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Initiating coverage

Technology

INDIA



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IT's time for multiple contraction!

Comparison of two-year rolling returns of Nifty IT and Nifty 50 over the past 20 years suggests that Nifty IT has never outperformed Nifty 50 for more than ~2.5 years (vs ~3.5 currently). Nifty IT has seen the highest rerating among all indexes from 17x in Dec'19 to 28.6x now (+68%) vs Nifty 50 multiple expansion of just ~8%.

Taking notes from the past, we believe Nifty IT should now start underperforming Nifty 50 due to slowing revenue growth, margin headwinds, elevated consensus expectations and valuations, and weak macro environment. Higher inflation will lead to postponement of discretionary spends, and focus on cost optimisation will increase. Higher focus on cost will likely lead to dampening of tech budgets and reduce discretionary spending. Even Gartner reduced forecast of CY22 IT spending to grow at 4% (vs 5.1% earlier) and that of IT services to grow at 6.8% (v/s 7.9%). We believe most tailwinds for margins will be backended – e.g. pyramid optimisation, pricing power, reduction in sub-con costs – and Nifty IT index might end up with negative returns in FY23E. In spite of rising bond yields, inflation and weak macro environment, we are amazed to see the resilience of Nifty IT index (up ~11% in a month). As compared to FY22, FY23E is missing large-deal contributions, which we estimate bring 2-3% of incremental revenues to companies.

With Indian IT sector already trading at 28x 1-year forward P/E vs past 10-year P/E of 18x, we believe much of the growth and earnings expectations (digitization, cloud migration etc.) over next three years are factored into share prices. Rising inflation (price & wage) compounded with talent shortages will likely dampen IT spending budgets going forward. We also like to note that as of now none of the companies globally has signaled demand compression – we believe they may signal out with 2-3 quarter lag. Given this background, we remain cautiously optimistic after our three-year-long bullish stance on the sector and selective in our idea generation. We initiate/reinitiate coverage on 18 stocks with 2 BUY, 8 HOLD, 3 ADD, 4 REDUCE and 1 SELL. Risks: INR depreciation, margin resilience, return of large deals.

- ▶ **NSE IT should start underperforming going forward.** Our comparison of NSE IT's two-year rolling returns vs that of Nifty 50 for past 20 years shows that NSE IT has never outperformed Nifty 50 for more than ~2.5 years. An exception is the current outperformance of NSE IT over Nifty from mid-CY18 (~3.5-year duration until now). Against this backdrop, we see a high likelihood of NSE IT strongly underperforming Nifty 50 in FY23E. We believe this extra run-up (1.5 years) is also led by lower cost of equity, excessive cost savings and strong pent-up demand.
- ▶ **Correlation with S&P 500 revenues / US GDP growth suggests IT revenues should moderate.** Our analysis suggests that for past 10+ years, Indian IT services revenue growth has moved in tandem with growth in S&P 500 revenue. Going forward, consensus S&P 500 revenue growth is expected to moderate to 8%/5% YoY in CY22E/CY23E vs 17% YoY growth in CY21, and this may result in moderation in technology spends. Further, we found that IT services revenue growth trend is correlated with US GDP growth as well. Bloomberg consensus expects moderation in US GDP growth to 9%/5% YoY in CY22E/CY23E vs 10% YoY in CY21. Given our forecast for slowdown in revenue and EPS growth in FY22-FY24E, we expect multiples of Indian IT services to normalise going forward. Also, our analysis suggests in IT companies forward *P/E multiple has a strong correlation with revenue growth*.

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- ▶ **Elevated margin pressure will further create headwinds for multiples:** We believe the demand environment will remain strong in the medium term, but we expect massive pressure on margins in H1FY23E, which will again stop earnings upgrade. Inflation in the US has risen to record highs with US CPI Urban consumer index growth of 7.9% YoY in Feb'22 vs 2% average growth in US inflation index for past 10 years – which will lead to further increase in onsite wage inflation. Talent shortage will continue to put pressure on demand fulfillment in spite of decadal strong hiring trend last year. We believe most tailwinds for margins will be backended – e.g. pyramid optimisation, pricing power, reduction in sub-con costs.
- ▶ **Multiples unlikely to rerate further:** We estimate revenue CAGR of 12%/19%/19% and EPS CAGR of 13%/22%/20% for tiers-1, 2 & ER&D companies over FY22-FY24E. With the sector currently trading at 28x, we believe the street has already factored-in EPS expansion due to revenue growth acceleration. As compared to FY22, FY23E too is missing large-deal contributions, which we estimate bring ~2-3% of incremental revenues to companies. Multiples are unlikely to rerate given the impending margin pressures and potential slowdown in discretionary spends due to macro reasons. Additionally, rising interest rates are driving up cost of equity and should put pressure on stock prices.

Our estimates on average are 4-6% below consensus estimates as we have assumed lower revenue growth and higher margin pressure as compared to consensus estimates. We believe there will be a series of EPS downgrades because of slowing revenue momentum and elevated margin pressures.

- ▶ We remain cautiously optimistic after our three-year-long bullish stance on the sector and selective in our idea generation. **We initiate/reinitiate coverage on 18 stocks with 2 BUY, 8 HOLD, 3 ADD, 4 REDUCE and 1 SELL.** We have BUY rating on Coforge and Mphasis (fastest growing) given their favorable risk-reward and as they are the only IT companies whose margins can expand in FY23E. We are impressed with the performance of PSYS and MTCL both on strategy of growth, margins, & TCV; we assign HOLD rating only because of elevated valuations and we believe they should be considered to be added on dips.
- ▶ We assign REDUCE rating on Wipro & INFY given their high PEG multiples and slowing revenue/earnings growth ahead. Though HCLT has been an underperformer since last one year, only cheap valuations led us to assign HOLD rating for the stock. TECHM has been a consistent performer since last one year, but increased acquisitions and moderating margin performance along with favorable valuations led us to assign HOLD rating on the stock.

In this detailed report, we have highlighted the positive and negative industry data points, which lead us to believe a multiple contraction cycle is beginning.

Table 1: Valuations

Companies	Rating	Target Price (Rs)	Target Multiple (x)	USD Revenue Growth (%)			EBIT Margin (%)			EBITDA Margin (%)			EPS (Rs)		
				FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E
TCS	HOLD	3,519	27.0	15.9	11.0	10.1	25.3	24.8	25.0	27.7	27.2	27.4	103.6	116.7	130.3
Infosys	REDUCE	1,628	24.0	20.6	13.1	11.7	23.3	22.6	23.3	26.2	25.4	26.1	51.9	57.7	67.8
Wipro	REDUCE	548	20.0	27.2	12.5	11.0	17.1	16.1	17.3	21.1	20.0	21.1	21.6	23.4	27.4
HCLT	HOLD	1,177	19.0	12.8	11.0	11.2	19.0	18.9	19.5	23.9	23.6	23.9	49.3	53.4	62.0
TechM	HOLD	1,502	19.0	17.4	16.2	11.6	14.9	14.2	14.6	18.2	17.9	18.3	62.6	68.7	79.1
LTI	HOLD	5,921	32.0	26.5	21.6	17.7	17.3	17.3	18.0	19.5	19.4	20.1	131.2	150.1	185.0
Mindtree	HOLD	4,266	32.0	31.1	21.9	15.5	18.3	17.5	17.8	20.6	20.0	20.3	97.7	111.8	133.3
Mphasis	BUY	3,659	32.0	21.7	20.2	14.8	15.2	15.8	16.1	17.7	17.9	18.1	75.6	95.0	114.3
Coforge	BUY	5,209	30.0	37.5	20.2	17.0	14.4	15.3	15.3	17.9	19.3	19.5	109.9	144.4	173.6
Persistent	HOLD	4,515	33.0	34.8	29.8	18.4	13.7	14.1	14.5	16.6	17.0	17.4	87.7	112.7	136.8
Zensar	HOLD	400	16.0	14.9	17.4	14.9	11.2	11.9	13.0	15.6	15.9	17.0	16.5	19.6	25.0
Sonata	ADD	904	18.0	28.5	19.7	17.4	8.1	8.3	8.4	8.9	9.0	9.1	35.9	43.5	50.2
BirlaSoft	HOLD	508	22.0	16.1	18.6	15.5	13.4	12.9	14.0	15.3	14.9	16.0	16.2	18.4	23.1
Newgen	ADD	573	24.0	14.5	21.0	22.0	22.1	22.4	22.5	24.6	24.9	25.0	18.9	23.3	28.4
Tata Elxsi	SELL	4,875	40.0	34.1	25.9	23.2	28.8	25.7	25.5	30.8	27.7	27.5	88.2	103.4	128.3
LTTS	REDUCE	4,413	34.0	19.9	19.4	17.7	18.1	17.9	18.0	21.4	21.1	21.1	90.5	109.5	129.8
Cyient	ADD	1,025	18.0	9.0	10.4	13.1	13.5	13.5	13.7	17.8	18.1	18.3	44.2	49.4	57.0
KPIT	REDUCE	535	34.0	19.8	20.3	19.5	12.9	13.5	14.0	17.9	18.5	19.0	10.0	12.6	15.7

Source: I-Sec research

Table 2: We are below consensus estimates in most of the companies...

Company	Revenue Growth (%)						EBIT margin (%)						EPS (Rs)					
	Our Estimates		Cons Estimates		Difference		Our Estimates		Cons Estimates		Difference		Our Estimates		Cons Estimates		Difference	
	FY23	FY24	FY23	FY24	FY23	FY24	FY23	FY24	FY23	FY24	FY23	FY24	FY23	FY24	FY23	FY24	FY23	FY24
TCS	11.0%	10.1%	14.1%	11.6%	-310	-160	24.8%	25.0%	25.6%	25.6%	-70	-60	117	130	120	135	-3%	-4%
Infosys	13.1%	11.7%	16.9%	12.9%	-380	-120	22.6%	23.3%	23.7%	23.9%	-120	-70	58	68	64	73	-9%	-7%
Wipro	12.5%	11.0%	13.7%	13.6%	-120	-260	16.1%	17.3%	17.9%	18.0%	-180	-80	23	27	25	28	-6%	-4%
HCLT	11.0%	11.2%	14.2%	12.0%	-330	-90	18.9%	19.5%	19.7%	20.1%	-90	-60	53	62	56	64	-5%	-4%
TechM	16.2%	11.6%	16.5%	12.1%	-30	-60	14.2%	14.6%	15.3%	15.5%	-110	-90	69	79	72	82	-5%	-3%
LTI	21.6%	17.7%	22.9%	18.1%	-120	-40	17.3%	18.0%	18.0%	18.1%	-80	-10	150	185	162	193	-7%	-4%
Mindtree	21.9%	15.5%	21.9%	15.5%	0	0	17.5%	17.8%	18.2%	18.3%	-70	-60	112	133	114	132	-2%	1%
Mphasis	20.2%	14.8%	21.8%	16.6%	-160	-180	15.8%	16.1%	15.7%	16.1%	10	0	95	114	95	115	0%	0%
Coforge	20.2%	17.0%	20.9%	16.9%	-70	0	15.3%	15.3%	15.3%	15.4%	0	-10	144	174	143	171	1%	2%
Persistent	29.8%	18.4%	29.0%	18.1%	80	40	14.1%	14.5%	13.9%	14.5%	20	0	113	137	110	133	2%	3%
Zensar	17.4%	14.9%	18.1%	14.9%	-70	10	11.9%	13.0%	12.5%	13.6%	-60	-60	20	25	19	24	1%	5%
Sonata	19.7%	17.4%	20.2%	17.3%	-40	10	8.3%	8.4%	8.4%	8.4%	0	0	43	50	42	49	4%	3%
Birlasoft	18.6%	15.5%	18.7%	15.5%	-10	0	12.9%	14.0%	14.4%	15.0%	-150	-100	18	23	20	24	-7%	-2%
Newgen	21.0%	22.0%	20.8%	22.1%	20	-10	22.4%	22.5%	22.4%	23.3%	0	-80	23	28	26	32	-9%	-10%
Tata Elxsi	25.9%	23.2%	31.3%	18.5%	-540	470	25.7%	25.5%	26.2%	26.4%	-50	-80	103	128	104	123	0%	4%
LTTS	19.4%	17.7%	20.1%	17.5%	-80	20	17.9%	18.0%	18.4%	18.5%	-50	-50	110	130	112	133	-2%	-3%
Cyient	10.4%	13.1%	14.5%	12.9%	-410	20	13.5%	13.7%	13.7%	14.0%	-20	-30	49	57	54	62	-9%	-8%
KPIT	20.3%	19.5%	20.6%	19.3%	-30	20	13.5%	14.0%	14.0%	14.8%	-50	-80	13	16	13	16	0%	-1%

Source: I-Sec research

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Demand is democratic, until when it can sustain?

Decadal spending compressed in a short 2-3 year period....

IT services industry in India is in the early phase of a multi-year technology upcycle with spending on digital transformation earlier planned for the next decade now being compressed into 3-5-year period. Digital leaders are racing to widen the gap and digital laggards are racing to leapfrog to stay ahead of competition.

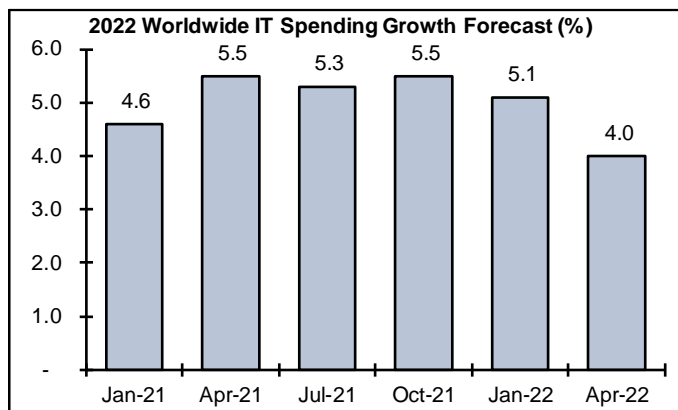
Enterprises are spending on technology to not only reduce costs, but also to enhance their business model to stay relevant for their customers. Technology spends are now directly linked to driving higher revenues, and hence, are shifting from cost of operations (SG&A) to a cost of revenue (COR) and becoming a bigger proportion of client's revenues. As per McKinsey, technology spend as a % of enterprise revenue is expected to move up to 5% over the next 5-10 years from 2-3% currently.

Gartner revises downward IT spending forecasts of CY22

Clients in US and Europe are facing highest ever wage inflation in past 20 years with annualized wages rising 4.5-5% YoY. There are 10.5mn job openings, as against 7.4mn unemployed workers in the US. Scarcity of tech talent in developed markets is driving up demand for automation and offshoring.

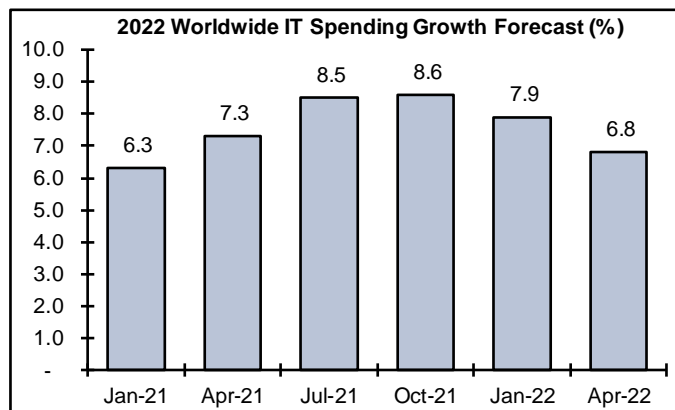
Gartner's recent forecast on worldwide IT spending saw a decline in its growth rates for 2022. While worldwide IT spending is forecasted to grow at 4% (vs 5.1% earlier), that of IT services is forecasted to grow at 6.8% (v/s 7.9%). Gartner has reduced its growth forecast for the 2nd quarter in a row on account of geopolitical disruption, inflation, currency fluctuations and supply chain challenges. Ukraine conflict is not expected to have a direct impact on global IT spending but price and wage inflation compounded with talent shortages and other delivery uncertainties are expected to dampen IT spending. This corroborates our thesis that despite demand environment being strong, rising inflation should lead to discretionary spends being postponed. Inflation will lead to rising pricing power which in turn will lead to reduction of discretionary spends from clients and thus eventually slow down revenue growth momentum of IT companies.

Chart 1: Gartner reduced growth forecasts...



Source: Company, I-Sec research

Chart 2: ...for 2 quarters in a row



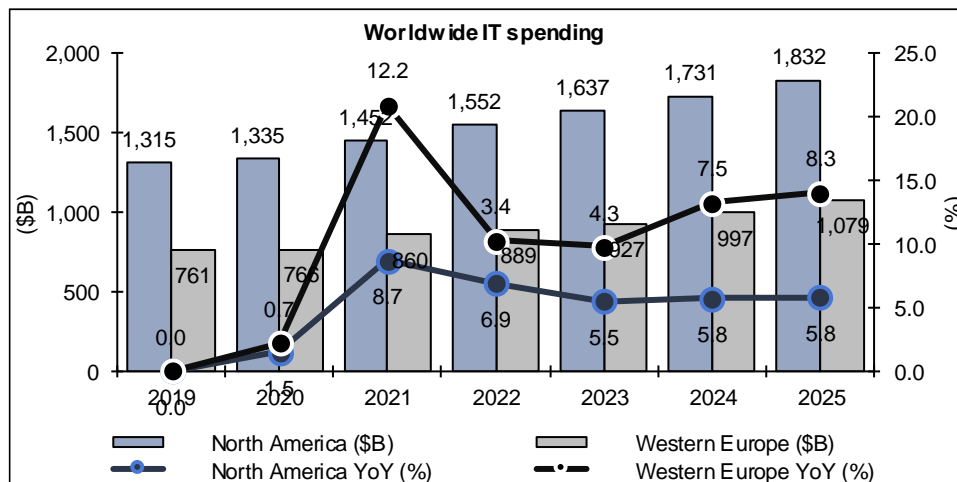
Source: Company, I-Sec research

Table 3: Worldwide IT spending and growth

	2019	2020	2021	2022	2023	2024	2025	CAGR (%) 2020-2025
Worldwide IT Spending Forecast								
Devices (US\$ bn)	708	697	787	814	804	824	843	3.9
Annual Growth (%)		-1.5	13.0	3.3	-1.2	2.5	2.3	
Data Center Systems (US\$ bn)	191	194	216	226	237	247	257	5.8
Annual Growth (%)		1.5	11.4	4.7	4.7	4.4	4.0	
Software (US\$ bn)	485	529	605	672	752	841	940	12.2
Annual Growth (%)		9.1	14.4	11.0	11.9	11.8	11.8	
IT Services (US\$ bn)	1,053	1,071	1,186	1,280	1,392	1,516	1,653	9.1
Annual Growth (%)		1.7	10.7	7.9	8.8	8.9	9.1	
Communication Services (US\$ bn)	1,418	1,396	1,444	1,463	1,494	1,524	1,554	2.2
Annual Growth (%)		-1.5	3.4	1.3	2.2	2.0	2.0	
All IT (US\$ bn)	3,855	3,888	4,239	4,454	4,679	4,952	5,247	6.2
Annual Growth (%)		0.9	9.0	5.1	5.0	5.8	6.0	

Source: Gartner, as per Jan-2022, I-Sec research.

Chart 3: North America and Western Europe IT spending



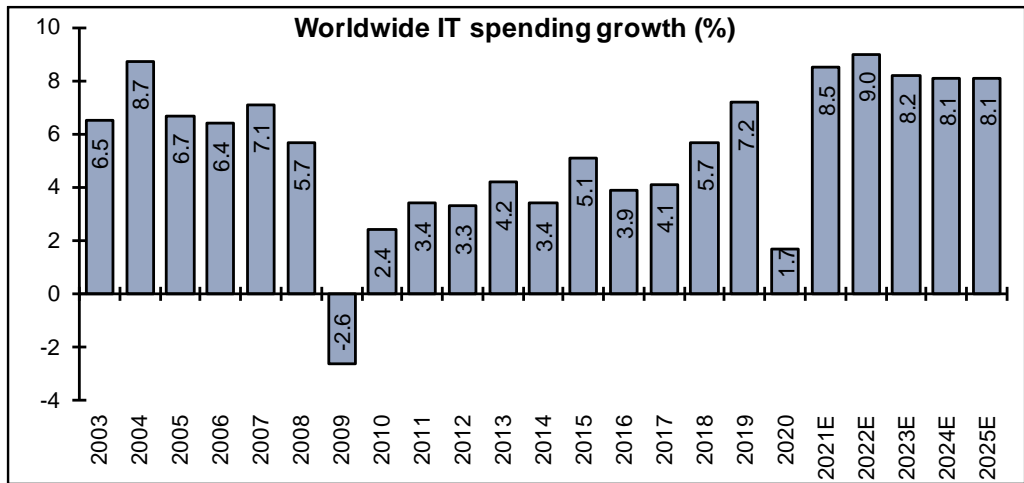
Source: Gartner, as per Jan-2022, I-Sec research.

Table 4: Region-wise IT spending

Regional wise IT spending (US\$ bn)	2021	2025	CAGR
North America	1,452	1,832	6.0%
LATM	199	217	2.2%
Europe	930	1,169	5.9%
Middle East & Africa	332	373	3.0%
China	544	714	7.0%
AsiaPac	519	621	4.6%
Japan	314	375	4.5%

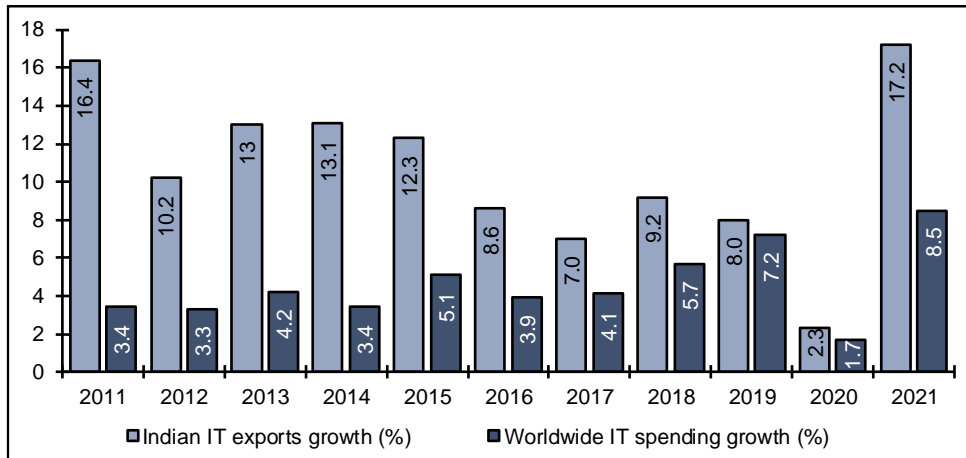
Source: Gartner, as per Jan-2022, I-Sec research.

Chart 4: IT spending expected to grow at 8% CAGR over 2021-25E vs 3-5% over 2011-20



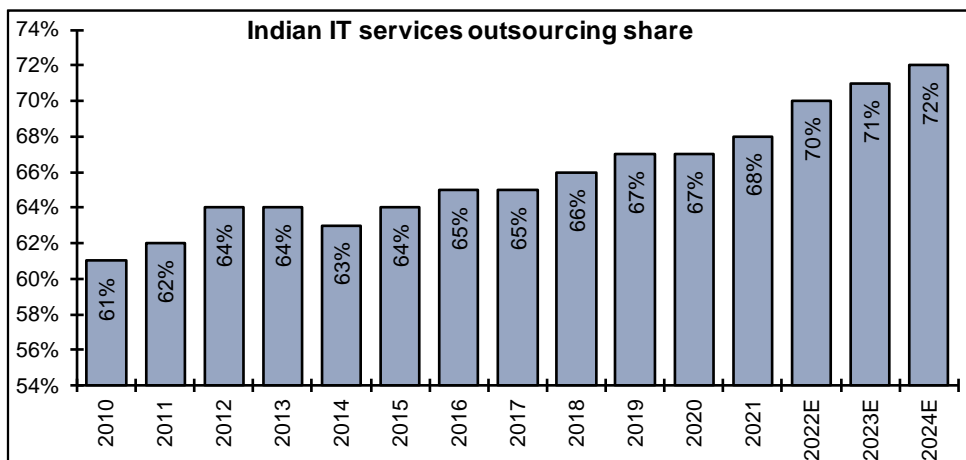
Source Gartner, as per Jan-2022, I-Sec research.

Chart 5: Indian IT exports growth ~2x global IT spending growth



Source: I-Sec research

Chart 6: Consistent growth in India's IT outsourcing revenue share



Source: NASSCOM, I-Sec research

Cloud adoption to be stronger and last longer (3-5 years)

While the transition to cloud has been ongoing for a few years, covid has accelerated cloud adoption due to higher resilience, shift of costs from capex to opex and 'anywhere, all-time' connectivity provided by cloud-based platforms.

For example, for one of the US-based fast-casual-restaurant chains, the number of online orders jumped to 400,000 per day, from 50,000 during covid lockdown. Company's legacy infrastructure would have not been able to support this surge in demand, but the business sailed through as it had transitioned its e-commerce and online-ordering system to the cloud before pandemic-related lockdowns occurred. Having seen the benefits, leaders in the company now plan to compress their five-year cloud migration plan to less than two years.

Cloud facilitates innovative business models

Enterprises across sectors and markets have realised that adoption of cloud increases their ability to respond to rapidly changing customer needs, a key competitive differentiator. Cloud facilitates rapid prototyping and innovation and helps speed time to market.

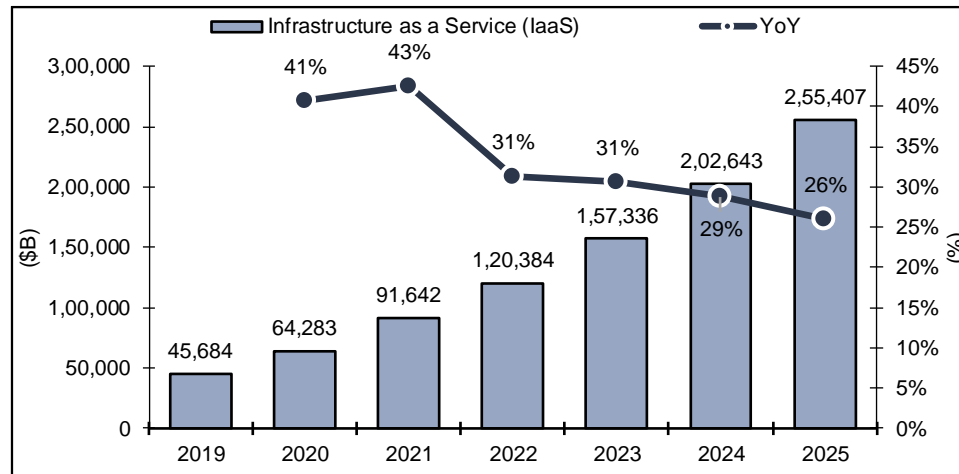
For example, ActiveVideo, a US based media and entertainment company, created CloudTV, a cloud-based platform that unifies all forms of content – web, television, mobile, social, video-on-demand, etc. – onto any video screen. The CloudTV approach of placing the intelligence in the network, rather than the device, enables content creators, service providers and consumer electronics manufacturers to create new television experiences for their viewers.

Hyperscalers remain confident of demand momentum in moving the data workloads to cloud across US as well as international geographies. Both AWS and Azure are seeing increase in long-term contracts. The Q4CY21 revenue performance for AWS, Microsoft Azure and GCP was strong with stable revenue growth for GCP though Azure growth slightly moderated. AWS saw the fourth successive quarter of growth acceleration in Q4CY21.

We expect cloud transformation cycle to be longer (potentially 3-5 years) and stronger given: 1) the complex process of digitizing the core of large enterprises led by movement to cloud, and 2) the fact that enterprises are still in the early stages of cloud transformation with only 30% of workloads migrated to cloud. By 2025, Gartner expects cloud market to be double the size of the non-cloud market. As per Gartner, cloud is responsible for nearly all of the 11% spending growth within the enterprise software segment in 2022.

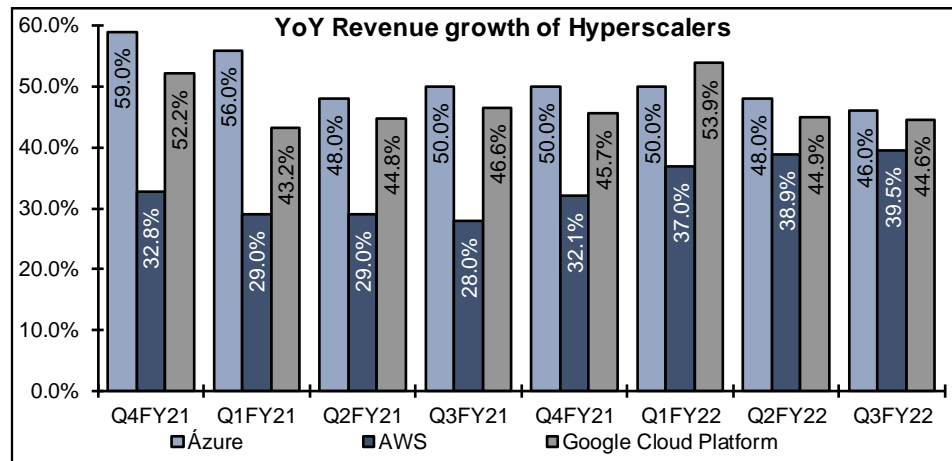
Surge in cloud adoption translates in strong growth for IT service providers on back of cloud platforms created by them to help speed up cloud transformation journey of clients thereby improving the utilisation of cloud capacity subscribed by clients and thus translating bookings into revenues for Hyperscalers partners.

Chart 7: Gartner estimates IaaS to grow at 29% CAGR over 2021-25 indicating strong growth in migration of on-premise IT infrastructure to cloud.



Source: Gartner, as per Jan-2022, I-Sec research.

Chart 8: Hyperscalers growing at hyper growth rate of 40-50% YoY



Source: Company, I-Sec research

Table 5: Cloud continues to be the key growth driver

Company	Remarks
TCS	"Cloud continues to be a big driver of growth. Cloud adoption will continue to drive significant amount of demand in the short term."
INFY	"Our digital business grew by 42.6% YoY and is now 58.5% of our overall revenues. Within digital, our cloud work is growing faster, and our Cobalt cloud capabilities are resonating tremendously with our clients. Today the biggest drive within our clients is really cloud"
WPRO	"Our cloud ecosystem revenues also grew at an accelerated pace of 30% on the YTD basis. My feel is that we are still in the early stage of the cloud transformation across industries and so it is a massive wave ahead of us. To a point that today when I look at the big eye for scalars will play a big role in cloud, the Microsoft, the Google, AWS, ServiceNow, SAP they are coming at us because they need us to serve them develop vertical solutions on their platforms or on the cloud and I think it is very clear that the more opportunities they are behind that is what the cloud and the growth in the cloud will be massive over the next five years at least."
HCLT	"Cloud is a very important theme, which is driving a lot of growth in the IT and Business Services. Cloud has become one of our key catalyst across segments representing dominant winning outcomes."
LTI	"The discussion does not even start or finish without talking about cloud to drive growth and expandability for an organization."
MPHL	"From a service line perspective, application services, our larger service offering, grew 39% YoY overall and 55% YoY for the Direct segment sustained by the theme of digitization and cloud powered transformation of apps."

Source: Company data, I-Sec research

Russia-Ukraine crisis provides opportunity for market share gains to Indian IT services players, but rising inflation will create headwinds ahead to full the demand

IT services is very critical to Ukraine given that its IT services exports of US\$6.8bn (36% YoY account for 4% of its GDP. One in five *Fortune 500* companies use Ukrainian IT services and, of its total IT services exports, 50% is exported to the US and UK. As per ISG, there are about 50,000 tech workers and 200,000-odd technology freelancers in Ukraine who could be affected by the hostile situation because of Russia-Ukraine war.

The war has resulted in supply-side disruptions for companies like EPAM who have significant delivery presence in Ukraine (~14K), Belarus (~9.5K) and Russia (~8.9K), together accounting to ~54% of its employee base. DXC (Luxoft) has around ~15K employees in Ukraine. The supply disruption in Ukraine is likely to remain for the near term as internet has been disrupted, many roads are blocked, and air space has been closed to commercial air traffic in Ukraine. Plus, there are increased incidences of cyber attacks affecting Ukraine delivery centres.

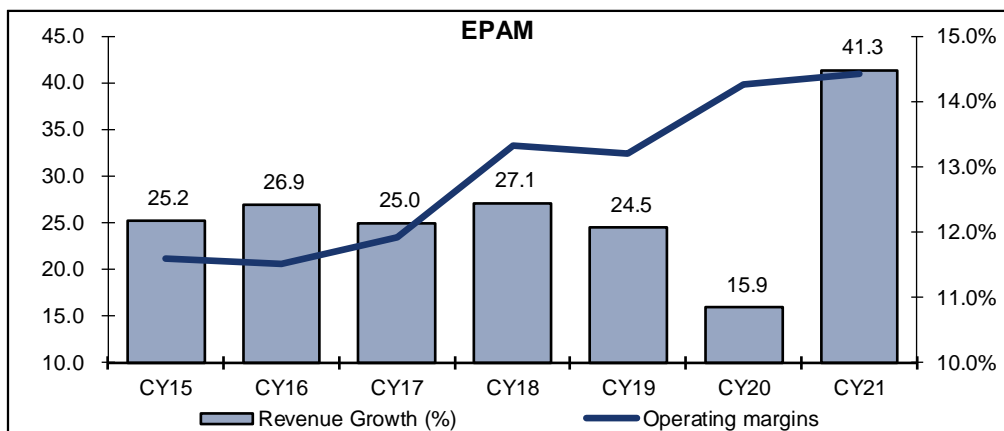
Accenture & DXC with ~2,300 and 4,000 employees respectively in Russia have announced closure of their offices in Russia. Tech giants such as Google, Apple, Microsoft, Oracle, Dell, IBM and Meta are among 29 major IT firms who have announced changes to their business plans in Russia.

Supply-side impact for Indian IT services is not material due to limited presence in war-affected east European countries. In fact, there is high likelihood for Indian IT services to gain market share from providers like EPAM who have high presence in Ukraine. Our channel checks suggest that select Indian IT companies have started getting massive enquiries from clients in areas such as business continuity support, data and cyber security. It is difficult to gauge whether these enquires will translate into long-term engagements, but the opportunity/optimism to gain market share gains is quite strong.

We want to highlight that select Indian IT companies have started getting massive enquiries from clients related to EPAM, especially. As of now, enquiries towards business continuity support and data security, cyber security are quite high. Cyber security, supply chain resiliency and energy efficiency are also top priority enterprises due to the Russia-Ukraine conflict.

Right now it is difficult to comment whether these enquiries will be short-lived or will translate into long-term engagements, but the opportunity / optimism to gain market share gains is quite strong. We believe even after market share opportunities for Indian IT in eastern Europe it will be difficult for them to fulfil the demand.

Chart 9: EPAM growth and margins



Source: Company, I-Sec research

Table 6: IT spending has elevated in eastern Europe

<i>IT spending</i>	CY19	CY20	CY21	CY22	CY23	CY24	CY25	CAGR (%) 2021-2025
Eastern Europe (\$B)	64	65	70	72	76	82	89	6%
<i>Eastern Europe YoY (%)</i>		1.2	7.8	3.0	4.4	8.1	9.3	
Eurasia (\$B)	58	56	57	61	63	66	67	4%
<i>Eurasia YoY (%)</i>		-4.7	2.1	6.9	4.4	3.7	2.4	

Source: Company, I-Sec research

Table 7: Delivery centers in Europe

Locations	Indian Service Providers	Global/European	Enterprise GIC
Ukraine	GlobalLogic (now Hitachi)	EPAM, Capgemini, Ni-X, Intive, DXC	Lyft
Russia	Infosys	EPAM, DXC, Accenture, IBM	Huawei, Airbus
Belarus	TechM	EPAM	Mapbox
Poland	LTTS, Cognizant, HCL, Wipro, TCS, TechM	EPAM, Accenture, DXC, Atos, IBM	Google, Graphcore, NorthVolt, ABB, Nokia, ABN Amro, Citi Bank, Coca Cola, Avon, Cargill, Goldman Sachs, DB, Ericsson, GM
Hungary	HCL, Cognizant, TCS, Infosys, Wipro, TechM	EPAM, Accenture, Capgemini, IBM	Huawei, AB InBev, Avaya, DHL, Nokia, GE, BT, BP, Citibank, Exxon, Corning, Diageo, Morgan Stanley, SAP, Emerson, Vodafone
Czech	Infosys, TechM, HCL, EXL	EPAM, Accenture, Capgemini, IBM	Honeywell, AB InBev, AXA, Atlas Copco, Barclays, eBay, Exxon, J&J, Pfizer, Tesco, GE
Croatia	Infosys, GlobalLogic		Xellia, Rimac
Romania	Wipro, HCL, WNS, Genpact	EPAM, Accenture, DXC, Capgemini	AMD, Continental, Acronis, Porsche, Hella, Microsoft, DB, Bombardier, Emerson, Xerox, Societe General, Ericsson, Bosch, Continental, Schnieder
Latvia	TechM, Infosys, Cognizant	Accenture, IBM, DXC, Tieto, EVRY	Barclays, AIG, Western Union
Serbia		Intellias, Transcom	ZF, Continental, SAS, NCR
Lithuania	Cognizant, Infosys, HCL	EPAM, Teleperformance, IBM	Barclays, AIG, Danske
Bulgaria	Infosys, HCL, TechM, EXL	EPAM, DataArt, IBM	SAP, Insurify, AIG, Coca Cola
Estonia		Dynatrace, Arvato	Symantec, Stora Enso Finnair
Slovakia	GlobalLogic, Infosys, TechM	Accenture, IBM	RioTinto, Allianz, BASF, Amazon, ING, KONE, Lenovo, Holcim, ZF, Osram, Danfoss

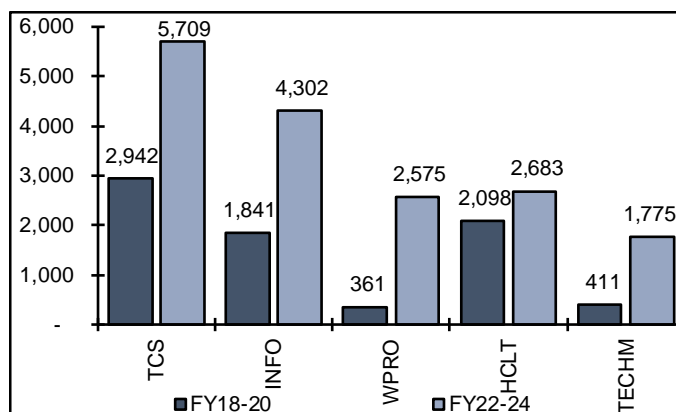
Source: Company, I-Sec research

Revenue growth momentum to soften ahead...

We estimate revenue CAGR of 12%/19%/19% and EPS CAGR of 13%/22%/20% for tiers-1, 2 & ER&D companies over FY22-FY24E. **Higher inflation will likely lead to postponement of discretionary spends, and focus on cost optimisation will increase. Higher focus on cost will likely lead to dampening of tech budgets and reduce discretionary spending. Even Gartner reduced forecast of CY22 IT spending to grow at 4% (vs 5.1% earlier) and that of IT services to grow at 6.8% (v/s 7.9%).**

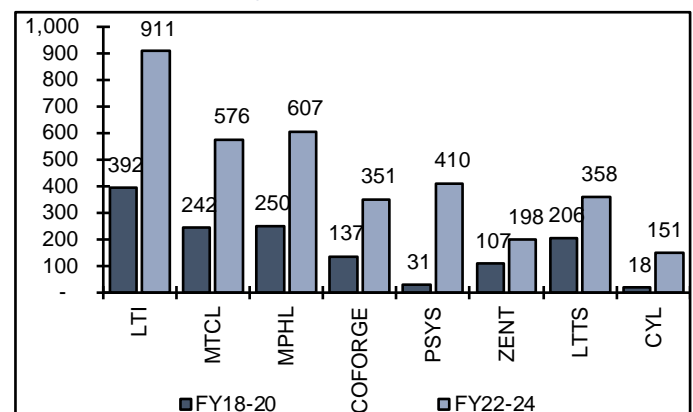
Management commentary across IT companies highlight that strength in demand is broad-based across verticals, markets and service lines. BFSI, technology services, and healthcare verticals were the first to recover followed by retail, manufacturing and communications. The sectors worst hit by pandemic – such as travel, transport and hospitality – have come back to pre-covid levels for most of the IT companies. Clients across verticals have realised the power of technology in enhancing revenues.

Chart 10: Incremental revenue over FY22-24...



Source: Company, I-Sec research

Chart 11: ...already baked in current consensus



Source: Company, I-Sec research

Table 8: Expect conservative guidance ahead...

Company	Guidance for FY22	Expected guidance for FY23
INFO	19.5-20% YoY CC 22-24% EBIT margin	11-13% YoY CC 22-24% EBIT margin
WPRO	2-4% QoQ CC (For Q4FY22)	2-4% QoQ CC (For Q1FY23)
LTI	14-15% PAT margin	14-15% PAT margin
MTCL	20%+ EBITDA margin	20%+ EBITDA margin
COFORGE	24% YoY CC / 37% YoY CC inorganic	20% YoY CC
LTTS	19-20% YoY USD	19-20% YoY USD

Source: Company data, I-Sec research

Table 9: Revenue growth momentum to soften ahead...

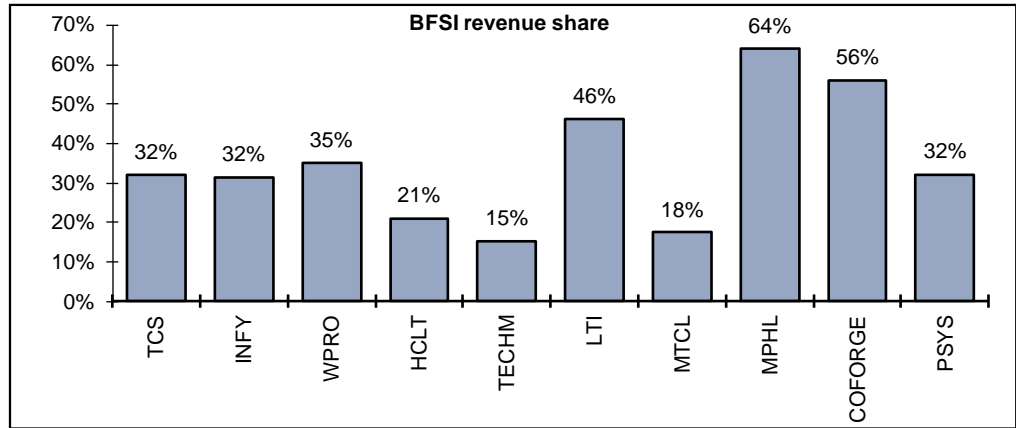
Companies	USD Revenue Growth (%)			Revenue CAGR (FY22-24E)
	FY22E	FY23E	FY24E	
TCS	15.9	11.0	10.1	10.6%
Infosys	20.6	13.1	11.7	12.4%
Wipro	27.2	12.5	11.0	11.8%
HCL Tech	12.8	11.0	11.2	11.1%
Tech M	17.4	16.2	11.6	13.8%
L&T Infotech	26.5	21.6	17.7	19.6%
Mindtree	31.1	21.9	15.5	18.7%
Mphasis	21.7	20.2	14.8	17.5%
L&T Tech.	19.9	19.4	17.7	18.5%
Coforge	37.5	20.2	17.0	18.6%
Persistent	34.8	29.8	18.4	24.0%
Cyient	9.0	10.4	13.1	11.7%
Zensar	14.9	17.4	14.9	16.2%
Sonata Software	28.5	19.7	17.4	18.6%
Tata Elxsi	34.1	25.9	23.2	24.5%
KPIT	19.8	20.3	19.5	19.9%
BirlaSoft	16.1	18.6	15.5	17.0%
Newgen	14.5	21.0	22.0	21.5%

Source: I-Sec research

Strong tailwinds from US BFSI

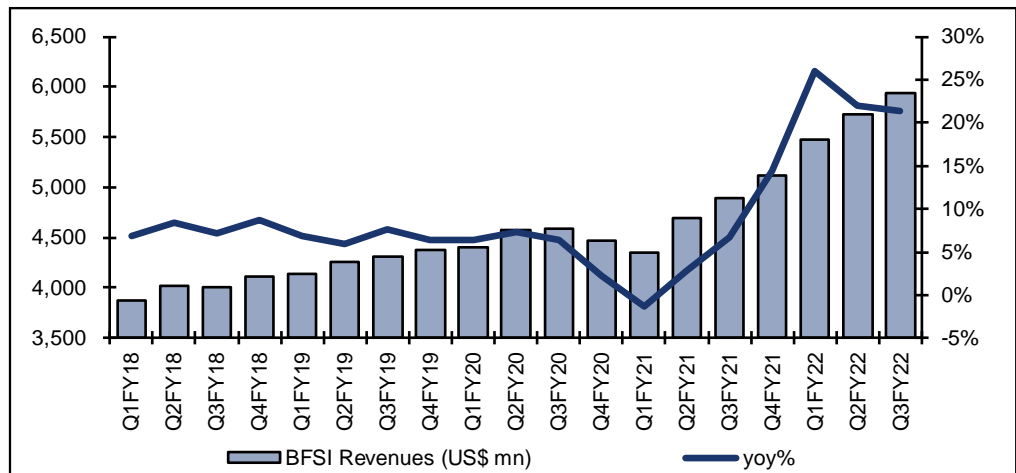
BFSI vertical is the largest revenue contributor (~30-40% of revenue) and key growth driver for IT services industry. Tier-1 IT BFSI vertical has grown at a strong rate of 5% in covid-impacted FY21 and 22% in 9MFY22 led by strong growth in technology spends in US and European banks and financial services firms. We believe rising interest rate environment will benefit banks, and spends wouldn't soften soon but there might be reduction in discretionary spends and delay in decision making which might soften revenue momentum.

Chart 12: BFSI vertical is largest revenue contributor for IT services



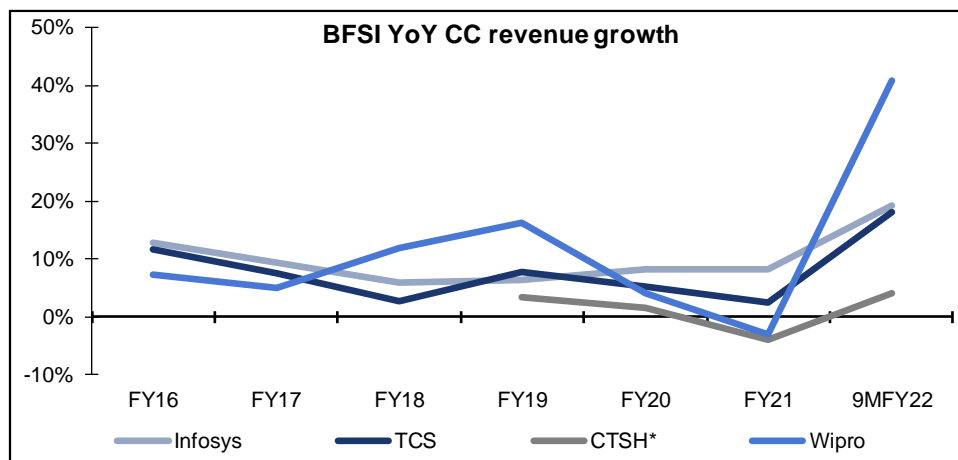
Source: Company data, I-Sec research

Chart 13: BFSI vertical is key growth driver with 22% YoY growth in 9MFY22



Source: Company data, I-Sec research. Note: Includes TCS, INFO, WPRO, HCLT, TECHM, LTI, MTCL, MPHL & COFORGE.

