

June 27, 2022

Price hike to be watched...

In our last update released in October 2021 ([link](#)) we had opined that IT companies were likely to benefit in the medium to long term from pricing discipline albeit in a gradual manner. Our analysis was based on the demand supply mismatch that the companies were facing. IT companies had been incurring elevated employee expenses in terms of retention costs, increase in frequency of salary hikes, etc. It was also evident that subcontractor costs for IT companies were also inching up on account of travel restrictions globally.

On the demand side, the companies were upbeat and continued to maintain robust demand outlook due to continued momentum in deal wins. To fulfil the demand, they have started hiring at elevated levels. If we look at the hiring trend across the top companies, the companies have hired more employees in FY22 than in the last three years combined.

However, the recent correction in IT stocks could be an indication that the revenue growth in FY23 could be healthy but it may be in the slow lane from FY24 onwards due to possible recession in the US, which subsequently could lead to a reduction in tech spending from some of their biggest clients. In this context, LTI had given cautious commentary on the growth outlook in Q4, while other companies were still upbeat on demand. We believe that growth outlook, more colour on attrition in Q1FY23 is expected to set the tone for FY24 numbers.

As far as price hike is concerned, it has been a part of active discussions of companies with their clients and some companies are getting price hikes in a few pockets. However, any meaningful price hike is yet to come and will take some more time to reflect that in numbers.

With the recent correction in the stocks, we upgrade TCS, Infosys to BUY from HOLD. We value TCS at ₹ 3835, assigning 29x FY24EPS while we value Infosys at ₹ 1,745 assigning 26x FY24 EPS. We maintain **BUY** at our remaining two top picks i.e. Coforge & Persistent Systems with revised target prices of ₹ 4,550 and ₹ 4065 assigning 26x and 29x multiple on FY24 earnings, respectively. We also teak estimates of few other companies and also revised target prices after recent correction (Refer Exhibit 4 & 5)

Hiring, attrition trend

The net hiring pace for IT companies has increased in the last three years. Net hiring in top seven companies in FY22 vs. FY20 and FY21 combined was in the ratio of 1.7x to 4x while if we go back one more year and compare it with FY19, FY20 and FY21 combined together is in the range of 1.1 to 2.2x except for TechM wherein the ratio was 3.7x. LTM attrition has been at elevated levels since FY21.

Fresher hiring comments

Commentary on hiring	
Infosys	We recruited 85K freshers in FY22, 50K target for FY23
TCS	We recruited 100K freshers in FY22, 40K target for FY23
Wipro	It added 19K freshers in FY22, planning to double fresher hiring in FY23
HCL Tech	We have added 20K freshers in FY22, we are also looking to add 2000 graduates in US market over next 2-3 years, which is over and above that 20K
Tech M	Added 10K freshers in FY22, we will add substantially more next year
LTI	It added 5.2K freshers in FY22, planning to add 6.5K freshers FY23
Mindtree	Have been adding 1.5 K freshers every quarters and we would continue with this pace

Sector View: Neutral

Top Picks in IT space

Company	CMP (₹)	Target Price (₹)		% Upsid	Rating	
		Old	New		Old	New
TCS	3,313	4,120	3,835	16	HOLD	BUY
Infosys	1,475	2,000	1,745	18	HOLD	BUY
Coforge	3,790	4,370	4,550	20	BUY	BUY
Persistent	3,459	5,075	4,065	18	BUY	BUY

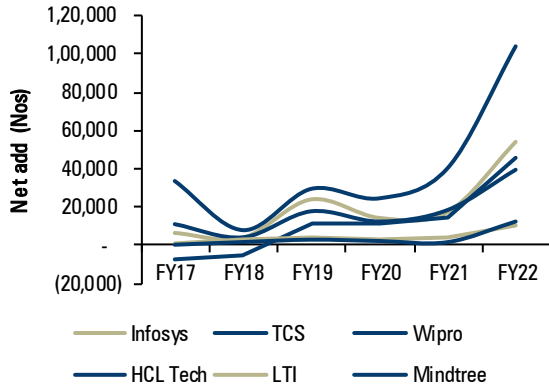
Key risks to our call

- Slower than expected revenue growth due to higher than expected tech spend cut in client spending
- Longer than expected attrition which would impacts margins

