindtree	1,078.1	1,046.7	3.0
Coforge	260.5	251.7	3.5
Staffing (in ₹)			
Teamlease	2,046.5	2,008.3	1.9
Info Edge	565.7	555.2	1.9

^ IT services

Top Picks

LTIM, Coforge

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We expect IT companies to post QoQ CC revenue growth between -1% and 2.5% for Q4FY23. Among Tier I IT companies, we expected TCS, Infosys and HCL Tech (IT services) to post a muted QoQ CC revenue growth of 1%, 0.5% & 1% QoQ, respectively, while Wipro is expected to report QoQ revenue decline of 0.5%. Among tier II IT companies, we expect LTIMindtree and Coforge to report a steady QoQ CC revenue growth of 2% & 2.5%, respectively, while Tech Mahindra's revenue is expected to decline by 1%. We expect currency tailwinds of 100 bps for all companies due to GBP & Euro appreciation against the US dollar. We expect QoQ dollar revenue growth between 0.5% and 2% for TCS, Infosys & Wipro while for HCL Tech (IT services) we expect dollar revenues to improve by 2%. In Tier II IT companies we expect Coforge to report QoQ growth of 3.5% on continued strong deal wins in previous quarters while LTIMindtree is expected to report a growth of 3% as furlough impact will fade. TechM is expected to report flattish QoQ growth. In rupee terms we expect TCS, Infosys & Wipro to report QoQ growth at 0.5%-1.9% while HCL Tech is expected to report 0.7% QoQ revenue decline at company level. Among Tier II IT companies, we expect TechM to report flattish revenue growth while LTIMindtree & Coforge are expected to report growth of 2.9% & 4.2%, respectively. We prefer LTIM & Coforge

Teamlease is expected to report weak numbers on EBITDA for the quarter. Revenue, in general staffing, is expected to increase by 2% QoQ. There would be some impact of Degree Apprentice program (DA) cancellation wherein the company may have to reduce the headcount a bit more. Hiring trends have been mixed wherein subdued trends in e-commerce, telecom, emerging startups (more layoffs) continued while some sectors like BFSI, consumer, retail are showing a stable trend. The manufacturing sector is yet to see green shoots. Specialised staffing will continue to impact due to moderated IT hiring. We are anticipating 1% QoQ decline there. Other HR services is likely to see some reversal from muted trends in the last quarter. We expect 10% QoQ increase in revenues resulting in 1.9% QoQ revenue growth at the company level. On EBITDA margins, we expect general staffing margins to decline 25 bps due to lower revenues and impact of DA cancellation while specialised staffing margins are expected to dip by 40 bps. Other HR services margins are expected to pick up and increase by 660 bps QoQ in a seasonally strong quarter. At the company level, we expect margins to decline by 13 bps. For Info Edge, we expect recruitment business to grow 2% QoQ on account of normalising of billings while for 99acres & other business we expect growth of 2% & 0.8% QoQ, respectively. At the company level, we expect muted QoQ revenue growth of 1.9% while on the margins front, we expect it to report 240 bps QoQ decline.

Margins except TCS, LTIM, Coforge likely to dip sequentially

On the margins front, we expect margins of most IT companies to be muted due to headwind such as lower revenue, which despite some cost optimisation levers will impact margins for the quarter. In Tier I, IT companies we expect moderate EBIT margin expansion of 20 bps for TCS (it will likely miss exit margin guidance of 25% in our view) while Infosys, Wipro & HCL Tech are expected to report a margin decline between 20 and 140 bp (IT services margins for HCL Tech are expected to increase QoQ while majority of the margin drag will come from seasonality in P&P business, which is high margin business). In Tier II IT companies, we expect EBITDA margin to decline 10 bps for TechM while LTIMindtree & Coforge are expected to report margin expansion of 170 bps & 120 bps, respectively. LTIM's margin was hit by 100 bps one time integration costs in Q3, which was non-recurring while for Coforge, cost rationalisation at its BPO business is likely aid margin expansion.