Chart 14: BFSI YoY CC revenue growth



Source: Company, I-Sec research

Commentary from large US banks indicates that digital transformation continues to be the key focus area. Technology investments within BFSI industry are broad-based across large and medium sized banks and across sub-verticals – capital markets, payments, retail banking, wealth management, etc.

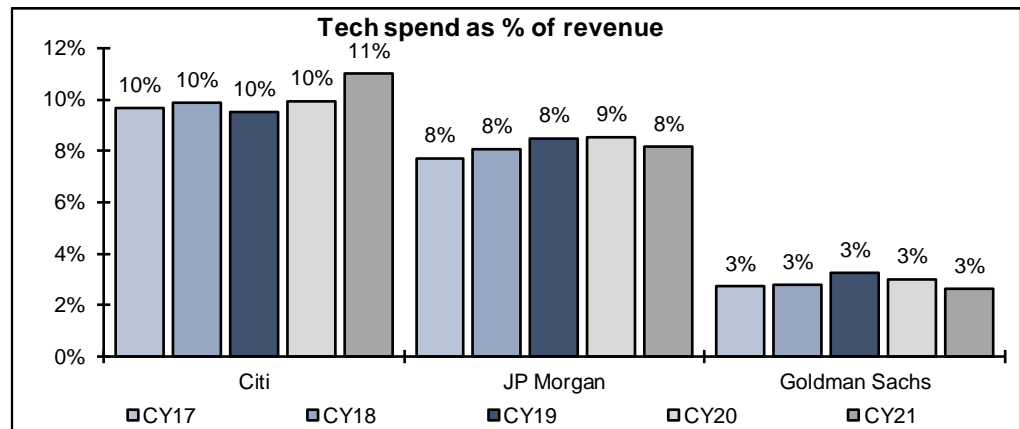
BFSI firms are spending on: 1) digitisation and modernisation of core systems, 2) improving customer experience to ensure seamless experience across online and offline banking channels, 3) leveraging technology to strengthen risks and controls, 4) unlocking value from data by applying advanced data analytics and AI/ML techniques.

US banks’ commentary on tech budgets for CY22 is strong. For example, J.P. Morgan is spending US\$12bn on technology with 50% on ‘change the bank’ spend. It mentioned in Q4CY21 earnings call that its investments in tech and tech adjacencies increased 25% YoY in CY21 and is expected to further increase 20% YoY in CY22. Focus areas of spending are on cloud capabilities, digital consumer experience, data centres and analytics. 30-50% of its apps and data will move to the cloud (AWS+ Google+ Azure) in CY22.

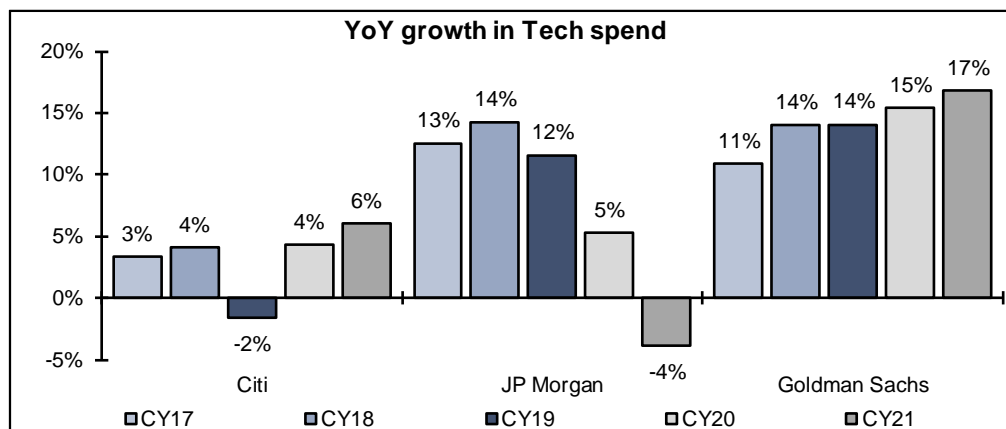
Banks are committed to accelerated cloud migration and are expressing strong urgency for technology transformation as indicated by comment made by **J.P. Morgan’s CEO during the Q4CY21 earnings call – “If we can spend US\$2bn more and get to the cloud tomorrow, I would do that in a second”.**

BFSI firms are no longer considering technology spends as merely cost items, but rather as investments that will pay off either in terms of the topline or the bottom-line. They are spending higher on ‘change the bank’ initiatives compared to ‘run the bank’ initiatives compared to 2-3 years back.

Chart 15: US banks’ technology spends remain strong



Source: Company data, I-Sec research

Chart 16: US banks' technology spends

Source: Company data, I-Sec research, Note: JPM's tech spend continues to healthy, its US\$12bn tech spend is captured in capex expenses, while above chart shows growth is in opex tech spends.

Table 10: IT Services concall commentary suggests strong growth outlook in BFSI

Company	Q3FY22 concall commentaries
TCS	"Deals in BFSI will not have a ramp down, but the base effect will kick in in the fourth quarter as you rightly pointed out. But overall the demand environment is fairly strong. So, if we are unable to maintain the demand momentum, but next quarter, we will see a base effect kicking in in BFSI specifically."
TECHM	"BFSI is one of those verticals, which we've said we will focus for high growth. This quarter, obviously, there's a degree of seasonality, some programs coming to an end and a timing issue. But from a demand perspective, it remains strong, we do see growth momentum across various sub-sectors."
LTI	"This vertical has seen holistic growth during the quarter across all geos and service lines. We talked in detail about key growth drivers and how banks are responding to the great restructuring during our Analyst Day."
MTCL	"In terms of the BFSI, I would say that you know the strategy that we have adopted is, first - we had to stabilise this. There was a big bit of consolidation that happened early days post the management change. So, we kind of went over that, now it's in a growth momentum. And what we are seeing over here is that the customers are very focused in terms of realigning their technology platforms, portfolios. They are very keen to accelerate their adoption of future technologies, modernize the legacy infrastructure, so there is a lot of demand."
MPHL	"BFS growth has accelerated to 29% YoY in CC for this quarter representing the sixth straight quarter of over 20% annual growth. Direct BFS grew 8.9% QoQ and 31.6% YoY in USD terms. This growth is broad based across sub-segments of BFS. We continue to enjoy market share gains with our key banking customers."

Source: Company data, I-Sec research

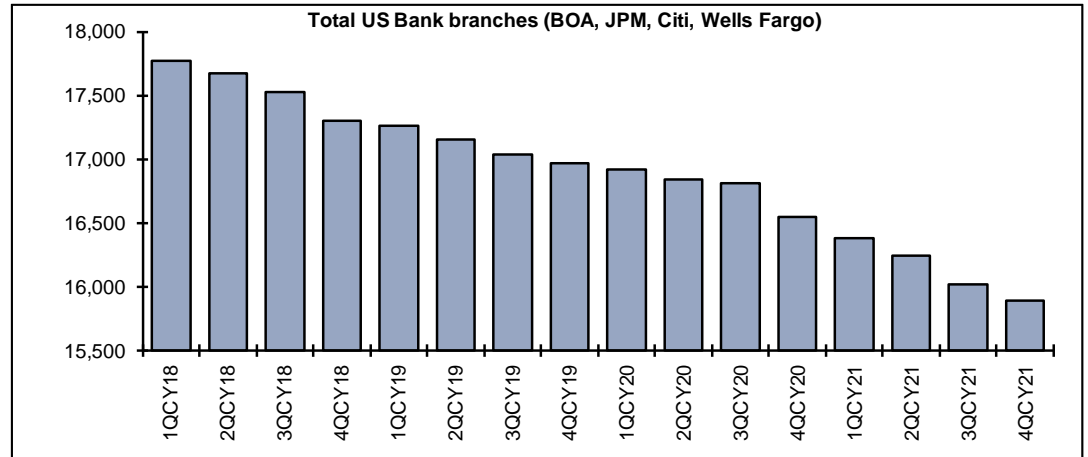
BFSI firms are funding the investments via reduction in other operating costs

BFSI firms are reducing operations cost via reduction of branch branches, cut in non-technology headcount through automation of processes, rationalization of real estate, etc. to create savings to fund technology investments.

For example, Wells Fargo's management in the company's Q4CY21 earnings call mentioned, "We eliminated management layers and increased span of control, a 20% decrease in managers with low span and control. We completed approximately 270 branch consolidations in 2021, a continuation of the progress we've made over the last few years with branches down 11% since 2019. We also reduced our office real estate portfolio by approximately 7% and occupancy expense was down 9% compared with a year ago. This year we expect to continue to realise savings from these initiatives and including an incremental 5% reduction in office real estate."

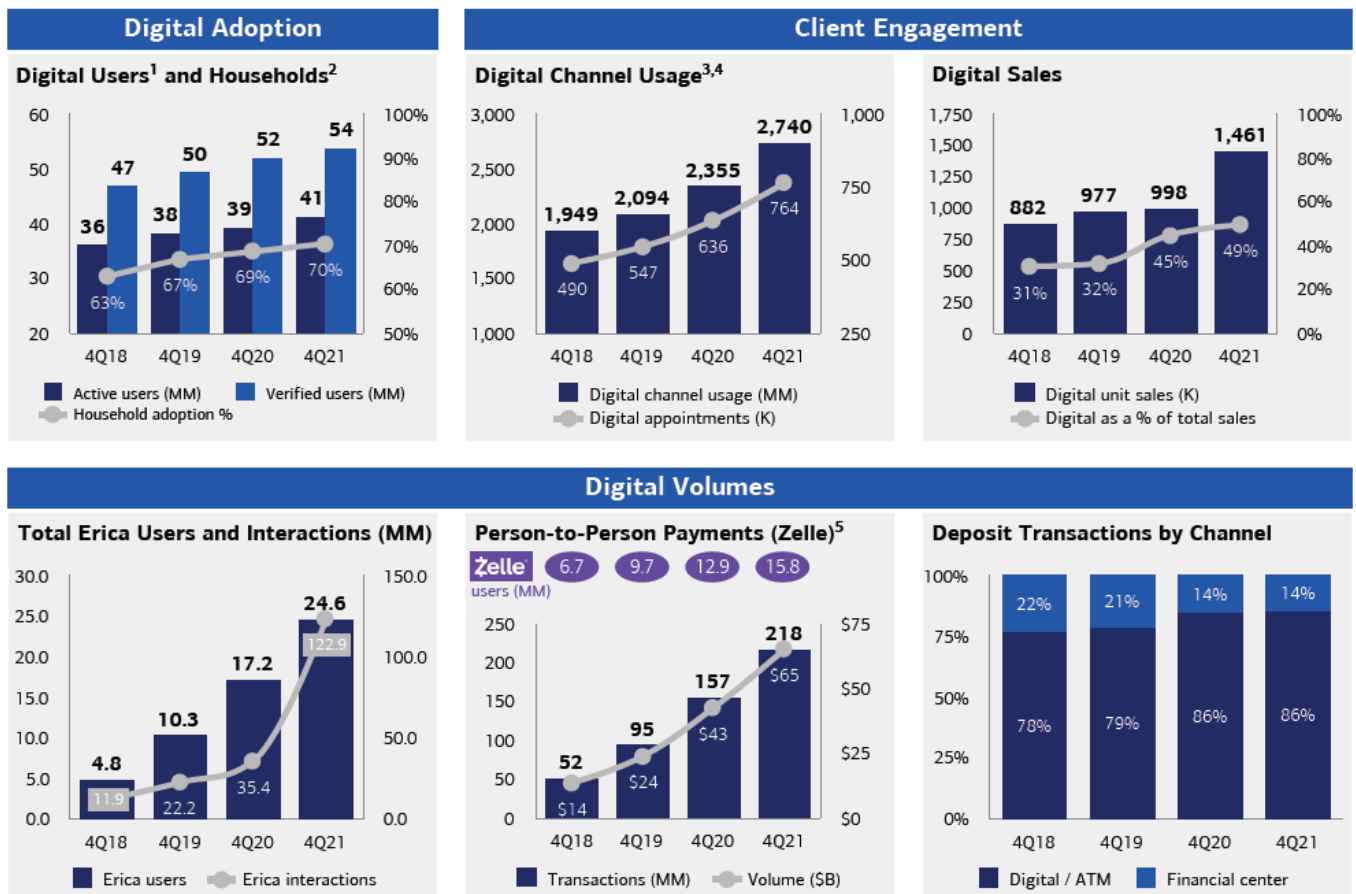
BFSI technology spend outlook remains positive and is likely to increase in CY22. TCS and INFY have the highest share in tier-1 & LTI, and Mphasis in tier-2 and are well placed to benefit from growth in BFSI technology spends.

Chart 17: Reduction in physical bank branches



Source: Company data, I-Sec research

Chart 18: Digital banking statistics



Source: BofA – Q4CY21 Earnings presentation, I-Sec research

Table 11: US banks' commentary indicates technology spends to continue

Company	Remarks
Bofa	Bank of America reiterated continued investment in technology at a high rate and is spending US\$3.5bn on new technology development. The company indicated that client activity increasingly is powered by its digital transformation, which is foundational to everything the firm does.
Citi Bank	Citi's management on the company's Q4CY21 earnings call said, "...the transformation over time will deliver efficiencies, will reduce the manual touch points, will drive straight through processing and therefore will allow for us to bring our expenses down... We've got clarity frankly on the idea that it's a multi-year spend and that is going to peak and then level off and ultimately we'll see some benefits as the cost come down"
J P Morgan	JPM is spending US\$12bn on technology with 50% on investments or 'change the bank' spend. The firm indicated that its investments in tech and tech adjacencies increased 25% over 2019-2021 and will further increase 20% in 2022 Focus areas of spending are on cloud capabilities, digital consumer experience, data centres and analytics. 30-50% of its apps and data will move to the cloud (AWS+ Google+ Azure) in 2022.
Goldman Sachs	Goldman Sachs spent US\$4.5bn-US\$5bn on tech and engineering spends in 2021 and expects to continue similar level of investments going forward.
Wells Fargo	Wells Fargo is heavily investing in technology to change laggard status and is cutting costs in operations to invest in the rest of the organization.
US Bancorp	US Bancorp investments in technology to support digital transformation and payments ecosystem initiatives are paying off, and we continue to look for uses of capital that would drive higher returns. US Bancorp is making significant investment in digital capabilities and as that investment matures, banks expects to see some operating efficiencies on the expense side.
TD Bank	TD Bank management on the company's Q4CY21 earnings call said, "But over the medium, we do not want to sort of compromise on investment opportunities in order to build out our platform stronger than it what might be, or technology investments or more capability investment, just because the number one quarter or for half year is not going to be looking that impressive".
State Street	State Street's management in the company's Q4CY21 earnings call mentioned, "Notably, our continued focus on digitisation automation, as well as resource discipline, have helped us reduce our headcount this year by 2 percentage points even as we on boarded larger deals and processed more transaction volume".

Source: Company data, I-Sec research

Retail – Accelerated digital adoption by consumers driving up tech spends

Surge in digital adoption and evolving consumer expectations throughout the pandemic have made retailers realise the importance of investing in technology to stay relevant for customers. IT services companies are seeing increased spend by their clients in the retail vertical on digital transformation including digital supply chain, omni-channel commerce, consumer experience, contactless solutions, leveraging data analytics for personalisation, core modernisation and large-scale cost take out initiatives to improve business resilience.

Walmart CEO mentioned in Q4FY22 earnings call, "*Headline is company is getting more digital. It is starting to become more automated and over time will become even more automated.*"

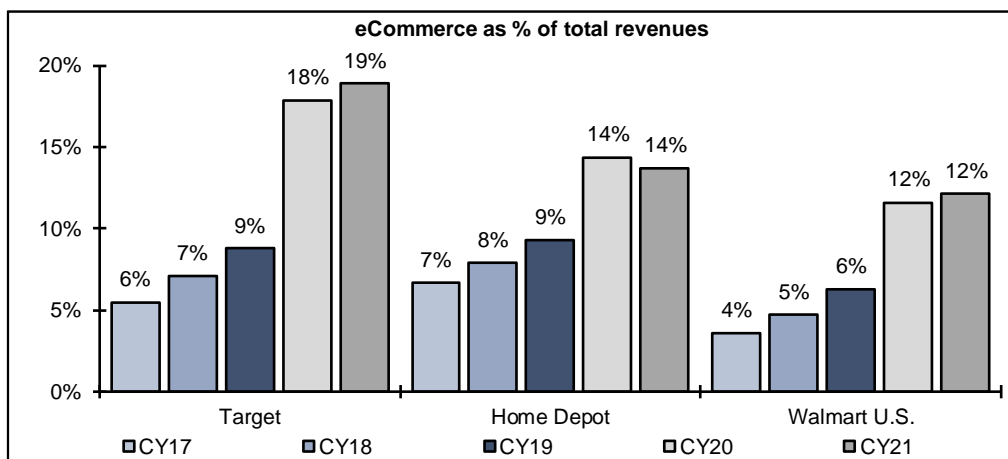
Large US and European retailer chains ramped up technology investments in e-commerce to deal with surge in online shopping demand during first wave of covid. Most retailers indicated healthy growth in digital/online sales channels despite store re-openings. For example, Kohl's digital sales grew 6% YoY in Q3CY21 and by 33% on 2-year basis. Digital sales accounted for 29% of total sales in Q3CY21.

Retailers have expanded fulfillment capabilities across a variety of options around buy-online-pickup-in-store, buy-online-ship-from-store, drive-through and curbside-pickup to increase availability, ease and convenience for customers. Home Depot CEO mentioned that its customers continue to shop in an interconnected manner as approximately 55% of its online orders are fulfilled through the company's stores." Kroger launched three new offerings during Nov'21 quarter that support the plan to double digital sales and digital profitability by 2023.

Retailers continue to invest in technology to ensure seamless shopping experience across different channels and minimise cost of omni-channel delivery.

Walgreen Boots Alliance is transforming and aligning the core business and building a pharmacy of the future. Its digital sales were up 88% YoY in the US in Nov'21 quarter, driven by 3.6mn same-day pickup orders. Walgreens saw its biggest Cyber Monday ever. Its average order value for online channel is about US\$30 vs US\$20 in stores, indicating higher adoption and preference for online shopping. **Management mentioned that they are still in early phase of realising full potential of their digital platform.**

Chart 19: E-commerce sales share is 2x pre-covid levels



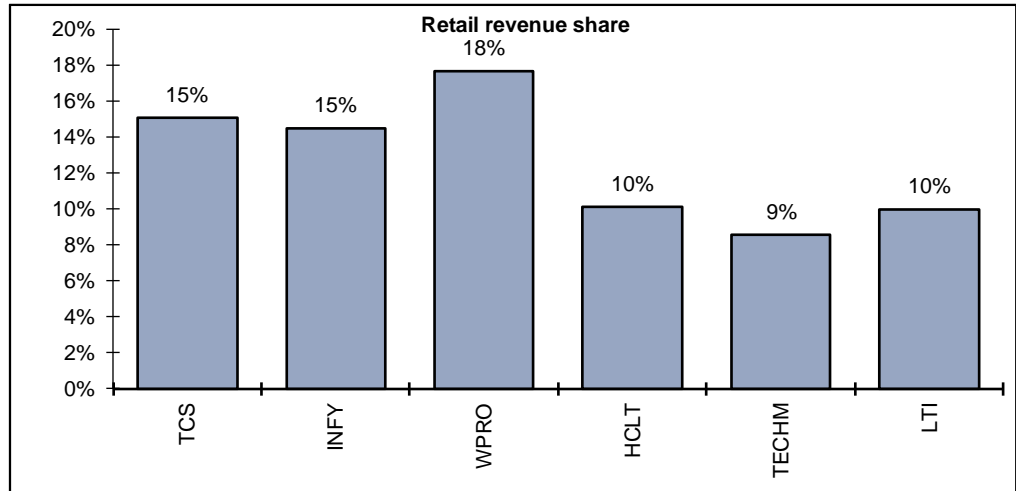
Source: Company data, I-Sec research

Table 12: US retailers' commentary indicates technology spends to continue

Company	Remarks
Walmart	"We'll continue the multiyear journey of accelerated capital investment focused on increasing fulfilment capacity, automation, and technology to enhance productivity."
Target	"Target's digital experience, which we have been investing in for years, plays a key role here as a gateway to our guests and a huge growth driver for us."
Kroger	"One of the reasons that we're increasing our capital investments in 2022 beyond the sort of catch-up of some of the things that were slowed down by covid is we are going to be investing more in technology. We still feel like as proud as we are of the US\$1bn+ we've saved for the last four years, we still think there's a lot of opportunity to use technology even more effectively to take more cost out of the business. And it's one of the reasons that we're accelerating capital because we believe it will help support -- continue to increase efficiency over the next few years as we continue to invest in average hourly rates."
Nike	"In order to enable this growth and drive the shift in marketplace composition, we have accelerated investment to evolve our distribution network and scale a digital first supply chain, leveraging advanced analytics, automation and technology. We continue to invest in the capabilities to support our consumer-led digital transformation."

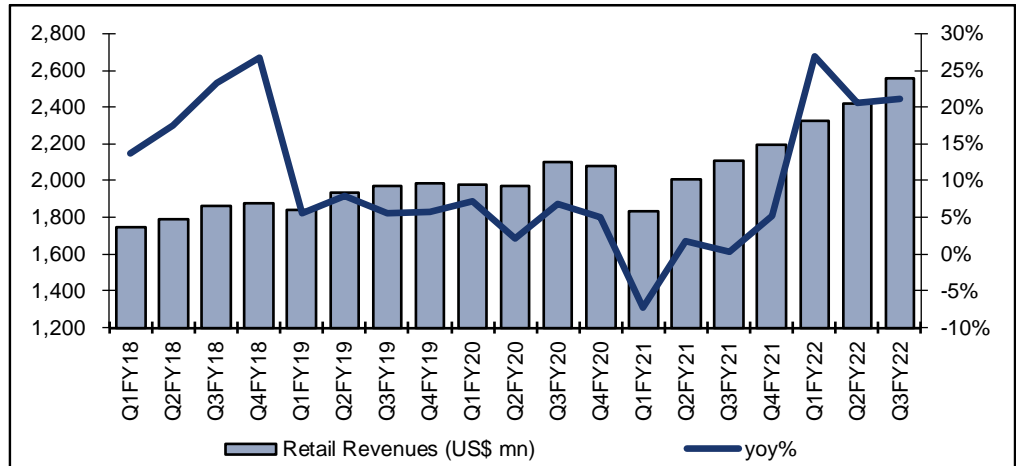
Source: Company data, I-Sec research

Chart 20: Retail vertical contributes 10-15% of IT services revenue



Source: Company data, I-Sec research

Chart 21: Strong growth momentum in retail and CPG vertical (~23% YoY in 9MFY22)



Source: Company data, I-Sec research. Note: Includes TCS, INFO, WPRO, HCLT, TECHM & LTI.

Table 13: IT services experiencing strong traction in retail and CPG verticals

Company	Remarks
INFY	"Retail segment growth was 19.8% in CC. Across sub-verticals we see increased client spend on digital transformation including digital supply chain, omni-channel commerce and large-scale cost take out initiatives to improve business resilience. We signed six large deals in this segment during the quarter. Retail is starting to come back nicely as well."
LTI	"CPG, Retail and Pharma grew at 7.2% QoQ. We see a consistent trend of leveraging data and supply chain resilience for optimisation."
MTCL	"We are seeing good traction in consumer experience, core modernisation, supply chain transformation, smart factory solutions and intelligent enterprise resource planning. Connected experiences have gained prominence as a result of a long drawn pandemic."

Source: Company data, I-Sec research

Strong recovery in manufacturing vertical

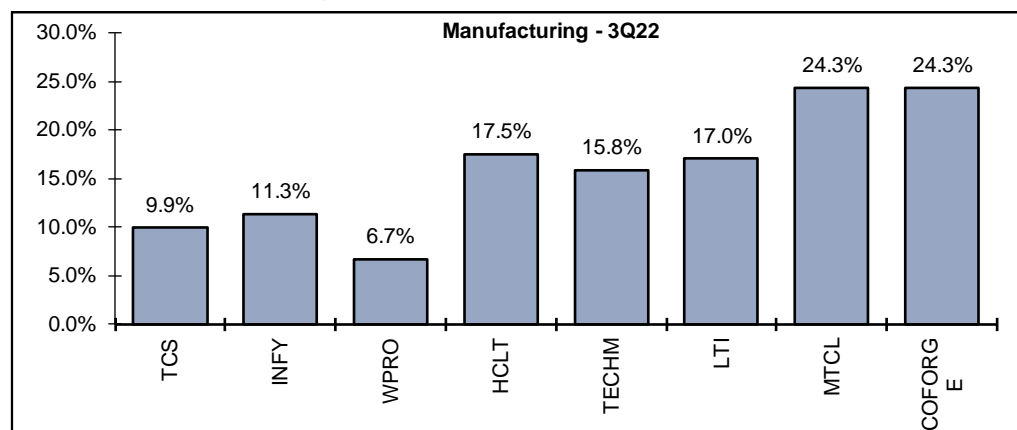
US manufacturing industry gained momentum in 2021 on back of vaccine rollout and rising demand. The outlook for the industry remains positive, but it is facing two major challenges of labour shortages and supply chain disruptions. Manufacturers are addressing these issues leveraging technologies such as robotic manufacturing, higher automation for tackling labour shortages and use of digital supply networks and data analytics to optimise supply chain costs and raw material availability.

Manufacturing companies are also spending on core modernisation, supply chain transformation, smart factory solutions and intelligent enterprise resource planning, which is vital for a more competitive and sustainable future in manufacturing.

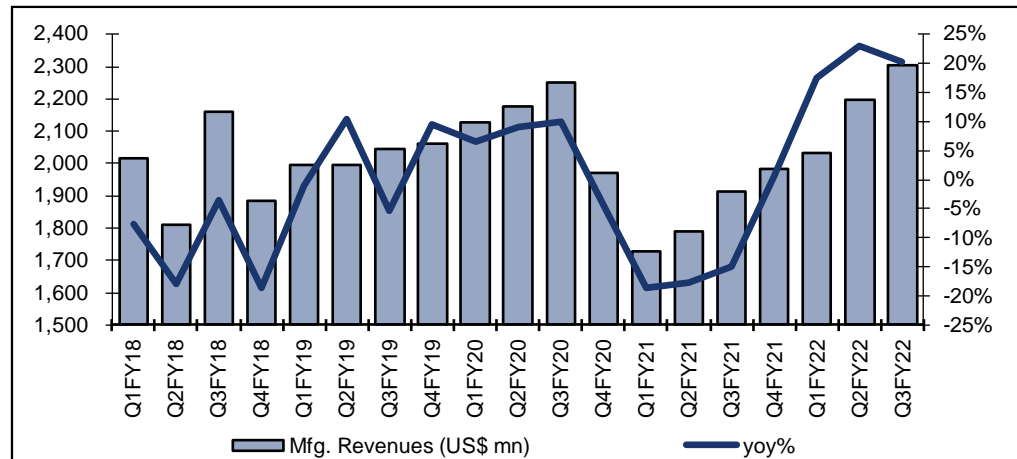
Connected experiences have gained prominence as a result of a long-drawn pandemic. This is driving the need to deliver real-time insights that can be leveraged for better productivity, supply chain fulfilment and customer service. Connected ecosystems are also providing impetus to IOT and Edge computing offerings. For example, in Q3FY22, Mindtree was selected as a partner by a global automotive manufacturer as part of its digital factory initiative to transform its applications portfolio leveraging Mindtree NxT capabilities.

LTTS management mentioned that there is good demand for platform development, digital twin and smart services leveraging data and analytics to transform the business. In one of the large deals that it won in Q3, it will use engineering data analytics to develop a software platform that will improve the customer's manufacturing process lines. TCS's TwinX, AI-based digital twin solution is used by a steel manufacturer to model their shop floor safety.

Chart 22: Manufacturing vertical contributes 7-15% of revenue for IT services



Source: Company, I-Sec research. Note: For MTCL, RCM (retail, CPG and manufacturing) revenue is considered. For Coforge, Others which includes manufacturing, media, etc. is considered

Chart 23: Strong recovery in manufacturing vertical over past four quarters

Source: Company data, I-Sec research. Note: Includes TCS, INFO, WPRO, HCLT, TECHM, LTI, MTCL & COFORGE.

5G capex gaining speed...

Communications service providers (CSPs) in mature markets accelerated 5G development in 2020 and 2021 with 5G representing 39% of total wireless infrastructure revenue. Verizon mentions in its Q3CY21 earnings call that it is seeing great momentum in 5G adoption with over 25% of consumers using 5G-capable device. Ericsson management mentioned in their Q4CY21 earnings call that 5G is the fastest growing technology.

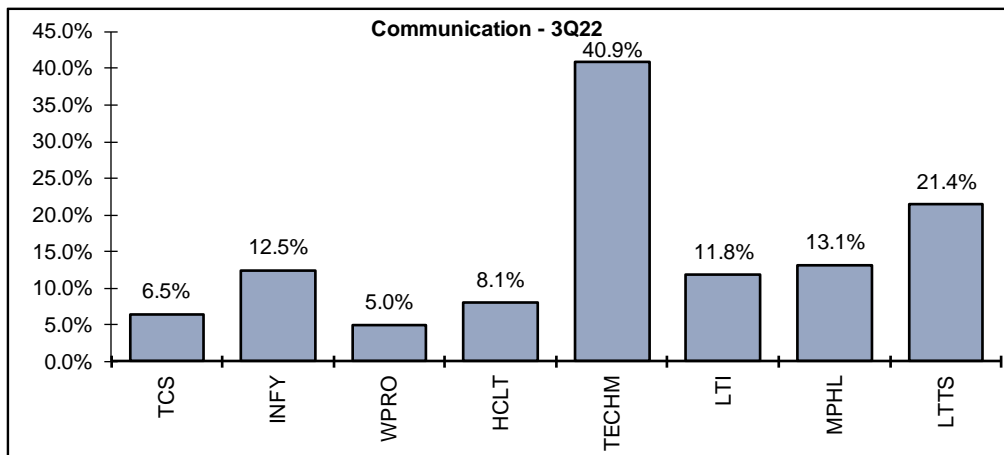
CRU's Global Fibre Optic Cable Index (FOCI) in Feb'22 reached record high levels of 142.7, far surpassing the previous record of 133.4 posted in Jul'21. Feb'22 saw unified growth across all five key regions and across all metrics. This data suggests continued strong capex in communications sector.

TechM management mentioned in their Nov'21 analyst day that investments in 5G are back with globally US\$130bn invested in 5G core network. 5G will enable sensor-based connected world and drive new business models. TechM management stated that 5G and 5G related business opportunity is expected to be US\$712bn by 2023.

5G for CSP and 5G for ecosystem has already started firing for TechM. 5G for Enterprise will grow in next two years. TechM is focusing on areas such as: 1) innovating on core network platforms to drive more automation, 2) integrating network with cloud, 3) managing the network. One of the deals that TechM signed in Q3FY22 is about building predictive analytics for a 5G network for the deployment and maintenance workforce.

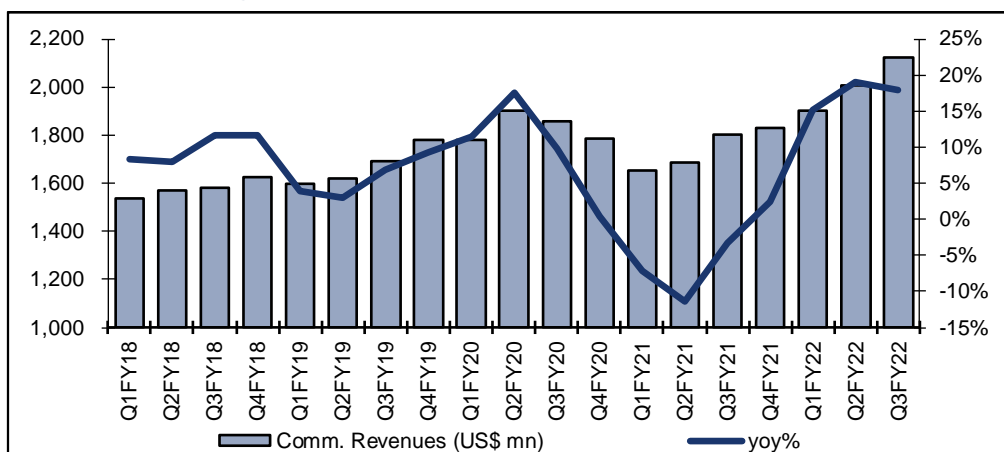
LTTS is also seeing a good set of opportunities in the 5G space such as integrating various network components and implementing AI solutions as the 5G network gets deployed. Company's engineers have deployed multi-discipline expertise – 5G, IoT, chip-to-cloud, and Industry 4.0 and designed an innovative lightweight small form-factor sensor that works on advanced 5G communications and is optimal for deployment in industrial mesh networks.

Chart 24: IT companies' communications vertical share



Source: Company, I-Sec research

Chart 25: Steady growth in communications 3Q22



Source: Company data, I-Sec research. Note: Includes TCS, INFO, WPRO, HCLT, TECHM, LTI, MPHL & LTTS.

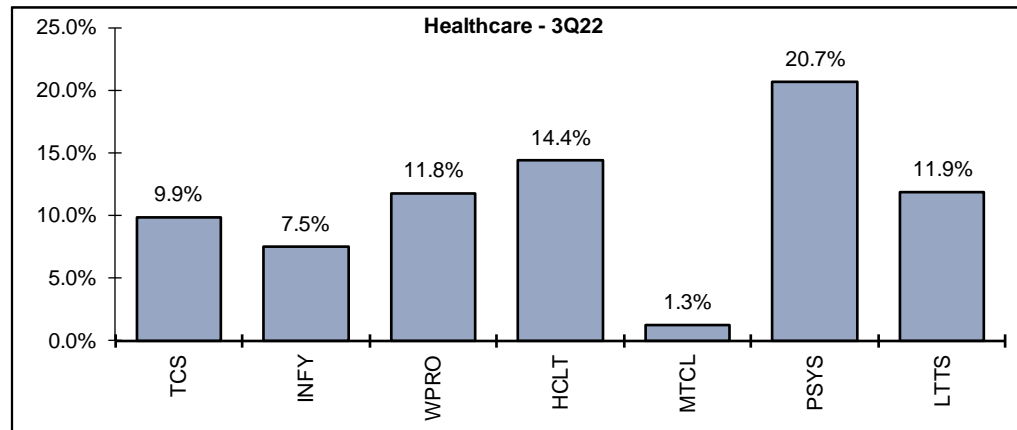
Healthcare & life sciences: Emerging as fastest-growing vertical

Healthcare and life sciences vertical continued to grow at a strong rate of 11% in the pandemic-impacted FY21 and grew 20% in 9MFY22. Hospitals and other providers are increasingly turning to telehealth services, remote care solutions, patient management platforms, and self-service portals in response to the covid crisis. These solutions require IT infrastructure that is reliable, scalable, and high-performance thereby resulting in significant uptake of cloud, IoT, patient-facing applications, patient portals, and next-generation CRM work.

IT services companies won several deals in healthcare and life sciences space ranging from end-to-end digitisation of patient care platforms, customer experience, predictive patient care and dynamic health monitoring, leveraging data analytics to offer customised health insurance plans, etc. ER&D players are witnessing demand in areas of digital/robotics surgery and connected medical devices for real-time patient diagnosis and care.

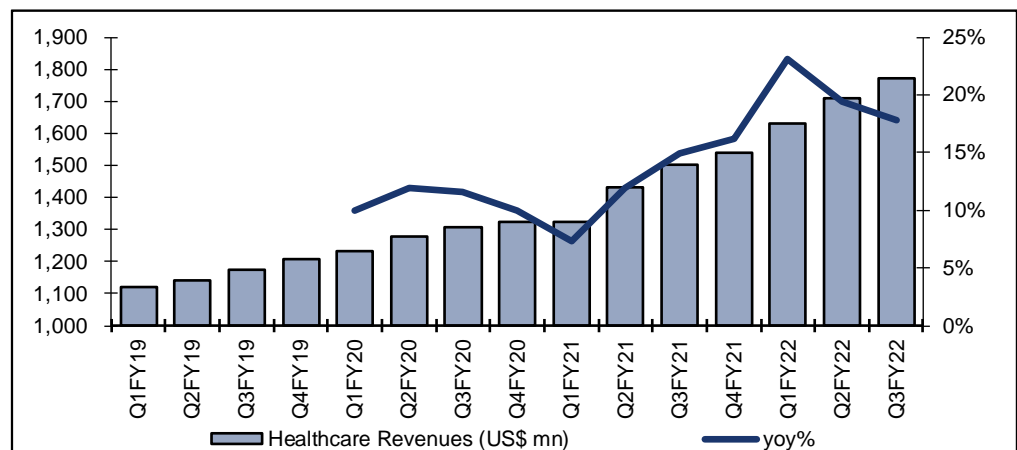
Mindtree’s newly incubated healthcare vertical is growing at strong pace of 25-30% QoQ USD for past two quarters. Mindtree is focusing on catering to two broad segments: 1) offering digital transformation solutions to provider segment, and 2) medical devices companies.

Chart 26: Healthcare vertical contributes 7-10% of revenue for IT services



Source: Company, I-Sec research

Chart 27: Healthcare vertical grew 20% YoY in 9MFY22 on top of 11% YoY in FY21



Source: Company, I-Sec research. Note: Includes TCS, INFO, WPRO, HCLT, PSYS & LTTS.

Deals coming in short sprints led by focus on speedy execution, but higher inflation will delay discretionary spending

Higher inflation will lead to postponement of discretionary spends and focus on cost optimisation will increase. Higher focus on cost will lead to dampening of tech budgets and reduce discretionary spending.

Urgency of digital transformation is changing the nature of demand. Client’s willingness to give purchase order of 3 to 5 years is lesser as compared to giving orders in sprints – as they target faster execution of projects. However, once an IT services vendor wins the short cycle project, it does not have to compete with other vendors to win subsequent sprints because engagement in terms of MSA is for three to five years. Therefore, revenue growth of IT companies is no longer contingent on winning large deals. IT

companies enter into strategic smaller engagements and then subsequently scale up revenues within their client.

Lack of large and mega deals in Q3FY22 led to decline in TCV on YoY basis and flattish on QoQ basis. However, we believe deal ACVs are healthy. Deal pipeline is strong and growing across companies. But rising inflation is going to put more focus on cost optimisation deals which might cause a decline in short duration deals.

Select mid-cap companies like Mphasis and Coforge are winning large deals led by proactive new deal hunting and ability to offer customised solutions at speed.

Table 14: Strong deal win momentum

Deal TCV (US\$ mn)	Q1FY20	Q2FY20	Q3FY20	Q4FY20	Q1FY21	Q2FY21	Q3FY21	Q4FY21	Q1FY22	Q2FY22	Q3FY22
TCS	5,700	6,400	6,000	8,900	6,900	8,600	6,800	9,200	8,100	7,600	7,600
INFY	2,714	2,847	1,813	1,650	1,650	3,150	7,129	2,100	2,600	2,150	2,530
TECHM	475	1,490	1,230	505	290	421	455	1,043	815	750	704
MTCL	324	307	207	393	391	303	312	375	504	360	358
MPHL	151	174	189	195	259	360	247	245	505	241	335
COFORGE	175	176	218	180	186	201	192	201	318	285	247
PSYS	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	302	247	245	283	334
CYL	155	165	181	255	117	127	195	238	140	156	226

Source: I-Sec research

Table 15: TTM Deal TCV also remained strong

TTM Deal TCV (US\$ mn)	Q1FY20	Q2FY20	Q3FY20	Q4FY20	Q1FY21	Q2FY21	Q3FY21	Q4FY21	Q1FY22	Q2FY22	Q3FY22
TCS	22,700	24,200	24,300	27,000	28,200	30,400	31,200	31,500	32,700	31,700	32,500
INFY	7,881	8,699	8,942	9,024	7,960	8,263	13,579	14,029	14,979	13,979	9,380
TECHM	1,873	2,813	3,603	3,700	3,515	2,446	1,671	2,209	2,734	3,063	3,312
MTCL	1,093	1,129	1,080	1,231	1,298	1,294	1,399	1,381	1,494	1,551	1,597
MPHL	629	593	660	709	817	1,003	1,061	1,111	1,357	1,238	1,326
COFORGE	395	405	424	468	465	489	501	520	645	688	701
PSYS	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	1,076	1,108
CYL	820	789	697	756	718	680	694	677	700	729	760

Source: I-Sec research

ER&D seeing strong spending led by digital and connected technologies

ER&D industry is expected to grow faster than IT services industry led by: 1) aggressive digital engineering spends driven by accelerated adoption of smart, connected devices and platforms; 2) mindset of clients towards outsourcing has turned positive in ER&D space which has traditionally been low compared to IT service; 3) shortage of digitally skilled talent globally driving offshoring spends to Indian ER&D players.

Zinnov forecasts global ER&D spend to grow at 9% CAGR to reach US\$2.1trn by 2024. Offshore ER&D spends are estimated to increase at a higher rate of 13% CAGR to reach US\$206bn in 2024.

Higher adoption of connected smart products and platforms

Indian ER&D companies are experiencing very strong demand environment driven by higher digital engineering spends due to accelerated adoption of smart, connected devices and platforms. The trend for platformization is leading to broad-based demand for collaborative and intuitive products like digital twin, analytics and AI led decision-making, etc.

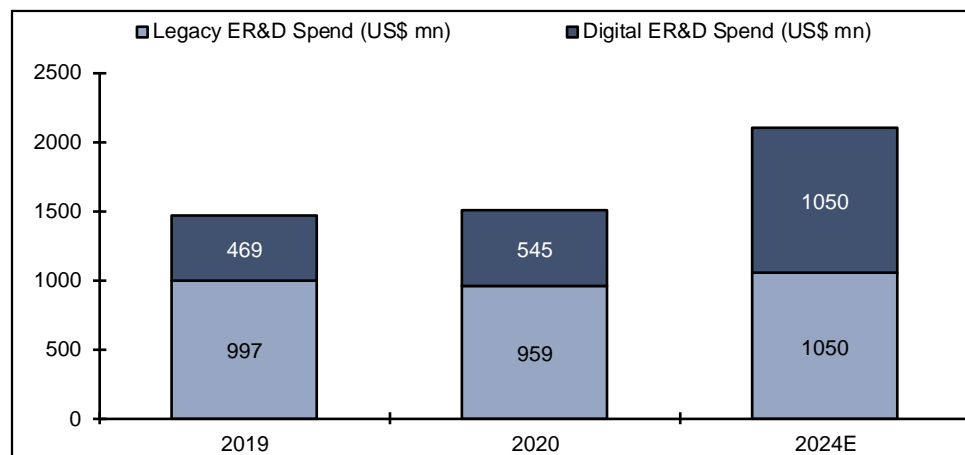
Historically ER&D deal durations have been 1-2 years. Now this scenario is changing as ER&D vendors are trying to become strategic partner for clients and are winning multi-year and larger sized deals. For example, LTTS has been recognised as a 'global preferred engineering supplier' for European multinational aerospace major Airbus, and has been awarded with a multi-year contract. LTTS has had a decade-long relationship with Airbus, which is further strengthened by this win.

Table 16: India's ER&D services market to grow at 17% CAGR over 2020-2024E

ER&D spends (US\$ bn)	2015	2020	2024	2015-2020 2020-2024E	
				CAGR	CAGR
Global ER&D Spend	1007	1504	2100	8%	9%
Outsourced ER&D Spend	67	126	206	13%	13%
<i>Outsourced spends as % of global spends</i>	7%	8%	10%		
India ER&D market	20	34	60	11%	15%
<i>India's share of total ER&D outsourced spends</i>	30%	27%	29%		
India ER&D Service Providers market	8	17	32	16%	17%
<i>Service providers share of Indian ER&D market</i>	40%	50%	53%		

Source: Zinnov, NASSCOM, I-Sec research

Chart 28: Digital ER&D spend growing at 18% CAGR over 2020-24 and account for 50% of total ER&D spend



Source: Zinnov, I-Sec research

Broad-based digital engineering adoption across verticals

Automotive sector is witnessing increased investments in electric, connected and autonomous vehicles. Higher level of software and electronics systems are being built into vehicles. Tata Elxsi CEO mentioned that next five years is going to be a huge opportunity in EV and connected vehicles space as OEMs are in early stages of building technology capabilities. LTTS is winning deals in areas of electrification across product categories like trucks, RVs and off-roaders.

Plant engineering and industrial segments are seeing strong demand for platformization, collaborative and intuitive products, and digital initiatives like smart factories, Industry 4.0, digital twins, analytics, AI led decision making. Environment sustainability led design opportunities are also emerging in these segments.

Medical is seeing demand for building software platforms for digital health monitoring, robotic surgery, patient monitoring as well as quality assurance and compliance. LTTS

has built solutions in digital robotic surgery space, which is finding good traction in the market.

In **telecom** sector, huge investments are being made in 5G by traditional telecom companies, infra OEMs as well as ISVs. Industry is also seeing increased spends on network virtualization and software define network. LTTS is witnessing huge spends coming up on integrating various network components and implementing AI solutions as the 5G network gets deployed.

In **semiconductor** segment, there is strong demand for chip design services for end-industries like automotive, consumer electronics, data centres and telecom.

In **media & entertainment**, growth is driven by increase in number of OTT channels and gaming. Tata Elxsi is winning contracts from operators in Middle East and South-East Asia apart from US and Europe as the trend of growing OTT platforms is spread across the world.

Table 17: Global ER&D spends driven by technology and services led spends

US\$ bn	2020			2023E			2020-2023E CAGR		
	Legacy	Digital	Total	Legacy	Digital	Total	Legacy	Digital	Total
Global ER&D Spend	959	545	1504	1017	911	1928	2%	18.7%	8.6%
Key verticals									
Manufacturing-led			812			925			4.4%
Automotive	122	33	155	129	54	183	1.90%	17.80%	5.7%
Aerospace	46	2	48	49	3	52	2.10%	14.50%	2.7%
Industrial	60	11	71	65	19	84	2.70%	20.00%	5.8%
Technology-led			541			752			11.6%
Software & Internet	36	219	255	17	382	399	-22.10%	20.40%	16.1%
Semi-conductor	68	13	81	84	19	103	7.30%	13.50%	8.3%
Telecom	44	39	83	36	62	98	-6.50%	16.70%	5.7%
Services led			150			251			18.6%
BFSI			58			100			19.9%
Retail			37			62			18.8%
Healthcare (Payer & Provider)			33			53			17.1%
Media & Entertainment			14			25			21.3%
Key geographies									
North America	374	340	714	395	576	971	1.80%	19.20%	10.80%
Western Europe	302	91	393	319	148	467	1.80%	17.60%	5.90%
APAC	270	110	380	290	180	470	2.40%	17.80%	7.30%

Source: Zinnov, I-Sec research

Higher offshoring of ER&D spends post covid

ER&D industry has traditionally had lower offshoring compared to IT services industry. However, client's acceptability towards offshoring of ER&D spends has increased post covid-led travel restrictions because enterprises are realising the benefits of collaborating with ER&D service providers and cost savings due to offshoring. Covid triggered accelerated digital adoption resulting in faster go-to-market and rapid evolution of new technologies has also led to higher outsourcing of work to ER&D vendors.