Research Analysts

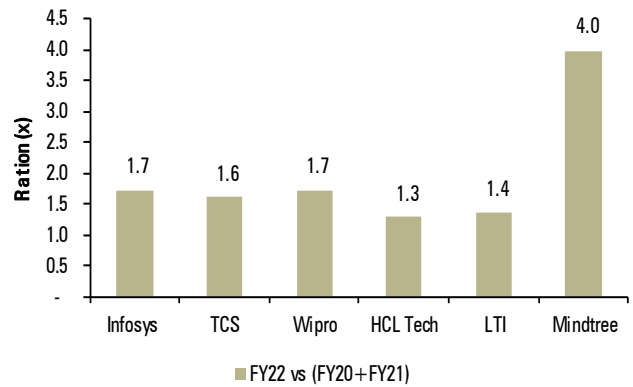
Sameer Pardikar
sameer.pardikar@icicisecurities.com

Exhibit 1: Net hiring over the years



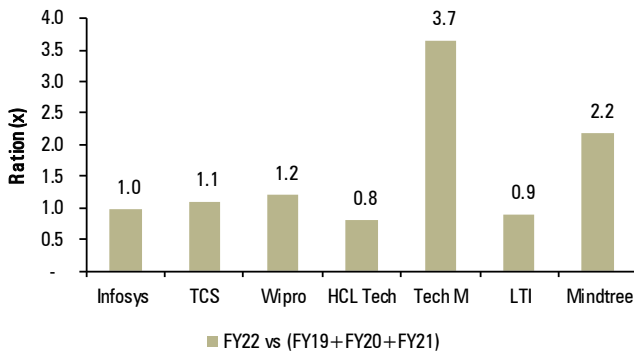
Source: Company, ICICI Direct Research

Exhibit 2: Net hiring in FY22 vs. previous two years combined



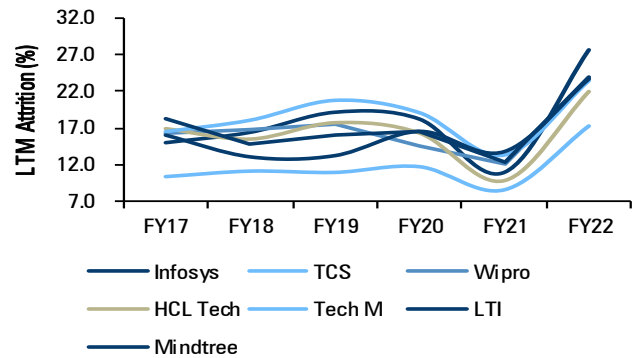
Source: Company, ICICI Direct Research

Exhibit 1: Net hiring in FY22 vs. previous three years combined



Source: Company, ICICI Direct Research

Exhibit 2: LTM attrition (%)



Source: Company, ICICI Direct Research

Top bets in IT Coverage Universe

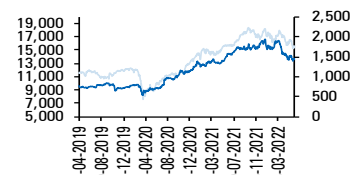
Infosys (INFTEC)

Infosys is the leading IT services company catering to BFSI, retail, communication, manufacturing & hi-tech verticals. The company generates 58% of revenue from digital technologies. Infosys has a strong workforce of 314,000 across the globe. Geography wise, North America contributes 61.4% of revenue while Europe market contributes 25%. India and RoW contribute the rest. In terms of verticals, BFSI contributes 31.3% of revenue mix, followed by retail & communication, which contribute 14.3% and 12.8%, respectively. E&U, manufacturing, hi-tech, life sciences contribute the rest.

We turn positive on Infosys amid undemanding valuations (after recent correction in the stock i. e. ~30% from top) as we believe that US recession related fears and consequent slow down expectations in US market seem to be largely priced in. The company continues to focus on large deal TCV (grew 3x in FY18-22) and account expansion (US\$100 mn clients increased from 20 in FY18 to 38 in FY22). The company has guided for 13-15% CC revenue growth. We expect Infosys to achieve the growth as per guidance, moderation in revenues in FY24 cannot be ruled out. Hence, we trim our FY23E, FY24E revenue numbers factoring in slowdown in FY24E.