Exhibit 1: Estimate for Q3FY23E (₹ crore)

Company	Revenue	Change (%)		EBITDA	Change (%)		PAT	Change (%)	
	Q4FY23E	YoY	QoQ	Q4FY23E	YoY	QoQ	Q4FY23E	YoY	QoQ
HCL Tech	26,503.8	17.3	-0.7	6,016.4	19.1	-5.5	3,719.3	3.5	-9.2
Infosys	38,899.8	20.5	1.5	9,398.0	19.8	0.3	6,577.9	15.7	-0.1
InfoEdge *	565.7	24.2	1.9	206.5	61.3	-4.8	181.7	50.6	-5.2
LTIMindtree	8,868.5	23.2	2.9	1,560.8	7.3	13.5	1,102.5	-0.7	10.2
Coforge	2,143.0	23.0	4.2	402.9	22.3	11.4	260.2	25.3	14.0
TCS	59,362.9	17.3	1.9	15,968.6	15.3	2.7	11,224.5	13.1	3.5
Teamlease	2,046.5	12.6	1.9	29.2	-28.9	-7.8	28.1	-11.3	-3.3
Tech Mahindra	13,723.4	13.3	-0.1	2,127.1	1.9	-0.8	1,277.4	-15.2	-1.5
Wipro	23,494.7	12.0	0.5	4,619.0	8.6	-0.6	3,040.5	-4.9	-0.4
Total	**1,75,608.3**	**17.3**	**1.2**	**40,328.5**	**15.1**	**0.7**	**27,412.1**	**8.0**	**0.3**

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

FY24 revenue, margin outlook, comments on BFSI vertical

In the current quarter the key thing to watch will be the outlook for FY24 revenue & margins with comments of the companies for the outlook of tech spending in BFSI space amid current events in this sector. We also will be watchful on commentary/outlook to be shared by the new management in some of our coverage companies. We expect Infosys to guide for mid-to-high single digit revenue growth for FY24.

Exhibit 2: Company Specific view

Company	Remarks
TCS	Q4 is a seasonally weak quarter due to fewer working days and some furlough impact in January. We also cannot rule out some impact (minor) on TCS' Q4 numbers on account of a surprise change at the top. We expect the company to report 1% CC revenue growth for the quarter. Growth is expected to be driven by continued deal momentum especially in cost take out deals, cloud transformation and some benefits likely coming from vendor consolidation. We expect 100 bps cross currency tailwinds due to GBP and EUR appreciation against US$. Hence, dollar revenues are expected to grow 2% QoQ. We expect rupee revenues to increase 1.9% QoQ on account of stable rupee-dollar movement. We believe TCS will miss target exit EBIT margin range of 25% as lower growth would be an additional headwinds. Hence, we build in only 20 bps QoQ margin expansion (vs. 50 bps implied margin expansion for target exit). We expect BFSI as a vertical and US as a geography likely see some growth moderation in the quarter. **Investor interest: Client budget commentary , strategy of the new CEO on long term growth**
Infosys	Q4 is a seasonally weak quarter due to fewer working days as well as some furlough impact in January. The company reported 17.8% YoY revenue growth in CC for YTDFY23 while the asking rate for annual guidance is not tall i.e. less than 1% in CC as per our calculation. We bake in 0.5% QoQ CC growth for Q4 for the company considering some pockets of slow growth visible. We expect 100 bps cross currency tailwinds due to GBP and EUR appreciation against US$, resulting in US$ growth of 1.5% QoQ. We expect rupee revenues to increase 1.5% QoQ. The company delivered 21.5% margins in YTDFY23. Hence, implied Q4 margins as per our calculations are down QoQ. We bake in 30 bps QoQ decline, which is in line with historical trends. Headwinds for margins are visa costs (annual booking in Q4), fewer working days, lower benefit of rupee dollar movement as well as some impact of seasonal weakness and furloughs, etc. We do not see any issues for achieving FY23 targets of both revenue and EBIT margin. We expect the company to guide for mid to high single digit growth for FY24 while margins are likely to improve from FY23 numbers. **Investor Interest: Client budget commentary, FY24 revenue and EBIT margin guidance**
Wipro	Q4 is seasonally weak due to fewer working days and some furlough impact in January. In IT services, the company is witnessing incremental pressure due to weak macros among some pockets such as US retail, Technology companies, investment banking, etc, which are likely to impact Q4 revenues. We bake in 0.5% QoQ decline in revenues in CC for the quarter while we build in 100 bps cross currency tailwinds for the quarter resulting in +0.5% QoQ increase in dollar revenues for the quarter. Rupee revenues are expected to increase 0.5% QoQ for the company. We expect Wipro to report 30 bps QoQ EBIT margin decline in IT services despite some tailwinds available in terms of moderation of attrition etc on account of weak revenues, lower utilisation, some incremental expenses in terms of facility, etc. The company is also witnessing delay in decision making leading to delay in deal closures as some cautious stance being taken by clients. **Investor interest: Client budget commentary, growth & margin guidance for FY24**
HCL Tech	Q4 is seasonally a weak quarter due to fewer working days and furlough impact in January. We expect HCL's IT services business to report 1% CC revenue growth for the quarter be aided by ramp up of deals but at the same time weakness mentioned by the company in their recent analyst meet in Hi-Tech and Media & Entertainment verticals are likely to have some impact in Q4.We expect ER&D business to continue its growth momentum and expect it to grow 2% sequentially. P&P business will likely impact QoQ on seasonality. We expect 20% decline in revenues. At the company level, it expects to report 0.7% de-growth in revenues. On the margin side, we expect IT services margins to improve on pricing discipline, operational efficiencies while margins for P&P business are likely to see a sharp decline sequentially on seasonality. As a result, we expect company level EBIT margins to decline 140 bps QoQ. The deal pipeline remains healthy, which is well distributed across large and medium sized deals. Deal signing has seen some moderation, especially in the Europe region where conversion of deals from pipeline to TCV may see some delay for the next couple of quarters. The US region is expected to do well on steady deal momentum. **Investor interest: Client budget commentary, growth & margin guidance for FY24**
Tech Mahindra	Q4 is seasonally a weak quarter due to fewer working days and extended furloughs in January. For Q4, we expect TechM to report 1.0% CC QoQ revenue decline on i) extended furlough in January ii) deterioration of demand iii) US$15 mn impact of portfolio re-alignment (exiting low margin markets), etc. On account of 100 bps tailwinds, we expect dollar revenues to be flat QoQ while rupee revenues are likely to decline 0.1% QoQ. The demand environment is challenging, which will likely reflect in their Q4 order book, which could be lower than guided range of US$700mn to US$1 bn. The company do not have exposure to regional banks while more than 50% of their BFSI vertical is towards insurance. We expect 20 bps sequential EBIT margin decline for Q4 due to revenue dip and elevated sub-contractor costs, etc. **Investor interest: Client budget commentary, FY24 outlook on revenue & margins**