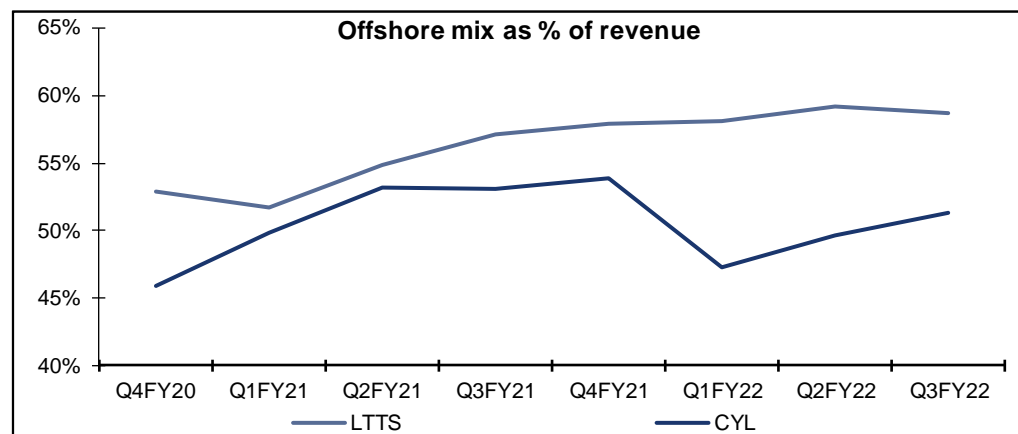
India is well positioned to benefit from increased outsourcing of ER&D spends given lower cost of talent and access to strong engineering talent base amidst scarcity of digitally skilled talent globally. Within offshore ER&D spends, India's share is expected to grow at 15% CAGR to reach US\$60bn in 2024 as per Zinnov.

Share of captive ER&D units of global companies is also expected to shift to Indian ER&D service providers because they have access to larger talent pool and can help

clients accelerate their products' go-to-market, especially in case of multi-product roll-outs. It is also easier and cost-effective for clients to use third party service providers for integration, upgrades and maintenance of products.

ER&D companies are also focusing on increasing their near-shore presence in areas such as Eastern Europe, Canada and Mexico wherein talent is located in similar time zone. LTTS is setting up an R&D centre in Krakow, Poland, that will help expand global footprint as well as EACV delivery. It is also expanding presence in Canada. Persistent Systems is ramping up its presence in Canada and Mexico while it also acquired Data Glove which gives it access to Costa Rica.

Chart 29: Offshore mix



Source: Company, I-Sec research

New areas of spends are emerging

New areas of spends such as metaverse and virtual economy having digital currencies enabled by blockchain technology are emerging. Gartner predicts that by 2026, 25% of people will spend at least one hour a day in the metaverse for work, shopping, education, social and/or entertainment reasons. As no single vendor will own the metaverse, Gartner expects it to have a virtual economy enabled by digital currencies and non-fungible tokens (NFTs). Gartner predicts that by 2026, 30% of the organisations in the world will have products and services ready for metaverse.

Metaverse is evolving and providing captivating experiences in various ways. Use cases are getting added daily and digital leaders have already started investing and exploring these technologies. For example, JP Morgan said that it has opened a lounge in Decentraland, a virtual world based on blockchain technology, and became the first lender in the metaverse. However, the JP Morgan paper on metaverse stated that many areas need to improve including the overall user experience and performance of avatars, as well as commercial infrastructure.

NVIDIA and BMW are building a 'Factory of the Future', an amalgamation of reality, virtual reality, robotics, and artificial intelligence (AI). BMW will replicate virtual operations of its manufacturing plant using this future factory, allowing humans and robots to collaborate.

Key growth drivers of metaverse are: 1) growth of live streaming, Cloud, AR & VR; 2) growth of games and social media; 3) technical advances in hardware, network infrastructure, visualisation, spatial computing and AI; 4) expansion of decentralised infrastructure boosted by mainstream interest in crypto, 5) accessibility of content creation and no-code platforms.

Metaverse can be a fairly exciting opportunity. These will form next waves of growth post cloud and data opportunity. Quantum computing, space tech and science tech are potential areas of big demand in future years.

IT services companies have been early investors in metaverse and blockchain technology. TCS Business & Technology Services head said, “Metaverse will become a ‘big force’ within the next three years and it will be a helpful tool for Indian IT companies in processes like employee onboarding and training. It will also help the entertainment and gaming industry.” However, he maintained that metaverse probably accounts for a very small portion of the US\$350bn IT industry revenue forecast.

Accenture management mentioned in Nov’21 quarter earnings call that it has been an early innovator in underlying metaverse technology. They have the largest enterprise Metaverse and are deploying over 60,000 virtual reality headsets and have created one Accenture Park, a virtual campus for onboarding and immersive learning, including meeting rooms and collaborative experiences.

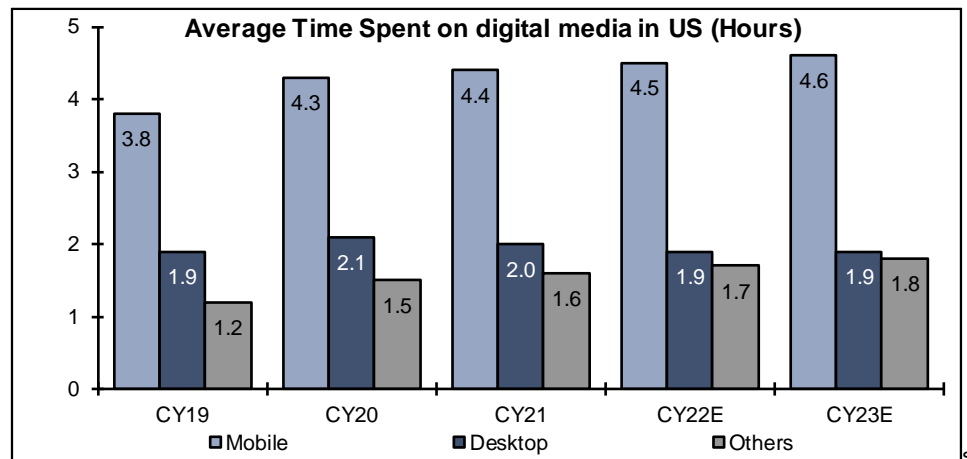
Accenture is also working with clients to help explore and shape their early forays into the metaverse through new digital experiences enabled by virtual reality and new ways to conduct commerce enabled by NFT (non-fungible tokens).

Mphasis has collaborated with CrossTower, one of the world’s leading crypto exchanges to build a Center of Excellence focused on Web 3.0. Mphasis CEO mentioned that the partnership between Mphasis and CrossTower will accelerate and scale the Web 3.0 talent within Mphasis, providing new avenues for application of innovative block chain-based solutions various industries including financial services, supply chain, healthcare, life sciences, insurance, logistics, retail etc.

Table 18: IT Services companies investing to develop capabilities in Web 3.0

Web 1.0	Desktop Browser, Banner Ads, Ecomm, Checkout, Consumer Adoption
Web 2.0	Mobile/App Economy Subscription, Streaming Media, Sharing Economy, Scaled Platform
Web 3.0	AR & Metaverse as new OS, Decentralised Web, Rise of Privacy, Anonymity, Local Experience & Commerce Creator Economy.

Source: I-Sec research

Chart 30: Time spent on digital media will continue to trend upwards

Source: I-Sec research

ESG & low carbon energy transition will remain focus points

Management commentary across IT services companies highlighted that sustainability is one of the key themes driving deal wins. TCS has won several deals in ESG space in Q3FY22. For example, TCS is helping manufacturers manage the downstream environmental footprint of their products by strengthening the end-of-life recycling and recovery of non-biodegradable components of their products and become better environmental stewards. This is known as Extended Producer Responsibility and is a legal obligation under the 'polluter pays' principle in many parts of the world.

Infy's study finds that companies can gain US\$357bn in annual profits globally through people-focused transformation efforts and a commitment to ESG. Infy has partnered with BP (a global integrated energy company) to develop and pilot an energy as a service (EaaS) solution, which will aim to help businesses improve the energy efficiency of infrastructure and help meet their decarbonization goals.

Table 19: New deal wins in ESG space

Company	Client	Remarks
TCS	Multi-national Furniture Retail Chains	"TCS is helping client to meet their Extended Producer Responsibility around plastic usage in their products and enable better recovery and recycling. TCS' solution leverages advanced PLM and CAD to help the chain move away from estimations, and accurately calculate the plastic usage in each of their products using product 3-D models. This enables more accurate tracking and end-of-life recycling ensuring the right amount of compliance and enhancing the brand's image as a responsible business."
TCS	Multinational food and drink processing conglomerate	"TCS is a trusted partner and advisor client's multi-year global program to build a robust digital data governance system that can reliably measure and analyze greenhouse gas emissions and track the progress in emission reductions versus corporate targets."
TCS	Leading multinational consumer goods company	"TCS will implement TCS Clever Energy™ product at client's 10 plants to make them energy efficient, reduce emissions and meet their sustainability cum financial goals."

Source: Company data, I-Sec research

Efficient supply-side mechanism will separate winners from losers; supply-side strategy will be the game changer

Unprecedented growth in demand leading to supply-side cost pressures

We believe demand environment will continue to be strong in medium term, but we expect massive pressure on margins in H1FY23 – which will again stop earnings upgrade. Inflation in US has risen to record high levels with US CPI Urban consumer index growth of 7.9% YoY in Feb'22 vs 2% average growth in US inflation index for past 10 years, which will lead to more increase in onsite wage inflation. Talent shortage will continue to put pressure on demand fulfillment in spite of decadal strong hiring trend last year. Tight labor market conditions onsite are driving higher use of sub-contractors. Travel expenses will rebound and companies will need to spend more on facility expenses to accommodate employees.

In FY21, margins increased by 200-300 bps YoY due to covid-led cost savings from reduction of travel and facility expenses, delayed wage hikes, higher offshoring and increase in utilisation levels. However, by end of FY21, the unprecedented strong demand environment led to sharp rise in attrition resulting in supply-side cost pressures in terms of higher cost of lateral hiring to backfill attrition, higher retention costs, multiple wage hikes, bonuses, promotions etc. As a result, margins are expected to decline by 100-200 bps YoY in FY22/23 for most of the IT companies. Exception to this is Persistent and Coforge, whose margins have increased for last several quarters.

Management commentaries indicate that quarterly attrition has stabilised in Q4FY22E, however it is not expected to inch down in the near term. Challenges due to higher attrition (wage increments, higher hiring and retention costs etc.) are expected to persist over H1FY23 and will put pressure on margins. Ukraine crisis is adding to supply-side shortages given the region has around ~50,000 tech workers and 200,000 odd technology freelancers. Facility and travel costs are expected to increase with return to office / hybrid work environment. We believe margins will remain under pressure in FY23.

Margins are expected to slightly improve by end of FY23 led by: 1) levers of pyramid optimisation, 2) sub-con costs and employee wage hike impact likely to subside with attrition stabilising, and 3) price increase for digital revenue.

In such strong demand environment constrained only by availability of talent, companies may face challenges in fulfillment of existing orders and in winning new deals. Company with efficient supply chain mechanism will have the ability to grow higher than industry average as well as maintain and improve margins. **Efficient supply-side strategy will be the game changer in this strong demand environment with elevated attrition levels.**

Table 20: EBIT margins to remain under pressure in FY23E

EBIT Margin	FY16	FY17	FY18	FY19	FY20	FY21	FY22E	FY23E	FY24E
TCS	26.5	25.7	24.8	25.6	24.6	25.9	25.3	24.8	25.0
INFO	25.0	24.7	24.3	22.8	21.3	24.5	23.3	22.6	23.3
WPRO	18.2	15.6	15.2	15.8	16.6	19.4	17.1	16.1	17.3
HCLT	20.1	20.3	19.8	19.6	19.6	20.4	19.0	18.9	19.5
TECHM	13.3	11.0	11.8	15.0	11.6	14.2	14.9	14.2	14.6
LTI	14.6	16.2	15.0	18.4	16.1	19.3	17.3	17.3	18.0
MTCL	14.0	9.7	10.4	12.8	10.1	17.4	18.3	17.5	17.8
MPHL	13.4	14.9	15.1	16.2	16.0	16.1	15.2	15.8	16.1
COFORGE	13.5	12.7	12.5	14.2	13.5	12.9	14.4	15.3	15.3
PSYS	13.9	10.6	10.2	12.6	9.2	12.1	13.7	14.1	14.5
LTTS	15.0	16.7	13.1	16.0	16.5	14.5	18.1	17.9	18.0
CYL	10.5	10.6	11.0	11.3	9.2	10.0	13.5	13.5	13.7

Source: Company, I-Sec research

Table 21: EBIT margins declined in 9MFY22 vs FY21 led by supply-side cost pressures, but are maintained within guided range

EBIT Margin	Q4FY20	Q1FY21	Q2FY21	Q3FY21	Q4FY21	Q1FY22	Q2FY22	Q3FY22
TCS	25.1	23.6	26.2	26.6	26.8	25.5	25.6	25.0
INFO	21.2	22.7	25.3	25.4	24.5	23.7	23.6	23.5
WPRO	15.9	17.2	18.5	21.3	20.5	18.4	17.3	16.9
HCLT	20.9	20.5	21.6	22.9	16.6	19.6	19.0	19.0
TECHM	10.0	10.1	14.2	15.9	16.5	15.2	15.2	14.8
LTI	16.7	17.4	19.9	20.6	19.4	16.4	17.2	17.9
MTCL	12.5	13.7	17.3	19.6	18.6	17.7	18.2	19.2
MPHL	16.3	15.7	16.1	16.4	16.1	15.9	15.1	15.1
COFORGE	13.9	11.6	13.8	13.0	13.3	11.6	14.0	15.1
PSYS	9.2	10.4	12.1	12.7	13.2	13.5	13.9	14.0
LTTS	15.2	12.1	13.7	15.2	16.6	17.3	18.4	18.6
CYL	8.4	4.7	11.0	11.2	12.7	13.1	14.0	13.9

Source: Company, I-Sec research

Near-term margin headwinds

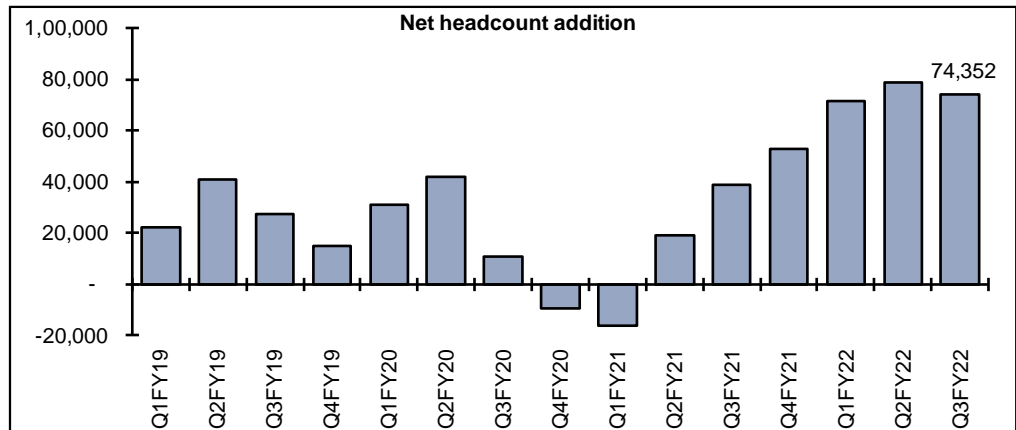
Supply-side costs pressure to weigh down margins in medium term

Strong recovery in technology spend coupled with low headcount addition in initial 2-3 quarters of pandemic led to strong hiring by IT companies in subsequent quarters resulting in 'war for IT talent'. LTM attrition increased sharply from lows of 8-10% at the start of pandemic to 20-24% over last four quarters.

Accenture did net addition of record 105K employees in H2CY21 (majority of new hires from India) vs 10K per quarter pre-covid. Net hiring by the top 5 IT firms (TCS, Infy, Wipro, HCLT and TechM) was 187K in 9MFY22 as against 87k in FY21 and average 50-60K per year pre-covid.

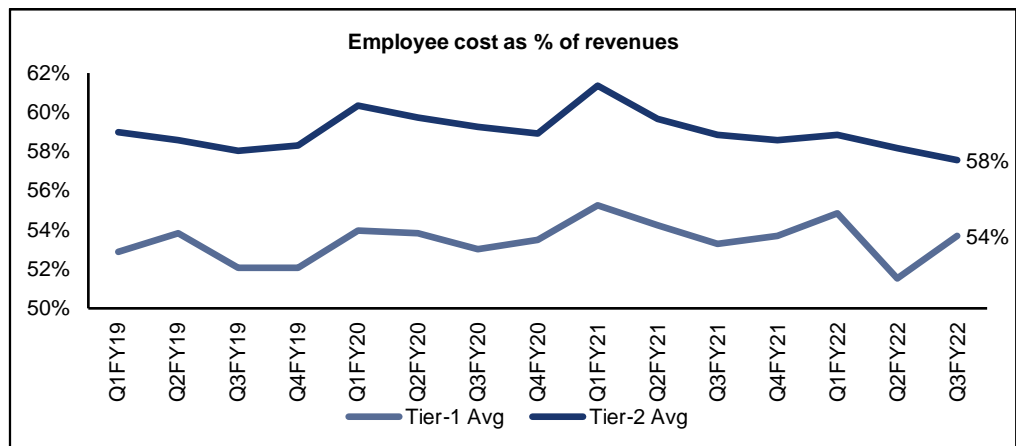
We expect supply-side cost pressures of higher retention cost, increase hiring cost, higher sub-con costs and wage hikes to continue to create margin headwinds in FY23. These costs are expected to cool off gradually as attrition trends downwards.

Chart 31: Tier-1 and tier-2 IT headcount grew 20% and 34% YoY in 9MFY22



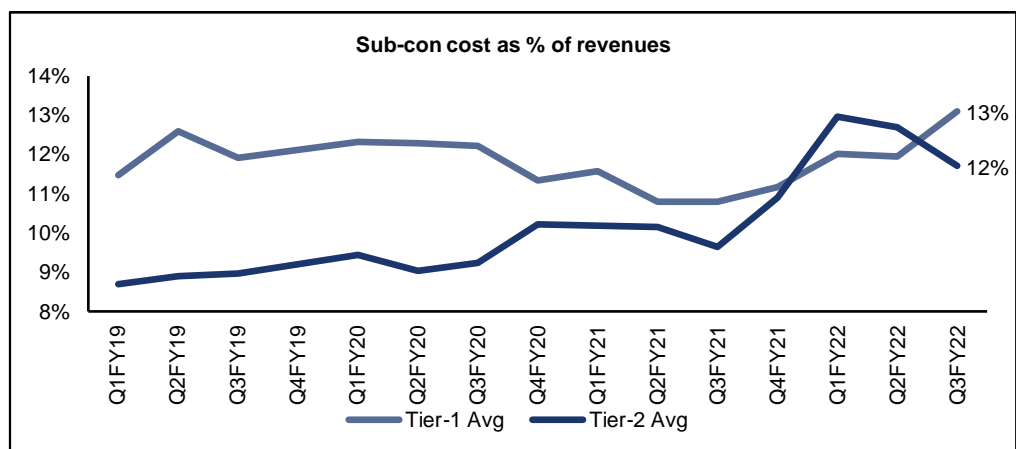
Source: Company data, I-Sec research

Chart 32: Employee expenses trend



Source: Company data, I-Sec research

Chart 33: Sub-con costs increased by 200-300 bps YoY led by travel restrictions and talent supply crunch



Source: Company data, I-Sec research

Table 22: Attrition increased sharply by ~1,000bps YoY over past four quarters

Attrition (%)	Q4FY20	Q1FY21	Q2FY21	Q3FY21	Q4FY21	Q1FY22	Q2FY22	Q3FY22
TCS	12.1	11.1	8.9	7.6	7.2	8.6	11.9	15.3
INFO	17.6	15.6	7.8	10.0	10.9	13.9	20.1	25.5
WPRO	12.6	10.7	11.0	11.0	12.1	15.5	20.5	22.7
HCLT	16.3	14.6	12.2	10.2	9.9	11.8	15.7	19.8
TECHM	19.0	16.6	14.0	12.0	13.0	17.0	21.0	24.0
LTI	16.5	15.2	13.5	12.4	12.3	15.2	19.6	22.5
MTCL	17.4	16.6	13.8	12.5	12.1	13.7	17.7	21.9
COFORGE	11.8	11.8	10.5	10.4	10.5	12.6	15.3	16.3
LTTS	13.8	11.4	10.8	10.7	12.2	14.5	16.5	17.5
CYL	13.2	13.2	13.2	13.2	21.2	23.5	24.3	29.3
BSOFT	18.9	16.5	11.4	10.9	11.6	16.5	24.2	31.4

Source: Company, I-Sec research

Table 23: Revenue per employee (US\$ '000)

	FY19	FY20	FY21	9MFY22
TCS	49.3	49.1	45.4	34.1
INFO	51.7	52.7	52.2	41.2
WPRO	49.2	46.9	42.3	33.6
HCLT	62.6	66.1	60.2	42.9
TECHM	41.1	41.4	42.2	30.3
LTI	47.9	48.5	46.4	34.7
MTCL	49.6	49.5	45.2	32.1
MPHL	45.7	46.9	44.4	33.3
COFORGE	51.7	53.2	50.7	28.7
PSYS	48.3	47.2	41.4	32.3
ZENT	58.0	61.9	60.6	39.1
LTTS	47.8	46.6	44.8	32.2
CYL	43.8	48.8	46.3	35.1
BSOFT	47.2	45.2	43.4	34.2
KPITTECH	n.a.	42.6	43.2	30.8
SSOF	41.5	44.5	40.5	30.3
TELX	37.8	34.5	33.5	26.7

Source: Company, I-Sec research

Table 24: Revenue per employee (Rs mn)

	FY19	FY20	FY21	9MFY22
TCS	3.5	3.5	3.4	2.5
INFO	3.6	3.7	3.9	3.1
WPRO	3.4	3.3	3.1	2.5
HCLT	4.4	4.7	4.5	3.2
TECHM	2.9	2.9	3.1	2.2
LTI	3.4	3.5	3.4	2.6
MTCL	3.5	3.5	3.3	2.4
MPHL	3.2	3.4	3.3	2.5
COFORGE	3.6	3.8	3.8	2.1
PSYS	3.4	3.4	3.1	2.4
ZENT	4.1	4.4	4.5	2.9
LTTS	3.4	3.3	3.3	2.4
CYL	3.1	3.5	3.4	2.6
BSOFT	3.3	3.2	3.2	2.5
KPITTECH	n.a.	3.0	3.2	2.3
SSOF	2.9	3.1	3.0	2.2
TELX	2.6	2.4	2.5	2.0

Source: Company, I-Sec research

Table 25: Cost per employee (Rs mn)

	FY19	FY20	FY21	9MFY22
TCS	1.4	1.5	1.5	1.1
INFO	1.8	1.9	1.9	1.5
WPRO	1.7	1.8	1.7	1.3
HCLT	2.1	2.3	2.3	n.a.
TECHM	1.4	1.5	1.6	n.a.
LTI	1.9	2.1	1.9	n.a.
MTCL	2.2	2.3	2.1	1.4
MPHL	1.8	1.9	1.9	n.a.
COFORGE	2.1	2.3	2.3	n.a.
PSYS	2.0	2.1	1.9	1.6
ZENT	2.2	2.5	2.6	n.a.
LTTS	2.0	1.9	2.0	n.a.
CYL	1.3	1.5	1.4	1.0
BSOFT	1.5	1.9	1.9	n.a.
KPITTECH	n.a.	2.0	2.1	n.a.
SSOF	1.5	1.6	1.6	n.a.
TELX	1.4	1.4	1.4	1.0

Source: Company, I-Sec research

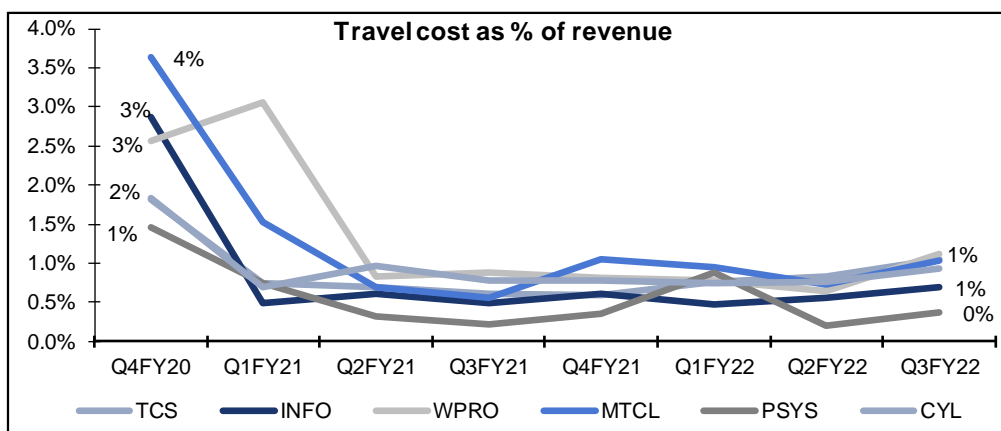
Travel and facility costs expected to normalise

Facility expenses declined by 150-200bps from 3-4% to 1-1.5%, during the pandemic, owing to work from home. Tier-1 IT companies' headcount increased by 23% in last five quarters by 230,000 whereas the physical seating capacity has not increased in the same proportion. Facility expenses are expected to increase gradually as adoption of work from office increases and as companies increase their physical seating capacity in FY23. But it is not expected to go back to pre-covid levels because companies will adopt hybrid work model given employees preference of flexible work location and work timings.

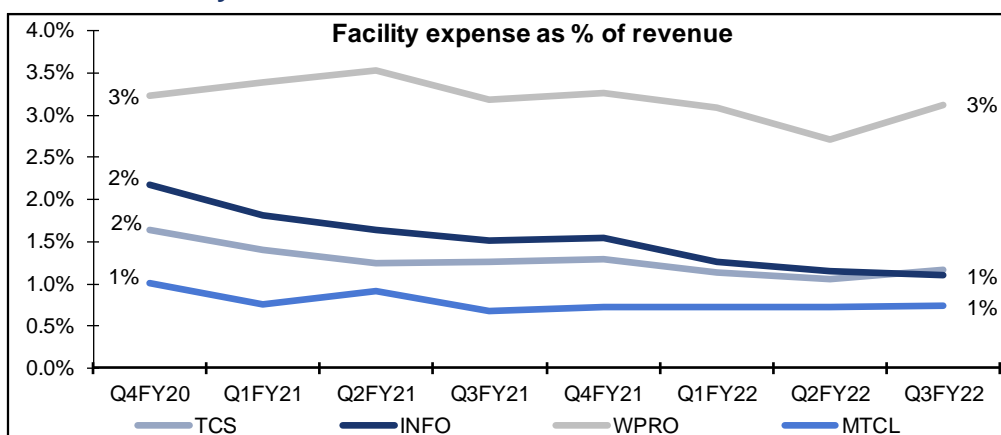
Mindtree plans to open multiple offices in existing locations of Pune, Bengaluru and Mumbai such that these offices are 5-7 miles of residential areas where majority of employees reside in-order to reduce employee travel time to office. It also plans to open new offices in Kolkata, Coimbatore and Warangal as considerable portion of employees belong to these cities and adjoining areas.

Companies are also expanding talent base to tier-2 cities in India and near shore centres in Latam and eastern Europe. TechM management mentioned that they have expanded in nine tier-2 cities in India where not only talent cost is lower but attrition is also considerably low compared to tier-1 cities. LTI is expanding in tier 2+ cities depending on the availability of talent in these cities. It has opened development centres in Coimbatore, Hyderabad and Kolkata.

Travel expenses also reduced drastically by ~200bps during the pandemic. As economies open up, travel costs are expected to increase, but will still be lower than pre-covid levels as clients now are more open to online deal closures and offshore delivery.

Chart 34: Travel cost to increase as international business travel resumes

Source: Company, I-Sec research

Chart 35: Facility costs to increase as share of work from offices increases

Source: Company, I-Sec research

Table 26: SG&A costs will normalize in FY23/24

SG&A costs as % of revenue	Q4FY20	Q1FY21	Q2FY21	Q3FY21	Q4FY21	Q1FY22	Q2FY22	Q3FY22
TCS	16.9	15.8	14.7	15.0	14.4	14.8	14.8	15.0
INFO	12.2	11.0	10.5	9.9	10.3	12.8	12.2	11.8
WPRO	11.4	13.3	11.8	12.2	11.9	11.7	12.8	12.8
HCLT	14.6	14.3	14.6	13.8	14.3	14.8	14.8	14.2
TECHM	15.3	14.2	13.3	13.3	13.7	13.3	13.3	12.1
LTI	13.6	12.4	12.0	11.7	10.1	12.3	11.5	10.9
MTCL	21.1	16.2	14.2	14.6	15.9	20.1	19.0	18.6
MPLH	10.6	11.2	12.3	12.7	13.1	10.8	12.0	12.7
COFORGE	16.4	14.4	13.8	14.0	14.0	13.7	13.5	12.9
PSYS	20.0	18.2	18.3	17.3	17.0	17.2	16.9	16.9
LTTS	23.3	19.2	20.2	19.2	20.7	21.4	22.1	23.6
CYL	20.6	20.7	19.9	18.8	18.9	18.2	19.8	18.4

Source: Company, I-Sec research

Margin tailwinds to take a back seat

Aggressive fresher hiring to improve employee pyramid

Headcount for tier-1 IT companies increased 20% YoY and that of tier-2 IT companies by 34% YoY in last four quarters. Substantial portion of this addition is freshers because to increase overall capacity in the industry, IT companies started aggressive fresher hiring. For example, Mindtree used to hire 1500 freshers per year earlier and now it is hiring 1,500 freshers per quarter. Infosys total fresher hiring target for FY22 is 55K (revised upwards for third consecutive quarter). TCS added 43K freshers in H1FY22 and further added 34K freshers in Q3 alone. TCS and Infosys intend to hire similar number of freshers in FY23 as well.

Companies are also focusing on fast-tracking fresher training to reduce time taken for fresher to be billable by partnering with educational institutes and introducing relevant training as part of college curriculum in final year.

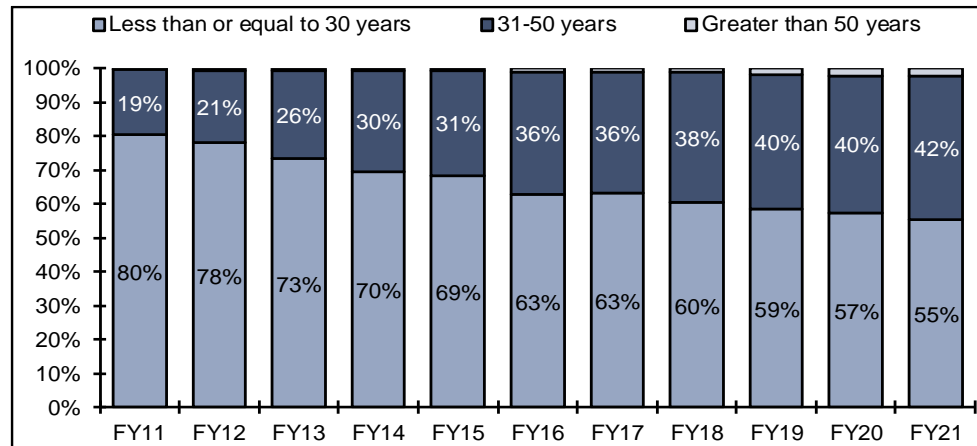
Massive increase in fresher hiring throughout FY22 will balance the employee pyramid and provide considerable margin tailwinds in FY23E. **War for IT talent in a way has been a blessing for IT industry as it is resulting in balancing of employee pyramid, widening of technology talent pool and potential for higher offshoring.**

Table 27: Aggressive fresher hiring done in FY22 and is likely to continue in FY23 as well

Company	Remarks
TCS	"In addition to the 43,000 freshers we onboarded in H1, we have brought in another 34,000 in Q3 and plan to bring onboard some more in the fourth quarter. Fresher hiring continues to be through our national qualifier test. However, we have increased its frequency to cater to our unprecedented volumes of hiring."
INFY	"In terms of attrition, I think it is a larger industry issue. It is not peculiar to us and fundamentally the volume increase for this industry has to come from freshers. So as long as the fresher intake starts increasing because first they have to come into training, then they go into production after 3 or 4 months and that is something which will help with the attrition in the medium term; and like I said we have seen attrition flattening sequentially on a quarterly annualised basis and looking ahead we are seeing some positive signs, but it is too early to say whether it will dramatically come down."
WPRO	"We on course to onboard over 70% more fresh talent from the campus in FY22 vs FY21."
HCLT	"At HCL while we continue to onboard experience domain and tech specialists, our strategy continues to lean more towards adding net new talent at scale through the fresh talent coming out of colleges and schools. We are in line to achieve a 20,000 campus hires target for FY22, having added more than 15,000 YTD. We intend to double our fresher hiring in the coming year induced by the good demand environment that we are seeing all around. Our campus hiring program in some of our largest markets like US are also accelerating with plans to hire over 2000 graduates in the next two to three years."
TECHM	"We continue to add more freshers to the organisation to change the pyramid, bring overall average cost down as we move forward. In this year, we'd probably add about 10,000 at the bottom of the pyramid, that's freshers. And the idea is to really increase it substantially as we go forward in the next year."
LTI	"We increased our fresher intake to 5,500 for FY22."
MTCL	"Yeah, roughly I would give a rough number of around 1500 freshers are getting added per quarter. In today's world, if we want to sort of ensure that our employee cost base does not increase exponentially, then the fresher addition strategy is going to be the key for us and we will continue to add. With a rejuvenated campus hiring program, we expect our hiring momentum from campuses to increase by 40 to 50% through FY23."
MPHL	"In FY22, we are likely to close with the highest ever fresher addition in a year of over 5500. Over the past few quarters, we have worked through substantially utilising the internal workforce capacity created by the DXC downsizing. With this behind us, we are now expanding our muscle in campus hiring and have increased our targets going forward."
COFORGE	"And the final lever, the 8th lever in play from our perspective is the delivery pyramid continued flattening, with the number of campus hires this year, being six times of what it was two years back and I would venture to say more than three times than what it was last year."
PSYS	"Yeah, so look, we have been doing fresher hiring for many years. Although I will say that the scale at which we hired freshers in the last 12 months and the scale at which we will hire freshers in the next 12 months, it is you know disproportionate to what we used to do earlier. And we look forward to the freshers coming in over the next few months and quarters at a bigger clip. So roughly about 3,000 is what we are looking to induct as freshers over the next 12 months, FY23."
LTTS	"Second is that we have taken about 3,000 freshers now and 1,100 plus 1,900. We will take some more in Q4, but the big haul will again start in Q1 or Q2 onward depending on when the students come out of college. I can confirm to you that the plans right now are to have similar intake of freshers in FY23 as FY22."

Source: Company data, I-Sec research

Chart 36: Infosys employee mix – Proportion of associates declined in FY21 providing scope for margin improvement via pyramid optimisation



Source: Company data, I-Sec research

Positive pricing environment

Management commentaries across companies indicate that pricing is no longer the focus of discussion with clients, especially in deals related to transforming business model of clients in terms of enhancing revenue or adding additional revenue streams. However, **pricing benefit will flow through P&L with a lag** because of higher likelihood of price increases in newer deals whereas wage inflation is front-ended.

TCS saw a small pricing uptick in Q3 and pricing power is expected to improve in FY23. Since TCS has long-standing customer relationships with deep level of trust, it doesn't prefer surprising clients by increasing pricing in existing deals. However, as cost of living adjustments are incorporated given rising inflation in US, pricing negotiations in long-term contracts will be easier. In newer outsourcing engagements, TCS expects to get improved pricing in-line with industry trends. Also in Growth and Transformation (G&T) deals, clients are not very sensitive to pricing as they are investing to improve topline. As proportion G&T deals increases it will drive pricing power for TCS.

Mindtree is focusing on outcome-based pricing constructs in new deals which acts as a positive lever for pricing.

Revenue growth led EPS upgrade cycle to take back seat

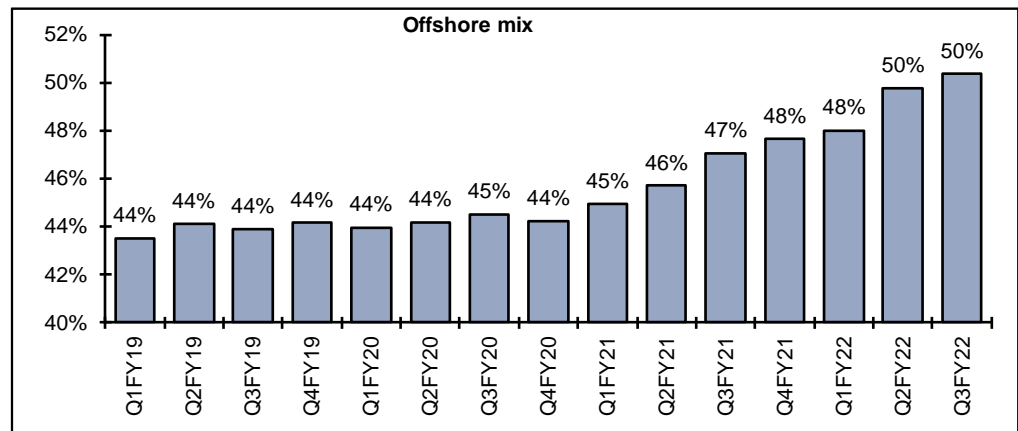
Tier-1 IT services player have received ~ 120-500 bps YoY cross currency tailwinds from 1QFY21-2QFY22 which have also helped them to report a strong USD revenue growth rate. Post weakening US macro environment, GBP and Euro have depreciated v/s the INR. Indian IT Services USD revenue growth will be hindered on account of depreciation in GBP and Euro V/s USD.

Though companies have indicated strength in pricing power, pyramid optimization, offshoring but this tailwind will be back ended. We believe companies will not be any more benefited by strong USD revenue growth (CC headwinds) and revenue growth led EPS upgrade cycle is expected to take a back seat.

Offshoring to remain at higher levels compared to pre-covid

LTI CEO Sanjay Jalona mentioned in Q3FY22 earnings call, “I think we are very comfortable with where we are with respect to onsite/offshore mix. People will actually communicate on these tools and platforms that do not go down, whether its Teams, WebEx, Zoom, there are many collaboration tools. But I hope we don't go back to the model of a lot more travel because these platforms are the good things that we need to continue. **To talk to more people using these platforms and customers are ready to do that. That is why I think we are comfortable with the offshore mix. And I think it can still continue to move a little bit more offshore.**”

Chart 37: Offshore mix continues to improve



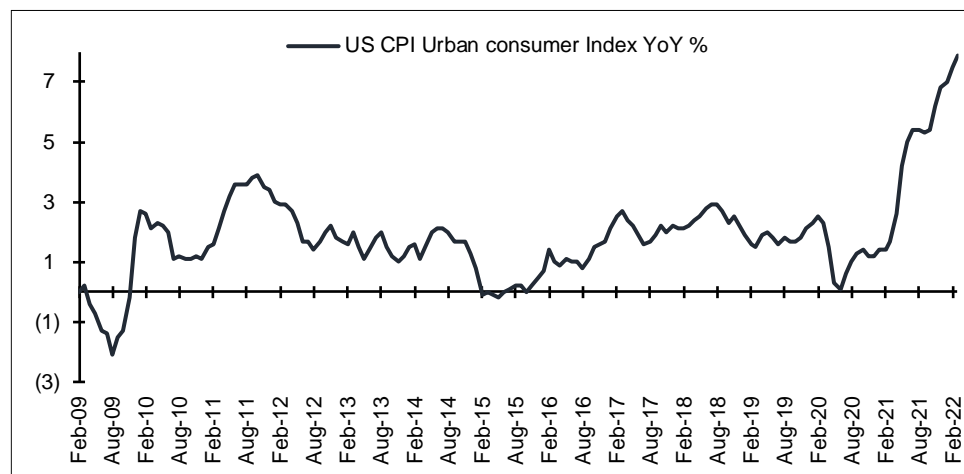
Source: Company data, I-Sec research. Note: Includes WPRO, TECHM, LTI, MPHL, COFORGE, LTTS & CYL.

Weakening US macro environment

Globally, US and European economies are grappling with soaring inflation and supply chain disruptions. Prices increased by 7.9% YoY through Feb'22 – the highest rate of inflation since 40 years. Ukraine crisis is also creating upward pressure on inflation and economic activity. Rising inflation, supply chain disruptions and geopolitical uncertainties due to Russia-Ukraine war may cause slowdown in global economies. If this results in slowdown in BFSI tech spending, then that would be the biggest trigger for de-rating of multiples of IT services.

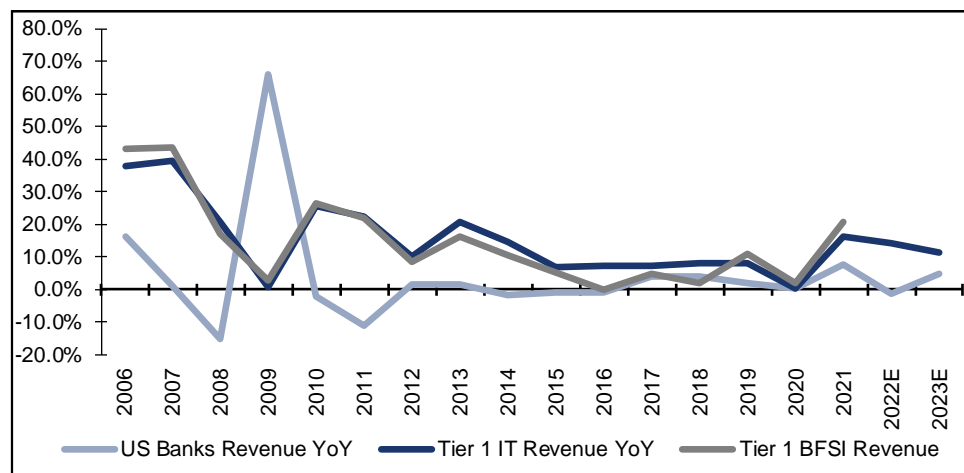
At the same time, management commentary during ACN Q2FY22 earnings call suggests that they are not witnessing any slowdown in tech spending. They mentioned that clients are not over-reacting to the crisis and are very focused on priorities they had before inception of these macro uncertainties, and that cyber security, supply chain resiliency and energy efficiency are on top of mind for enterprises due to the Russia-Ukraine conflict. In fact, technology will be critical component to navigate these macroeconomic uncertainties.

Chart 38: Consumer price index shows highest inflation in 12 years



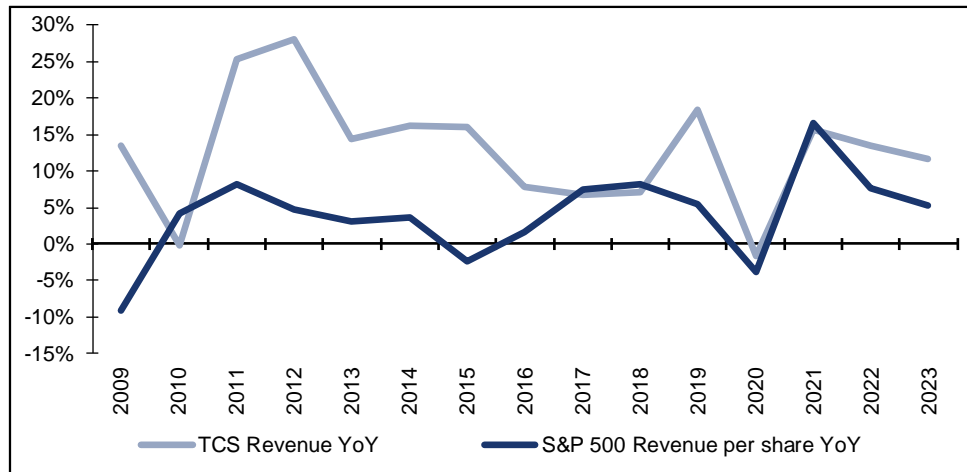
Source: Company data, I-Sec research

Chart 39: Tier-1 IT BFSI revenue is strongly correlated with US banks' revenue



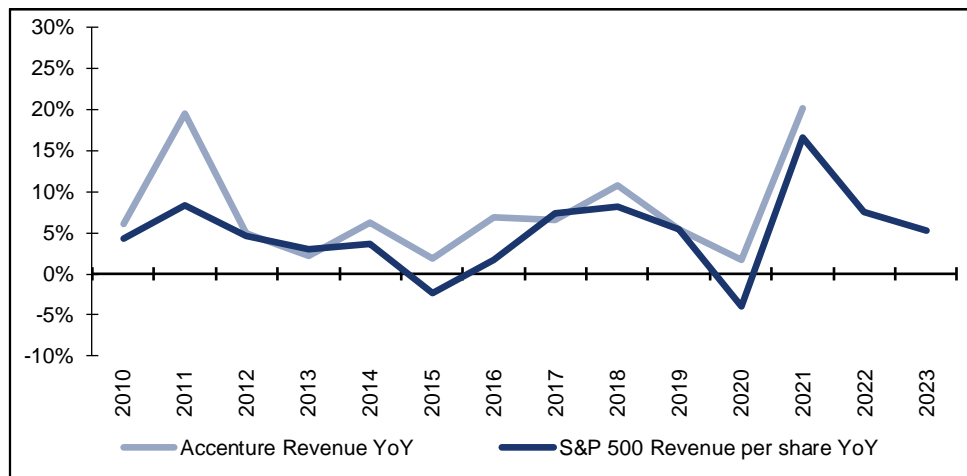
Source: Company data, I-Sec research

Chart 40: TCS vs S&P 500 revenue growth



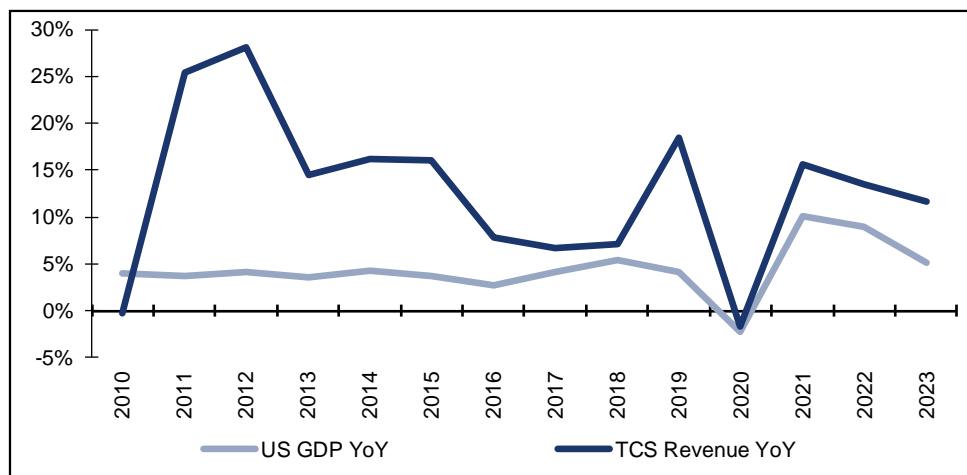
Source: Company data, I-Sec research

Chart 41: Accenture vs S&P 500 revenue growth



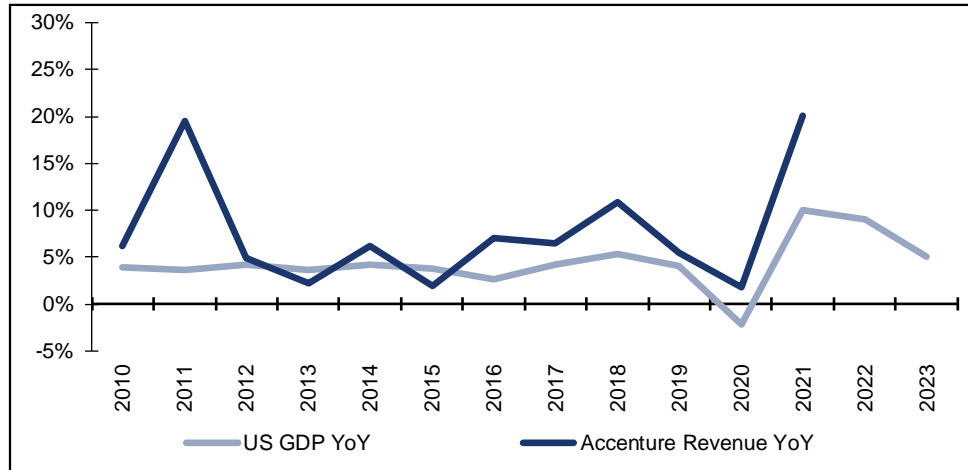
Source: Company data, I-Sec research

Chart 42: US nominal GDP growth vs TCS revenue growth



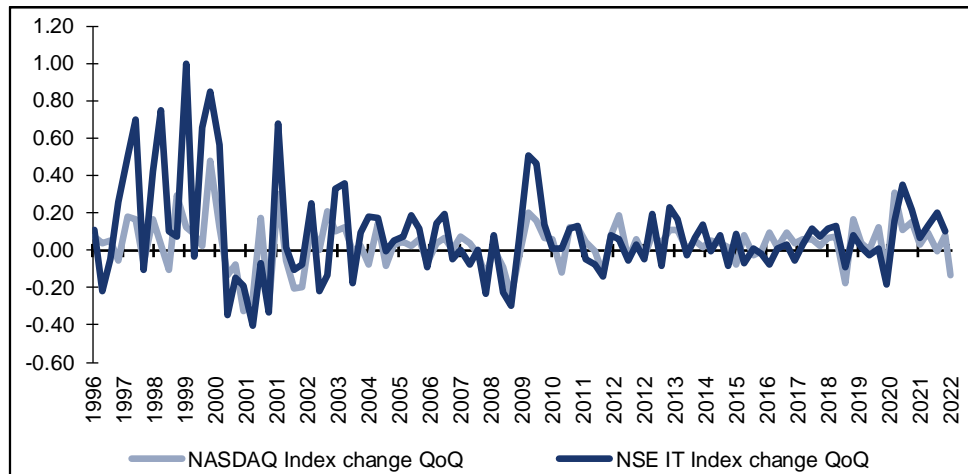
Source: Company data, I-Sec research

Chart 43: US nominal GDP growth vs Accenture revenue growth



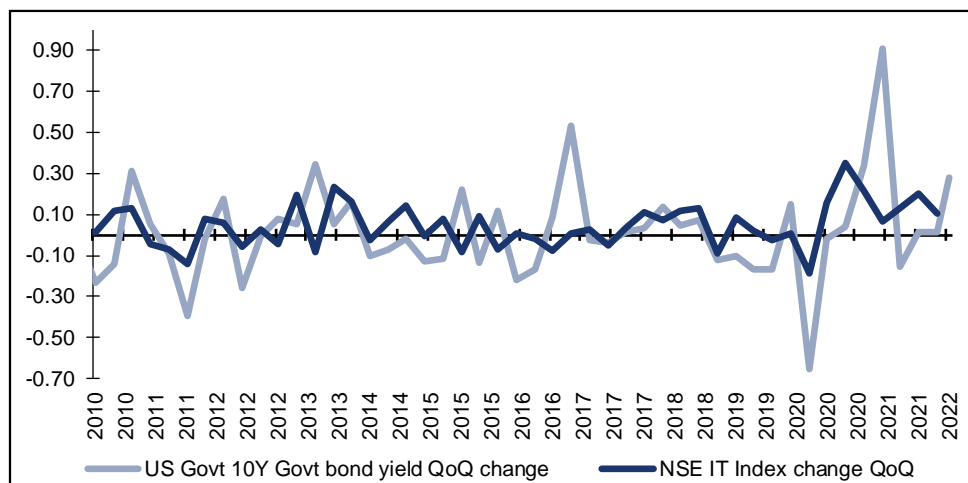
Source: Company data, I-Sec research

Chart 44: NASDAQ vs NIFTY IT movement



Source: Company data, I-Sec research

Chart 45: US government bond yield vs NIFTY IT index QoQ change



Source: Company data, I-Sec research

Valuation multiples unlikely to rerate

IT stocks have undergone strong V-shaped recovery led by accelerated revenue growth expectations over FY22-FY24E and strong margin expansion in FY21. We estimate revenue CAGR of 12%/19%/19% and EPS CAGR of 13%/22%/20% for tiers-1, 2 & ER&D companies over FY22-FY24E. With tier-1 / tier-2 IT already trading at 25x/35x (vs FY18-20 average of 17x), EPS expansion due to revenue growth acceleration is already factored in and it is unlikely for the sector to further rerate because of impending margin pressures due to supply-side constraints and potential slowdown in discretionary spends due to rising inflation and supply chain issues globally. We believe that mid-cap IT will continue to deliver much higher growth as compared to its large cap peers.