We upgrade Infosys to BUY valuing it at ₹1,745 i.e. 26x PE on FY24E EPS.

Price Chart



Particulars

Particular	Amount
Market CAP (₹ Crore)	6,27,887.2
Total Debt	-
CC&E (₹ Crore)	24,145.0
EV (₹ Crore)	6,03,742.2
52 week H/L	1953/ 1367
Equity capital	2,098.0
Face value	₹ 5

Exhibit 3: Financial summary

₹ Crore	FY20	FY21	FY22	5 year CAGR (FY17-22)	FY23E	FY24E	2 years CAGR (FY22-24E)
Net Sales	90,791	1,00,472	1,21,641	12.2%	1,38,526	1,53,744	12.4%
EBITDA	22,268	27,890	31,492	8.4%	34,435	38,987	11.3%
EBITDA Margins (%)	24.5	27.8	25.9		24.9	25.4	
Net Profit	16,595	19,351	22,111	6.2%	24,684	28,485	13.5%
EPS (₹)	38.9	45.6	52.1		58.2	67.1	
P/E	37.1	31.7	27.7		24.8	21.5	
RoNW (%)	25.2	25.2	29.2		29.2	31.2	
RoCE (%)	30.8	31.7	36.0		35.2	37.7	

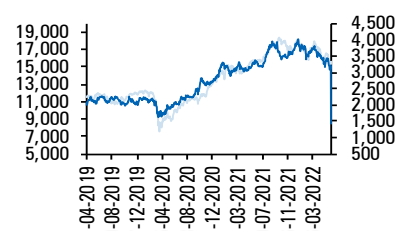
Source: Company, ICICI Direct Research

Tata Consultancy Services (TCS)

Tata Consultancy Services (TCS) is the flagship company of the Tata group. It is one of the leading IT services company catering to BFSI, retail & CPG, manufacturing, life sciences & healthcare, etc. The company generates 32% of revenue from BFSI. The company has a strong workforce of 592,000 across the globe. Geography wise, North America contributes 50.5% of the revenue while UK & Continental Europe market contributes 15.9% and 16%, respectively. In terms of verticals apart from BFSI, retail & CPG contribute 15.1% of revenue mix, followed by manufacturing, technology & services contributing 9.9%, 8.7%, respectively.

We turn positive on TCS as the company is a key beneficiary of multiyear growth in digital technologies amid broader set of capabilities to address large portion of IT spending pool. Over the last 10 years, global IT & ITes market grew 1.4x while TCS grew by 2.5x indicating market share gains. The company continues to focus on client expansion (US\$100 mn, US\$50 mn, US\$20 mn clients increased from 38, 97, 207 in FY18 to 58, 120, 268, respectively, in FY22). Industry leading EBIT margins and shareholder friendly capital allocation policy also made it stand out. We expect strong revenue growth in FY23E while some moderation in revenues in FY24 cannot be ruled out. Hence, we trim our FY23E, FY24E revenue numbers factoring potential slowdown in FY24E. **We upgrade TCS to BUY valuing it at ₹3,835 i.e. 29x PE on FY24E EPS.**

Price Chart



Particulars

Particular	Amount
Market Capitalization (₹ Crore)	12,25,440.0
Total Debt (₹ Crore)	7,818.0
Cash and equivalents (₹ Crore)	48,483.0
EV (₹ Crore)	11,94,746.0
52 week H/L	4045/ 3023
Equity capital (₹ Crore)	366
Face value	₹ 1

Exhibit 1: Financial summary

Financials	FY20	FY21	FY22P	5 year CAGR (FY17-22P)	FY23E	FY24E	2 year CAGR (FY22-24E)
Net Sales	1,56,949	1,64,177	1,91,754	12.9	2,14,348	2,36,378	11.0
EBITDA	42,110	46,546	53,057	13.2	58,946	64,768	10.5
EBITDA Margins (%)	26.8	28.4	27.7		27.5	27.4	
Net Profit	32,340	32,430	38,327	9.9	43,075	48,061	12.0
EPS (₹)	86.2	86.7	104.7	9.9	117.7	131.3	
P/E	38.3	37.7	31.6		28.1	25.2	
RoNW (%)	38.4	37.5	43.0		42.7	41.2	
RoCE (%)	44.4	45.9	51.4		50.2	48.9	