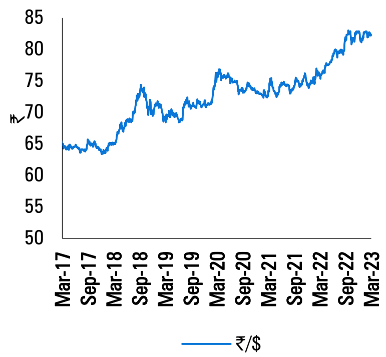
Source: Company, ICICI Direct Research

EBIT/EBITDA margin impact

EBIT margins	Q4FY23E	Q3FY23	Change (bps)
TCS	24.7	24.5	17
Infosys	21.2	21.5	(30)
Wipro ^	15.7	15.9	(19)
HCL Tech	18.2	19.6	(141)
EBITDA margins			
Tech M	15.5	15.6	(11)
LTIMindtree	17.6	15.9	165
Coforge	18.8	17.6	122
Internet & Staffing (in %)			
Teamlease	1.4	1.6	(15)
Info Edge	36.5	39.1	(255)

^ *IT services*

$/₹



$ vs. global currencies

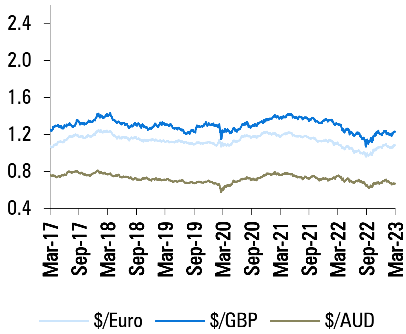


Exhibit 3: Company Specific views

Company	Remarks
LTIMindtree	LTIM's Q3 performance was impacted by furloughs while in Q4, we expect the company to report descent numbers as the impact of furloughs eases. We expect the company to report 2% CC revenue growth on sequential basis factoring some impact of deteriorating macros while we expect outperformance of erstwhile LTI and Mindtree with respect to peers on revenue growth in Q4 continues. Due to cross currency tailwinds of 100bps , we expect the company to report 3% QoQ growth in dollar revenue while in rupee terms, it is expected to report 2.9% QoQ revenue growth. On EBIT margin, we expect the company to report 140bps QoQ expansion, largely on maximum impact of one time integration costs already taken in Q3 (100bps) and reversal of some impact of furloughs in Q3. **Investor interest: Client budget commentary, FY24 outlook on revenue & margins**
Info Edge	Info edge is expected to report muted numbers as hiring trends are not encouraging across IT sector. On account of normalising billings in the last couple of quarters, we expect recruitment solutions business to report 2% QoQ revenue growth. On 99acres, the company has reported decline in billings in the last quarter and it is likely to have an impact on Q4 revenues. We are building in 2% QoQ revenue growth in 99acres. We anticipate flat revenues for other business for the quarter, resulting into overall revenues to grow by 1.9%. On margin we expect certain moderation in recruitment solutions business which is as per historical trends on account of some deferment in subscription renewals. For 99acres and other business we expect margins to be at the similar levels as that of last quarter resulting into overall margins for the company to decline by 250bps QoQ.
Coforge	Coforge is expected to post steady results for the quarter. The company had given 22% CC growth guidance for FY23, it has already reported strong growth in 9MFY23 and which means that asking rate for Q4 to be in the range of 3 to 3.5% in CC . We are building in 2.5% CC revenue growth for Q4 taking some impact of their exposure to SVB (low single digit). We expect the company to post 3.5% growth in dollar terms, factoring 100bps tailwinds while rupee revenues are expected to grow by 4.2% for the quarter. The growth is expected to be broad based across BFS, Insurance, Travel verticals due to strong deal signing especially in the BFSI verticals in the last few quarters. On Margin front, we are building 120bps margin expansion for the quarter better revenue growth, continued focus on offshoring, utilisation improvement as well as savings on rationalisation of BPO business headcount (rationalisation took place in Q3 while the impact will be visible in Q4 as per management). **Investor interest: Client budget commentary, FY24 outlook on revenue & margins**