With Indian IT sector already trading at 28x P/E vs last 10-year P/E of 18x, we believe much of the growth & earnings expectations over next 3 years are factored in share prices. Given this background, we remain cautiously optimistic and selective in our idea generation.

Our estimates on average are 4-6% below consensus estimates as we have assumed lower revenue growth and higher margin pressure compared to consensus estimates. We believe there will be a series of EPS downgrades because of slowing revenue momentum and elevated margin pressures.

We remain cautiously optimistic after our three-year-long bullish stance on the sector and selective in our idea generation. . We initiate/reinitiate coverage on 18 stocks with 2 BUY, 8 HOLD, 3 ADD, 4 REDUCE and 1 SELL. We have BUY rating on Coforge and Mphasis (fastest growing) given their favorable risk-reward and as they are the only IT companies whose margins can expand in FY23E.

We are impressed with the performance of PSYS and MTCL both on strategy of growth, margins, & TCV; we assign HOLD rating only because of elevated valuations and we believe they should be considered to be added on dips.

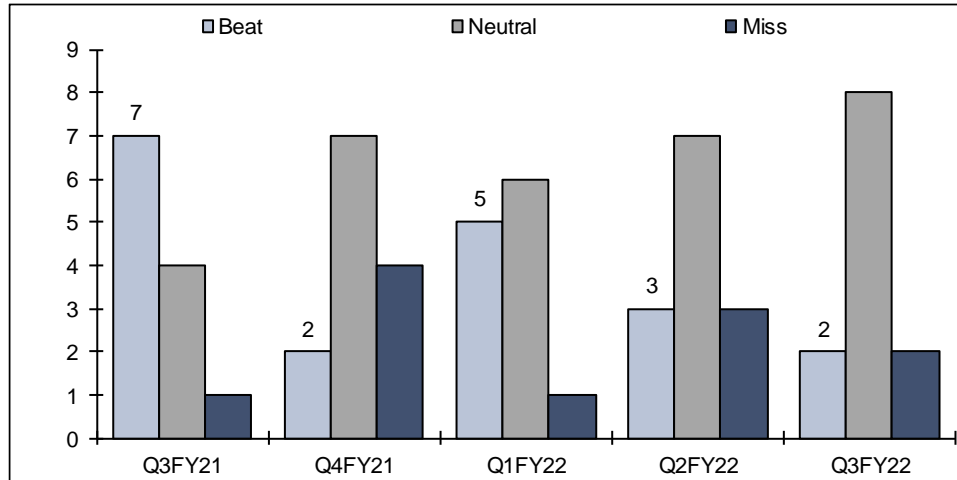
We assign REDUCE rating on Wipro & INFY given their high PEG multiples and slowing revenue/earnings growth ahead. Though HCLT has been an underperformer since last one year, only cheap valuations led us to assign HOLD rating for the stock. TECHM has been a consistent performer since last one year, but increased acquisitions and moderating margin performance along with favorable valuations led us to assign HOLD rating on the stock.

Table 28: Stocks have re-rated massively...

	TCS	Infosys	Wipro	HCLT	TechM	LTI	Mindtree	Mphasis	LTTS	Coforge	Persistent
Pre-covid FY18-FY 20 average P/E	23	18	15	14	14	20	20	16	21	19	14
Current P/E (as on 11th March)	31	29	23	21	20	38	38	33	45	30	42
Rerating from pre-covid (%)	33%	55%	53%	48%	39%	92%	91%	104%	114%	64%	194%
Max P/E	35	32	30	25	33	49	52	39	25	44	48
Derating from peak (%)	-12%	-10%	-21%	-18%	-39%	-23%	-28%	-15%	75%	-32%	-12%

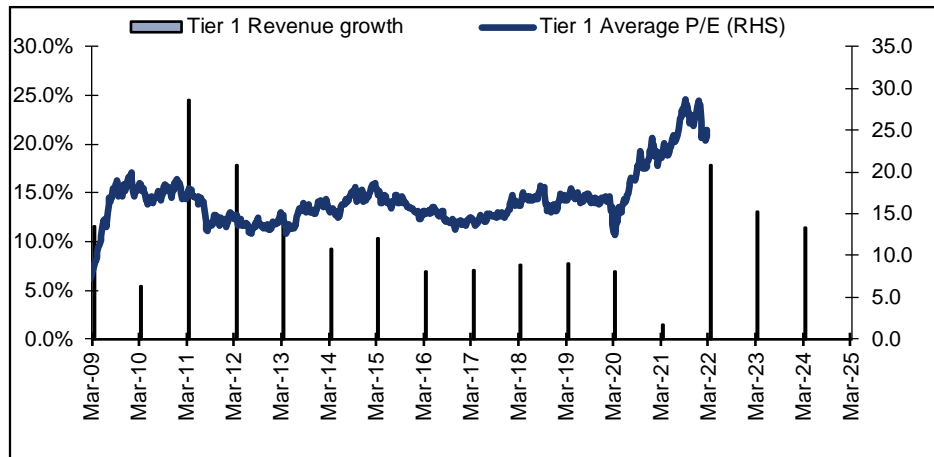
Source: Company data, I-Sec research

Chart 46: Surprises on estimates have reduced over the time..



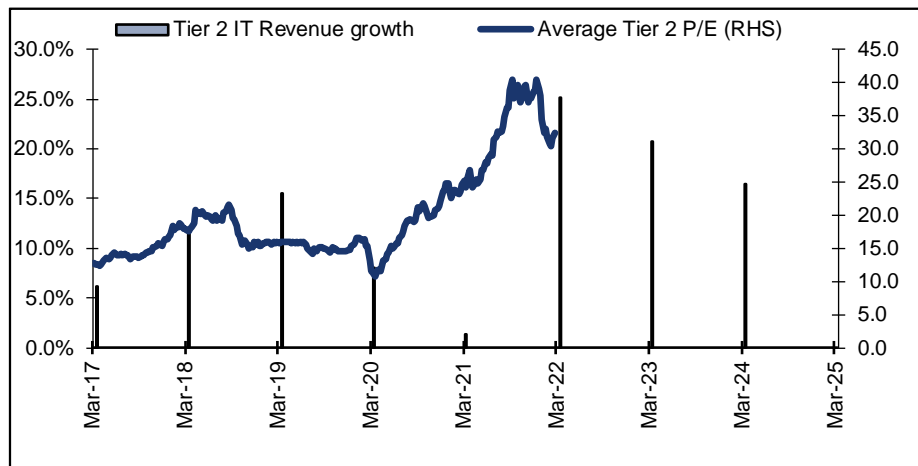
Source: Company data, I-Sec research

Chart 47: Multiples are very sensitivity to revenue growth



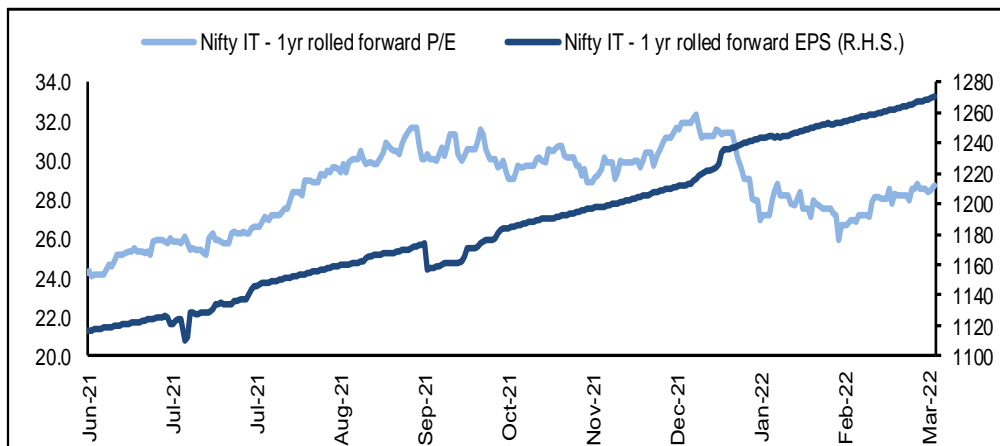
Source: Company data, I-Sec research

Chart 48: Multiples are very sensitivity to revenue growth



Source: Company data, I-Sec research

Chart 49: EPS de-rating cycle may start...



Source: Company data, I-Sec research

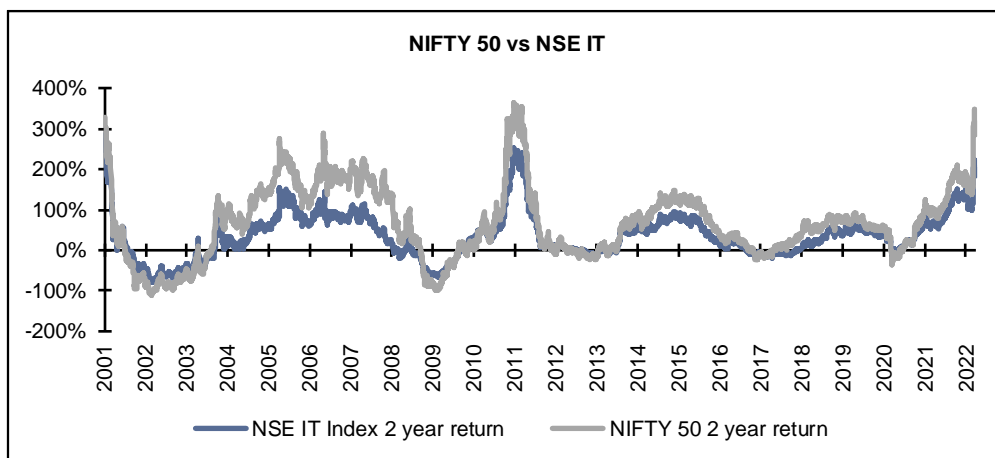
Our comparison of NSE IT’s 2-year rolling returns vs that of NIFTY50 for past 20 years shows that NSE IT has never outperformed NIFTY50 for more than ~2.5 years. An exception is the current outperformance of NSE IT over NIFTY from mid CY18 (~3.5-year duration till now). Against this backdrop, we see a high likelihood of NSE IT strongly underperforming NIFTY50 in FY23E. We believe this extra run-up (1.5 years) is also led by lower cost of equity, excessive cost savings and strong pent-up demand.

Table 29: NSE IT has never outperformed NIFTY50 for more than ~2.5 years

Time line	May 98- Sep 01	Sep 01 - Apr 05	Apr 05 - May 06	May 06 - Oct-09	Oct 09 - May 12	May 12 - July 13	July 13 - July 15	July 15 - July 16	July 16 - July 18	July 18- Apr 22
2 Yr rolling returns in NSE IT higher than NIFTY IT?	Out-perform	Under-perform	Out-perform	Under-perform	Out-perform	Volatility	Out-perform	Volatility	Under-perform	Out-perform
No. of years of outperformance	2.5		1		2.5		2			3.5

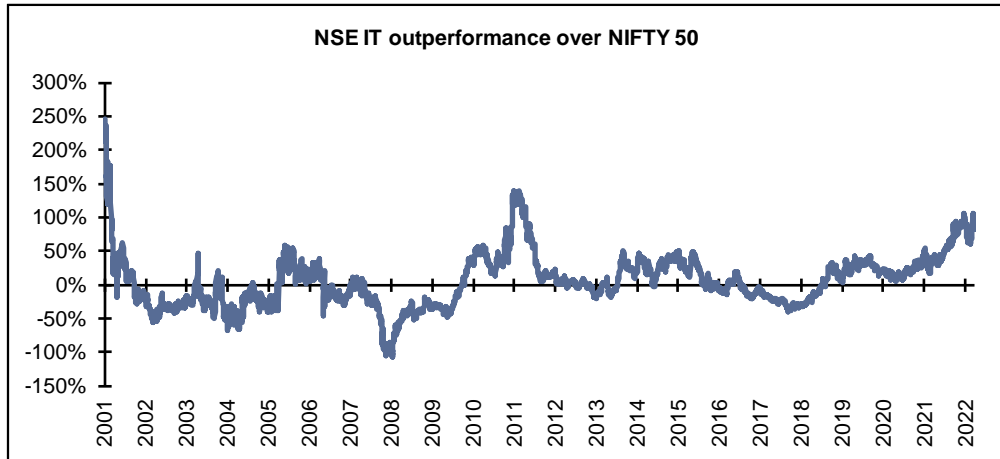
Source: I-Sec research

Chart 50: NIFTYIT index may underperform NIFTY Index hereon..



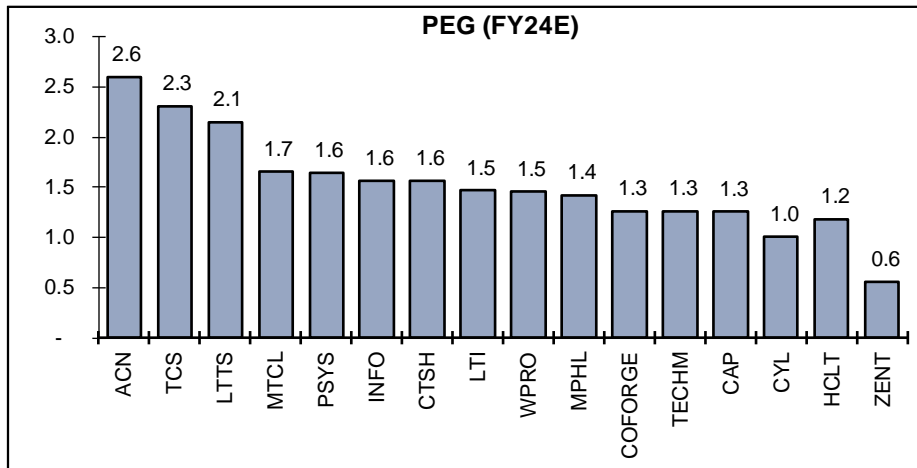
Source: Company data, I-Sec research

Chart 51: NSE IT has never outperformed NIFTY50 for more than ~2.5 years



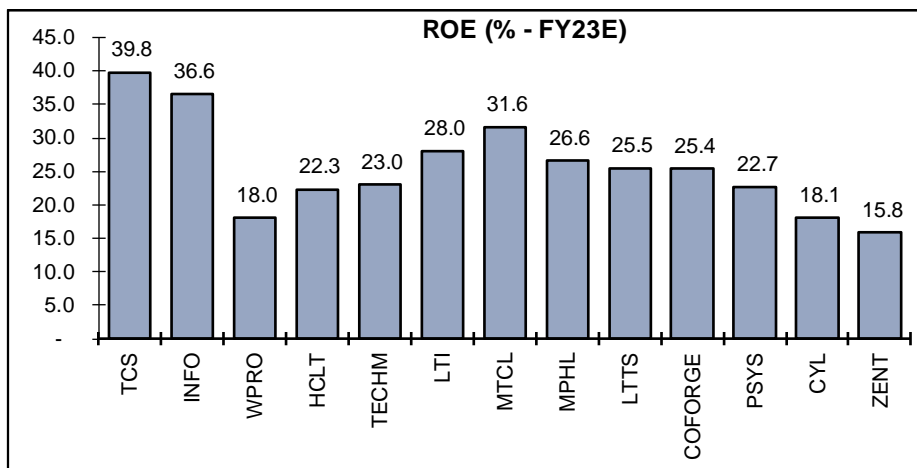
Source: Company data, I-Sec research

Chart 52: PEG ratios are elevated...



Source: Company data, I-Sec research

Chart 53: ROE continues to remain strong



Source: Company data, I-Sec research

Table 30: Key Risks

Company	Rating	Risk
TCS	Hold	1. Strong large deal win momentum, 2. Margin expansion, 3. INR Depreciation, 4. Continuation of discretionary spends
Infosys	Reduce	1. Strong large deal win momentum, 2. Margin expansion, 3. INR Depreciation, 4. Continuation of discretionary spends
Wipro	Reduce	1. Strong large deal win momentum, 2. Margin expansion, 3. INR Depreciation, 4. Continuation of discretionary spends
HCL Tech	Hold	1. Continued weak margin performance, 2. Weak growth in Services business, 3. Weak TCV momentum, 4. INR appreciation
Tech M	Hold	1. Weak revenue growth from communication, 2. Delay in 5G capex, 3. Margin contraction, 4. INR appreciation
L&T Infotech	Reduce	1. Strong margin performance, 2. Strong growth in BFSI, 3. INR depreciation
Mindtree	Hold	1. Weak revenue growth from Hi-tech vertical, 2. Contraction of margins, 3. INR appreciation
Mphasis	Buy	1. Weak revenue growth from direct core, 2. No expansion of margins, 3. INR appreciation, 4. Contraction in US capital market IT spends
L&T Tech.	Reduce	1. Strong large deal win momentum, 2. Margin expansion, 3. INR Depreciation, 4. Continuation of discretionary spends
Coforge	Buy	1. Weak revenue growth from BFSI vertical, 2. Contraction of margins, 3. Promoter (PE) selling, 4. INR appreciation
Persistent	Hold	1. Weak revenue growth, 2. Contraction of margins, 3. INR appreciation
Cyient	Add	1. Weak revenue growth, 2. Contraction of margins, 3. INR appreciation
Zensar	Hold	1. Weak revenue growth, 2. Further contraction in margins, 3. INR appreciation
Sonata Software	Add	1. Weak revenue growth in Microsoft dynamics, 2. Elevated margin pressure, 3. INR appreciation
Tata Elxsi	Sell	1. Strong large deal win momentum, 2. Margin expansion, 3. INR Depreciation, 4. Continuation of discretionary spends
KPIT	Reduce	1. Strong large deal win momentum, 2. Margin expansion, 3. INR Depreciation, 4. Continuation of discretionary spends
BirlaSoft	Hold	1. Slowdown in enterprise portfolio growth, 2. Elevated attrition, 3. INR appreciation
Newgen	Buy	1. Inability to generate revenues through GSIs, 2. Faster transition to SaaS from on-premise in emerging markets

Source: Company data, I-Sec research

Table 331: Valuations

Companies	Rating	Target Price (Rs)	Target Multiple (x)	USD Revenue Growth (%)			EBIT Margin (%)			EBITDA Margin (%)			EPS (Rs)		
				FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E
TCS	HOLD	3,519	27.0	15.9	11.0	10.1	25.3	24.8	25.0	27.7	27.2	27.4	103.6	116.7	130.3
Infosys	REDUCE	1,628	24.0	20.6	13.1	11.7	23.3	22.6	23.3	26.2	25.4	26.1	51.9	57.7	67.8
Wipro	REDUCE	548	20.0	27.2	12.5	11.0	17.1	16.1	17.3	21.1	20.0	21.1	21.6	23.4	27.4
HCLT	HOLD	1,177	19.0	12.8	11.0	11.2	19.0	18.9	19.5	23.9	23.6	23.9	49.3	53.4	62.0
TechM	HOLD	1,502	19.0	17.4	16.2	11.6	14.9	14.2	14.6	18.2	17.9	18.3	62.6	68.7	79.1
LTI	HOLD	5,921	32.0	26.5	21.6	17.7	17.3	17.3	18.0	19.5	19.4	20.1	131.2	150.1	185.0
Mindtree	HOLD	4,266	32.0	31.1	21.9	15.5	18.3	17.5	17.8	20.6	20.0	20.3	97.7	111.8	133.3
Mphasis	BUY	3,659	32.0	21.7	20.2	14.8	15.2	15.8	16.1	17.7	17.9	18.1	75.6	95.0	114.3
Coforge	BUY	5,209	30.0	37.5	20.2	17.0	14.4	15.3	15.3	17.9	19.3	19.5	109.9	144.4	173.6
Persistent	HOLD	4,515	33.0	34.8	29.8	18.4	13.7	14.1	14.5	16.6	17.0	17.4	87.7	112.7	136.8
Zensar	HOLD	400	16.0	14.9	17.4	14.9	11.2	11.9	13.0	15.6	15.9	17.0	16.5	19.6	25.0
Sonata	ADD	904	18.0	28.5	19.7	17.4	8.1	8.3	8.4	8.9	9.0	9.1	35.9	43.5	50.2
BirlaSoft	HOLD	508	22.0	16.1	18.6	15.5	13.4	12.9	14.0	15.3	14.9	16.0	16.2	18.4	23.1
Newgen	ADD	573	24.0	14.5	21.0	22.0	22.1	22.4	22.5	24.6	24.9	25.0	18.9	23.3	28.4
Tata Elxsi	SELL	4,875	40.0	34.1	25.9	23.2	28.8	25.7	25.5	30.8	27.7	27.5	88.2	103.4	128.3
LTTS	REDUCE	4,413	34.0	19.9	19.4	17.7	18.1	17.9	18.0	21.4	21.1	21.1	90.5	109.5	129.8
Cyient	ADD	1,025	18.0	9.0	10.4	13.1	13.5	13.5	13.7	17.8	18.1	18.3	44.2	49.4	57.0
KPIT	REDUCE	535	34.0	19.8	20.3	19.5	12.9	13.5	14.0	17.9	18.5	19.0	10.0	12.6	15.7

Source: I-Sec research

Table 332: We are below consensus estimates in most of the companies...

Company	Revenue Growth (%)						EBIT margin (%)						EPS (Rs)					
	Our Estimates		Cons Estimates		Difference		Our Estimates		Cons Estimates		Difference		Our Estimates		Cons Estimates		Difference	
	FY23	FY24	FY23	FY24	FY23	FY24	FY23	FY24	FY23	FY24	FY23	FY24	FY23	FY24	FY23	FY24	FY23	FY24
TCS	11.0%	10.1%	14.1%	11.6%	-310	-160	24.8%	25.0%	25.6%	25.6%	-70	-60	117	130	120	135	-3%	-4%
Infosys	13.1%	11.7%	16.9%	12.9%	-380	-120	22.6%	23.3%	23.7%	23.9%	-120	-70	58	68	64	73	-9%	-7%
Wipro	12.5%	11.0%	13.7%	13.6%	-120	-260	16.1%	17.3%	17.9%	18.0%	-180	-80	23	27	25	28	-6%	-4%
HCLT	11.0%	11.2%	14.2%	12.0%	-330	-90	18.9%	19.5%	19.7%	20.1%	-90	-60	53	62	56	64	-5%	-4%
TechM	16.2%	11.6%	16.5%	12.1%	-30	-60	14.2%	14.6%	15.3%	15.5%	-110	-90	69	79	72	82	-5%	-3%
LTI	21.6%	17.7%	22.9%	18.1%	-120	-40	17.3%	18.0%	18.0%	18.1%	-80	-10	150	185	162	193	-7%	-4%
Mindtree	21.9%	15.5%	21.9%	15.5%	0	0	17.5%	17.8%	18.2%	18.3%	-70	-60	112	133	114	132	-2%	1%
Mphasis	20.2%	14.8%	21.8%	16.6%	-160	-180	15.8%	16.1%	15.7%	16.1%	10	0	95	114	95	115	0%	0%
Coforge	20.2%	17.0%	20.9%	16.9%	-70	0	15.3%	15.3%	15.3%	15.4%	0	-10	144	174	143	171	1%	2%
Persistent	29.8%	18.4%	29.0%	18.1%	80	40	14.1%	14.5%	13.9%	14.5%	20	0	113	137	110	133	2%	3%
Zensar	17.4%	14.9%	18.1%	14.9%	-70	10	11.9%	13.0%	12.5%	13.6%	-60	-60	20	25	19	24	1%	5%
Sonata	19.7%	17.4%	20.2%	17.3%	-40	10	8.3%	8.4%	8.4%	8.4%	0	0	43	50	42	49	4%	3%
Birlasoft	18.6%	15.5%	18.7%	15.5%	-10	0	12.9%	14.0%	14.4%	15.0%	-150	-100	18	23	20	24	-7%	-2%
Newgen	21.0%	22.0%	20.8%	22.1%	20	-10	22.4%	22.5%	22.4%	23.3%	0	-80	23	28	26	32	-9%	-10%
Tata Elxsi	25.9%	23.2%	31.3%	18.5%	-540	470	25.7%	25.5%	26.2%	26.4%	-50	-80	103	128	104	123	0%	4%
LTTS	19.4%	17.7%	20.1%	17.5%	-80	20	17.9%	18.0%	18.4%	18.5%	-50	-50	110	130	112	133	-2%	-3%
Cyient	10.4%	13.1%	14.5%	12.9%	-410	20	13.5%	13.7%	13.7%	14.0%	-20	-30	49	57	54	62	-9%	-8%
KPIT	20.3%	19.5%	20.6%	19.3%	-30	20	13.5%	14.0%	14.0%	14.8%	-50	-80	13	16	13	16	0%	-1%

Source: I-Sec research

Table 33: Preview- Q4FY22

Q3FY22	USD Revenue growth QoQ	USD Revenue growth YoY	CC revenue growth QoQ	EBIT Margins	QoQ Bps	YoY Bps	EPS Growth QoQ	EPS Growth YoY
TCS	2.4%	11.6%	2.2%	25.0%	-3 bps	-185 bps	1.5%	7.2%
Infosys	1.9%	19.9%	2.3%	22.7%	-79 bps	-180 bps	-0.4%	16.1%
Wipro	2.9%	26.2%	3.3%	16.0%	-90 bps	-449 bps	2.7%	3.5%
HCLT	0.3%	10.8%	0.6%	18.5%	-54 bps	194 bps	0.1%	44.4%
TechM	5.0%	21.2%	5.3%	14.5%	-37 bps	-202 bps	3.1%	30.3%
Average Tier-1	2.5%	17.9%	2.7%	19.3%	-52 bps	-164 bps	1.4%	20.3%
LTI	5.0%	29.8%	5.3%	17.4%	-55 bps	-196 bps	3.4%	16.0%
Mphasis	4.0%	25.8%	4.4%	15.0%	-6 bps	-106 bps	3.7%	17.0%
Mindtree	4.9%	33.4%	5.4%	18.1%	-113 bps	-45 bps	-2.0%	35.0%
Coforge	4.0%	33.9%	4.4%	16.3%	123 bps	306 bps	14.5%	58.1%
LTTS	4.4%	19.0%	4.8%	18.0%	-63 bps	140 bps	1.2%	29.3%
CYIENT	-1.6%	3.6%	-1.2%	12.8%	-107 bps	15 bps	-9.9%	15.8%
Persistent	7.9%	40.5%	8.3%	13.6%	-36 bps	45 bps	2.8%	31.6%
Zensar	3.0%	26.1%	3.3%	10.4%	33 bps	-441 bps	-7.6%	-7.2%
Average Tier-2	3.9%	26.5%	4.3%	15.2%	-28 bps	-35 bps	0.8%	24.4%

	USD Revenue growth QoQ	USD Revenue growth YoY	CC revenue growth QoQ	EBIT Margins	QoQ Bps	YoY Bps	EPS Growth QoQ	EPS Growth YoY
Q3FY22								
Sonata	-27.6%	22.6%	n.a.	8.7%	227 bps	-4 bps	0.1%	17.6%
KPIT	5.1%	18.1%	5.3%	13.0%	-47 bps	251 bps	3.0%	41.0%
Birlasoft	3.4%	20.2%	3.6%	13.2%	-19 bps	-167 bps	2.5%	16.8%
Tata Elxsi	6.0%	26.5%	6.3%	30.2%	-81 bps	-7 bps	5.7%	38.6%
Overall Average	1.8%	22.9%	4.0%	16.7%	-24 bps	-61 bps	1.4%	24.2%

Source: I-Sec research

Table 34: Preview Q4FY22

Company	Q4FY22E	Q3FY22	QoQ gr.	Q4FY21	YoY gr.
TCS					
Revenues (US\$ mn)	6,681	6,524	2.4%	5,989	11.6%
Revenues	5,03,082	4,88,850	2.9%	4,37,050	15.1%
EBITDA	1,37,844	1,34,330	2.6%	1,28,010	7.7%
EBITDA margin (%)	27.4%	27.5%	-8 bps	29.3%	-189 bps
EBIT margin (%)	25.0%	25.0%	-3 bps	26.8%	-185 bps
Adjusted net profit	99,117	97,690	1.5%	92,500	7.2%
PAT margin (%)	19.7%	20%	-28 bps	21%	-146 bps
EPS	26.8	26.4	1.5%	25.0	7.2%
Infosys					
Revenues (US\$ mn)	4,332	4,250	1.9%	3,613	19.9%
Revenues	3,26,206	3,18,670	2.4%	2,63,100	24.0%
EBITDA	83,251	83,830	-0.7%	72,770	14.4%
EBITDA margin (%)	25.5%	26.3%	-79 bps	27.7%	-214 bps
EBIT margin (%)	22.7%	23.5%	-79 bps	24.5%	-180 bps
Adjusted net profit	57,879	58,090	-0.4%	50,450	14.7%
EPS	13.8	13.9	-0.4%	11.9	16.1%
HCLT					
Revenues (US\$ mn)	2,987	2,978	0.3%	2,696	10.8%
Revenues	2,24,932	2,23,310	0.7%	1,96,420	14.5%
EBITDA	54,404	52,420	3.8%	43,690	24.5%
EBITDA margin (%)	24%	23%	71 bps	22%	194 bps
EBIT margin (%)	18.5%	19.0%	-54 bps	16.6%	194 bps
Adjusted net profit	34,471	34,430	0.1%	23,870	44.4%
EPS	12.7	12.7	0.1%	8.8	44.4%
Wipro					
IT Services revenue (US\$ mn)	2,716	2,640	2.9%	2,152	26.2%
Consolidated Revenue (US\$ mn)	2,756	2,685	2.6%	2,221	24.1%
Revenues	2,07,526	2,03,136	2.2%	1,62,454	27.7%
EBITDA	41,453	41,793	-0.8%	41,258	0.5%
EBITDA margin (%)	20.0%	20.6%	-60 bps	25.4%	-542 bps
EBIT	33,204	34,334	-3.3%	33,281	-0.2%
EBIT margin (%)	16.0%	16.9%	-90 bps	20.5%	-449 bps
Adjusted net profit	30,533	29,723	2.7%	29,741	2.7%
EPS	5.6	5.4	2.7%	5.4	3.5%
Tech M					
Revenues (US\$ mn)	1,611	1,534	5.0%	1,330	21.2%
Revenues	1,21,298	1,14,508	5.9%	97,299	24.7%
EBITDA	21,834	20,601	6.0%	19,482	12.1%
EBITDA margin (%)	18.0%	18.0%	1 bps	20.0%	-202 bps
EBIT margin (%)	14.5%	14.8%	-37 bps	16.5%	-202 bps
Adjusted net profit	14,112	13,686	3.1%	10,815	30.5%
EPS	16.0	15.5	3.1%	12.3	30.3%
LTI					
Revenues (US\$ mn)	581	553	5.0%	447	29.8%
Revenues	43,719	41,376	5.7%	32,694	33.7%
EBITDA	8,542	8,311	2.8%	7,155	19.4%
EBITDA margin (%)	19.5%	20.1%	-55 bps	21.9%	-235 bps
EBIT margin (%)	17.4%	17.9%	-55 bps	19.4%	-196 bps
Adjusted net profit	6,331	6,125	3.4%	5,457	16.0%
EPS	36.2	35.0	3.4%	31.2	16.0%

Company	Q4FY22E	Q3FY22	QoQ gr.	Q4FY21	YoY gr.
Mindtree					
Revenues (US\$ mn)	385	366	4.9%	288	33.4%
Revenues	28,954	27,500	5.3%	21,093	37.3%
EBITDA	5,820	5,921	-1.7%	4,626	25.8%
EBITDA margin (%)	20%	22%	-143 bps	22%	-183 bps
EBIT margin (%)	18.1%	19.2%	-113 bps	18.6%	-45 bps
Adjusted net profit	4,287	4,375	-2.0%	3,173	35.1%
EPS	26.0	26.5	-2.0%	19.3	35.0%
Mphasis	430	414	4.0%	342	25.8%
Revenues (US\$ mn)	32,407	31,237	3.7%	25,243	28.4%
Revenues	5,681	5,531	2.7%	4,671	21.6%
EBITDA	18%	18%	-18 bps	19%	-97 bps
EBITDA margin (%)	15.0%	15.1%	-6 bps	16.1%	-106 bps
EBIT margin (%)	3,709	3,576	3.7%	3,169	17.0%
Adjusted net profit	19.8	19.1	3.7%	17.0	17.0%
EPS					
Coforge	230	222	4.0%	172	33.9%
Revenues (US\$ mn)	17,354	16,581	4.7%	12,615	37.6%
Revenues	3,440	3,068	12.1%	2,122	62.1%
EBITDA	19.8%	18.5%	132 bps	16.8%	300 bps
EBITDA margin (%)	16.3%	15.1%	123 bps	13.3%	306 bps
EBIT margin (%)	2,103	1,837	14.5%	1,330	58.1%
Adjusted net profit	35	30	14.5%	22	58.1%
EPS					
Persistent	215	199	7.9%	153	40.5%
Revenues (US\$ mn)	16,171	14,917	8.4%	11,134	45.2%
Revenues	2,663	2,511	6.1%	1,883	41.4%
EBITDA	16.5%	16.8%	-36 bps	16.9%	-45 bps
EBITDA margin (%)	13.6%	14.0%	-36 bps	13.2%	45 bps
EBIT margin (%)	1,812	1,764	2.8%	1,378	31.6%
Adjusted net profit	23.7	23.1	2.8%	18.0	31.6%
EPS					
Zensar	152	147	3.0%	120	26.1%
Revenues (US\$ mn)	11,409	11,025	3.5%	8,767	30.1%
Revenues	1,677	1,584	5.9%	1,743	-3.8%
EBITDA	15%	14%	33 bps	20%	-518 bps
EBITDA margin (%)	10.4%	10.1%	33 bps	14.8%	-441 bps
EBIT margin (%)	840	909	-7.6%	905	-7.2%
Adjusted net profit	3.7	4.0	-7.6%	4.0	-7.2%
EPS					
LTTS	235	225	4.4%	198	19.0%
Revenues (US\$ mn)	17,702	16,875	4.9%	14,405	22.9%
Revenues	3,742	3,674	1.9%	2,931	27.7%
EBITDA	21.1%	21.8%	-63 bps	20.3%	79 bps
EBITDA margin (%)	18.0%	18.6%	-63 bps	16.6%	140 bps
EBIT margin (%)	2,519	2,488	1.2%	1,945	29.5%
Adjusted net profit	24.0	23.7	1.2%	18.5	29.3%
EPS					
Cyient	155	158	-1.6%	150	3.6%
Revenues (US\$ mn)	11,699	11,834	-1.1%	10,932	7.0%
Revenues	1,979	2,128	-7.0%	1,874	5.6%
EBITDA	16.9%	18.0%	-107 bps	17.1%	-23 bps
EBITDA margin (%)	12.8%	13.9%	-107 bps	12.7%	15 bps
EBIT margin (%)	1,185	1,316	-9.9%	1,033	14.8%
Adjusted net profit	10.9	12.1	-9.9%	9.4	15.8%
EPS	385	366	4.9%	288	33.4%

Company	Q4FY22E	Q3FY22	QoQ gr.	Q4FY21	YoY gr.
Sonata					
IT services Revenues (US\$ mn)	55	53	3.8%	44	26.6%
Domestic Products (US\$ mn)	126	198	-36.1%	105	20.9%
Consolidated Revenues (US\$m)	182	251	-27.6%	148	22.6%
Consolidated Revenues (Rs mn)	13,693	18,580	-26.3%	10,757	27.3%
EBITDA	1,324	1,317	0.6%	1,031	28.5%
EBITDA margin (%)	9.7%	7.1%	258 bps	9.6%	9 bps
EBIT margin (%)	8.7%	6.4%	227 bps	8.7%	-4 bps
Adjusted net profit	978	977	0.1%	831	17.7%
EPS	9.4	9.4	0.1%	8.0	17.6%
KPIT Tech					
Revenues (US\$ mn)	88	84	5.1%	75	18.1%
Revenues	6,625	6,224	6.4%	5,403	22.6%
EBITDA	1,192	1,150	3.7%	876	36.2%
EBITDA margin (%)	18.0%	18.5%	-47 bps	16.2%	180 bps
EBIT margin (%)	13.0%	13.5%	-47 bps	10.5%	251 bps
Adjusted net profit	724	703	3.0%	528	37.2%
EPS	2.7	2.6	3.0%	1.9	41.0%
Birlasoft					
Revenues (US\$ mn)	148	143	3.4%	123	20.2%
Revenues	11,162	10,719	4.1%	9,029	23.6%
EBITDA	1,674	1,628	2.8%	1,524	9.8%
EBITDA margin (%)	15.0%	15.2%	-19 bps	16.9%	-188 bps
EBIT margin (%)	13.2%	13.4%	-19 bps	14.9%	-167 bps
Adjusted net profit	1,169	1,140	2.5%	990	18.0%
EPS	4.2	4.1	2.5%	3.6	16.8%
Tata Elxsi					
Revenues (US\$ mn)	90	85	6.0%	71	26.5%
Revenues	6,780	6,354	6.7%	5,184	30.8%
EBITDA	2,160	2,108	2.5%	1,680	28.6%
EBITDA margin (%)	31.9%	33.2%	-132 bps	32.4%	-55 bps
EBIT margin (%)	30.2%	31.0%	-81 bps	30.2%	-7 bps
Adjusted net profit	1,596	1,510	5.7%	1,152	38.6%
EPS	25.6	24.2	5.7%	18.5	38.6%

Source: I-Sec research

Key Risks

- Depreciation of INR vs USD will be headwind for margins
- Increase in offshoring mix back to pre-covid levels will be tailwinds for margin
- Continuation of discretionary spends by clients.
- Come back of large deals.