Source: Company, ICICI Direct Research

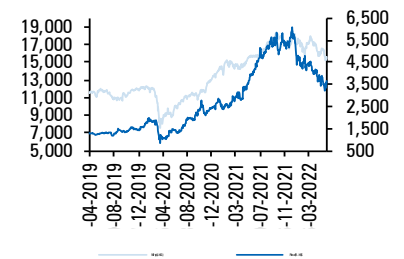
Top bets in IT Coverage Universe

Coforge (NIITEC)

Coforge (erstwhile NIIT Technologies) started in 1984 and split out of its parent company in 2004-05. We maintain our positive stance on Coforge amid undemanding valuations (after recent correction in the stock i.e. ~38% from top). The company generates 28% of the revenue from insurance while banking and travel forms 26% and 19%, respectively. The company has a strong workforce of 22,500 across the globe. Geography wise, RoW contributes 52% of revenue while Americas & EMEA market contribute 13% and 35%, respectively. Service line wise Application development & management (ADM) contributes one-fourth of revenue while the rest comes from BPM, product engineering, intelligent automation, etc.

The company is aspiring to reach US\$2 bn revenues in the medium term as the order book remains healthy. The company's order book has almost doubled in the last four years from US\$646 mn to US\$1.1 bn in FY22 as it has been focusing on large deals (it won one US\$100 mn deal and three US\$50 mn deals in FY22). It has the lowest attrition among our coverage companies at 17.7% (behind TCS). We are keeping our estimate unchanged while increase target multiple. We maintain **BUY** on Coforge valuing it at ₹ 4550 i.e. 26x PE on FY24E.

Price Chart



Particulars

Particular	Amount
Market Capitalisation (₹ Cro)	23,573
Total Debt (₹ Crore)	336.5
Cash & Investment (₹ Crore)	453.5
EV (₹ Crore)	23,456
52 week H/L	6133/ 3243
Equity capital	60.9
Face value	10.0

Exhibit 2: Financial summary

Financials	FY20	FY21	FY22	5 Year CAGR (FY17-22)	FY23E	FY24E	2 year CAGR (FY22-24E)
Net Sales	4,184	4,663	6,432	18.1	7,972	9,123	19.1%
EBITDA	720	786	1,115	18.1	1,523	1,779	26.3%
EBITDA Margins (%)	17.2	16.9	17.3		19.1	19.5	
Net Profit	444	456	662	12.7	918	1,087	28.2%
EPS (₹)	71.4	73.3	106.5		147.8	175.0	
P/E	53.1	51.7	35.6		25.7	21.7	
RoNW (%)	18.5	18.5	24.2		28.4	28.3	
RoCE (%)	23.0	23.3	25.6		31.5	31.8	

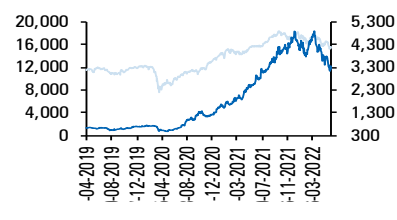
Source: Company, ICICI Direct Research

Persistent systems (PERSYS)

Persistent System (Persistent) offers cloud, data, product & design led services to BFSI, healthcare & hi tech verticals. The company generates 31.6% of the revenue from BFSI. Persistent has a strong workforce of 18,599 across the globe. Geography wise North America contributes 78.8% of revenue while Europe, India & RoW market contributes 8.7%, 10.6% and 1.9%, respectively. In terms of client profile top client, top five clients and top 10 clients contribute 18.4%, 38.7%, 47.7%, respectively.

The company is aiming to reach US\$1 bn revenue in six to eight quarters. It has acquired five companies in FY22 building capabilities in payments, cloud, etc, while the company is not shying away from acquisitions in coming years as well as the management focus is on growth over margin. TCV remained healthy at US\$1.2 bn. The company has recently hired few senior team members (i.e. chief people officer, chief of operations, etc). Persistent maintained 14% EBIT margin guidance for FY23E, taking some cost increase in employee costs. We are keeping our estimate unchanged while cut target multiple. We maintain **BUY** on Persistent valuing it at 4065 i.e. 29x PE on FY24E.