Teamlease Services	Teamlease is expected to report weak numbers on EBITDA for the quarter. Revenue in general staffing is expected to increase by 2% QoQ, there would be some impact of Degree Apprentice program (DA) cancellation wherein the company might have to let go few more headcount. Hiring trends have been mixed wherein subdued trends in E-commerce, Telecom, emerging startups (more layoffs) continued while some sectors like BFSI, consumer, retail are showing stable trend. Manufacturing sector yet to see green shoots. Specialised staffing will continue to impact due to moderated IT hiring and we are anticipating 1% QoQ decline there. Other HR services likely to see some reversal from muted trends in the last quarter, we expect 10% QoQ increase in revenues resulting 1.9% QoQ revenue growth at the company level. On EBITDA margins, we expect general staffing margins to decline by 25bps due to lower revenues and impact of DA cancellation while specialised staffing margins are expected to dip by 40bps. Other HR services margins are expected to pick up and increase by 660bps QoQ in seasonally strong quarter. At company level, we expect margins to decline by 13bps.

Source: Company, ICICI Direct Research

Exhibit 4: ICICI Direct Coverage universe (IT)

Company Name	CMP	TP (₹)	Rating	Mcap (₹)	EPS (₹)			P/E			RoCE (x)			RoE(x)		
					FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E
HCL Tech (HCLTEC)	1,098	1,220	BUY	2,97,960	49.8	53.6	59.2	22.0	20.5	18.6	24.2	26.2	27.7	21.8	22.2	23.3
Infosys (INFTEC)	1,411	1,730	BUY	5,90,657	52.1	60.7	70.8	27.1	23.2	19.9	36.0	36.2	39.1	29.2	30.1	32.3
TCS (TCS)	3,199	3,780	BUY	11,70,531	104.7	118.5	133.4	30.5	27.0	24.0	51.4	50.1	49.3	43.0	42.6	41.5
Tech M (TECMAH)	1,103	1,130	HOLD	1,07,302	63.1	63.0	74.0	17.5	17.5	14.9	22.5	20.9	21.8	20.7	18.6	19.5
Wipro (WIPRO)	368	455	BUY	2,01,711	23.5	23.3	26.4	15.7	15.8	13.9	18.8	18.9	20.5	19.6	18.7	20.3
LTIM (LTINFO)	4,739	5,320	BUY	1,40,178	133.4	153.9	181.0	35.5	30.8	26.2	34.9	33.8	34.2	27.6	27.2	27.6
Coforge (NIITEC)	3,849	4,870	BUY	23,442	106.5	148.9	172.7	36.1	25.9	22.3	25.6	31.8	31.5	24.2	28.5	28.0
TeamLease (TEASER)	2,203	2,335	HOLD	3,766	22.5	73.7	77.5	98.0	29.9	28.4	15.4	15.5	14.3	(4.7)	15.3	14.0
Infoedge (INFEDG)	3,695	3,265	HOLD	46,436	35.8	52.1	54.6	103.3	70.9	67.7	4.3	6.3	6.3	3.2	4.7	4.8

Source: Company, ICICI Direct Research

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Reduce: -15% to -5%;

Sell: <-15%

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