One-year forward P/E charts

Chart 54: One-year Fwd P/E - TCS

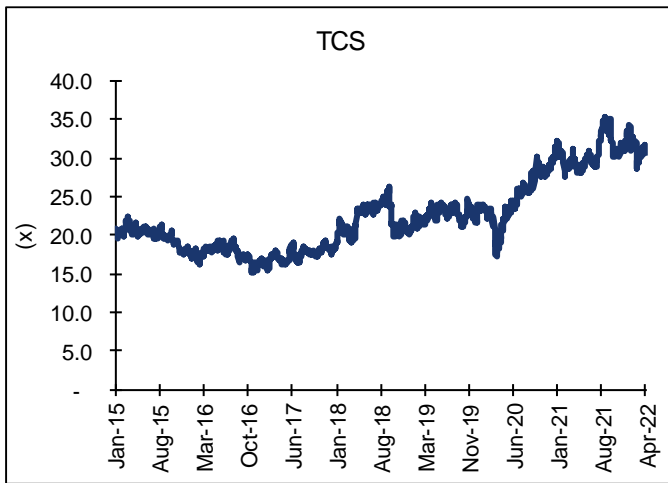


Chart 55: One-year Fwd P/E - Infosys

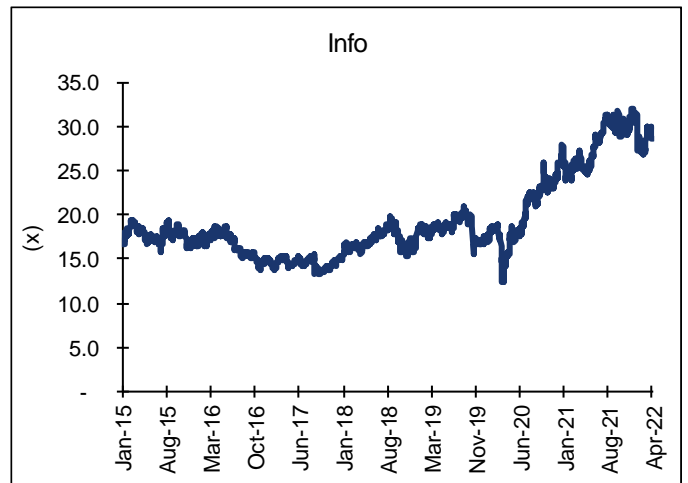


Chart 56: One-year Fwd P/E - Wipro

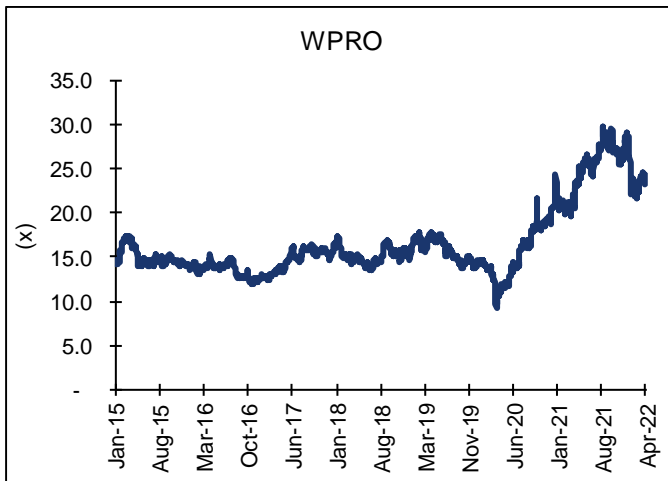


Chart 57: One-year Fwd P/E - HCL Tech

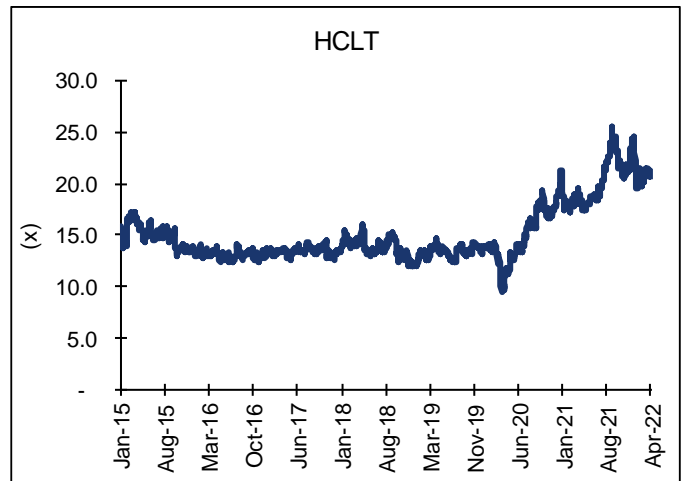


Chart 58: One-year Fwd P/E - Tech Mahindra

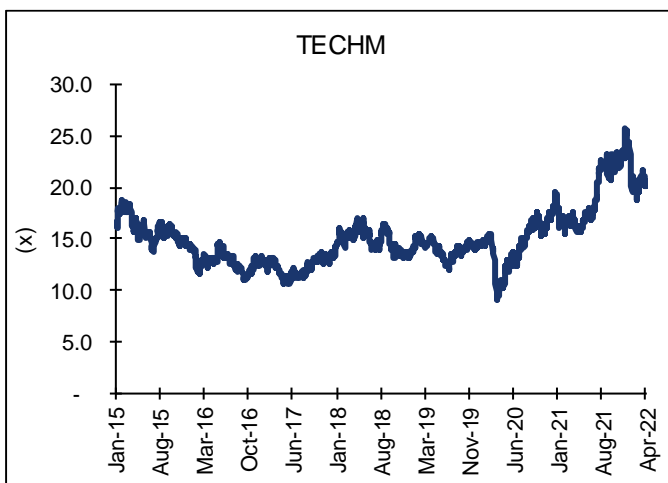
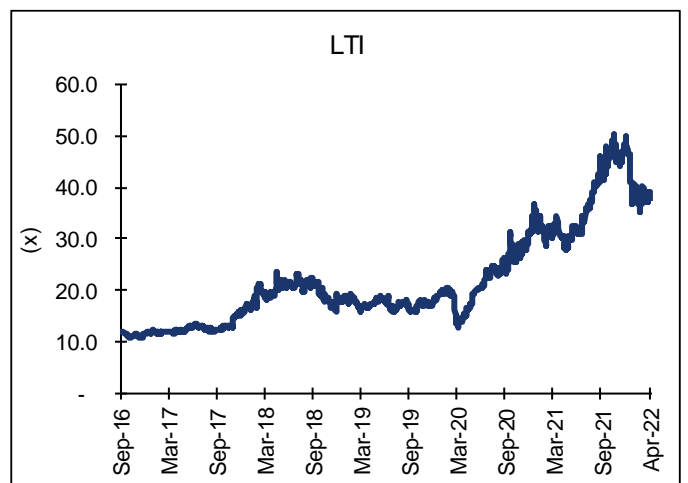


Chart 59: One-year Fwd P/E - L&T Infoech



Source: Company, I-Sec research

Chart 60: One-year Fwd P/E - Mindtree

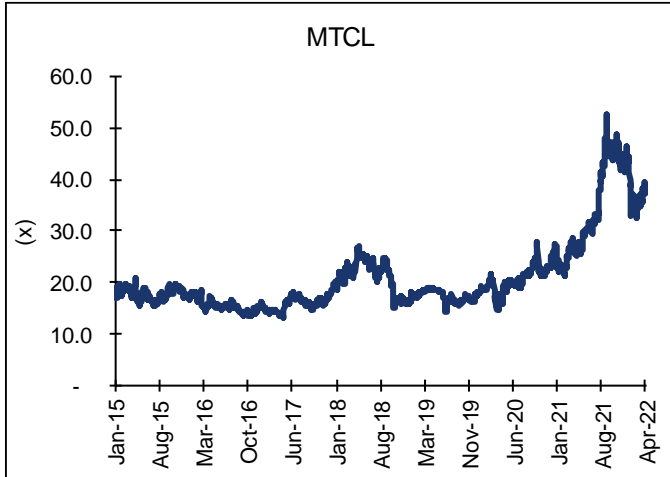


Chart 61: One-year Fwd P/E – Persistent Systems

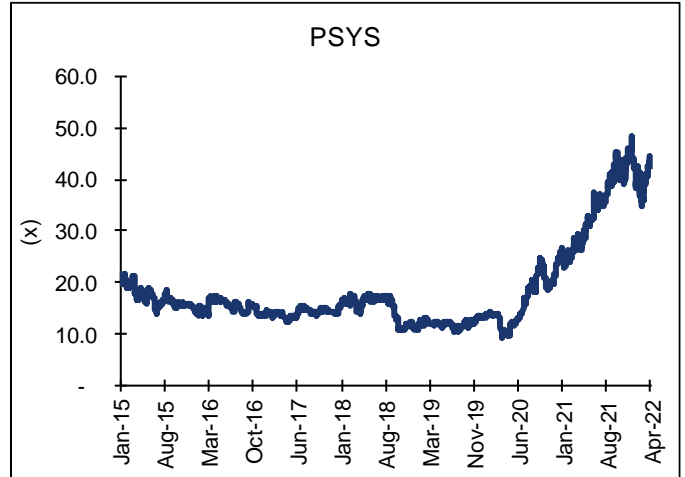


Chart 62: One-year Fwd P/E - Cyient

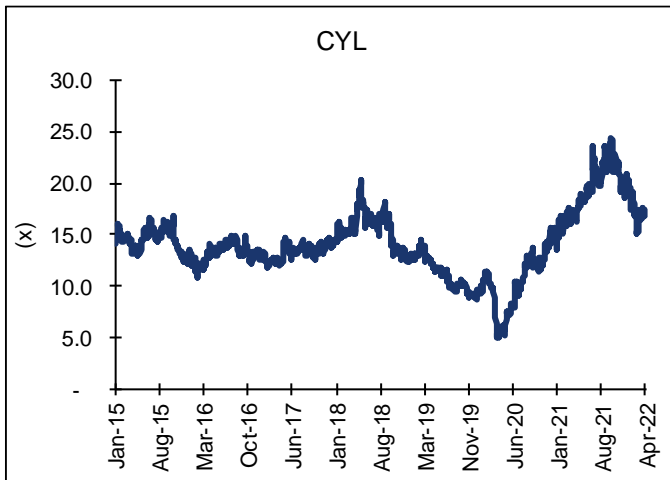


Chart 63: One-year Fwd P/E – BirlaSoft

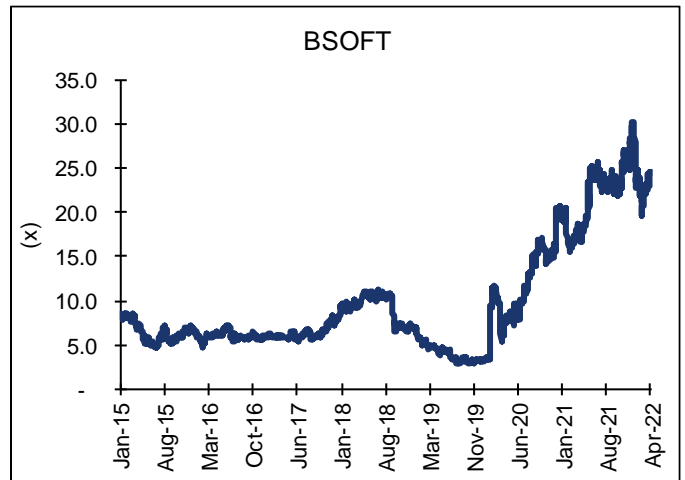


Chart 64: One-year Fwd P/E - Mphasis

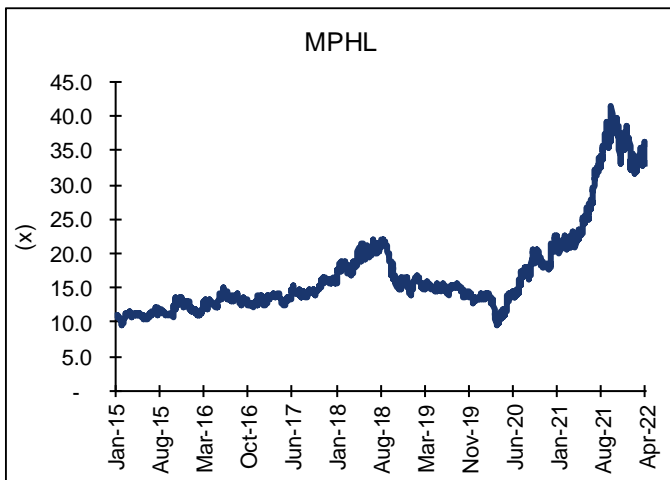
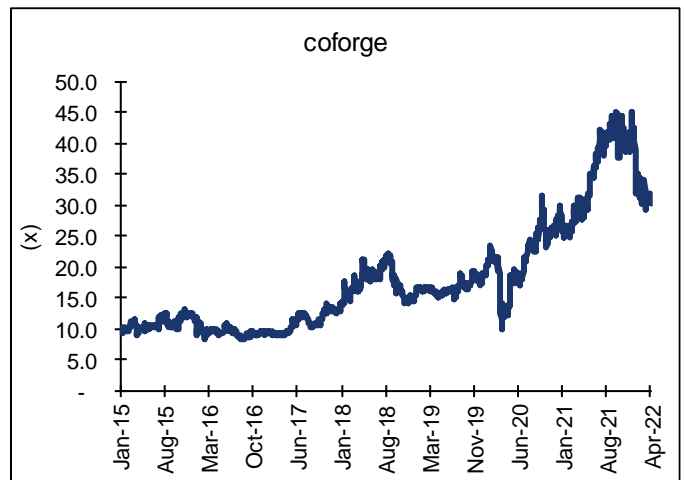


Chart 65: One-year Fwd P/E - Coforge



Source: Company, I-Sec research

Chart 66: One-year Fwd P/E – L&T Technology Serieses

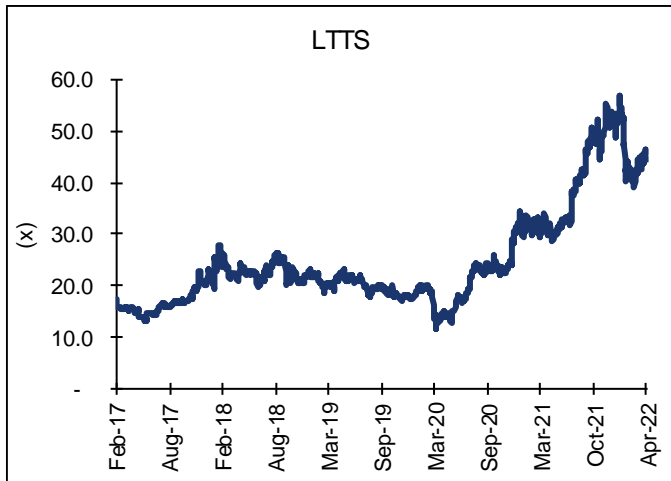


Chart 67: One-year Fwd P/E – Zensar Technologies

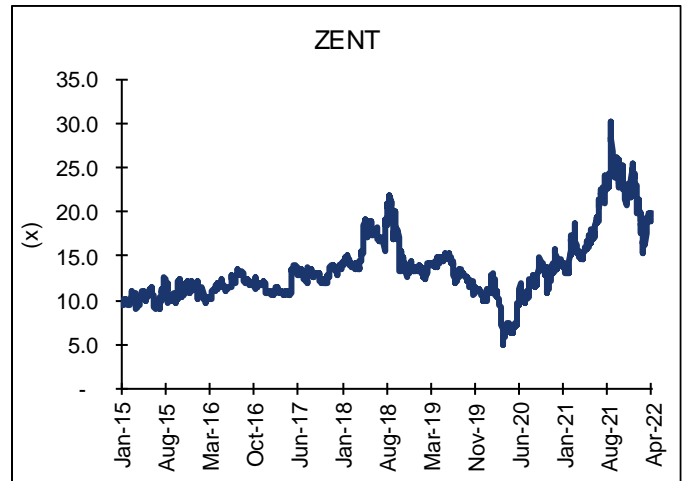


Chart 68: One-year Fwd P/E – KPIT Technologies

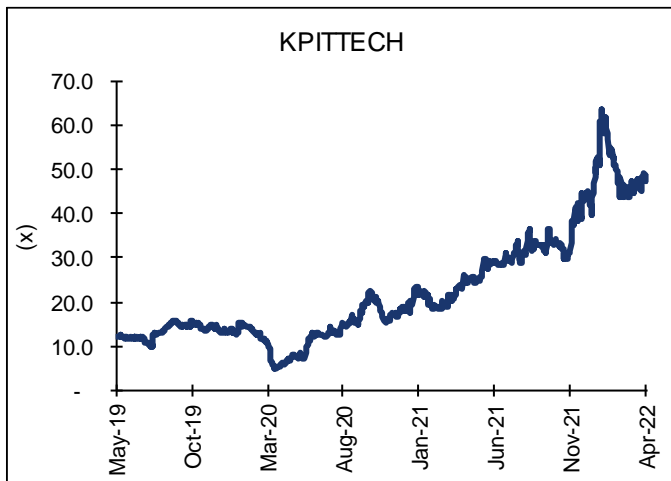


Chart 69: One-year Fwd P/E – Tata Elaxi

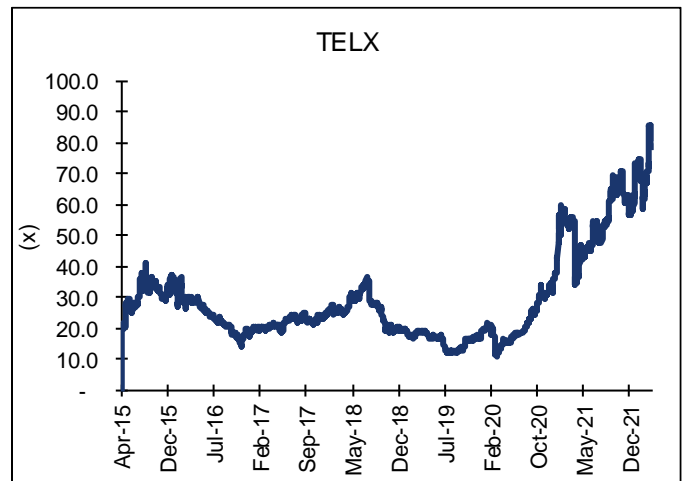


Chart 70: One-year Fwd P/E – Newgen Technologies

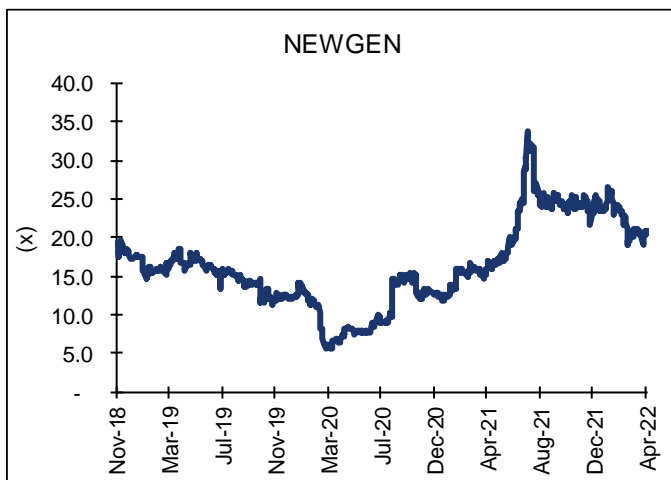


Chart 71: One-year Fwd P/E - Sonata Software



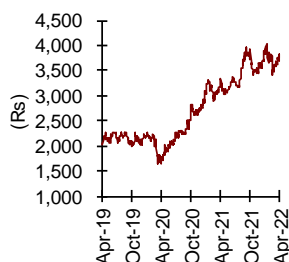
Source: Company, I-Sec research

Company section

Tata Consultancy Services

(HOLD; CMP: Rs3,686; TP: Rs3,519)**Shareholding pattern**

	Jun '21	Sep '21	Dec '21
Promoters	72.2	72.2	72.2
Institutional investors	23.4	23.3	22.9
MFs and others	3.0	3.1	3.3
FIs/Bank	0.0	0.0	0.0
Insurance Cos.	4.9	4.7	4.5
FII	15.5	15.5	15.1
Others	4.4	4.6	4.9

Price chart**Well positioned!**

We believe TCS is well positioned to benefit from transformation spending on account of: 1) full-service model, deep expertise and presence across technologies, 2) robust client base, 3) best-in-class execution and 4) ability to leverage contextual client knowledge on basis of long-term client partnership to further mine clients. TCS' well-managed supply-side engine is an ace in the current battle for talent.

We believe that leaders have far broader set of capabilities and they end up addressing larger portion of IT spending pool, which helps them to grow at a solid rate on a high base (example – ACN – has guided for absolute revenue addition of US\$7.5bn for FY22E (Aug ending), very impressive unbelievable number).

Triggers & catalyst for the stock:

Increased participation in large/mega deals: TCS' headcount additions remained strong since the pandemic. 9MFY22 net additions were 1.5x of FY21 additions, suggesting healthy growth outlook. We do believe that TCV should not be tracked on QoQ basis, but TCV of US\$7.6bn in Q3FY22 same as the TCV in Q2FY22 shows a hope of acceleration ahead. TCS' client additions across buckets have been healthy – indicates market share gains and strong client mining. We believe TCS will get more aggressive in large/mega deals as now supply-side engine is ready and enough bench is available.

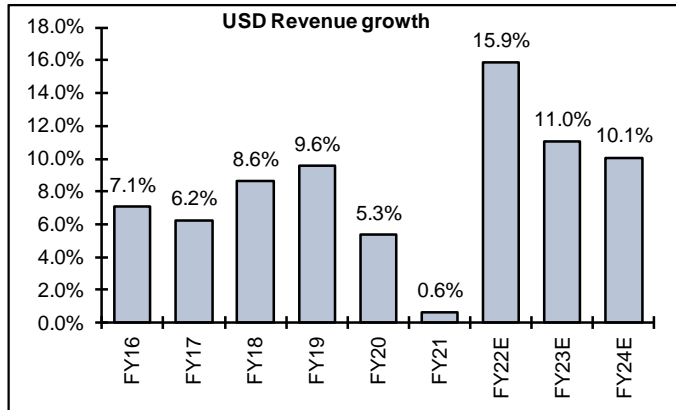
Margins positioned much better than others: TCS' well-managed supply-side engine is an ace in the current battle for talent. Company's margins have improved from 24.6% (pre-covid FY20) to 26% as of 9MFY22. This is mainly due to reduction in employee costs by 400bps as compared to pre-covid levels. Going forward, TCS margins will get tailwinds from reduction in sub-con costs, pyramid optimisation and better realisation. We have projected margins at 24.8%/25% for FY23E/FY24E.

Valuation: TCS currently trades at 28.3x FY24E P/E for FY22-FY24E EPS CAGR of 12.2%, PEG ratio of 2.4x vs the tier-1 Indian IT sector trading at 23x FY24E for FY22-FY24E EPS CAGR of 13% and PEG ratio of 1.5x. TCS has better-than-peer's supply-side management, which will allow it to grow profitably. We assign **HOLD** rating on account of slowing earning growth and elevated PEG ratios with a fair value of Rs3,519 based on 27x FY24E earnings.

Key Risks: 1) Strong large deal win momentum, 2) Margin expansion, 3) INR Depreciation, 4) Continuation of discretionary spends

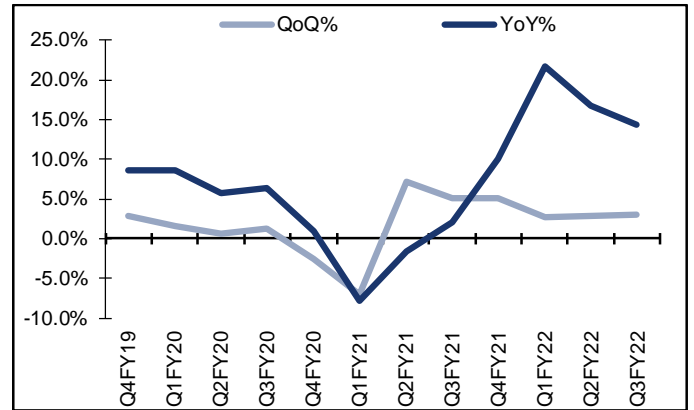
Market Cap	Rs13633bn/US\$179.9bn	Year to March	FY21	FY22E	FY23E	FY24E
Reuters/Bloomberg	TCS.BO/TCS IN	Revenue (Rs mn)	1641,750	1914,712	2168,236	2417,828
Shares Outstanding (mn)	174.5	Net Income (Rs mn)	333,880	383,117	431,769	482,065
52-week Range (Rs)	4019/3036	EPS (Rs)	89.3	103.6	116.7	130.3
Free Float (%)	27.8	% Chg YoY	3.8	3.6	16.0	12.7
FII (%)	15.1	P/E (x)	41.3	35.6	31.6	28.3
Daily Volume (US\$'000)	1,41,634	CEPS (Rs)	100.1	116.0	130.8	146.0
Absolute Return 3m (%)	(4.2)	EV/E (x)	28.8	24.7	22.2	19.6
Absolute Return 12m (%)	12.3	Dividend Yield	1.0	1.1	2.7	2.7
Sensex Return 3m (%)	(0.3)	RoCE (%)	32.9	30.9	32.7	33.5
Sensex Return 12m (%)	20.7	RoE (%)	38.8	39.8	39.3	40.4

Chart 1: Revenue growth to moderate



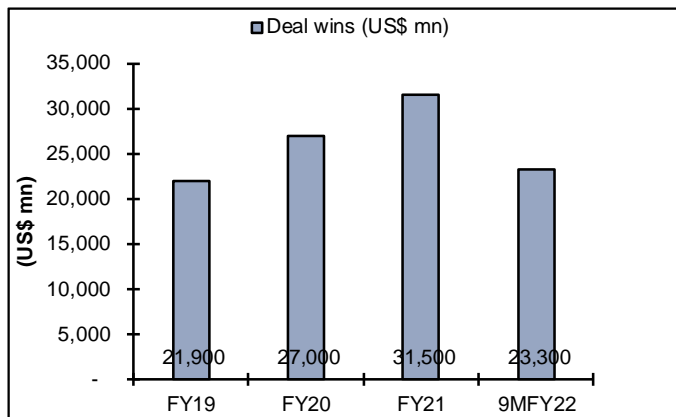
Source: Company, I-Sec research

Chart 2: Steady QoQ growth



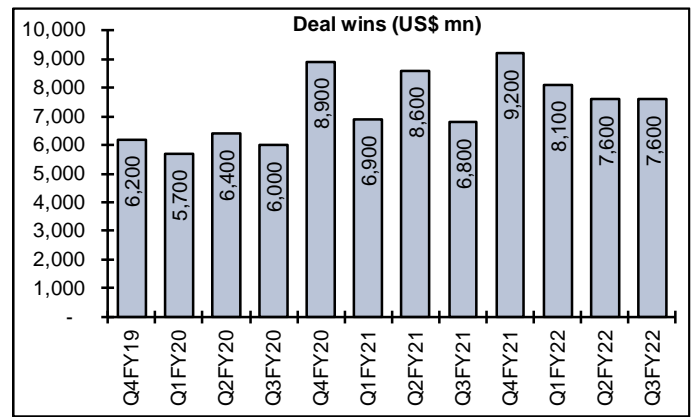
Source: Company, I-Sec research

Chart 3: TCS' deal momentum...



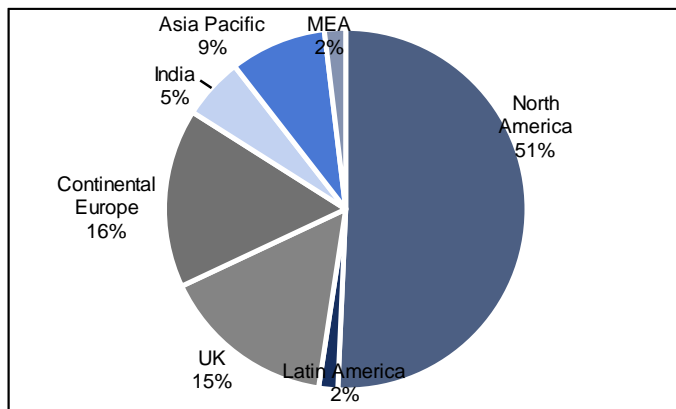
Source: Company, I-Sec research

Chart 4: ...continues to be healthy, may soften ahead



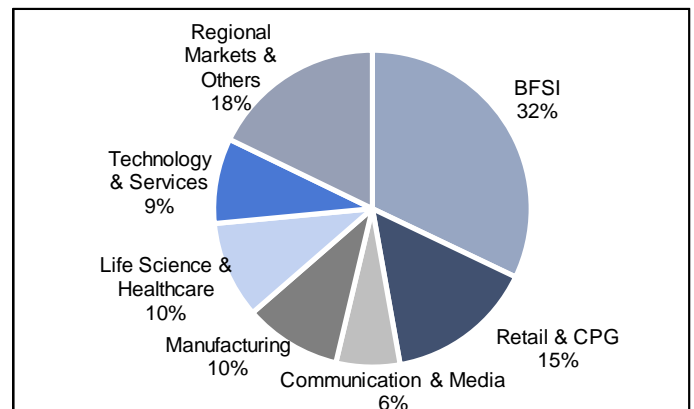
Source: Company, I-Sec research

Chart 5: Geographical mix (%)



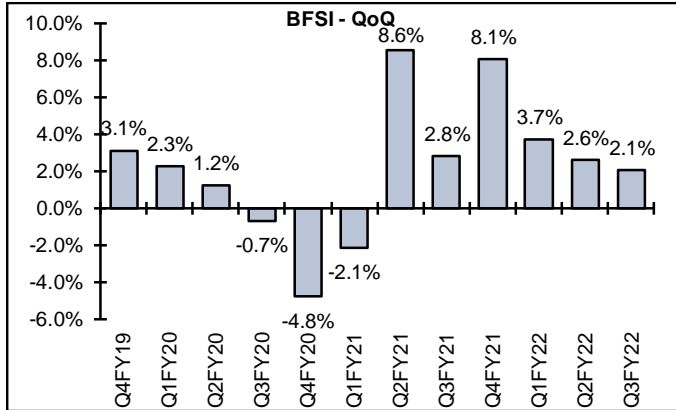
Source: Company, I-Sec research

Chart 6: Vertical mix (%)



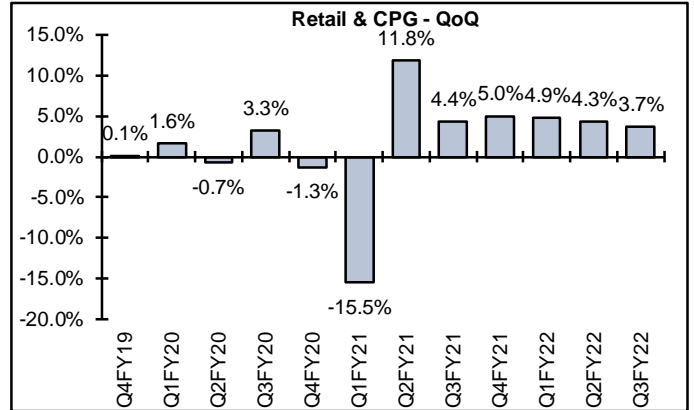
Source: Company, I-Sec research

Chart 7: Steady growth in BFSI



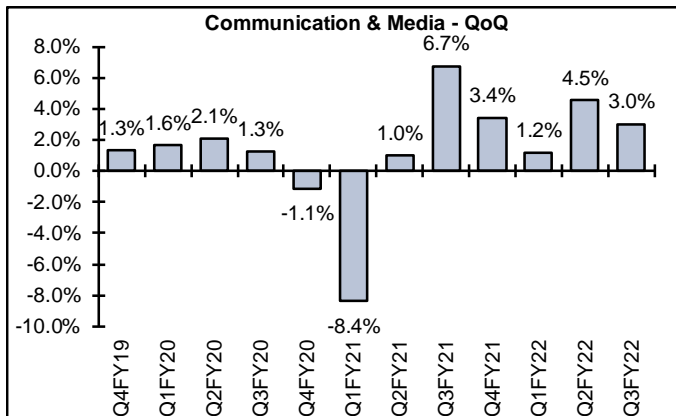
Source: Company, I-Sec research

Chart 8: Retail is now stabilised



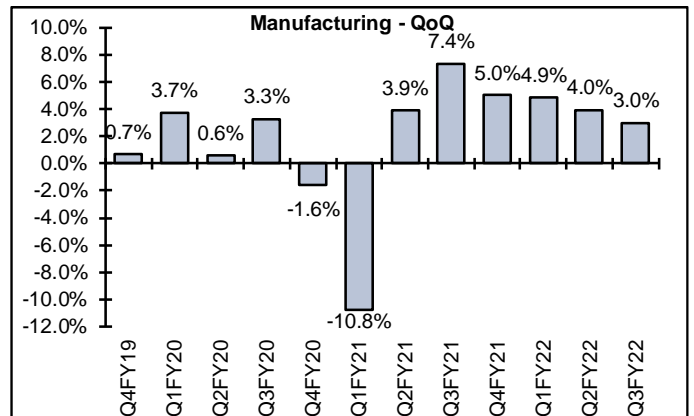
Source: Company, I-Sec research

Chart 9: Growth now stabilizing in Communication



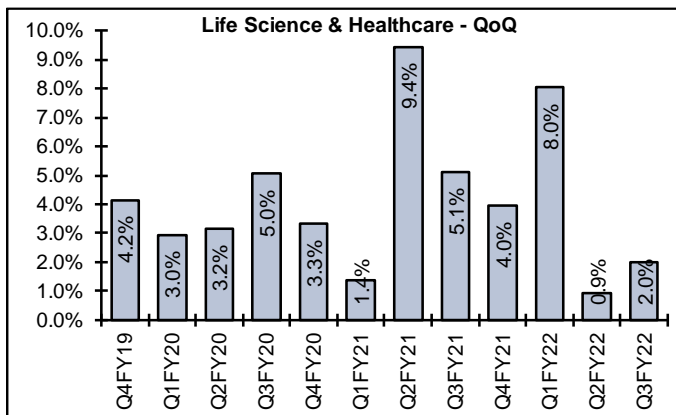
Source: Company, I-Sec research

Chart 10: Growth expected to pick up in Mfg.



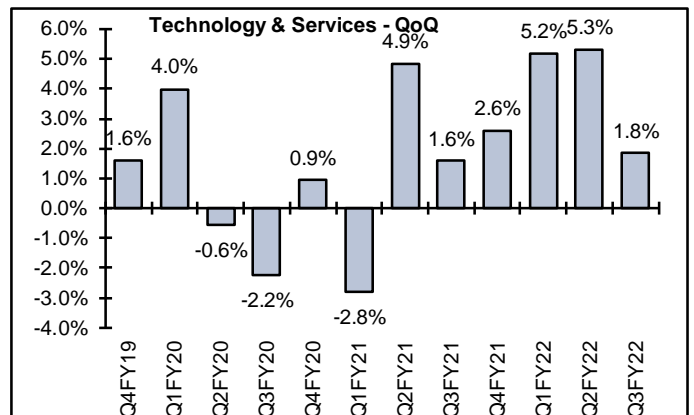
Source: Company, I-Sec research

Chart 11: Healthcare to report healthy growth



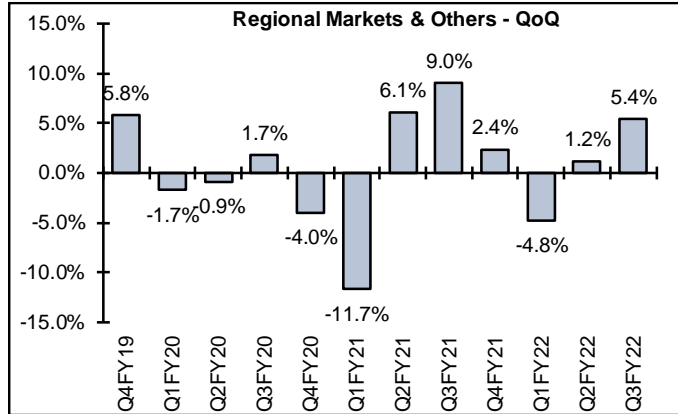
Source: Company, I-Sec research

Chart 12: Tech. & Services is now stabilizing



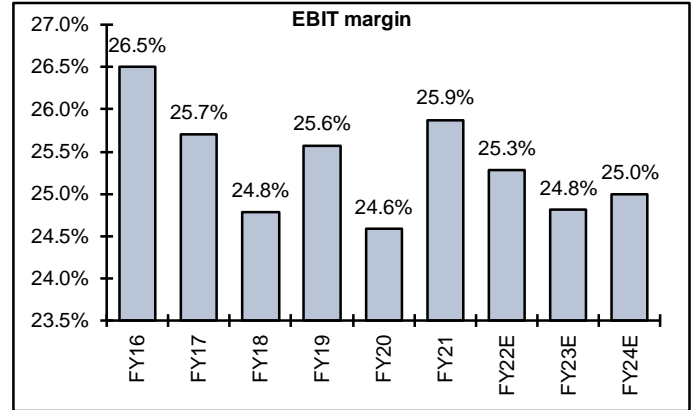
Source: Company, I-Sec research

Chart 13: Lumpy growth within the segment



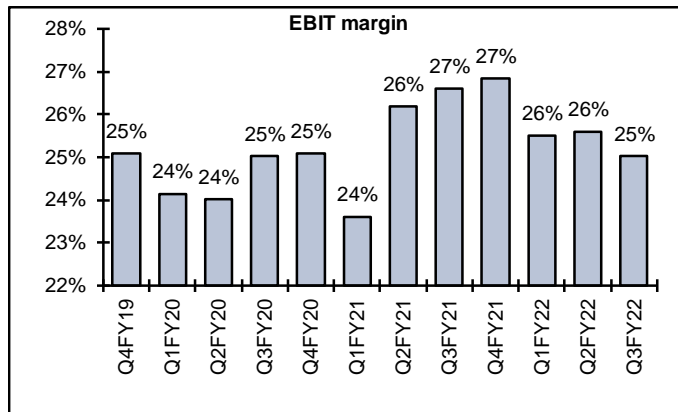
Source: Company, I-Sec research

Chart 14: Margins expected to contract



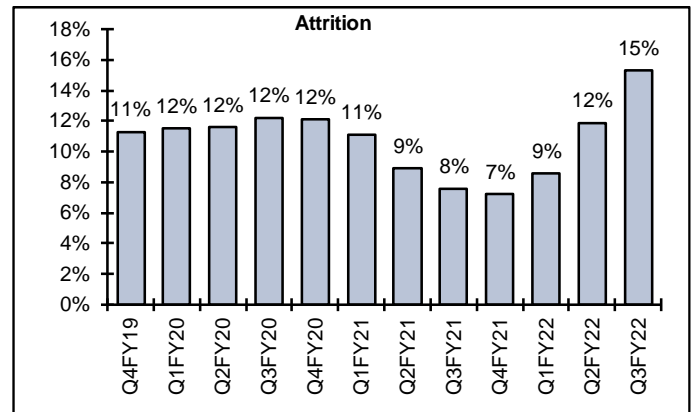
Source: Company, I-Sec research

Chart 15: Supply headwinds led to contraction



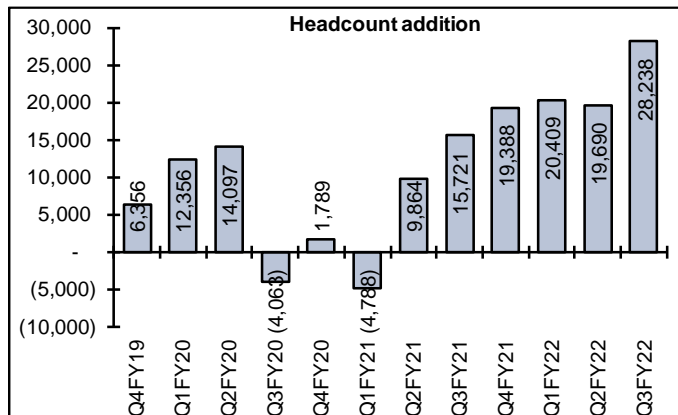
Source: Company, I-Sec research

Chart 16: Attrition higher than pre-covid levels



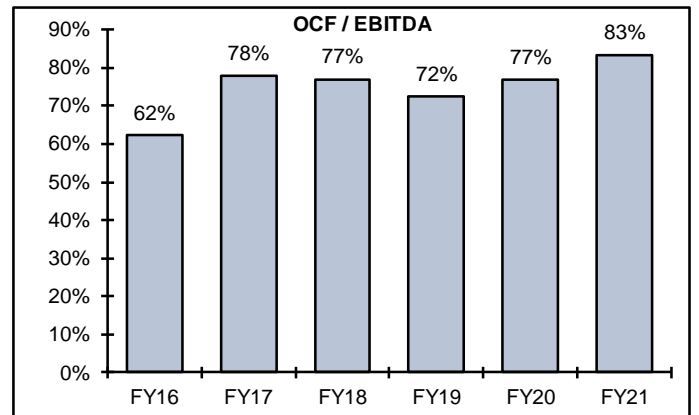
Source: Company, I-Sec research

Chart 17: Aggressive hiring to match demand



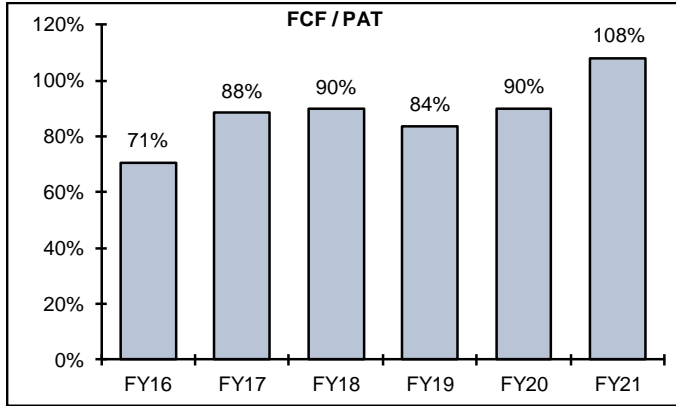
Source: Company, I-Sec research

Chart 18: Robust conversion despite pressures



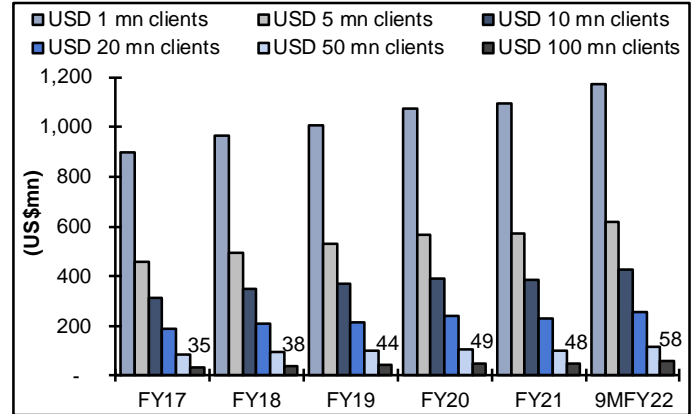
Source: Company, I-Sec research

Chart 19: Robust conversion despite pressures



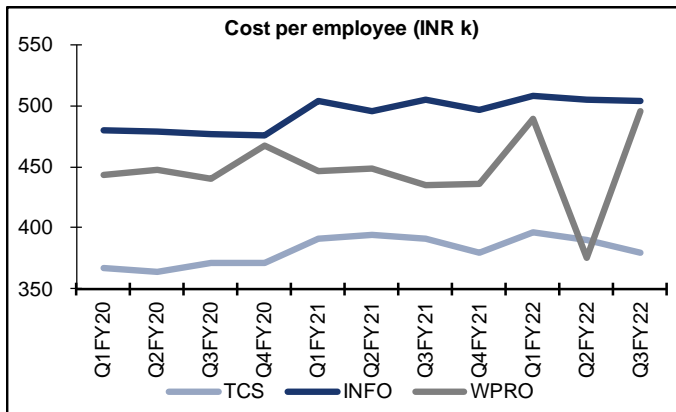
Source: Company, I-Sec research

Chart 20: Healthy increase in US\$100mn+ clients



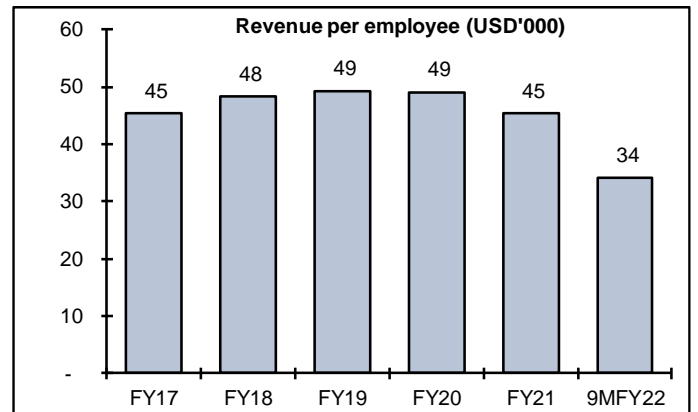
Source: Company, I-Sec research

Chart 21: TCS has the lowest cost per employee



Source: Company, I-Sec research

Chart 22: Aggressive hiring resulted in decline



Source: Company, I-Sec research

Financial summary – Tata Consultancy Services

Table 1: Profit and Loss statement

(Rs mn, year ending March 31)

	FY21	FY22E	FY23E	FY24E
Revenues (US\$ mn)	22,174	25,691	28,529	31,400
Operating Revenues (Sales)	16,41,750	19,14,712	21,68,236	24,17,828
Operating Expenses	11,76,360	13,84,757	15,78,358	17,55,343
EBITDA	4,65,390	5,29,954	5,89,878	6,62,485
% margin	28.3	27.7	27.2	27.4
Depreciation & Amortisation	40,560	45,934	52,038	58,028
EBIT	4,24,830	4,84,020	5,37,840	6,04,457
% margin	25.9	25.3	24.8	25.0
Other Income	24,940	30,970	36,000	36,000
Recurring PBT	4,49,770	5,14,990	5,73,840	6,40,457
Add: Extraordinaries	0	0	0	0
Less: Taxes	1,14,580	1,30,614	1,40,591	1,56,912
Add: Earnings in Affiliates	0	0	0	0
Less: Minority Interest	-1,310	-1,260	-1,480	-1,480
Net Income (Reported)	3,33,880	3,83,117	4,31,769	4,82,065

Source: Company data, I-Sec research

Table 2: Balance sheet

(Rs mn, year ending March 31)

	FY21	FY22E	FY23E	FY24E
Net Worth	8,59,690	10,64,137	11,33,404	12,52,967
Minority Interest	6,750	7,290	8,770	10,250
Other Long term liabilities	95,100	98,490	98,490	98,490
Total liabilities	9,61,540	11,69,917	12,40,664	13,61,707
Net Block	1,96,660	1,98,030	2,02,030	2,06,030
Intangibles	22,800	29,030	29,030	29,030
Other LT assets	94,640	97,090	97,090	97,090
Curr. Assets	9,90,340	12,08,121	12,93,499	14,30,604
Debtors	3,66,800	4,22,218	4,70,749	5,22,865
Cash & Bank Balance	68,500	70,566	96,088	1,68,915
Other Current Assets	5,55,040	7,15,337	7,26,662	7,38,824
Current Liab. & Prov	3,42,900	3,62,355	3,80,985	4,01,047
Net Current Assets	6,47,440	8,45,767	9,12,514	10,29,557
Application of Funds	9,61,540	11,69,917	12,40,664	13,61,707

Source: Company data, I-Sec Research

Table 3: Cashflow statement

(Rs mn, year ending March 31)

	FY21	FY22E	FY23E	FY24E
CF from Operations	3,74,390	3,98,081	4,47,807	5,04,093
Cash for Working Capital	12,610	(33,047)	(49,208)	(52,991)
Net Operating CF	3,87,000	3,65,034	3,98,599	4,51,102
Net Purchase of FA	(27,000)	(53,534)	(56,038)	(62,028)
Free Cashflow	3,60,000	3,11,500	3,42,562	3,89,074
Net Purchase of Invest.	(54,000)	(1,44,470)	36,000	36,000
Net Cash from Invest.	(81,000)	(1,98,004)	(20,038)	(26,028)
Proceeds from LTB/STB	-	13,166	7,982	8,775
Others	(19,000)	(17,664)	1,480	1,480
Dividend Payments	(3,06,000)	(1,60,466)	(3,62,502)	(3,62,502)
Cashflow from Fin.	(3,25,000)	(1,64,964)	(3,53,040)	(3,52,247)
Net Cashflow	(19,000)	2,066	25,522	72,827

Source: Company data, I-Sec research

Table 4: Key ratios

(Year ending March 31)

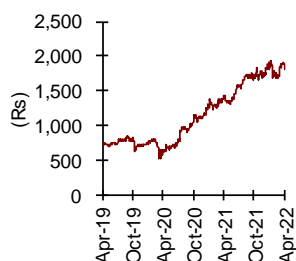
	FY21	FY22E	FY23E	FY24E
Per Share Data (Rs)				
Diluted Recurring EPS	89.3	103.6	116.7	130.3
Recurring Cash EPS	100.1	116.0	130.8	146.0
Dividend per share (DPS)	38.0	41.0	98.0	98.0
Book Value per share (BV)	229.9	287.7	306.4	338.7
Growth Ratios (%)				
Operating Income (Sales) - US\$	0.6	15.9	11.0	10.1
Operating Income (Sales)	4.6	16.6	13.2	11.5
EBIT	10.1	13.9	11.1	12.4
Recurring Net Income	3.2	14.7	12.7	11.6
Diluted Recurring EPS	3.8	3.6	16.0	12.7
Diluted Recurring CEPS	4.8	15.8	12.8	11.6
Valuation Ratios (x)				
P/E	41.3	35.6	31.6	28.3
P/CEPS	36.8	31.8	28.2	25.2
P/BV	16.0	12.8	12.0	10.9
EV / EBITDA	28.8	24.7	22.2	19.6
EV / Sales	8.2	6.8	6.0	5.4
Operating Ratios				
Other Income / PBT (%)	5.5	6.0	6.3	5.6
Effective Tax Rate (%)	25.5	25.4	24.5	24.5
Fixed Asset Turnover (x) on average	8.3	9.7	10.7	11.7
Receivables (days)	82	80	79	79
Return/Profitability Ratios (%)				
Recurring Net Income Margins	20.3	20.0	19.9	19.9
RoIC	65.3	69.6	72.0	74.5
RoCE	32.9	30.9	32.7	33.5
RoNW	38.8	39.8	39.3	40.4
Dividend Payout Ratio	42.6	39.6	84.0	75.2
Dividend Yield	1.0	1.1	2.7	2.7
EBITDA Margins	28.3	27.7	27.2	27.4
EBIT Margins	25.9	25.3	24.8	25.0

Source: Company data, I-Sec research

Infosys

(REDUCE; CMP: Rs1,815; TP: Rs1,628)**Shareholding pattern**

	Jun '21	Sep '21	Dec '21
Promoters	13.0	13.1	13.1
Institutional investors	55.4	49.1	49.5
MFs and others	12.8	12.2	12.8
FIs/Bank	0.0	0.0	0.0
Insurance Cos.	8.9	3.1	3.2
FII	33.7	33.8	33.5
Others	31.6	37.8	37.4

Price chart**Worsening macro environment may impact margins**

Infosys (Infy) has emerged as the fastest-growing large cap IT company with ~21% organic growth in FY22E vs 13-17% of other tier-1 peers. Infy is well positioned to gain market share in strong demand environment aided by its strong digital and cloud capabilities. Its strength in Cobalt solution to implement flexible, scalable and secure hybrid cloud model helped them win the highly competitive mega deals last year.

Growth is expected to moderate in FY23E compared to FY22 given lack of very large or mega deal announcements. We expect Infy to provide 11-13% YoY CC growth guidance for FY23 and margin guidance to be maintained at 22-24%.

Triggers & catalysts for the stock

Strong cloud and digital capabilities driving industry-leading growth: Infy's digital business showed sustained strong growth (9% CQGR over past 4 quarters) and now accounts to 58.5% of total revenue. Within digital, cloud is growing much faster as Infy's Cobalt cloud capabilities are resonating well with clients. Having high share of digital revenue, Infy is likely to benefit more from improved pricing for digital work.

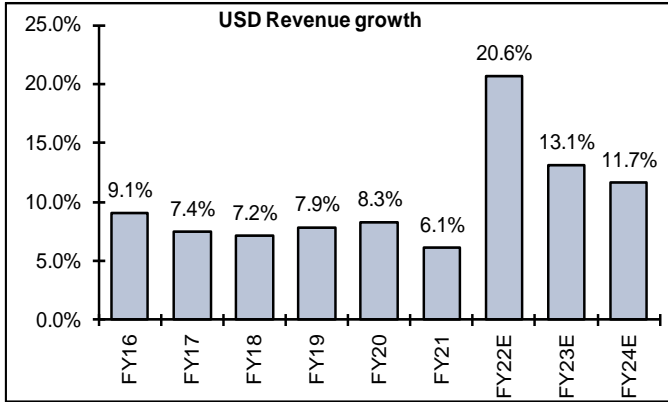
Margins to moderate: Infy reported very strong margin expansion of ~320 bps in FY21. However, margins are expected to decline by 112bps in FY22E and remain under pressure in FY23E (FY23E:22.6%) because of higher supply-side costs. Gradual return of travel and facility costs will also add to margin headwinds. Aggressive fresher addition (~55K and in FY22E and similar hiring expected in FY23E) will provide considerable margin tailwinds and may partially offset margins pressures but elevated inflation will drive onsite costs way higher. We model 22.6%/23.3% margins in FY23E/FY24E.