Price Chart



Particulars

Particular	Amount
Market Cap (₹ Crore)	26,515
Total Debt (₹ Crore)	600
Cash & Invests (₹ Crore)	1,349
EV (₹ Crore)	25,766
52 week H/L	4987 / 2584
Equity capital	76.4
Face value	10.0

Exhibit 3: Financial summary

(₹ Crore)	FY20	FY21	FY22	5 Year CAGR (FY17-22)	FY23E	FY24E	2 Year CAGR (FY22-24E)
Net Sales	3,566	4,188	5,711	14.7%	7,292	8,750	23.8%
EBITDA	493	683	958	16.1%	1,286	1,569	28.0%
EBITDA Margins (%)	13.8	16.3	16.8		17.6	17.9	
Net Profit	340	451	690	18.0%	882	1,071	24.6%
EPS (₹)	44.4	59.0	90.3		115.5	140.2	
P/E (x)	77.9	58.6	38.3		30.0	24.7	
RoCE (%)	18.5	21.6	23.1		26.3	28.0	
RoE (%)	14.3	16.1	20.5		22.7	23.7	

Source: Company, ICICI Direct Research

Exhibit 4: TP & rating change

Company	CMP (₹)	New TP (Rs)	Upside (%)	Earlier TP (₹)	Earlier Target P/E multiple	New Target P/E multiple	Old rating	New rating
TCS	3,313	3,835	16	4,120	31	29	HOLD	BUY
Infosys	1,475	1,745	18	2,000	28	26	HOLD	BUY
Wipro	425	465	10	575	21	17	HOLD	HOLD
HCL Tech	992	1,090	10	1,220	22	20	HOLD	HOLD
Tech M	1,007	1,190	18	1,410	17	15	BUY	BUY
LTI	4,164	4,480	8	4,990	30	27	HOLD	HOLD
Mindtree	2,962	3,195	8	3,700	29	25	HOLD	HOLD
Coforge	3,790	4,550	20	4,370	25	26	BUY	BUY
Mphasis	2,339	2,730	17	3,420	30	24	BUY	BUY
Persistent	3,459	4,065	18	5,075	36	29	BUY	BUY

Source: Company, ICICI Direct Research

Exhibit 5: Change in Estimates

	FY23E EPS	FY24E EPS	FY23E EPS	FY24E EPS	FY23E	FY23E	Revenue CAGR (FY22-24E) in ₹ terms	Revenue CAGR (FY22-24E) in ₹ terms	FY23E EBIT margin (%)	FY24E EBIT margin (%)	FY23E EBIT margin (%)	FY24E EBIT margin (%)	FY23E	FY24E
TCS	119.3	133.0	117.7	131.3	(1.3)	(1.2)	12.5	11.0	25.1	25.0	25.1	25.2	0 bps	20 bps
Infosys	61.0	71.1	58.2	67.1	(4.6)	(5.6)	13.4	12.4	23.0	23.5	22.0	22.5	-100 bps	-100 bps
Wipro	24.5	27.4	24.5	27.4	-	-	11.8	11.8	16.8	17.0	16.8	17.0	0 bps	0 bps
HCL Tech	51.4	55.4	50.8	54.6	(1.0)	(1.5)	12.8	12.0	17.7	17.6	17.7	17.6	0 bps	0 bps
Tech M	73.4	83.0	68.5	79.5	(6.7)	(4.3)	12.8	11.9	14.5	14.5	13.7	14.0	-80 bps	-50 bps
LTI	140.3	165.9	140.3	165.9	(0.0)	-	16.1	16.1	16.2	17.2	16.2	17.2	0 bps	0 bps
Mindtree	109.8	127.9	109.8	127.9	-	-	19.4	19.4	17.5	17.5	17.5	17.5	0 bps	0 bps
Coforge	147.8	175.0	147.8	175.0	-	-	19.1	19.1	15.6	16.0	15.6	16.0	0 bps	0 bps
Mphasis	90.8	113.8	90.8	113.8	-	-	19.9	19.9	15.0	16.0	15.0	16.0	0 bps	0 bps
Persistent	115.5	140.2	115.5	140.2	-	-	23.8	23.8	14.4	14.7	14.4	14.7	0 bps	0 bps

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, Akruiti Trade Centre,
Road No 7, MIDC,
Andheri (East)
Mumbai – 400 093
research@icicidirect.com

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