Valuation: Infy currently trades at 27x FY24E P/E for FY22-FY24E EPS CAGR of 14%, PEG ratio of 1.5x vs the tier-1 Indian IT sector trading at 23x FY24E for FY22-FY24E EPS CAGR of 13% and PEG ratio of 1.5x. We believe consensus estimates for Infy are aggressive at 17% YoY USD growth and 23.7% margins for FY23, which will reduce in coming quarters. Our EPS estimates are 8% and 5% lower as compared to consensus for FY23/24. While we are impressed with progress on growth and margin priorities, we believe they are adequately priced in current valuation of 27x FY24E EPS and do not offer margin of safety. We assign **REDUCE** rating with a fair value of Rs1,628 based on 24x FY24E earnings.

Key Risks: 1) Strong large deal win momentum, 2) Margin expansion, 3) INR Depreciation, 4) Continuation of discretionary spends

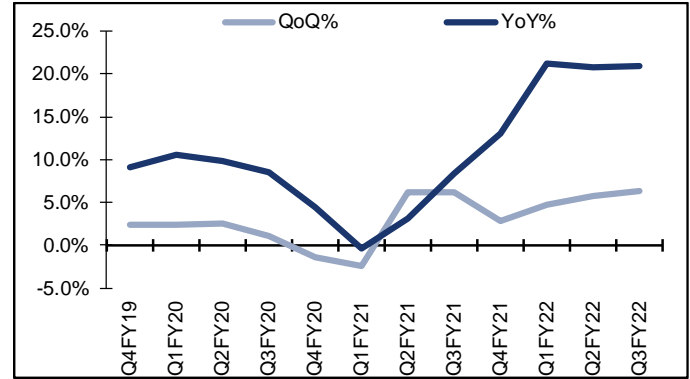
Market Cap	Rs7634bn/US\$100.7bn	Year to March	FY21	FY22E	FY23E	FY24E
Reuters/Bloomberg	INFY.BO/INFO IN	Revenue (Rs mn)	1004,750	1219,856	1406,604	1591,148
Shares Outstanding (mn)	4,206.7	Net Income (Rs mn)	193,900	221,019	2,45,540	2,88,800
52-week Range (Rs)	1940/1316	EPS (Rs)	45.5	51.9	57.7	67.8
Free Float (%)	86.9	% Chg YoY	16.8	14.0	11.1	17.6
FII (%)	33.5	P/E (x)	39.9	35.0	31.5	26.8
Daily Volume (US\$'000)	1,57,401	CEPS (Rs)	53.2	60.1	67.0	78.4
Absolute Return 3m (%)	0.0	EV/E (x)	26.7	23.7	21.0	17.9
Absolute Return 12m (%)	28.5	Dividend Yield	1.5	2.2	2.4	2.6
Sensex Return 3m (%)	(0.3)	RoCE (%)	23.0	26.4	30.7	32.5
Sensex Return 12m (%)	20.7	RoE (%)	27.4	31.3	36.2	38.1

Chart 1: Revenue growth to moderate



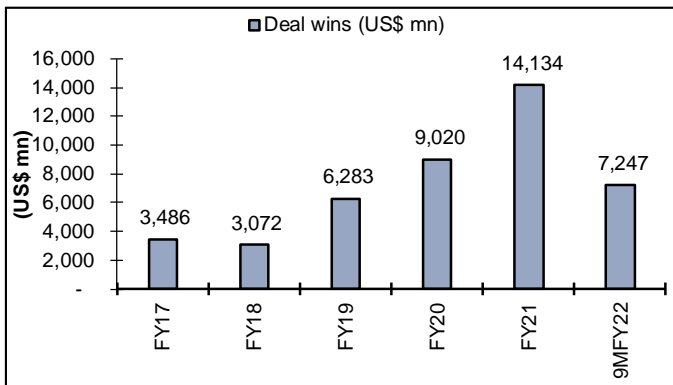
Source: Company, I-Sec research

Chart 2: Strong QoQ growth



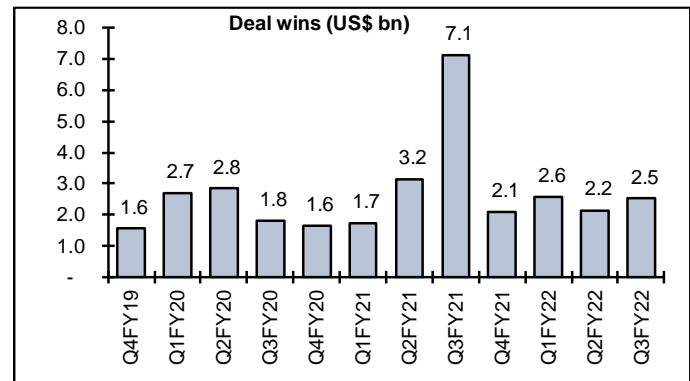
Source: Company, I-Sec research

Chart 3: Lack of large deals in the pipeline...



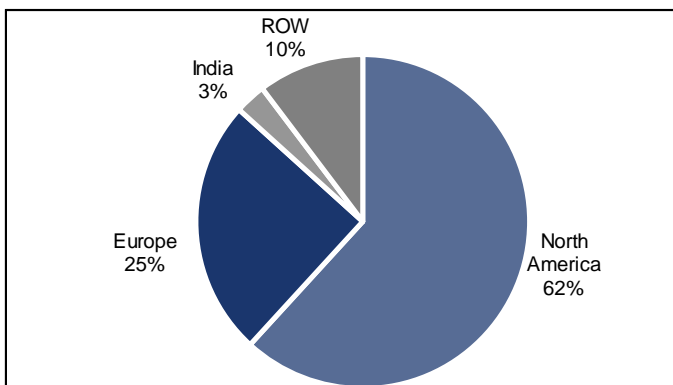
Source: Company, I-Sec research

Chart 4: ...resulted in lower deal wins



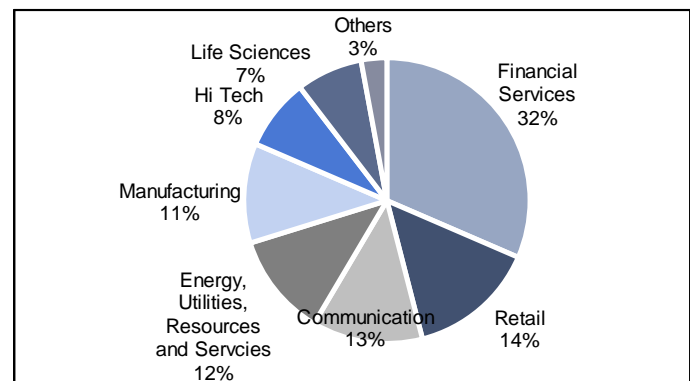
Source: Company, I-Sec research

Chart 5: Geographical mix (%)



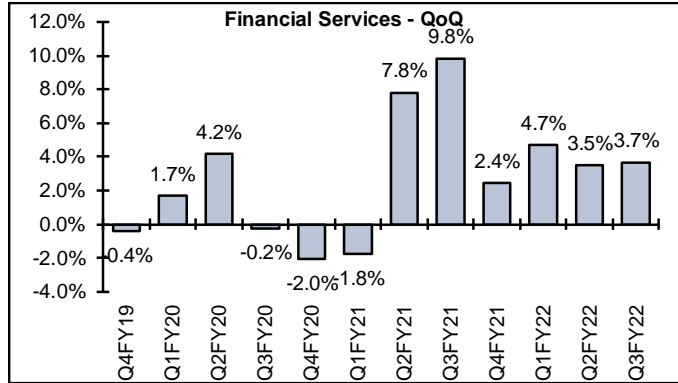
Source: Company, I-Sec research

Chart 6: Vertical mix (%)



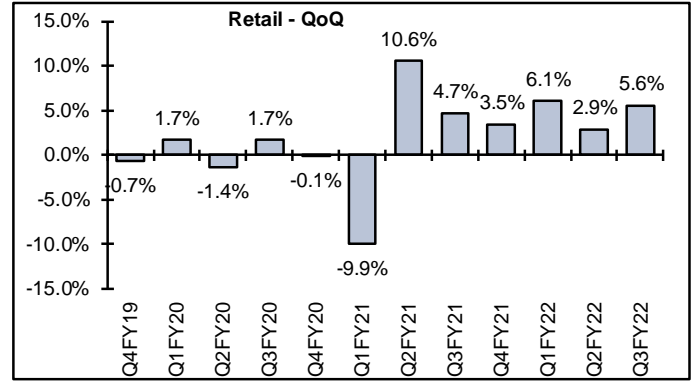
Source: Company, I-Sec research

Chart 7: Steady growth in financial services



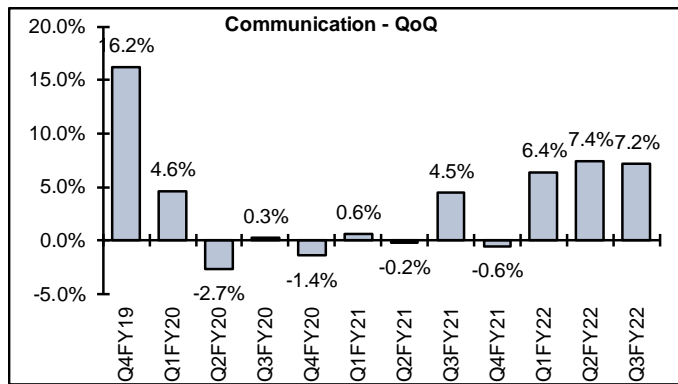
Source: Company, I-Sec research

Chart 8: Retail to stabilise going ahead



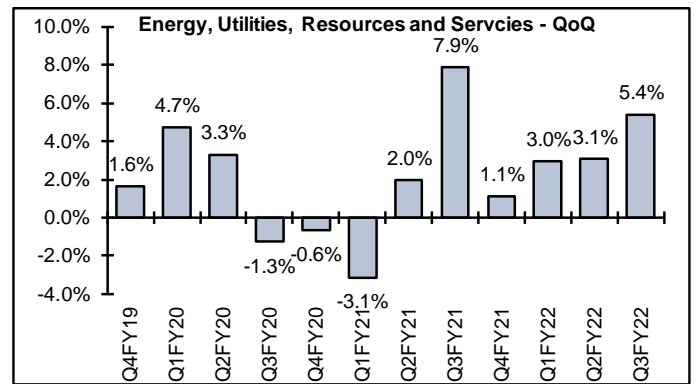
Source: Company, I-Sec research

Chart 9: Steady growth in communications



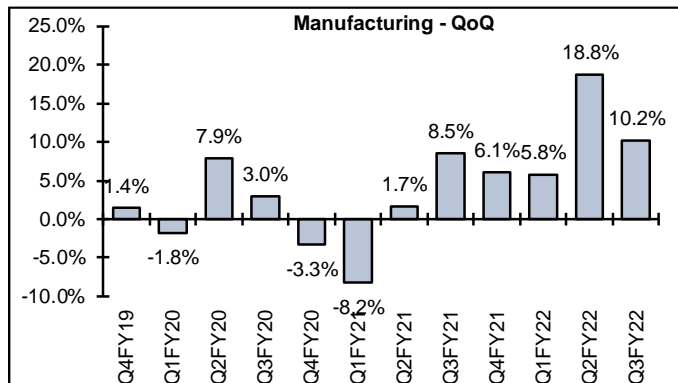
Source: Company, I-Sec research

Chart 10: Growth to pick up in E&U



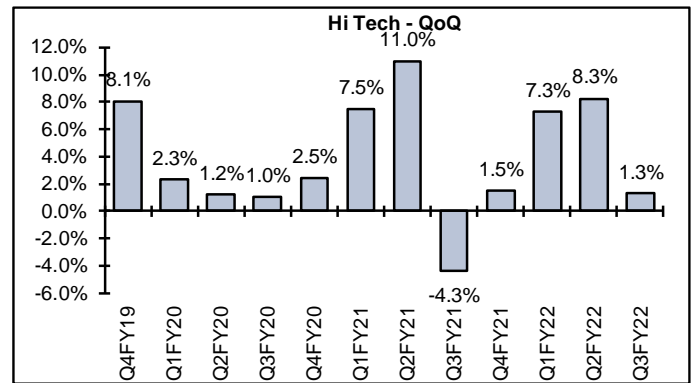
Source: Company, I-Sec research

Chart 11: Manufacturing to improve further



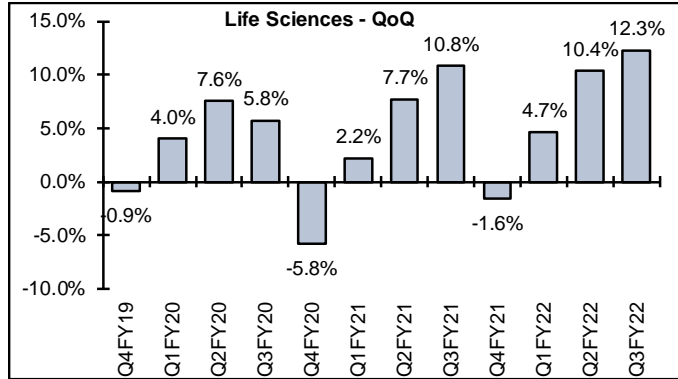
Source: Company, I-Sec research

Chart 12: Growth to normalise in Hi-tech



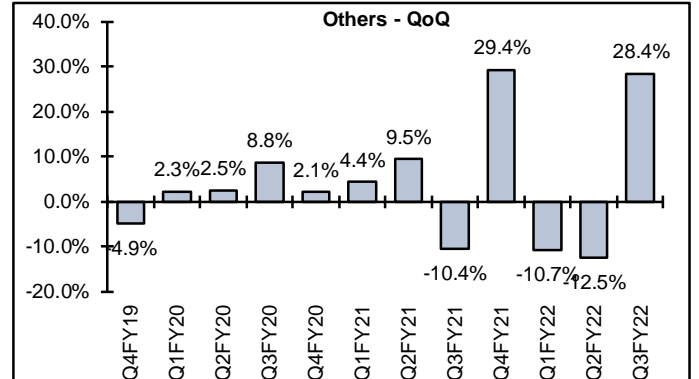
Source: Company, I-Sec research

Chart 13: Growth to pick up in Life Sciences



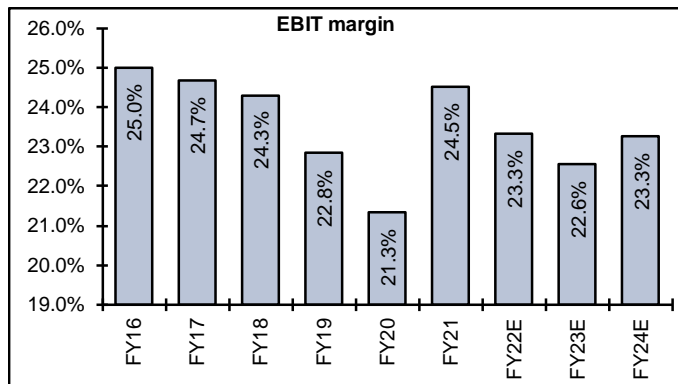
Source: Company, I-Sec research

Chart 14: Others segment to normalise



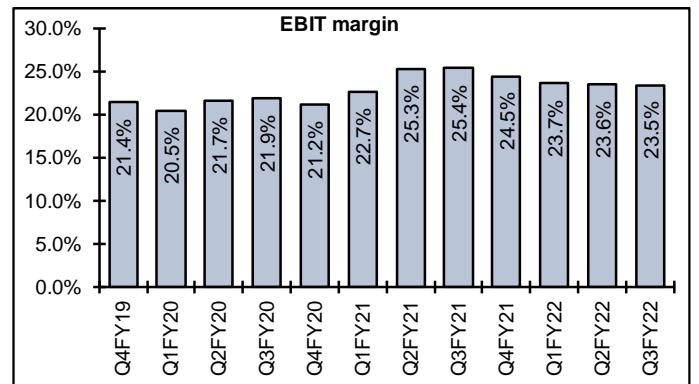
Source: Company, I-Sec research

Chart 15: Margins expected to contract ahead



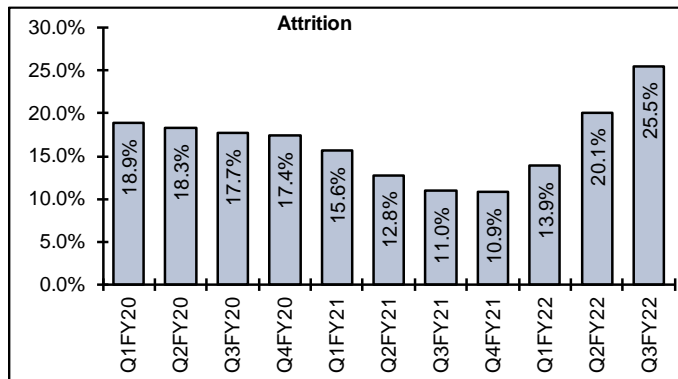
Source: Company, I-Sec research

Chart 16: Margins have been largely resilient



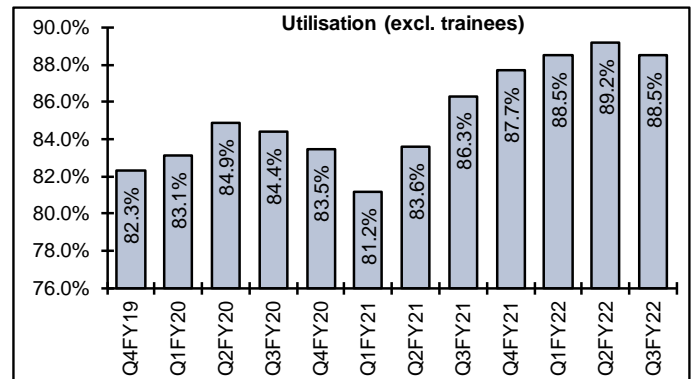
Source: Company, I-Sec research

Chart 17: Attrition expected to further increase



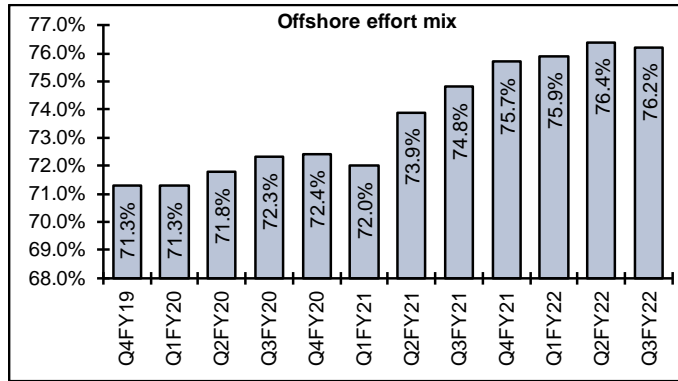
Source: Company, I-Sec research

Chart 18: Utilisation to stabilise going forward



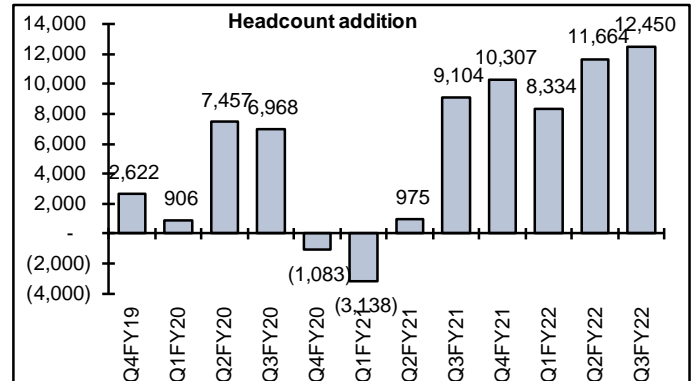
Source: Company, I-Sec research

Chart 19: Largely stable offshore mix



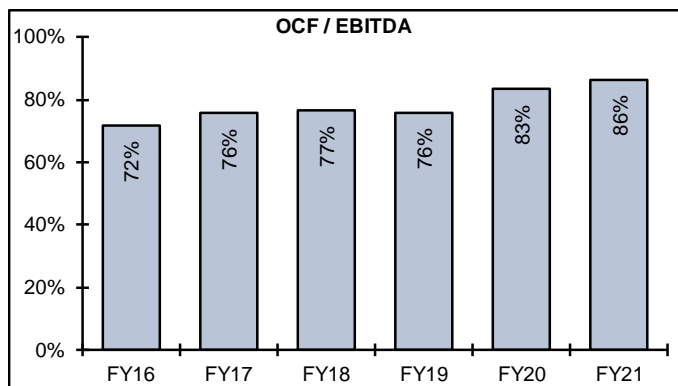
Source: Company, I-Sec research

Chart 20: Aggressive hiring to fulfil demand



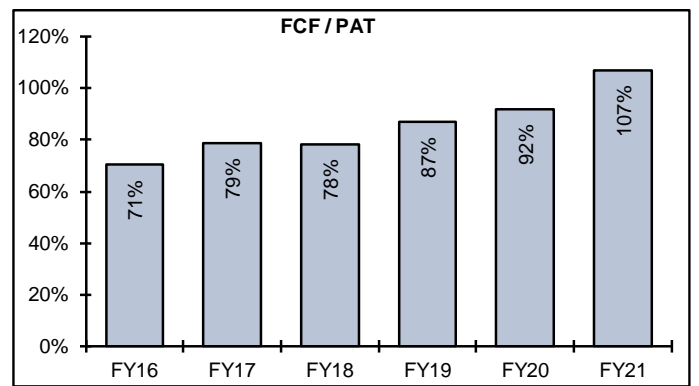
Source: Company, I-Sec research

Chart 21: Robust conversions despite...



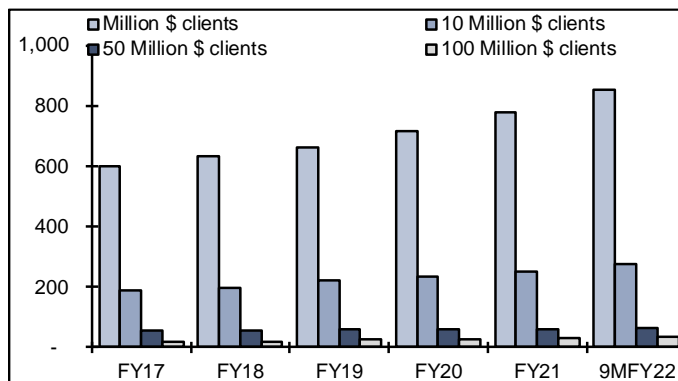
Source: Company, I-Sec research

Chart 22: ...covid-led pressures



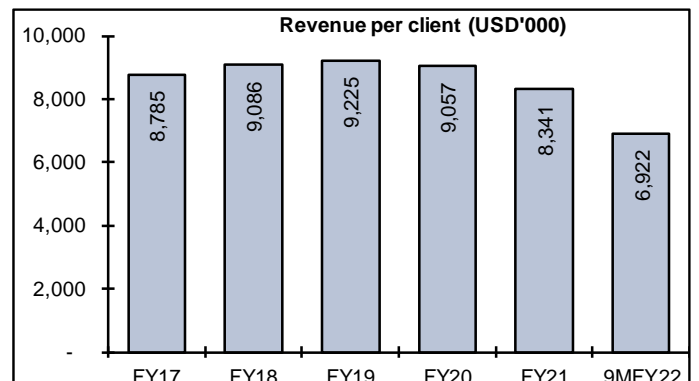
Source: Company, I-Sec research

Chart 23: Consistent increase in client base...



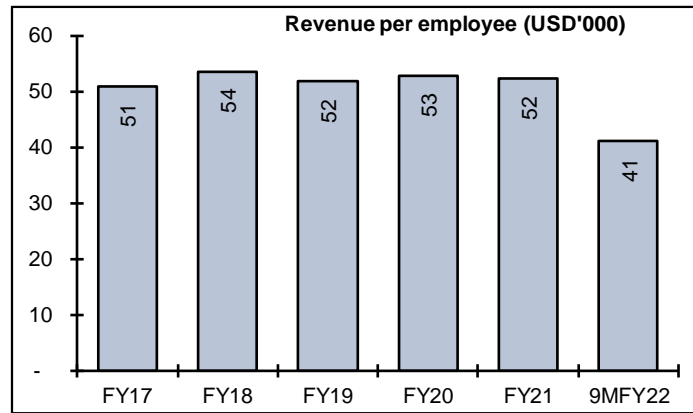
Source: Company, I-Sec research

Chart 24: ...resulting in declining trend



Source: Company, I-Sec research

Chart 25: Aggressive hiring resulted in decline



Source: Company, I-Sec research

Financial summary – Infosys

Table 1: Profit and Loss statement

(Rs mn, year ending March 31)

	FY21	FY22E	FY23E	FY24E
Revenues (US\$ mn)	13,562	16,362	18,508	20,664
Operating Revenues (Sales)	10,04,750	12,19,856	14,06,604	15,91,148
Operating Expenses	7,25,750	9,00,145	10,49,675	11,76,030
EBITDA	2,79,000	3,19,711	3,56,928	4,15,118
% margins	27.8	26.2	25.4	26.1
Depreciation & Amortisation	32,660	35,073	39,682	44,888
EBIT	2,46,340	2,84,639	3,17,247	3,70,230
% margins	24.5	23.3	22.6	23.3
Other Income	20,060	19,421	17,875	23,350
Recurring PBT	2,66,400	3,04,060	3,35,122	3,93,581
Less: Taxes	72,050	81,591	87,132	1,02,331
Less: Minority Interest	450	1,450	2,450	2,450
Less: Exceptional items	-	-	-	-
Net Income (Reported)	1,93,900	2,21,019	2,45,540	2,88,800

Source: Company data, I-Sec research

Table 2: Balance sheet

(Rs mn, year ending March 31)

	FY21	FY22E	FY23E	FY24E
LIABILITIES				
Equity Capital	21,200	20,970	20,970	20,970
Reserves and Surpluses	7,46,540	6,29,909	6,92,968	7,86,713
Shareholders' funds	7,67,740	6,50,879	7,13,938	8,07,683
Non-current Liabilities	77,550	81,340	81,340	81,340
Total Liabilities	8,45,290	7,32,219	7,95,278	8,89,023
ASSETS				
Fixed Assets	2,65,680	2,55,760	2,41,320	2,28,320
Other non-current assets	2,10,630	2,24,910	2,24,910	2,24,910
Total non-current assets	4,76,310	4,80,670	4,66,230	4,53,230
Current Assets				
Cash and cash equivalents	2,70,560	1,54,506	2,15,947	2,97,912
Other current assets	3,37,120	4,14,732	4,58,547	5,26,163
Total Current Assets	6,07,680	5,69,238	6,74,495	8,24,075
less: Current Liabilities	2,38,700	3,17,689	3,45,446	3,88,281
Net Current Assets	3,68,980	2,51,549	3,29,048	4,35,793
Total Assets	8,45,290	7,32,219	7,95,278	8,89,023

Source: Company data, I-Sec Research

Table 3: Cashflow statement

(Rs mn, year ending March 31)

	FY21	FY22E	FY23E	FY24E
Op CF before W Cap changes	2,34,620	2,58,450	2,69,277	3,12,267
Working Capital Inflow / (Outflow)	6,460	(13,623)	(16,058)	(24,780)
Operating Cashflow (OCF)	2,41,080	2,44,827	2,53,219	2,87,487
Capex	(21,080)	(20,533)	(25,242)	(31,888)
Free Cashflow (FCF)	2,20,000	2,24,294	2,27,977	2,55,599
Cashflow from other Invst Act (Ex Capex)	(62,710)	(9,409)	19,995	25,470
Inc/dec in Equity and related items	110	50	-	-
Inc/(Dec) in Borrowings	(6,940)	(4,810)	(2,120)	(2,120)
Dividend paid	(91,480)	(3,43,429)	(1,84,411)	(1,96,985)
Others	-	(2,080)	-	-
Inc./(Dec.) in Cash	58,980	(1,35,384)	61,441	81,965

Source: Company data, I-Sec research

Table 4: Key ratios

(Year ending March 31)

	FY21	FY22E	FY23E	FY24E
Per Share Data (Rs)				
Reported EPS	45.5	51.9	57.7	67.8
Recurring Cash EPS	53.2	60.1	67.0	78.4
Dividend per share (DPS)	27.0	40.0	44.0	47.0
Book Value per share (BV)	179.3	152.0	166.8	188.8
Growth Ratios (%)				
Operating Income (Sales) - US\$ terms	6.1	20.6	13.1	11.7
Operating Income (Sales)	10.7	21.4	15.3	13.1
EBITDA	25.3	14.6	11.6	16.3
Reported Net Income	16.8	14.0	11.1	17.6
Reported EPS	16.8	14.0	11.1	17.6
Recurring Cash EPS	16.3	13.0	11.4	17.0
Valuation Ratios (x)				
P/E	39.9	35.0	31.5	26.8
P/CEPS	34.1	30.2	27.1	23.2
P/BV	10.1	11.9	10.9	9.6
EV / EBITDA	26.7	23.7	21.0	17.9
EV / Sales	7.4	6.2	5.3	4.7
Operating Ratios				
Other Income / PBT (%)	7.5	6.4	5.3	5.9
Effective Tax Rate (%)	27.0	26.8	26.0	26.0
Receivables (days)	70	99	95	97
D/E Ratio (x)	-	-	-	-
Return/Profitability Ratios (%)				
Reported Net Income Margins	19.3	18.1	17.5	18.2
RoCE	23.0	26.4	30.7	32.5
RoNW	27.4	31.3	36.2	38.1
Dividend Payout Ratio	59.3	77.1	76.3	69.3
Dividend Yield	1.5	2.2	2.4	2.6
EBITDA Margins	27.8	26.2	25.4	26.1
EBIT Margins	24.5	23.3	22.6	23.3

Source: Company data, I-Sec research

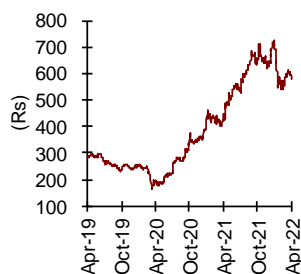
Wipro

(REDUCE; CMP: Rs584; TP: Rs548)

Shareholding pattern

	Jun '21	Sep '21	Dec '21
Promoters	73.0	73.0	73.0
Institutional investors	15.5	11.7	12.1
MFs and others	1.9	1.9	2.7
FIs/Bank	0.0	0.0	0.0
Insurance Cos.	3.8	0.1	0.0
FII	9.8	9.7	9.4
Others	11.5	15.3	14.9

Price chart



Turnaround adequately priced in, add on dips!

We expect the leadership overhaul in Wipro to aid strategic turnaround for the company. Wipro is progressing well on their new strategic imperatives: 1) Capco, one of the biggest consulting acquisitions, is performing well with 22 joint deal wins and 45 deals in pipeline), 2) Focus on high-performance driven culture (incentives for top performers increased 2x), and 3) moving closer to clients (60% of leadership in local markets with increased proximity to clients, increased number of global account executives).

Revenue growth trajectory has significantly improved with 12% CAGR over FY22-FY24E vs 2.5% CAGR over FY18-FY20. Success of the new model will be visible gradually and consistency of revenue growth and ability to maintain margins will be the key parameter to monitor.

Triggers & catalysts for the stock

Focus on winning large deals and improving win rates: Change in leadership has brought in sharp focus on winning deals leading to improving win-rate by 300bps in FY22. Orderbook in ACV terms grew 27% on YTD basis and bookings in the range US\$10mn-30mn grew 50% YoY in Q3FY22. Client addition of 7 in US\$100mn+ category, 5 in US\$75mn+ and 9 in US\$50mn+ on YoY basis in Q3FY22 is also impressive.

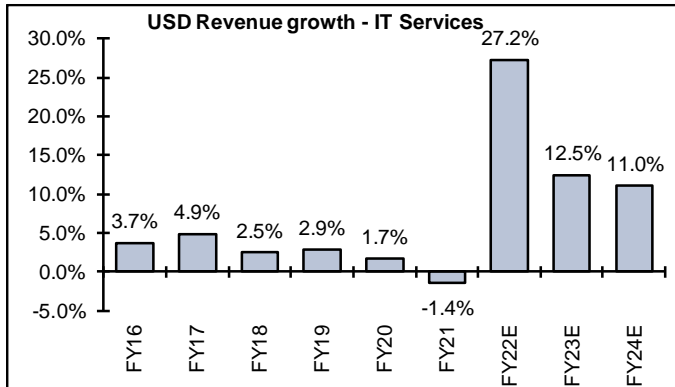
Margins pressure to get elevate: Company's new leadership is focused on delivering profitable growth and has considerably improved margins. Simplified organisation structure improved operating efficiencies aiding margins. Wipro is delivering in line with its IT services EBIT margin guidance of 17-17.5%, ~200bps above pre-covid level margins of ~15.5%. Supply-side cost pressures are expected to weigh down on margins in FY23E, but we expect margins to be at 16.1% for FY23.

Valuation: Wipro currently trades at 21x FY24E P/E for FY22-FY24 EPS CAGR of 13% PEG ratio of 1.2x vs. the tier-1 Indian IT sector trading at 23x FY24E for FY22-FY24E EPS CAGR of 13% and PEG ratio of 1.5x. We are impressed with the turnaround of Wipro and the management's renewed focus on growth, but this is adequately priced in the current valuation of 21x FY24E EPS. We assign **REDUCE** rating with a fair value of Rs548 based on 20x FY24E earnings.

Key Risks: 1) Strong large deal win momentum, 2) Margin expansion, 3) INR Depreciation, 4) Continuation of discretionary spends

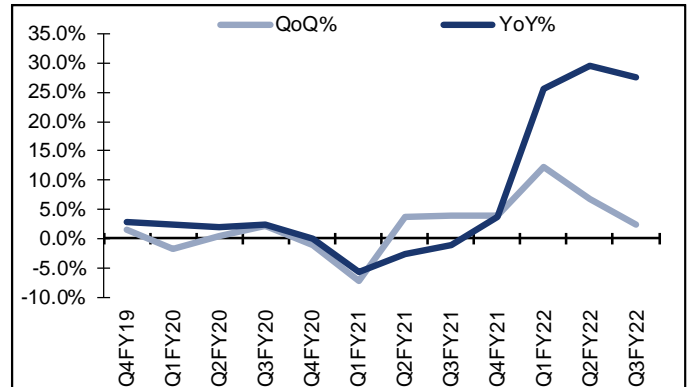
Market Cap	Rs3199bn/US\$42.2bn	Year to March	FY21	FY22E	FY23E	FY24E
Reuters/Bloomberg	WIPR.BO/WPRO IN	Revenue (Rs mn)	619,430	789,860	897,783	1010,127
Shares Outstanding (mn)	5,481.3	Net Income (Rs mn)	107,991	121,883	1,32,020	1,54,660
52-week Range (Rs)	722/419	EPS (Rs)	19.1	21.5	23.3	27.3
Free Float (%)	27.0	% Chg YoY	14.7	12.9	8.3	17.1
FII (%)	9.4	P/E (x)	30.6	27.1	25.0	21.4
Daily Volume (US\$'000)	73,818	CEPS (Rs)	24.1	27.1	29.5	34.2
Absolute Return 3m (%)	(17.1)	EV/E (x)	20.5	18.3	16.4	13.2
Absolute Return 12m (%)	33.3	Dividend Yield	0.2	0.2	0.2	0.2
Sensex Return 3m (%)	(0.3)	RoCE (%)	31.7	29.8	25.7	29.6
Sensex Return 12m (%)	20.7	RoE (%)	19.4	19.7	17.7	17.5

Chart 1: Revenue growth to moderate



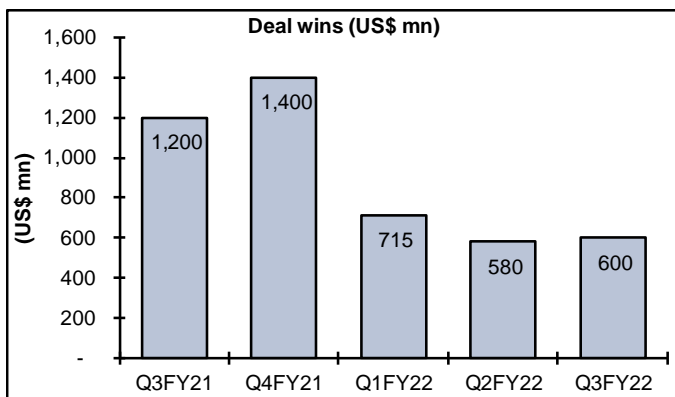
Source: Company, I-Sec research

Chart 2: Strong growth led by acquisitions



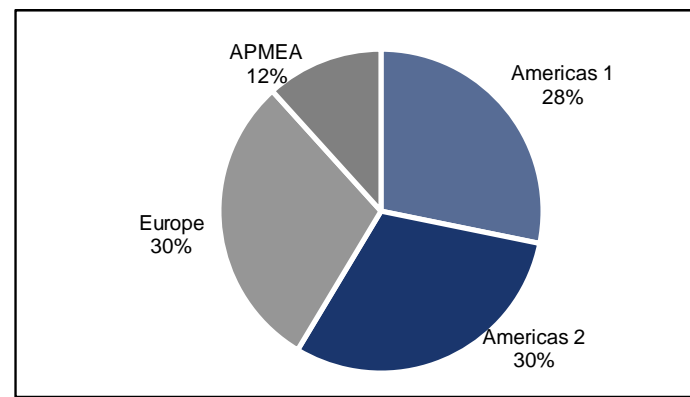
Source: Company, I-Sec research

Chart 3: Absence of large deals in the pipeline



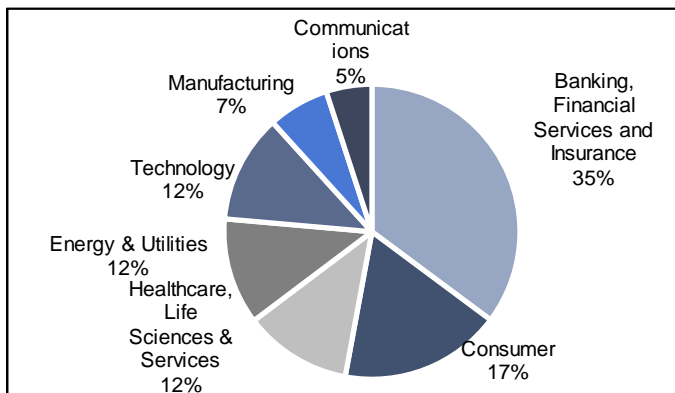
Source: Company, I-Sec research

Chart 4: Geographical mix (%)



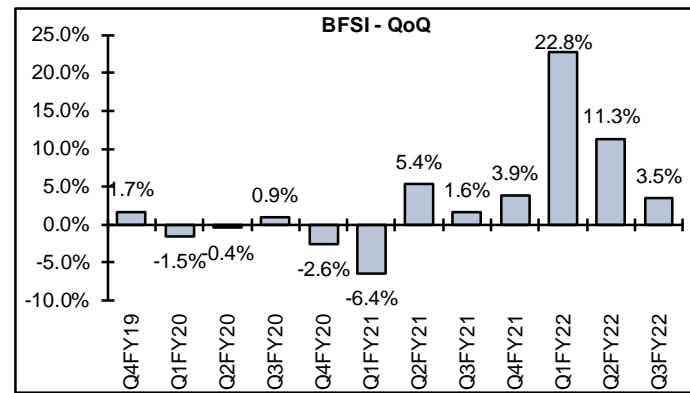
Source: Company, I-Sec research

Chart 5: Vertical mix (%)



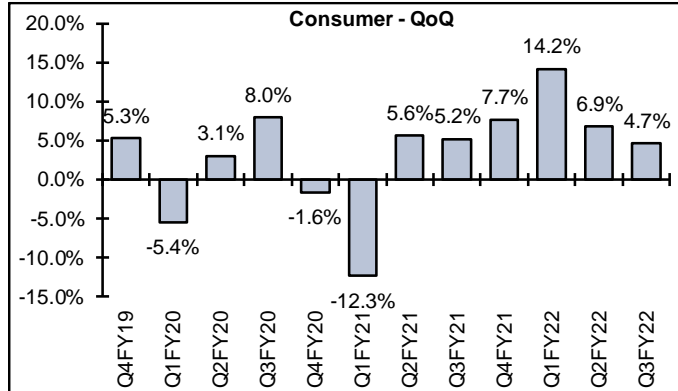
Source: Company, I-Sec research

Chart 6: Growth to stabilise going forward



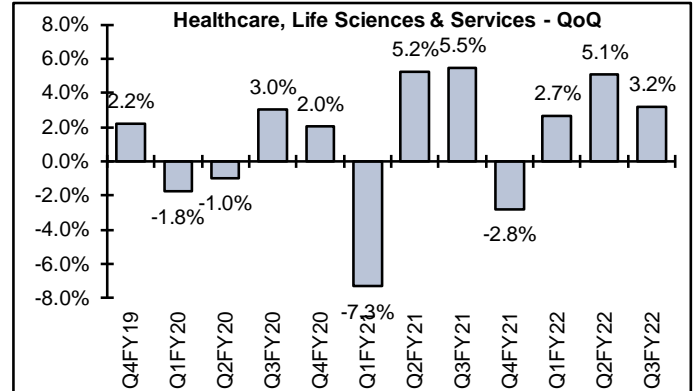
Source: Company, I-Sec research

Chart 7: Consumer segment expected to pick up



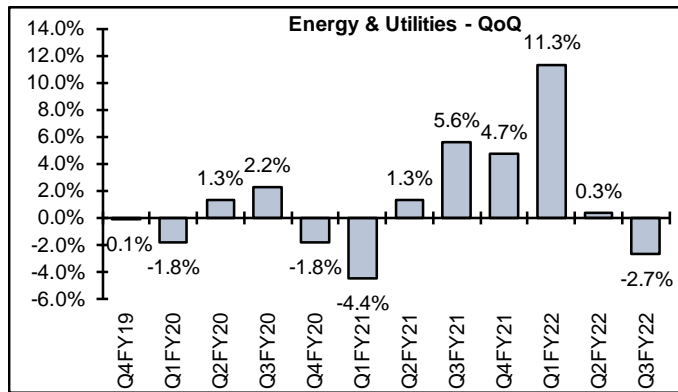
Source: Company, I-Sec research

Chart 8: Growth to pick up within the segment



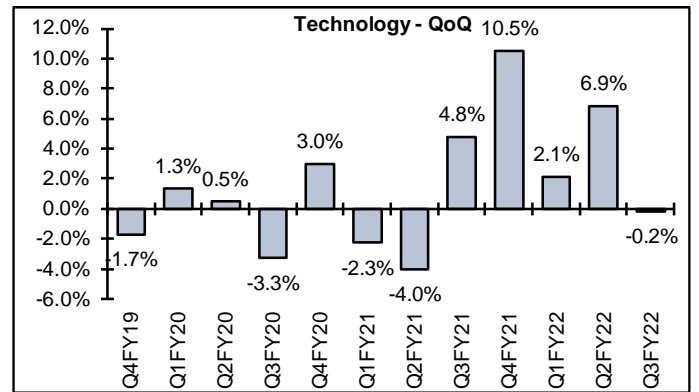
Source: Company, I-Sec research

Chart 9: E&U to stabilise going forward



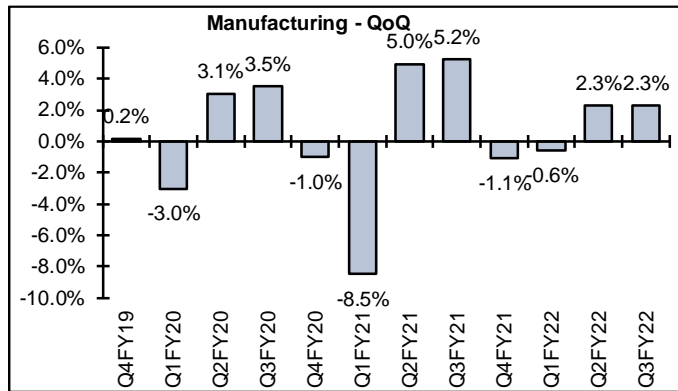
Source: Company, I-Sec research

Chart 10: Technology to stabilise going forward



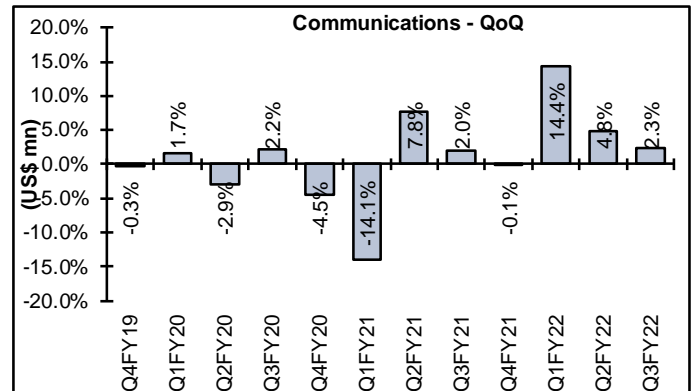
Source: Company, I-Sec research

Chart 11: Growth to pick up in manufacturing



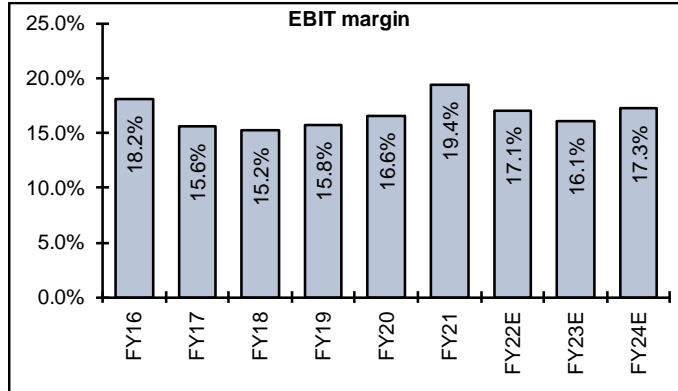
Source: Company, I-Sec research

Chart 12: Communications to normalise



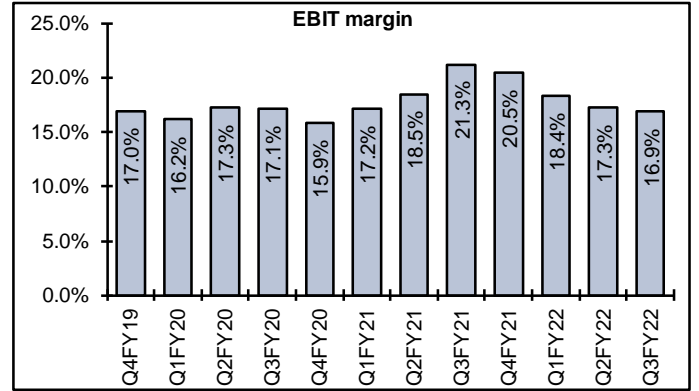
Source: Company, I-Sec research

Chart 13: Margins expected to contract



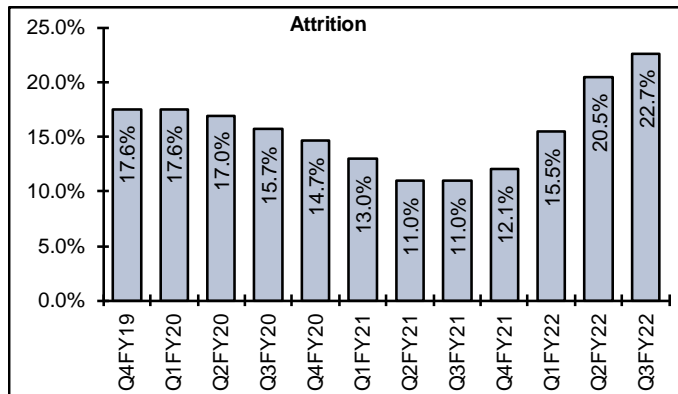
Source: Company, I-Sec research

Chart 14: Supply headwinds led to contraction



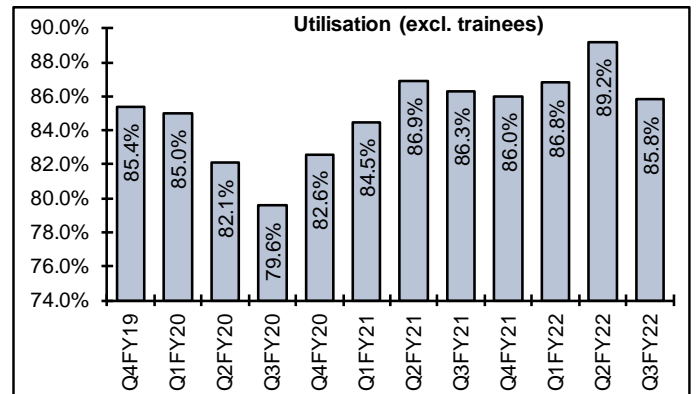
Source: Company, I-Sec research

Chart 15: Attrition higher than pre-covid levels



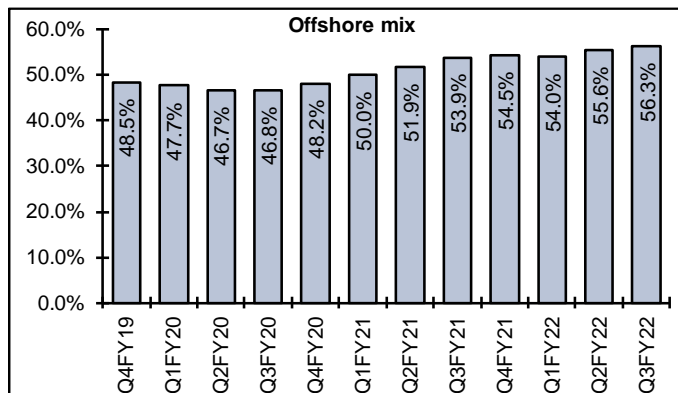
Source: Company, I-Sec research

Chart 16: Utilisation rates now normalising



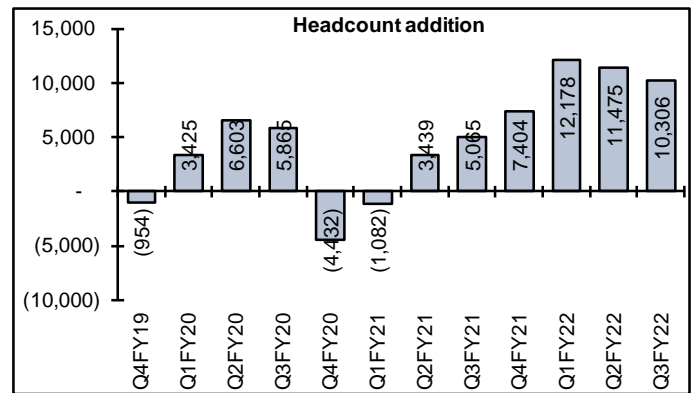
Source: Company, I-Sec research

Chart 17: Largely stale offshore mix to aid margins



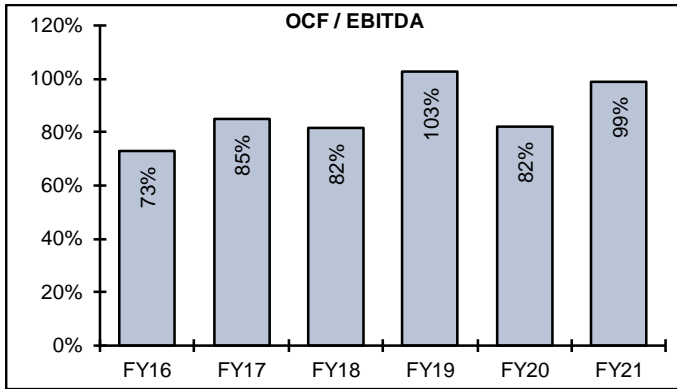
Source: Company, I-Sec research

Chart 18: Aggressive hiring to match the demand



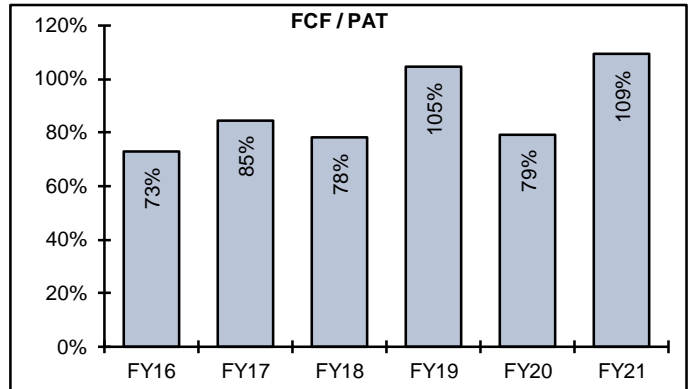
Source: Company, I-Sec research

Chart 19: Robust conversions despite...



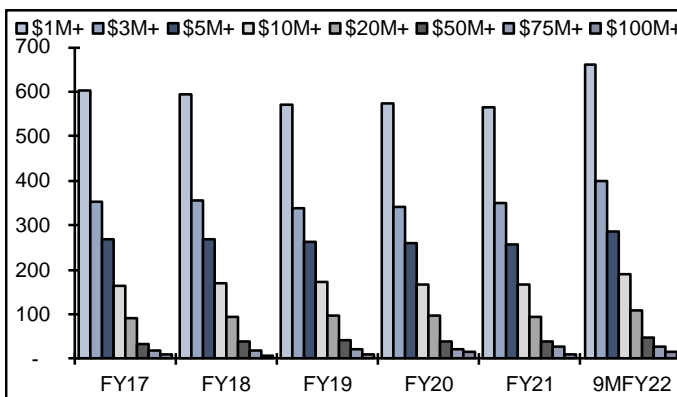
Source: Company, I-Sec research

Chart 20: ...covid-led pressures



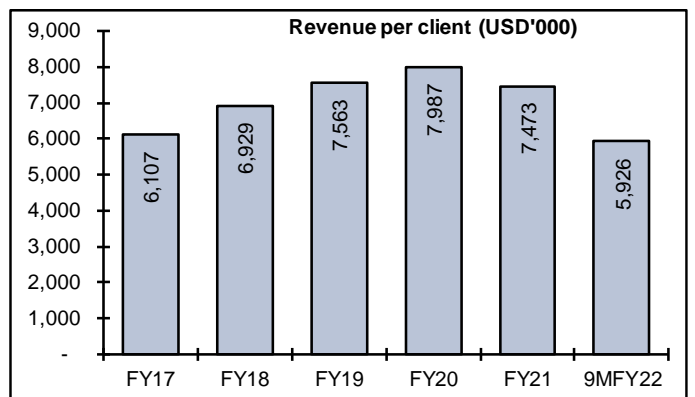
Source: Company, I-Sec research

Chart 21: Consistent increase in client base...



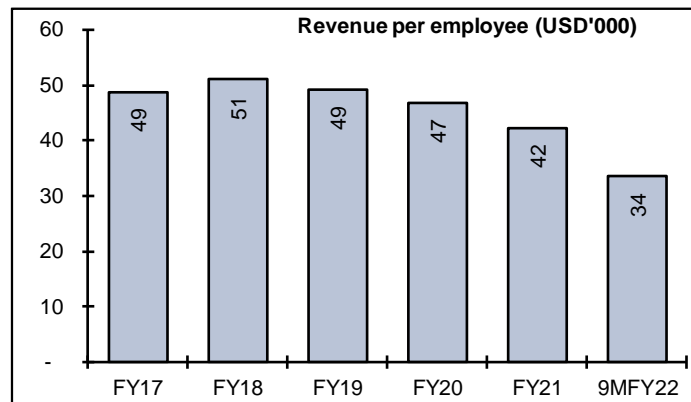
Source: Company, I-Sec research

Chart 22: ...resulting in declining trend



Source: Company, I-Sec research

Chart 23: Aggressive hiring resulted in decline



Source: Company, I-Sec research

Financial summary – Wipro

Table 1: Profit and Loss statement

(Rs mn, year ending March 31)

	FY21	FY22E	FY23E	FY24E
Revenues - IT Services (US\$mn)	8,137	10,350	11,640	12,926
Operating Revenues (Sales)	6,19,430	7,89,860	8,97,783	10,10,127
Operating expenses	4,99,238	6,54,790	7,52,847	8,35,819
EBIT	1,20,192	1,35,070	1,44,936	1,74,308
EBIT margin (%)	19.4%	17.1%	16.1%	17.3%
Other Income	18,856	17,642	22,689	22,063
Recurring PBT	1,39,048	1,52,712	1,67,625	1,96,371
Less: Taxes	30,341	30,776	35,606	41,711
Add: Extraordinary income	-	-	-	-
Less: Non-controlling interest	(716)	(54)	-	-
Net Income (Reported)	1,07,991	1,21,883	1,32,020	1,54,660

Source: Company data, I-Sec research

Table 2: Balance sheet

(Rs mn, year ending March 31)

	FY21	FY22E	FY23E	FY24E
Net Worth	5,53,095	6,84,458	8,11,009	9,60,201
Minority Interest & others	1,498	446	446	446
Non current liabilities	46,801	1,11,805	1,11,805	1,11,805
Sources of Funds	6,01,394	7,96,709	9,23,260	10,72,452
Net Block	85,192	91,248	95,248	99,248
Intangible Assets	1,52,212	2,87,265	2,87,265	2,87,265
Other non current assets	70,844	69,107	69,107	69,107
Curr. Assets				
Debtors	94,298	1,20,461	1,35,679	1,52,426
Inventories	1,064	1,047	1,179	1,325
Cash & Bank Balance	3,45,500	3,84,507	4,91,713	6,20,400
Adv., Other Current Assets	82,324	96,069	1,07,010	1,19,051
Current Liab. & Prov	2,30,040	2,52,994	2,63,941	2,76,370
Net Current Assets	2,93,146	3,49,089	4,71,640	6,16,832
Application of Funds	6,01,394	7,96,709	9,23,260	10,72,452

Source: Company data, I-Sec Research

Table 3: Cashflow statement

(Rs mn, year ending March 31)

	FY21	FY22E	FY23E	FY24E
CF from Operations	1,27,028	1,40,621	1,49,169	1,76,782
Cash for Wkg. Capital	20,522	(15,000)	(14,998)	(16,505)
Net Operating CF	1,47,550	1,25,621	1,34,171	1,60,278
Net Purchase of FA	(29,450)	(1,72,791)	(38,731)	(43,078)
Others	37,189	(46,511)	17,581	16,955
Net Cash from Invest.	7,739	(2,19,302)	(21,149)	(26,123)
Change in Equity	-	14,122	226	226
Proceeds from LTB/STB	6,212	65,004	-	-
Dividend Payments	(1,22,103)	(5,694)	(5,694)	(5,694)
Others	(12,949)	-	-	-
Net CF from Finan.	(1,28,840)	73,432	(5,468)	(5,468)
Net Cashflow	26,449	(20,249)	1,07,554	1,28,687

Source: Company data, I-Sec research

Table 4: Key ratios

(Year ending March 31)

	FY21	FY22E	FY23E	FY24E
Per Share Data (Rs)				
Fully Diluted EPS	19.1	21.5	23.3	27.3
Recurring Cash EPS	24.1	27.1	29.5	34.2
Dividend per share (DPS)	1.0	1.0	1.0	1.0
Book Value per share (BV)	94.6	117.0	138.7	164.2
Growth Ratios (%)				
Revenues - IT Services (US\$)	(1.4)	27.2	12.5	11.0
Operating Income (Sales)	1.5	27.5	13.7	12.5
EBIT	18.5	12.4	7.3	20.3
Reported Net Income	11.1	12.9	8.3	17.1
Fully Diluted EPS	14.7	12.9	8.3	17.1
Recurring Cash EPS	19.5	12.4	8.6	16.2
Valuation Ratios (x)				
P/E	30.6	27.1	25.0	21.4
P/CEPS	24.2	21.5	19.8	17.1
P/BV	6.2	5.0	4.2	3.6
EV / EBITDA	20.5	18.3	16.4	13.2
EV / Sales	4.9	3.9	3.3	2.8
Operating Ratios				
Other Income / PBT (%)	13.6	11.6	13.5	11.2
Effective Tax Rate (%)	21.8	20.2	21.2	21.2
Fixed Asset Turnover (x) on average	0.1	0.1	0.1	0.1
Receivables (days)	56	56	55	55
Return/Profitability Ratios (%)				
Recurring Net Income Margins	17.4	15.4	14.7	15.3
RoNW (Based on Avg)	19.4	19.7	17.7	17.5
RoCE (Based on Avg)	31.7	29.8	25.7	29.6
Dividend Payout Ratio	5.2	4.6	4.3	3.7
Dividend Yield	0.2	0.2	0.2	0.2
EBITDA Margin	24.0	21.1	20.0	21.1

Source: Company data, I-Sec research

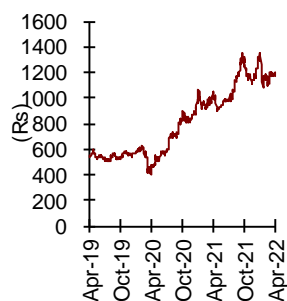
HCL Technologies

(HOLD; CMP: Rs1,165, TP: Rs1,177)

Shareholding pattern

	Jun '21	Sep '21	Dec '21
Promoters	60.3	60.3	60.3
Institutional investors	34.6	34.8	34.2
MFs and others	7.2	7.8	9.0
FIs/Bank	0.2	0.2	0.1
Insurance Cos.	3.7	4.3	4.4
FII	23.5	22.5	20.7
Others	5.1	4.9	5.5

Price chart



Delivery on margins remains a pain-point!

HCLT's traditional strength in IMS and improving capabilities in digital and application competencies have led to consistent integrated deal wins driving sustainable growth for IT services business. Strong deal wins with deal TCV growth of 46% YoY in 9MFY22 indicate strong revenue growth momentum to continue for IT services and ER&D in FY23E. However, product portfolio is dragging down overall growth and recovery in P&P will be the key for sustainable growth momentum.

Payout ratio has improved considerably (~73% in FY22E) and board has approved dividend payout of 75% of net income cumulatively to be paid over FY22 to FY26.

Triggers & catalysts for the stock

IT services and ER&D growing well; P&P portfolio is a drag on growth: HCLT's IT services and ER&D segments grew at strong pace of 15.3%/13% YoY in 9MFY22 led by consistent strong deal win momentum. Deal TCV has grown 46% YoY in 9MFY22. Company is well positioned to win integrated apps+infra deals – it has won several such significant deals. P&P business is dragging down overall growth and is expected to report muted growth of 0-1% YoY CC in FY22 because 25% of P&P portfolio is comprised of end-of-life products and license based pricing makes the revenue unpredictable.

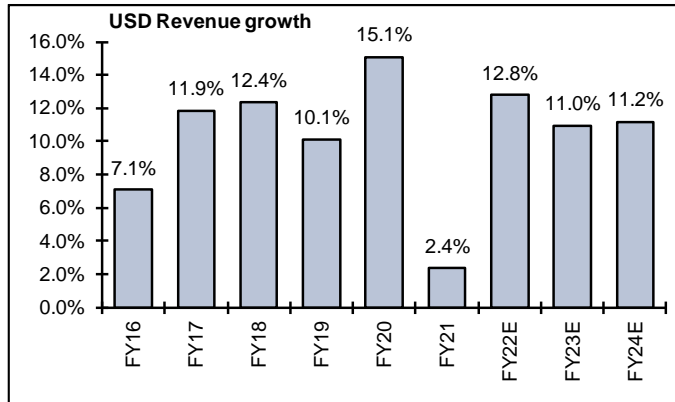
Margins declined below pre-covid levels: HCLT has not been able to improve its profitability despite covid-led savings. In Q4FY21 the company negatively surprised the street by reducing its lower end of FY22E margin guidance band from 19.5% to 19%, below its pre-covid levels of ~19.6-19.8%, led by supply-side cost pressures from higher attrition, higher hiring and retention costs, etc. Its margins declined sharply by 632bps QoQ to 16.6% in Q4FY21 led by one-time milestone bonus, supply-side pressures and investments. Margins are trending near lower end of guidance at ~19% in FY22E and we expect the management to provide EBIT margin guidance of 18-20% for FY23.

Valuation: HCLT currently trades at 19x FY24E P/E for FY22-FY24 EPS CAGR of 12%, PEG ratio of 1.2x vs the tier-1 Indian IT sector trading at 23x FY24E for FY22-FY24E EPS CAGR of 13% and PEG ratio of 1.5x. HCLT used to trade at average 14x at pre-covid (FY18-FY20), but unlike others its performance has worsened and it hasn't been able to get tailwinds of COVID. We do believe that HCLT's underperformance in growth and margins w.r.t. to peers will continue, but risk-rewards looks favorable to us. We assign **HOLD** rating with multiple of 19x on FY24E EPS of Rs62 to arrive at a target price of Rs1,177.

Key Risks: 1) Continued weak margin performance, 2) Weak growth in Services business, 3) Weak TCV momentum, 4) INR appreciation

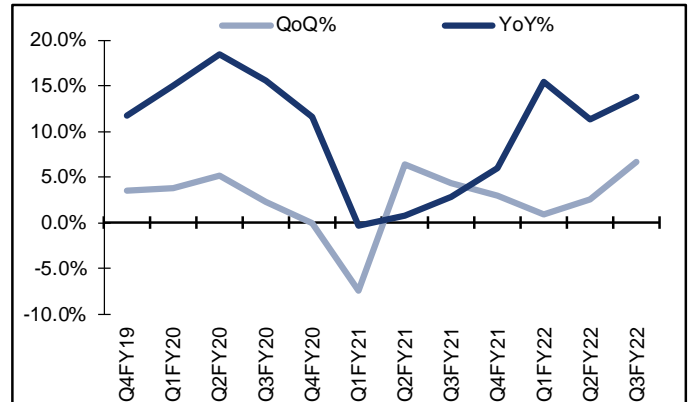
Market Cap	Rs3162bn/US\$41.7bn	Year to March	FY21	FY22E	FY23E	FY24E
Reuters/Bloomberg	HCLT.BO/HCLT IN	Revenue (Rs mn)	753,790	855,472	967,708	1090,161
Shares Outstanding (mn)	2,713.7	Net Income (Rs mn)	124,330	133,691	144,817	168,105
52-week Range (Rs)	1358/899	EPS (Rs)	45.8	49.3	53.4	62.0
Free Float (%)	39.7	% Chg YoY	12.4	7.5	8.3	16.1
FII (%)	20.7	P/E (x)	25.4	23.6	21.8	18.8
Daily Volume (US\$'000)	72,490	CEPS (Rs)	60.5	64.6	70.1	79.7
Absolute Return 3m (%)	(8.9)	EV/E (x)	15.5	14.6	13.0	11.2
Absolute Return 12m (%)	16.9	Dividend Yield	2.2	3.1	3.4	3.4
Sensex Return 3m (%)	(0.3)	RoCE (%)	18.0	17.8	19.1	20.9
Sensex Return 12m (%)	20.7	RoE (%)	22.0	21.5	22.3	24.1

Chart 1: Revenue growth to normalise



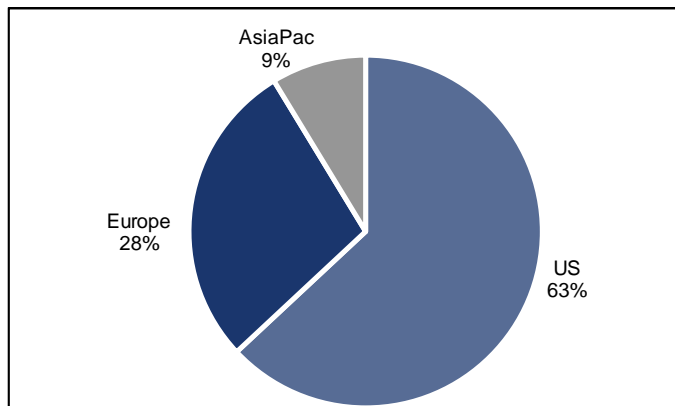
Source: Company, I-Sec research

Chart 2: Growth due to ER&D / P&P segment



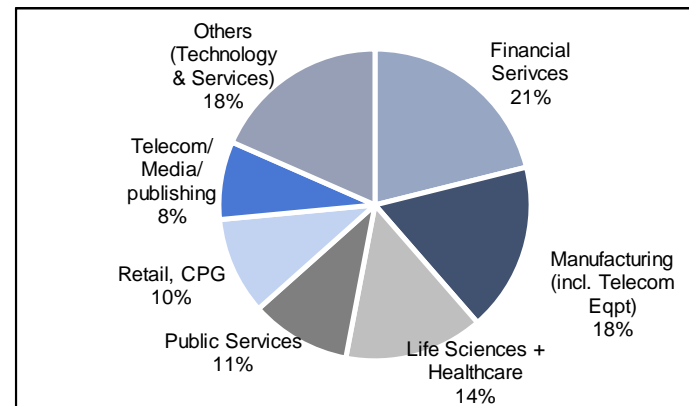
Source: Company, I-Sec research

Chart 3: Geographical mix (%)



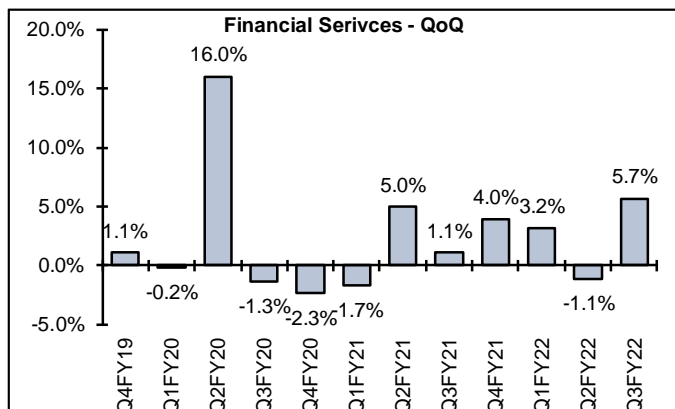
Source: Company, I-Sec research

Chart 4: Vertical mix (%)



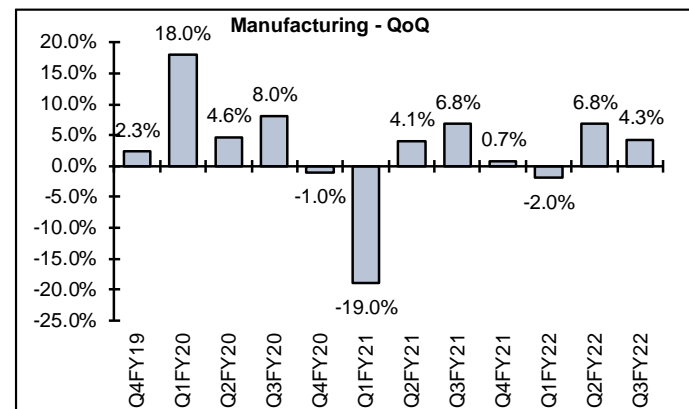
Source: Company, I-Sec research

Chart 5: Financial services to stabilise



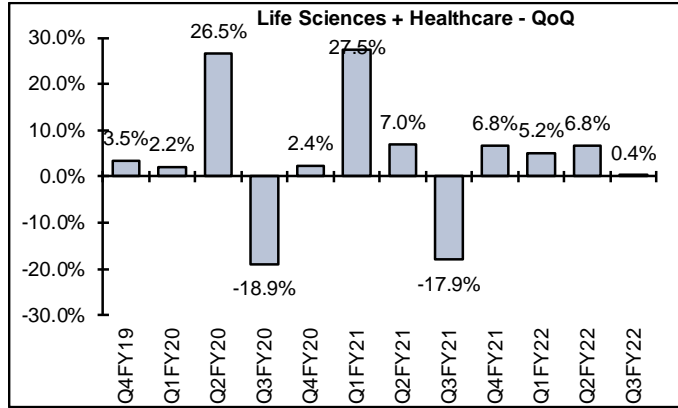
Source: Company, I-Sec research

Chart 6: Manufacturing to pick up



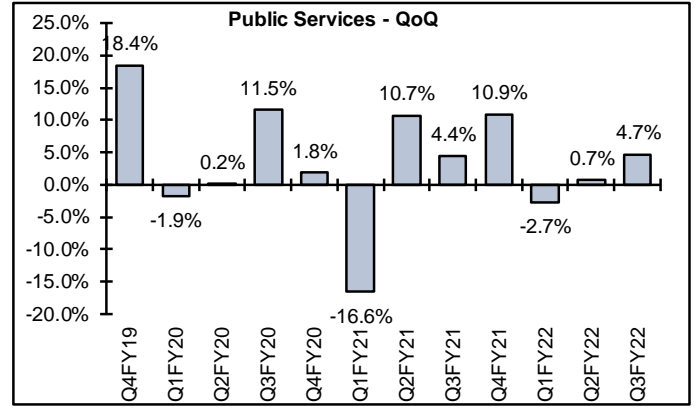
Source: Company, I-Sec research

Chart 7: Growth to pick up in the segment



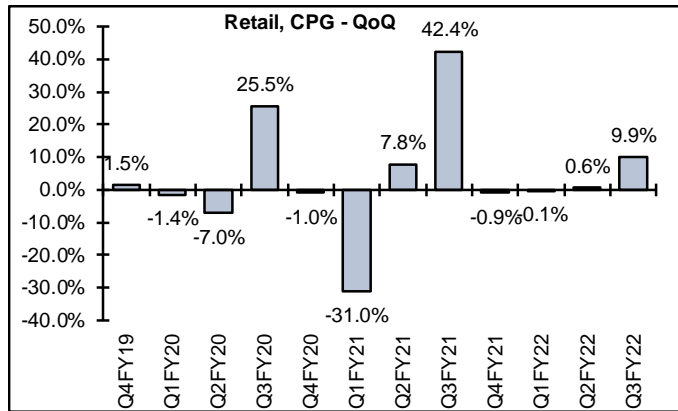
Source: Company, I-Sec research

Chart 8: Lumpy growth in public services



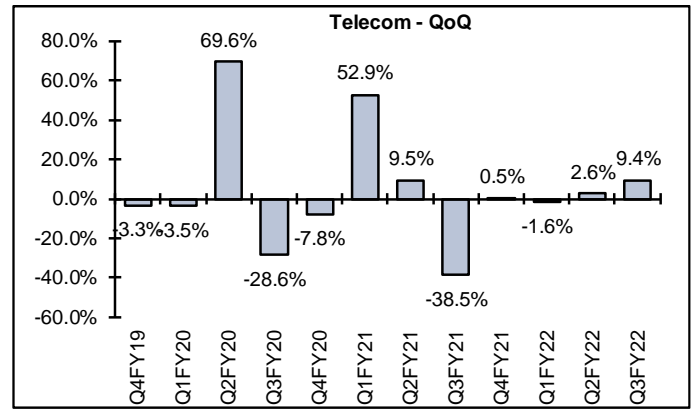
Source: Company, I-Sec research

Chart 9: Retail to now stabilise ahead



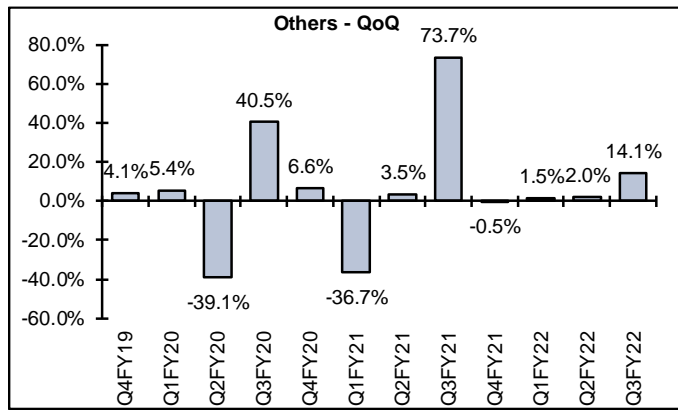
Source: Company, I-Sec research

Chart 10: Growth in telecom to normalise



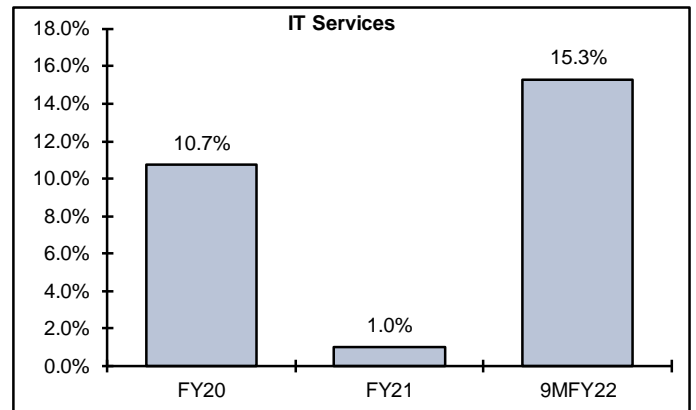
Source: Company, I-Sec research

Chart 11: Lumpy growth in others vertical



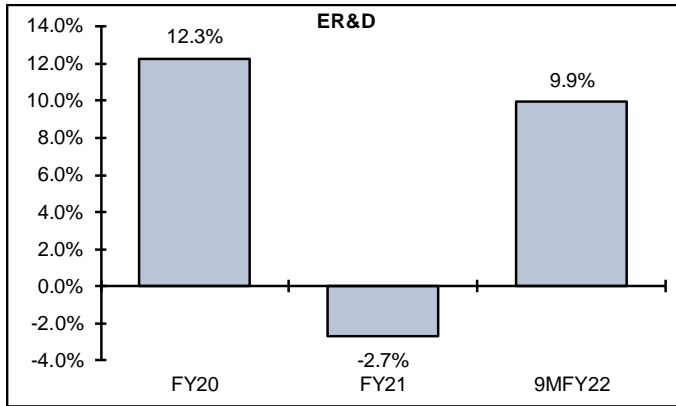
Source: Company, I-Sec research

Chart 12: Robust growth in IT services segment



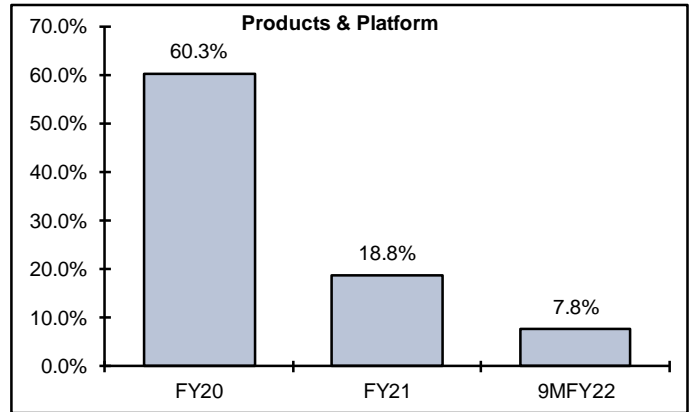
Source: Company, I-Sec research

Chart 13: Robust growth in ER&D segment



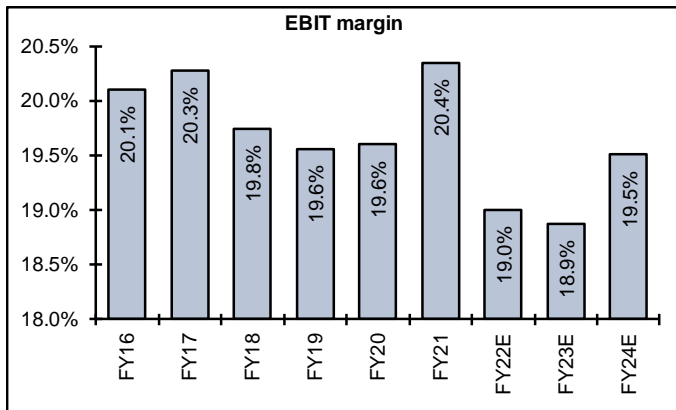
Source: Company, I-Sec research

Chart 14: Declining growth trend in P&P segment



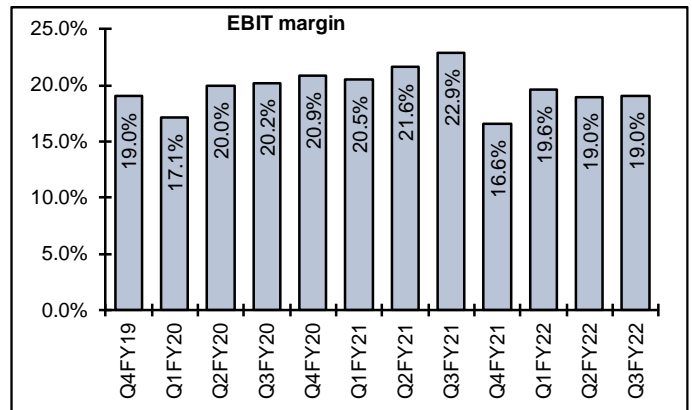
Source: Company, I-Sec research

Chart 15: Increased need for investments has...



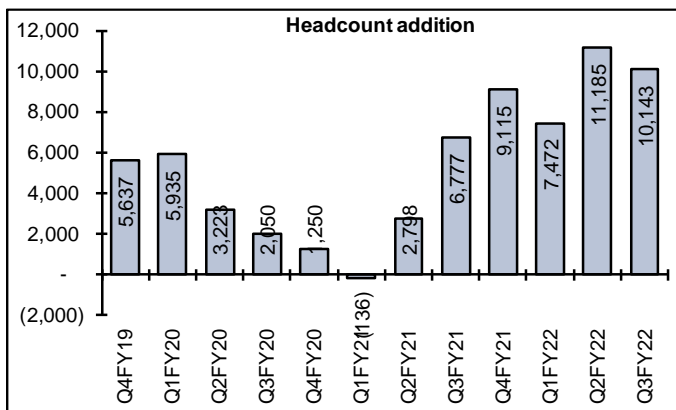
Source: Company, I-Sec research

Chart 16: ...led to contraction in margins



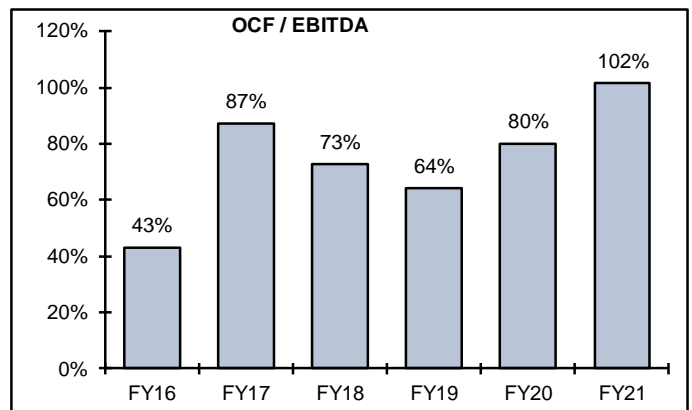
Source: Company, I-Sec research

Chart 17: Aggressive hiring to fulfil demand



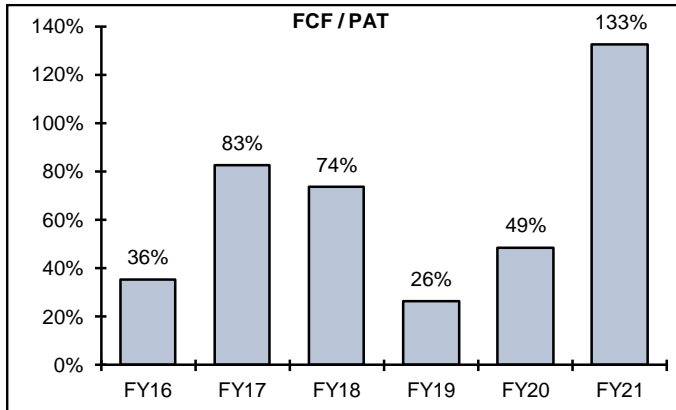
Source: Company, I-Sec research

Chart 18: Robust conversion despite pressures



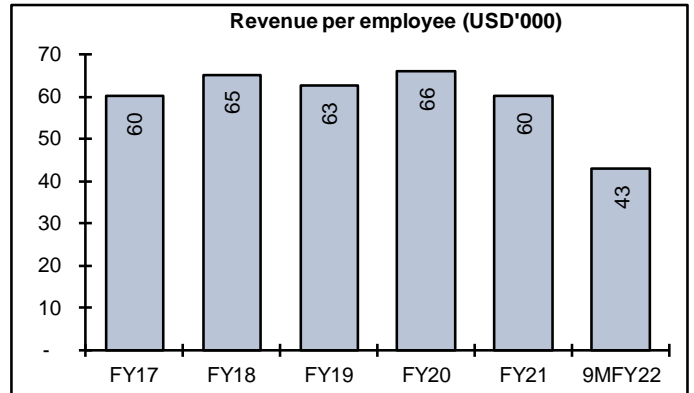
Source: Company, I-Sec research

Chart 19: Robust conversion despite pressures



Source: Company, I-Sec research

Chart 20: Aggressive hiring resulted in decline



Source: Company, I-Sec research

Financial summary – HCL Technologies

Table 1: Profit and Loss statement

(Rs mn, year ending March 31)

	FY21	FY22E	FY23E	FY24E
Revenues (US\$mn)	10,175	11,475	12,733	14,158
Operating Revenues (Sales)	7,53,790	8,55,472	9,67,708	10,90,161
Operating Expenses	5,60,510	6,51,188	7,39,740	8,29,278
EBITDA	1,93,280	2,04,284	2,27,968	2,60,883
% margins	25.6	23.9	23.6	23.9
Depreciation/Amortisation	39,850	41,691	45,299	48,151
EBIT	1,53,430	1,62,592	1,82,669	2,12,732
% margins	20.4	19.0	18.9	19.5
Other Income	6,570	8,800	4,920	4,920
Recurring PBT	1,60,000	1,71,392	1,87,589	2,17,652
Less: Taxes	35,100	37,132	42,212	48,987
Less: Minority Interest	570	570	560	560
Net Income (Reported)	1,24,330	1,33,691	1,44,817	1,68,105

Source: Company data, I-Sec research

Table 2: Balance sheet

(Rs mn, year ending March 31)

	FY21	FY22E	FY23E	FY24E
Assets				
Total Current Assets	4,30,520	4,64,836	5,16,167	5,97,041
Total Current Liabilities & Provisions	1,67,550	1,69,422	1,88,483	2,13,799
Net Current Assets	2,62,970	2,95,414	3,27,684	3,83,242
Investments	890	570	570	570
Net Fixed Assets	3,77,870	3,34,070	3,38,070	3,42,070
Other Assets	67,750	92,870	92,870	92,870
Total Assets	7,09,480	7,22,924	7,59,194	8,18,752
Liabilities				
Borrowings	39,070	39,110	39,110	39,110
Other Liabilities	49,500	47,860	47,860	47,860
Net Worth	6,20,910	6,35,954	6,72,224	7,31,782
Total Liabilities	7,09,480	7,22,924	7,59,194	8,18,752

Source: Company data, I-Sec Research

Table 3: Cashflow statement

(Rs mn, year ending March 31)

	FY21	FY22E	FY23E	FY24E
Operating Cashflow before W Cap changes	1,59,290	1,69,752	1,87,196	2,13,336
Working Capital Inflow / (Outflow)	36,890	(27,600)	(9,638)	(12,801)
Operating Cashflow	1,96,180	1,42,152	1,77,557	2,00,535
Capex	(31,150)	2,109	(49,299)	(52,151)
Other investing activities	(26,270)	(19,170)	2,920	2,920
Proceeds from Issue of Share Capital	-	(20,955)	-	-
Inc/(Dec) in Borrowings / other L.Term Liabs	(79,240)	(1,600)	-	-
Dividend paid	(32,560)	(97,692)	(1,08,547)	(1,08,547)
Increase/(Decrease) in Cash	26,960	4,844	22,631	42,757

Source: Company data, I-Sec research

Table 4: Key ratios

(Year ending March 31)

	FY21	FY22E	FY23E	FY24E
Per Share Data (in Rs)				
Adjusted EPS	45.8	49.3	53.4	62.0
Recurring Cash EPS	60.5	64.6	70.1	79.7
Dividend per share (DPS)	26.0	36.0	40.0	40.0
Book Value per share (BV)	226.7	232.5	245.9	267.8
Growth Ratios (%)				
Operating Income (Sales) - US\$ terms	2.4	12.8	11.0	11.2
Operating Income (Sales)	6.6	13.5	13.1	12.7
EBITDA	15.8	5.7	11.6	14.4
Reported Net Income	12.4	7.5	8.3	16.1
Adjusted EPS	12.4	7.5	8.3	16.1
Recurring Cash EPS	18.1	6.8	8.4	13.7
Valuation Ratios (x)				
P/E	25.4	23.6	21.8	18.8
P/CEPS	19.3	18.0	16.6	14.6
P/BV	5.1	5.0	4.7	4.3
EV / EBITDA	15.5	14.6	13.0	11.2
EV / Sales	4.0	3.5	3.1	2.7
Operating Ratios				
Other Income / PBT (%)	4.1	5.1	2.6	2.3
Effective Tax Rate (%)	21.9	21.7	22.5	22.5
Receivables (days)	85	86	84	85
Return/Profitability Ratios (%)				
Reported Net Income Margins	16.5	15.6	15.0	15.4
RoCE (Based on Avg)	18.0	17.8	19.1	20.9
RoNW (Based on Avg)	22.0	21.5	22.3	24.1
Dividend Yield	2.2	3.1	3.4	3.4
EBITDA Margins	25.6	23.9	23.6	23.9

Source: Company data, I-Sec research

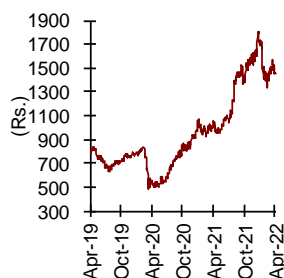
Tech Mahindra

(HOLD; CMP: Rs1,450, TP: Rs1,502)

Shareholding pattern

	Jun '21	Sep '21	Dec '21
Promoters	35.7	35.7	35.7
Institutional investors	52.7	52.4	52.6
MFs and others	9.5	9.8	9.6
FIs/Bank	0.3	0.2	0.1
Insurance Cos.	6.6	6.8	7.4
FII	36.3	35.6	35.4
Others	11.6	11.9	11.7

Price chart



Headwinds on margins ahead...

TechM was in 'rally phase' in FY22 as reflected in strong growth in deal TCV – enterprise TCV grew 93% YoY in FY22 and communications grew 97% YoY in FY22. We expect moderation in revenue growth in enterprise segment in FY23E, but expect it to continue in communications as TechM is best placed to capture growth in 5G-related capex spends.

Company has considerably improved its margin profile (~263bps YoY in FY21 and ~60bps YoY in FY22E). Focused efforts on cost optimisation and restructuring of acquired entities helped expand margins. However, margins are likely to decline because of supply-side cost pressures in FY23E. We model 14.2%/14.6% in FY23E/FY24E.

Triggers & catalysts for the stock

Best placed to capture 5G-led growth in communications: Growth momentum in communications vertical is back with 16.5% YoY growth in 9MFY22. Management mentioned that demand momentum is strong in 5G and network services led by software defined network and modernisation of telcos' network. TechM's investments in 5G and strong long-term relationships with service providers are also yielding results. Management mentioned that 5G is going to be dominant part of pipeline as well as wins.

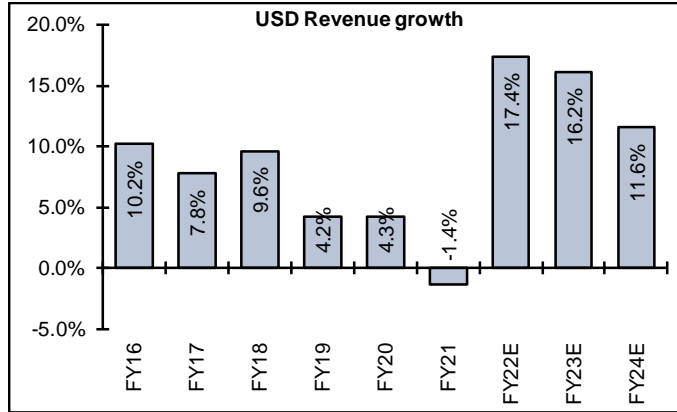
Margins may come under pressure: TechM has strengthened its supply-side engine with 3x increase in fresher hiring, increased hiring from tier-2 cities and near shore centres and investments in GiG talent platform. Pyramid optimisation and portfolio synergies are expected to drive margins over the medium term. But in near term, margins are expected to come under pressure due to supply-side cost pressures (sub-con costs rose to 16.4% of revenue and attrition jumped to 24% in Q3FY22). We are factoring margins at 14.2%/14.6% for FY23E/FY24E (100 bps lower than street).

Valuation: TechM currently trades at 18x FY24E P/E for FY22-FY24E EPS CAGR of 12%, PEG of 1.2x vs the tier-1 Indian IT sector trading at 23x FY24E for FY22-FY24E EPS CAGR of 13% and PEG ratio of 1.5x. We believe consensus estimates on margins are aggressive at 15.4%/15.6% for FY23E/FY24E. We are factoring margins at 14.2%/14.6% for FY23E/FY24E. We are 5% below consensus estimates (FY23) and value TechM at 19x on FY24E earnings to arrive at a target price of Rs1,502 with **HOLD** rating.

Key Risks: 1) Weak revenue growth from communication, 2) Delay in 5G capex, 3) Margin contraction, 4) INR appreciation

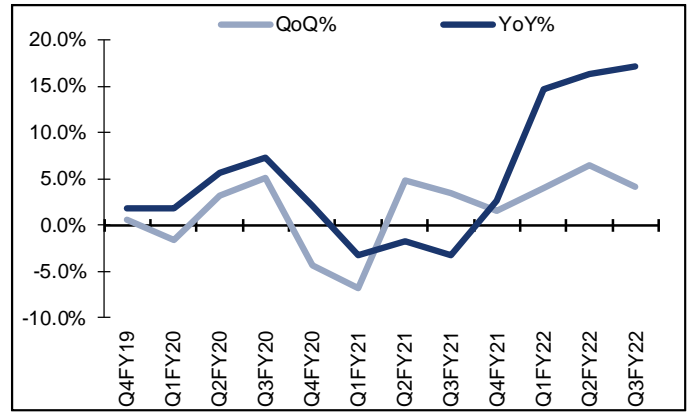
Market Cap	Rs1409bn/US\$18.6bn	Year to March	FY21	FY22E	FY23E	FY24E
Reuters/Bloomberg	TEML.BO/TECHM IN	Revenue (Rs mn)	378,551	446,595	529,763	598,747
Shares Outstanding (mn)	971.8	Net Income (Rs mn)	44,281	54,717	60,092	69,117
52-week Range (Rs)	1806/950	EPS (Rs)	50.7	62.6	68.7	79.1
Free Float (%)	64.3	% Chg YoY	9.6	23.6	9.8	15.0
FII (%)	35.4	P/E (x)	28.6	23.2	21.1	18.3
Daily Volume (US\$'000)	63,414	CEPS (Rs)	67.3	79.4	91.1	104.4
Absolute Return 3m (%)	(14.9)	EV/E (x)	17.0	14.9	12.5	10.6
Absolute Return 12m (%)	46.1	Dividend Yield	3.1	3.1	2.1	2.1
Sensex Return 3m (%)	(0.3)	RoCE (%)	14.1	16.7	18.1	18.7
Sensex Return 12m (%)	20.7	RoE (%)	18.7	22.0	23.0	23.1

Chart 1: Revenue growth to be maintained



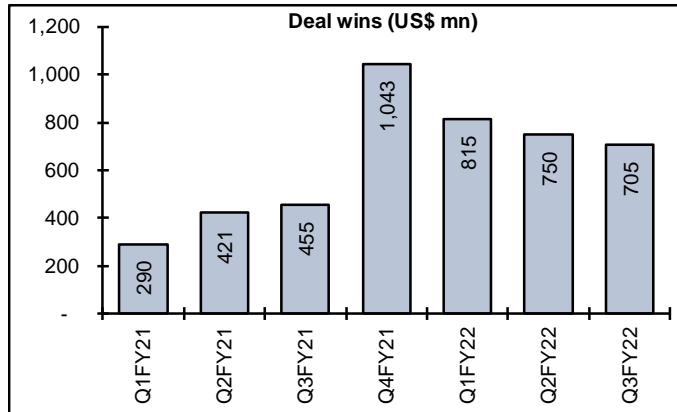
Source: Company, I-Sec research

Chart 2: Strong YoY growth given low base



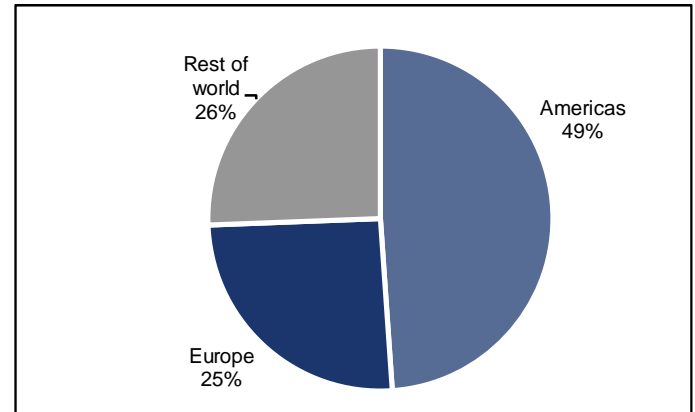
Source: Company, I-Sec research

Chart 3: Healthy deal wins over the quarters



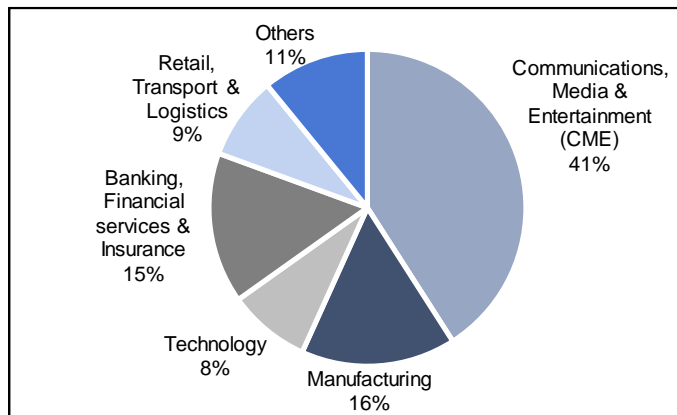
Source: Company, I-Sec research

Chart 4: Geographical mix (%)



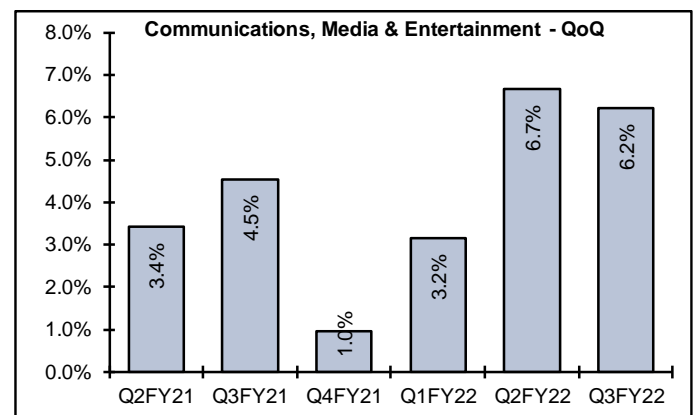
Source: Company, I-Sec research

Chart 5: Vertical mix (%)



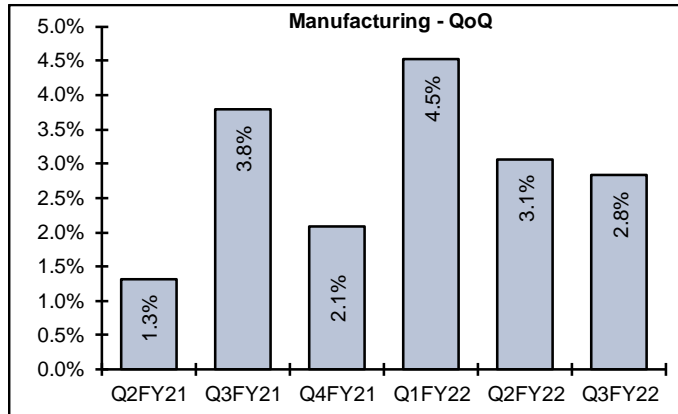
Source: Company, I-Sec research

Chart 6: CME vertical to pick up due to 5G



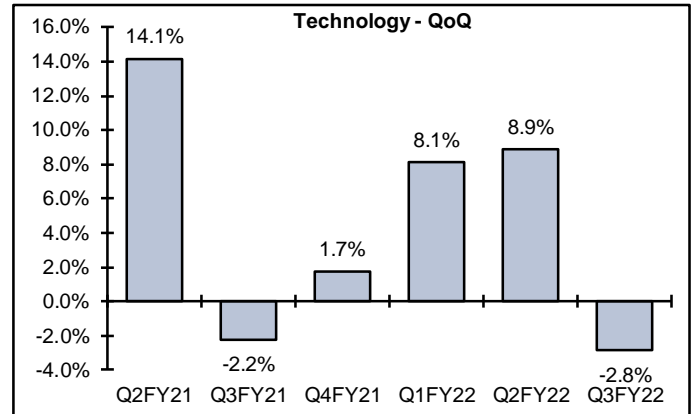
Source: Company, I-Sec research

Chart 7: Manufacturing expected to grow



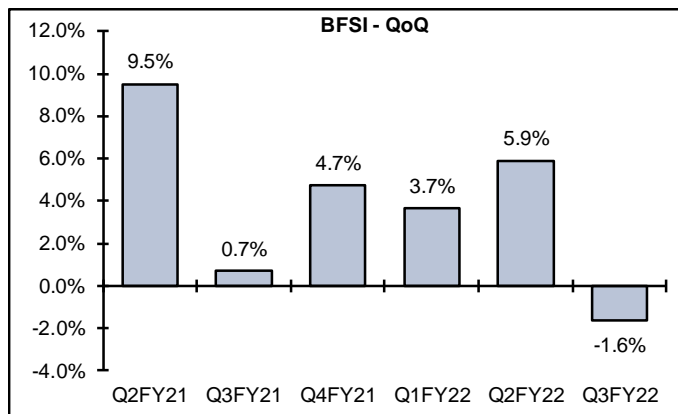
Source: Company, I-Sec research

Chart 8: Growth to stabilise ahead



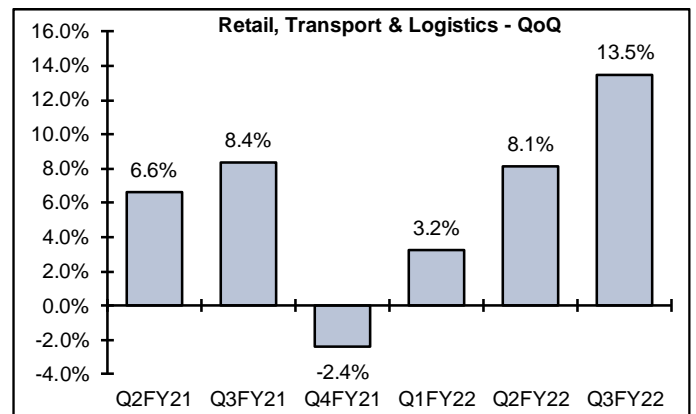
Source: Company, I-Sec research

Chart 9: Growth to stabilise ahead



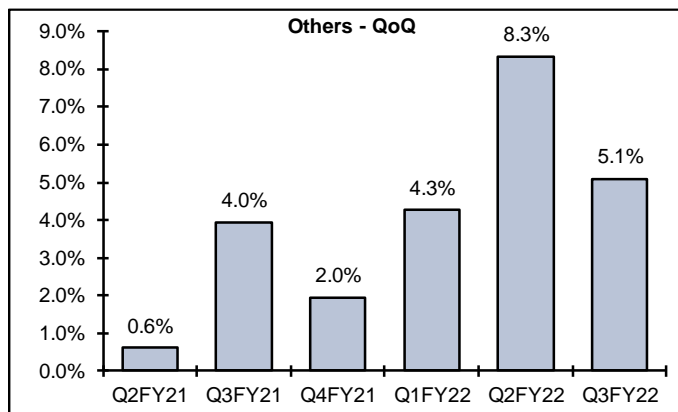
Source: Company, I-Sec research

Chart 10: Retail spends expected to pick up



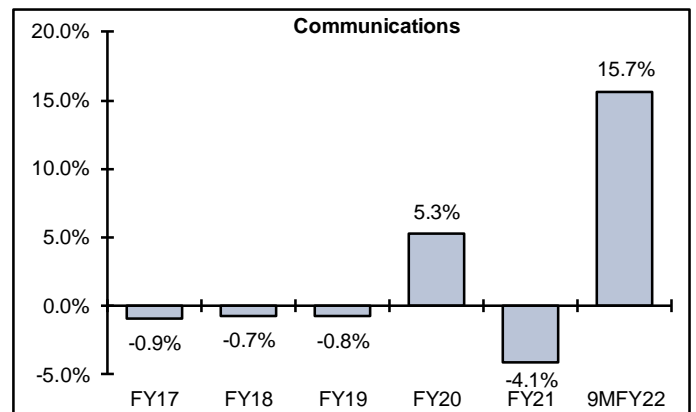
Source: Company, I-Sec research

Chart 11: Growth to stabilise ahead



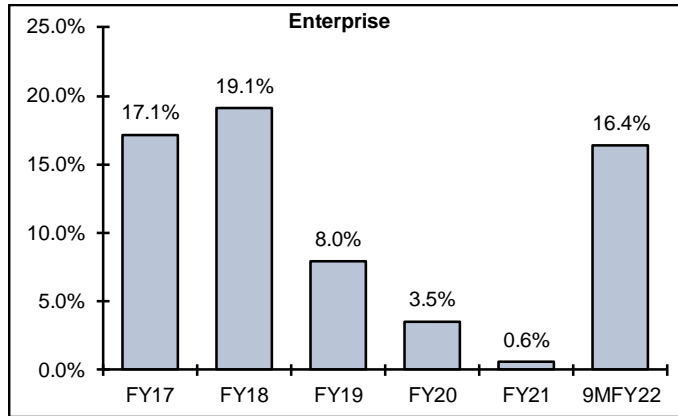
Source: Company, I-Sec research

Chart 12: Strong growth owing to pick up in 5G



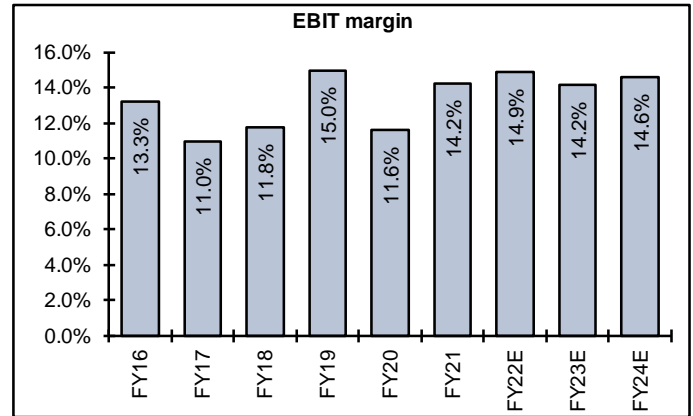
Source: Company, I-Sec research

Chart 13: Growth to now normalise



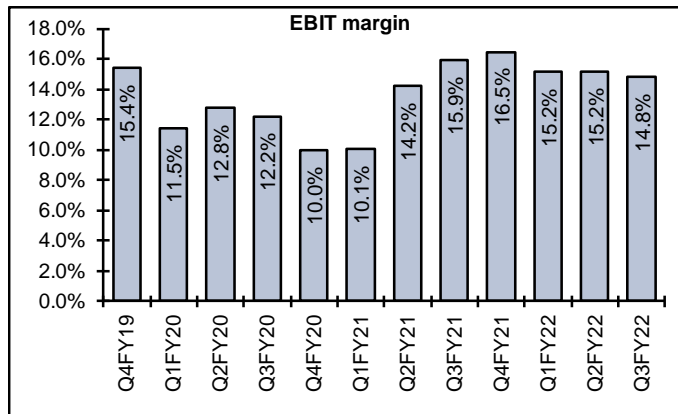
Source: Company, I-Sec research

Chart 14: Margins may moderate ahead



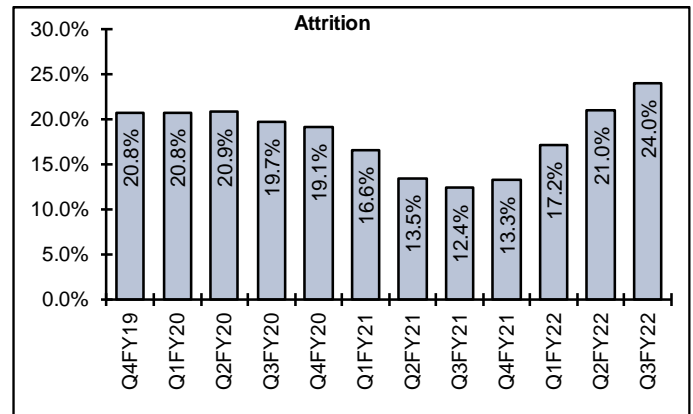
Source: Company, I-Sec research

Chart 15: Supply headwinds led to contraction



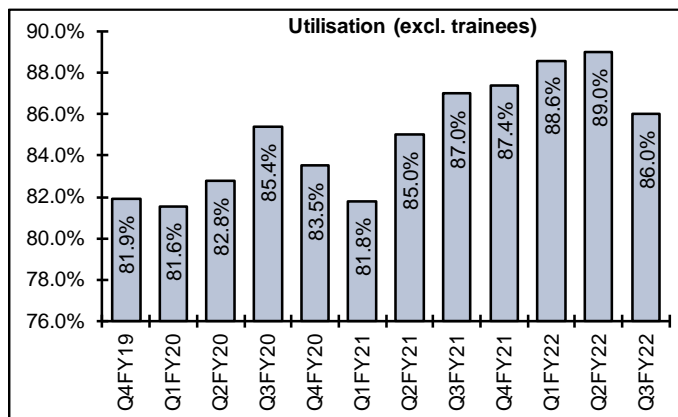
Source: Company, I-Sec research

Chart 16: Attrition higher than pre-covid levels



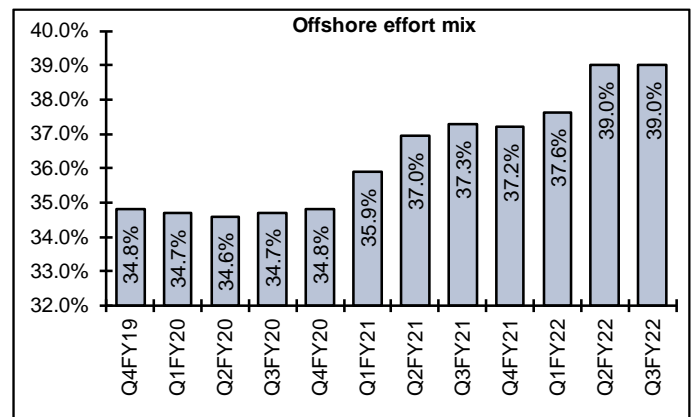
Source: Company, I-Sec research

Chart 17: Utilisation rates to normalise while...



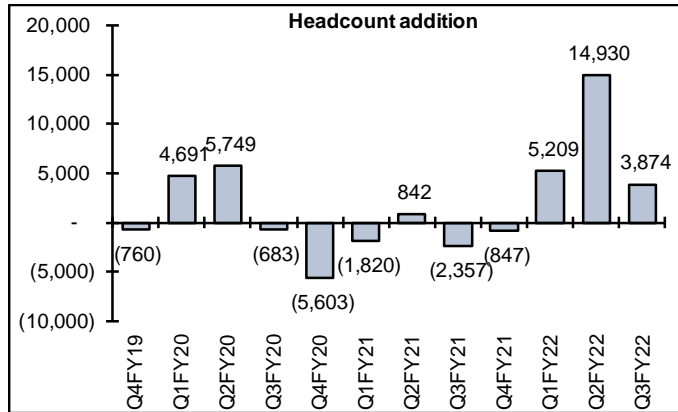
Source: Company, I-Sec research

Chart 18: ...improving offshore mix to aid margins



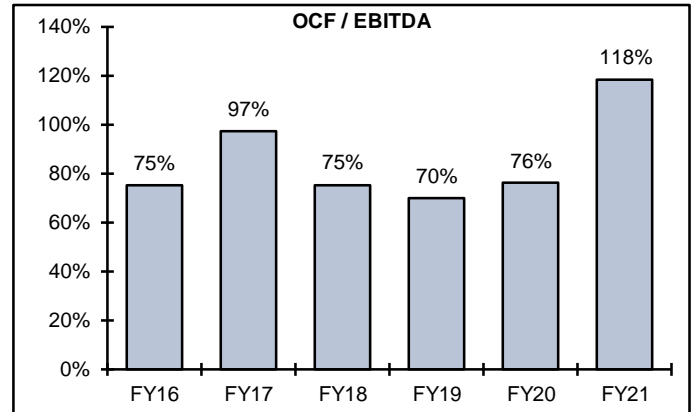
Source: Company, I-Sec research

Chart 19: Aggressive hiring to match demand



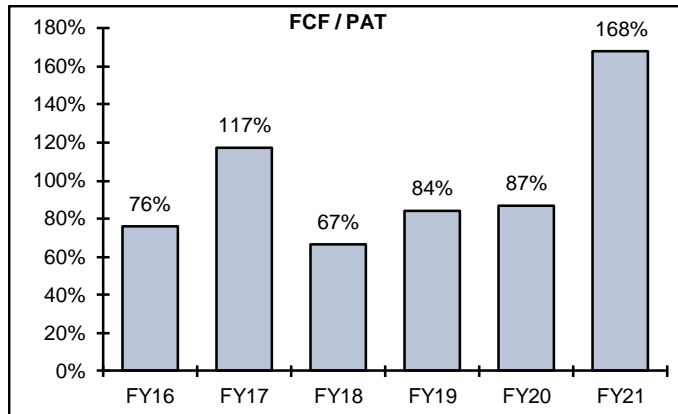
Source: Company, I-Sec research

Chart 20: Robust conversion despite pressures



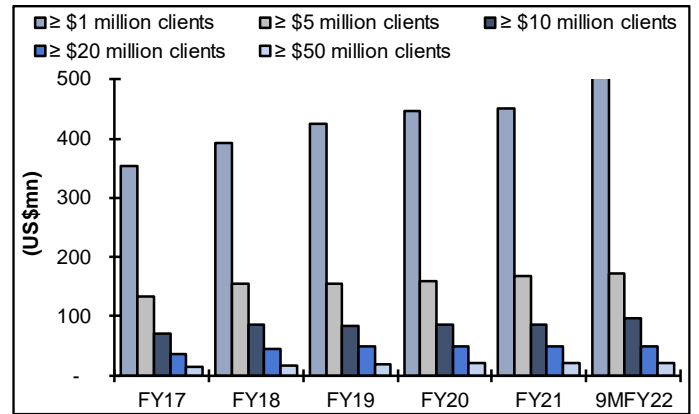
Source: Company, I-Sec research

Chart 21: Robust conversion despite pressures



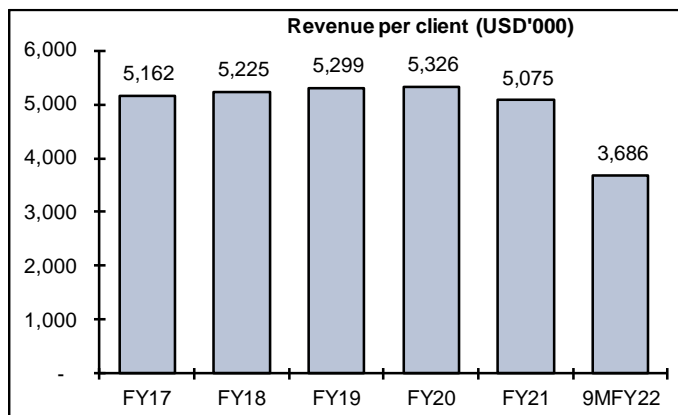
Source: Company, I-Sec research

Chart 22: Increasing client base...



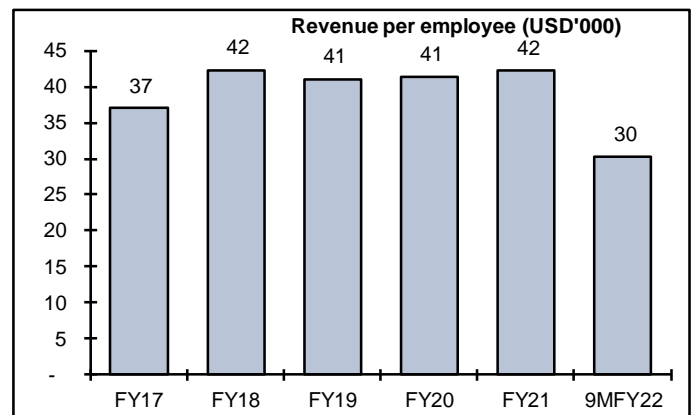
Source: Company, I-Sec research

Chart 23: ...resulting in declining trend



Source: Company, I-Sec research

Chart 24: Aggressive hiring resulted in decline



Source: Company, I-Sec research

Financial summary – Tech Mahindra

Table 1: Profit and Loss statement

(Rs mn, year ending March 31)

	FY21	FY22E	FY23E	FY24E
Revenues (US\$mn)	5,111	6,001	6,971	7,776
Operating Revenues (Sales)	3,78,551	4,46,595	5,29,763	5,98,747
Operating Expenses	3,10,081	3,65,444	4,35,088	4,89,336
EBITDA	68,470	81,150	94,676	1,09,411
% margins	18.1	18.2	17.9	18.3
Depreciation & Amortisation	14,576	14,655	19,590	22,129
EBIT	53,894	66,495	75,086	87,281
% margins	14.2	14.9	14.2	14.6
Net other income	5,636	8,495	6,644	6,644
Recurring PBT	59,530	74,990	81,730	93,925
Less: Taxes	15,999	19,932	21,250	24,421
Add: Extraordinaries Inc/(Exp)	-	-	-	-
Less: Minority Interest/Income from Associates	750	(341)	(388)	(388)
Net Income (Reported)	44,281	54,717	60,092	69,117

Source: Company data, I-Sec research

Table 2: Balance sheet

(Rs mn, year ending March 31)

	FY21	FY22E	FY23E	FY24E
LIABILITIES				
Shareholders' funds	2,48,650	2,39,743	2,73,542	3,16,367
Minority Interest	3,795	4,194	4,194	4,194
Non-current liabilities	29,256	33,635	33,635	33,635
Current Liabilities	1,02,775	1,27,126	1,34,062	1,40,959
Amounts pending investigation	12,304	12,304	12,304	12,304
Total Liabilities	3,96,780	4,17,001	4,57,737	5,07,459
ASSETS				
Fixed Assets	91,647	1,20,227	1,20,427	1,20,627
Other non-current assets	52,580	57,600	57,600	57,600
Total non-current assets	1,44,227	1,77,826	1,78,026	1,78,226
Current Assets	2,52,553	2,39,175	2,79,711	3,29,233
Total Assets	3,96,780	4,17,001	4,57,737	5,07,459

Source: Company data, I-Sec Research

Table 3: Cashflow statement

(Rs mn, year ending March 31)

	FY21	FY22E	FY23E	FY24E
Operating Cashflow before W Cap changes	52,089	59,447	71,682	83,246
Working Capital Inflow / (Outflow)	28,850	22,206	(9,877)	(9,821)
Capex	(6,660)	(43,235)	(19,790)	(22,329)
Free Cashflow	74,278	38,419	42,015	51,095
Cashflow from other Invst Act (Ex Capex)	(47,841)	4,905	8,000	8,000
Change in equity	569	(23,763)	0	0
Change in debt	(7,949)	1,054	-	-
Dividend paid	(17,594)	(39,462)	(26,292)	(26,292)
Others	(4,895)	3,325	-	-
Increase/(Decrease) in Cash	(3,431)	(15,522)	23,723	32,803

Source: Company data, I-Sec research

Table 4: Key ratios

(Year ending March 31)

	FY21	FY22E	FY23E	FY24E
Per Share Data (Rs)				
Earnings per share (Basic Reported)	50.7	62.6	68.7	79.1
Cash earnings per share	67.3	79.4	91.1	104.4
Dividend per share	45.0	45.0	30.0	30.0
Book Value per share	288.8	279.0	317.7	366.7
Growth Ratios (%)				
Operating Income (Sales) - US\$	(1.4)	17.4	16.2	11.6
Operating Income (Sales)	2.7	18.0	18.6	13.0
EBITDA	19.6	18.5	16.7	15.6
Reported Net Income	9.8	23.6	9.8	15.0
Earnings per share (Basic Reported)	9.6	23.6	9.8	15.0
Cash earnings per share	7.3	17.9	14.9	14.5
Valuation Ratios (x)				
P/E	28.6	23.2	21.1	18.3
P/CEPS	21.5	18.3	15.9	13.9
P/BV	5.0	5.2	4.6	4.0
EV / EBITDA	17.0	14.9	12.5	10.6
EV / Sales	3.1	2.7	2.2	1.9
Operating Ratios				
Other Income / PBT (%)	9.5	11.3	8.1	7.1
Effective Tax Rate (%)	26.9	26.6	26.0	26.0
Receivables (days) on average	69	65	66	65
D/E Ratio (x)	0.1	0.1	0.1	0.0
Return/Profitability Ratios (%)				
Net Income Margins	11.7	12.3	11.3	11.5
RoCE	14.1	16.7	18.1	18.7
RoNW	18.7	22.0	23.0	23.1
Dividend Payout Ratio	88.8	71.9	43.6	37.9
Dividend Yield	3.1	3.1	2.1	2.1
EBITDA Margin	18.1	18.2	17.9	18.3

Source: Company data, I-Sec research

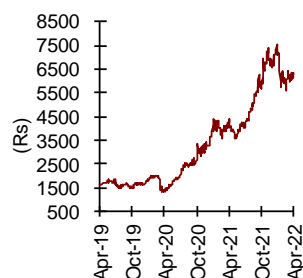
Larsen & Toubro Infotech

(HOLD; CMP: Rs6,153; TP: Rs5,921)

Shareholding pattern

	Jun '21	Sep '21	Dec '21
Promoters	74.3	74.1	74.1
Institutional investors	17.8	18.0	17.9
MFs and others	4.0	4.0	4.4
FIs/Bank	0.1	0.0	0.0
Insurance Cos.	0.3	0.3	0.7
FII	13.4	13.7	12.8
Others	7.9	7.9	8.0

Price chart



Consistent performance, elevated valuations!

We have always liked LTI, as we believe it has all the ingredients of being a sustainable growth engine given its: 1) given its track record of delivering consistent strong industry leading growth (15% revenue CAGR over FY17-FY21), 2) strong capabilities in digital and next-gen services, 3) strong referenceable longstanding client relationships including 72 G-500 accounts, 4) top-tier alliances with key ecosystem partners, 5) highly focused and stable senior management team, and 6) higher offshore revenues to protect margins structurally.

LTI's client addition in 9MFY22 (75 clients) has been noteworthy. Given the company's proven account mining abilities, these should be good scale-up opportunities for further growth.

Triggers & catalysts for the stock

Consistent deal wins: Robust headcount addition in the past couple of quarters indicates a healthy demand outlook. Further, management's confident commentary around demand pipeline and indication of sustaining growth momentum suggest robust industry-leading growth outlook for the company. Also, increasing number of deals being won by the company against its large-cap peers instills confidence in the company's capabilities.

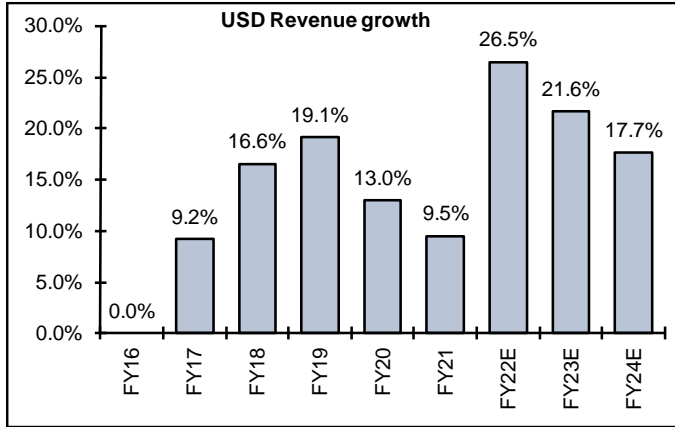
Stable margin outlook: Management has alluded to a stable margin outlook despite impending cost pressures (e.g. return of travel, facility expenses, wage hikes, etc.) on the back of improving operational efficiencies. The 'Great Resignation' theme playing out in the industry should ensure offshore effort mix to stay elevated in the medium term aiding margins. Company's ability to maintain current level of margins are a key positive and we build-in EBIT margins of 17.3/18% for FY23E/FY24E.

Valuation: LTI currently trades at 33x FY24E P/E for FY22-FY24 EPS CAGR of 19%, PEG of 1.4x vs the tier-2 Indian IT sector trading at 28.5x FY24E for FY22-FY24E EPS CAGR of 21% and PEG ratio of 1.3x. While we are impressed with the progress on growth priorities, this is more than adequately priced in the current valuation of 35x FY24E EPS. Valuations do not offer any margin of safety. We assign **HOLD** rating with multiple of 32x on FY24 EPS of Rs185 to arrive at a target price of Rs5,921.

Key Risks: 1) Strong margin performance, 2) Strong growth in BFSI, 3) INR appreciation

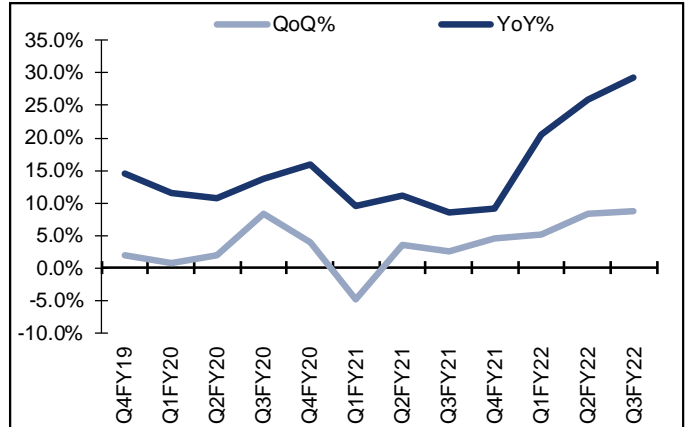
Market Cap	Rs1078bn/US\$14.2bn	Year to March	FY21	FY22E	FY23E	FY24E
Reuters/Bloomberg	LRTI.BO / LTI IN	Revenue (Rs mn)	123,698	157,390	1,95,317	2,32,866
Shares Outstanding (mn)	175.3	Net Income (Rs mn)	19,381	22,942	26,247	32,346
52-week Range (Rs)	7562/3584	EPS (Rs)	110.9	131.2	150.1	185.0
Free Float (%)	25.9	% Chg YoY	27.0	18.4	14.4	23.2
FII (%)	12.8	P/E (x)	55.5	46.9	41.0	33.3
Daily Volume (US\$'000)	34,240	CEPS (Rs)	129.9	151.1	174.0	213.5
Absolute Return 3m (%)	(14.6)	EV/E (x)	37.9	34.0	27.1	21.5
Absolute Return 12m (%)	43.8	Dividend Yield	0.7	0.8	0.7	0.7
Sensex Return 3m (%)	(0.3)	RoCE (%)	24.6	23.5	24.8	25.3
Sensex Return 12m (%)	20.7	RoE (%)	30.5	29.2	28.0	27.9

Chart 1: Revenue growth to moderate..



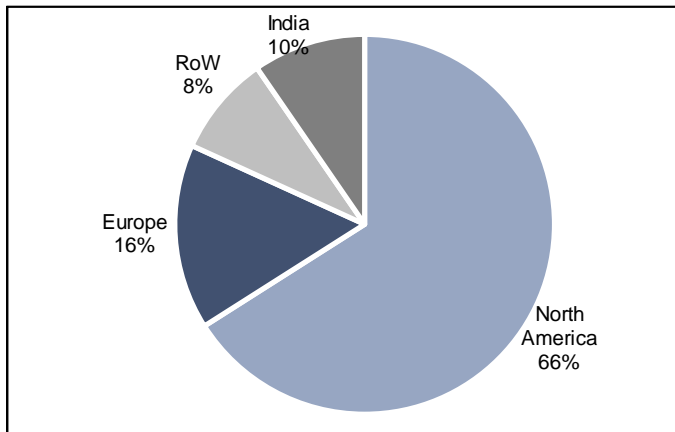
Source: Company, I-Sec research

Chart 2: Strong growth over the quarters



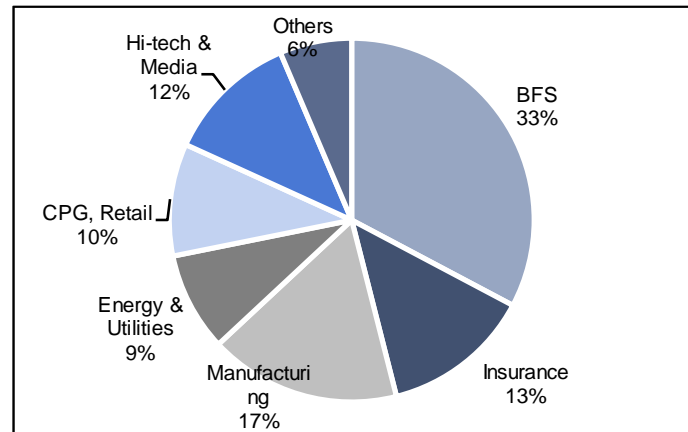
Source: Company, I-Sec research

Chart 3: Geographical mix (%)



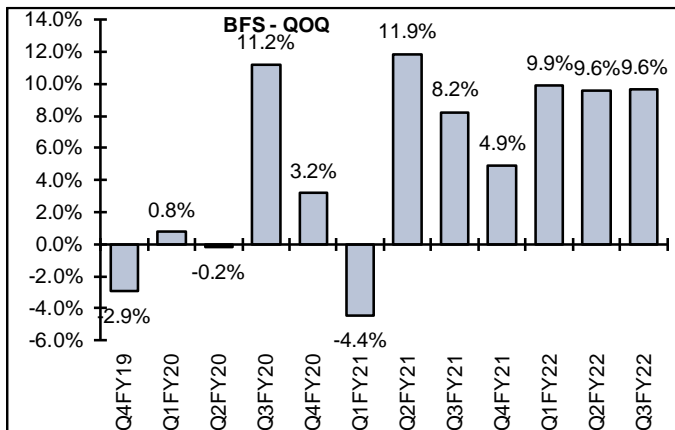
Source: Company, I-Sec research

Chart 4: Vertical mix (%)



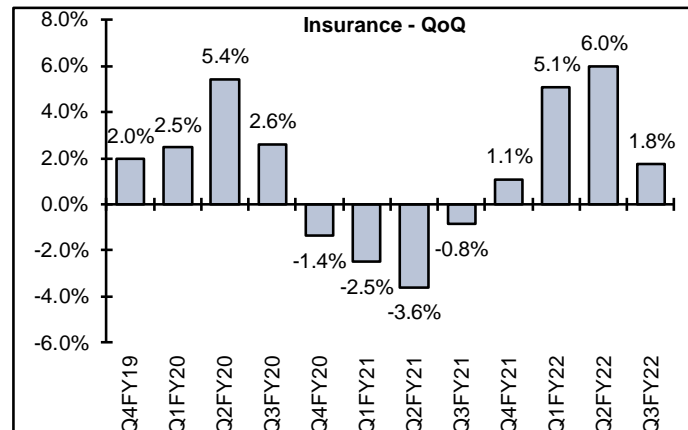
Source: Company, I-Sec research

Chart 5: BFS to pick up due to increased spends



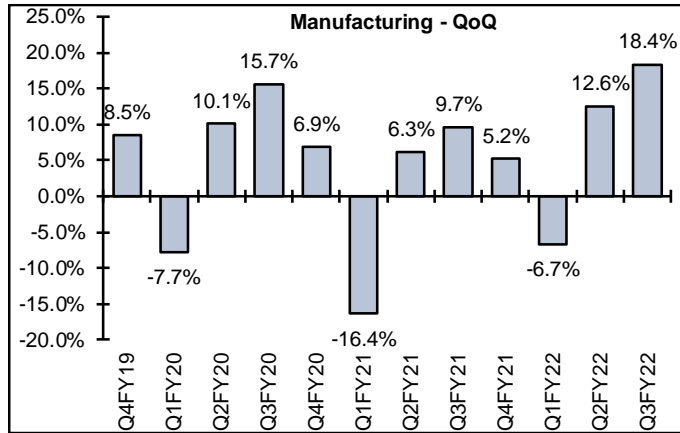
Source: Company, I-Sec research

Chart 6: Insurance to stabilise ahead



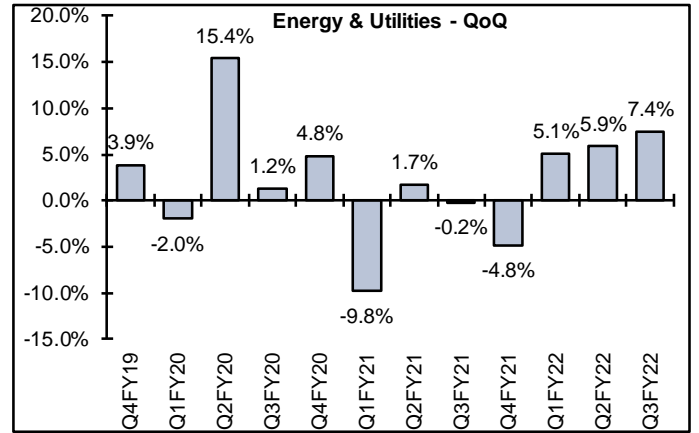
Source: Company, I-Sec research

Chart 7: Growth expected to pick up in Mfg.



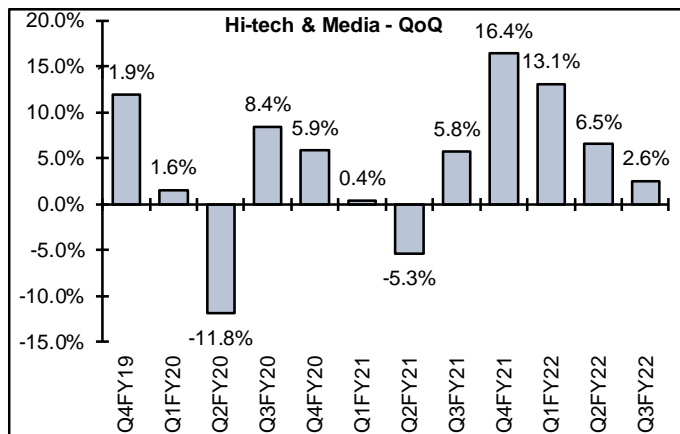
Source: Company, I-Sec research

Chart 8: E&U continues to post robust growth



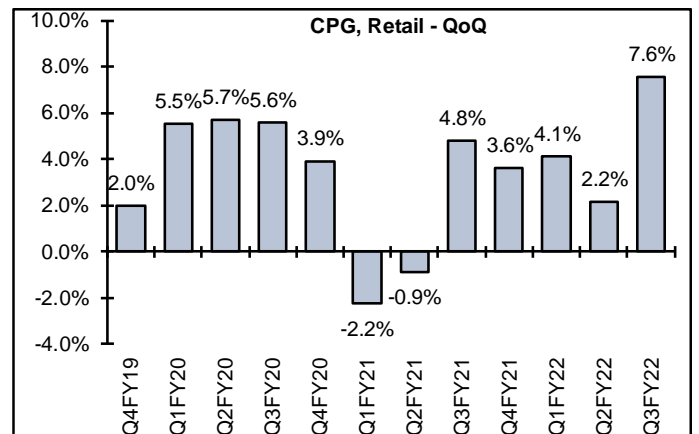
Source: Company, I-Sec research

Chart 9: Growth now normalizing in Hi-tech



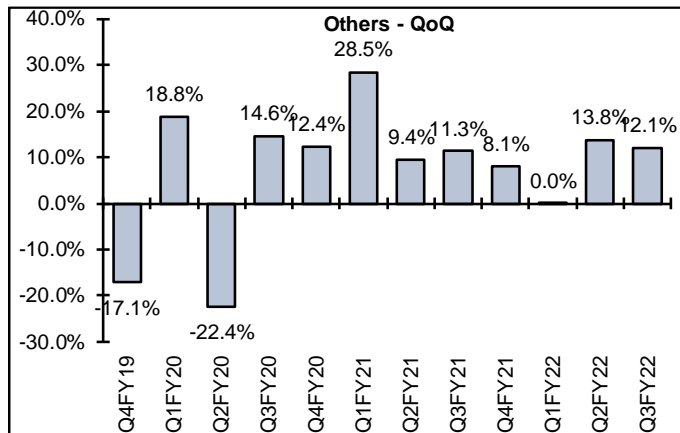
Source: Company, I-Sec research

Chart 10: Retail sector now stabilising



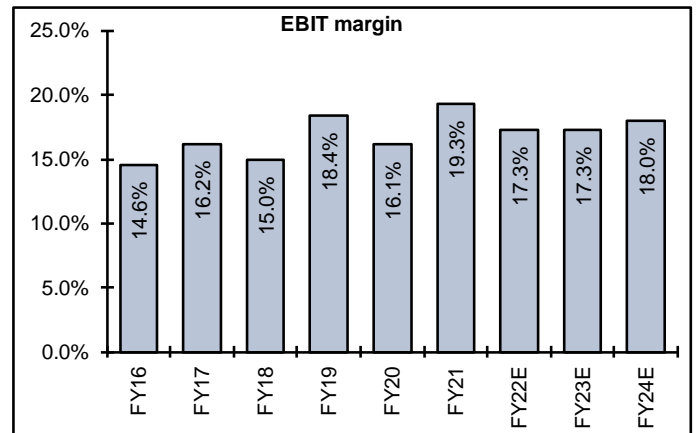
Source: Company, I-Sec research

Chart 11: Growth to now stabilize in Others



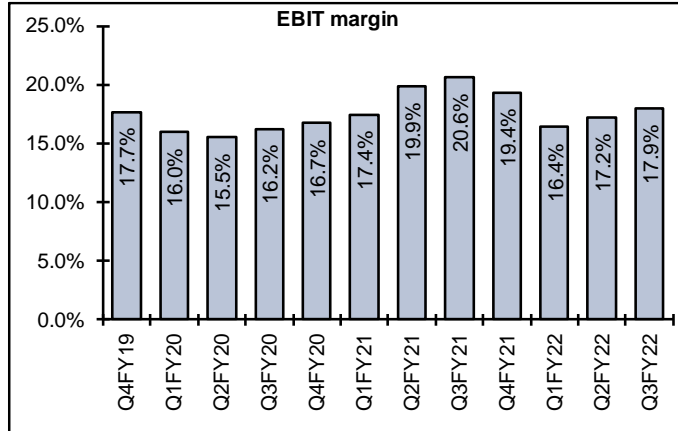
Source: Company, I-Sec research

Chart 12: Margins to remain stable in FY23E



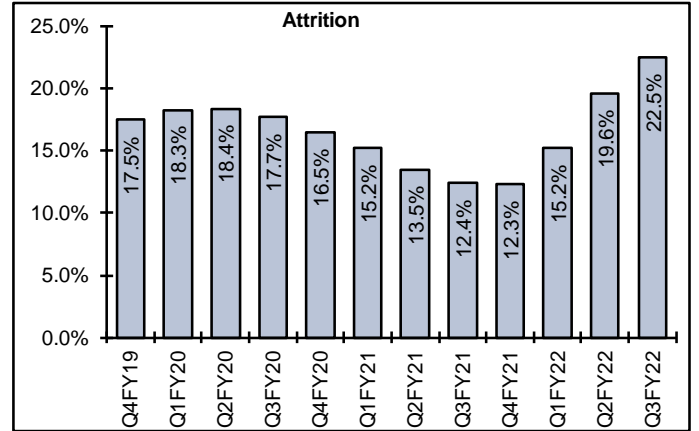
Source: Company, I-Sec research

Chart 13: Improving margin trajectory



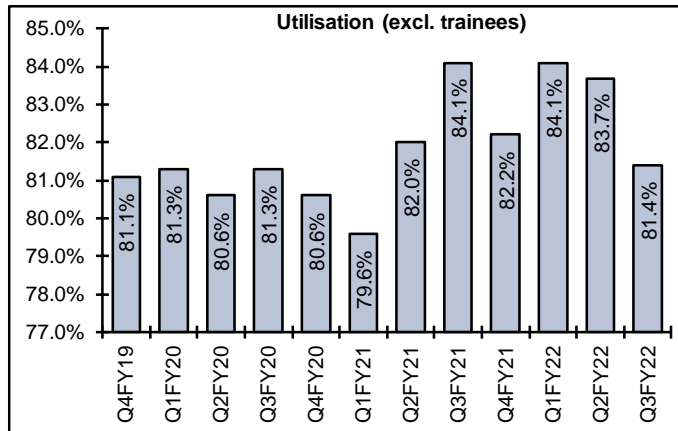
Source: Company, I-Sec research

Chart 14: Attrition higher than pre-covid levels



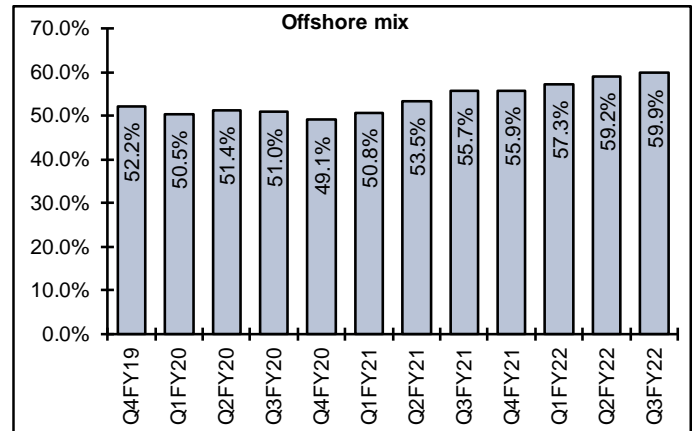
Source: Company, I-Sec research

Chart 15: Utilisation rates now normalising



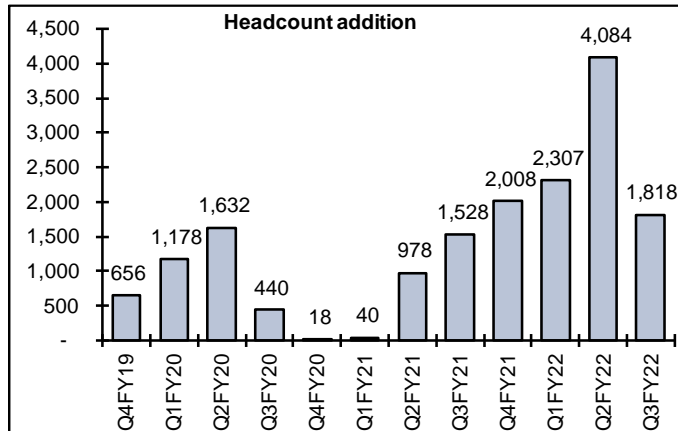
Source: Company, I-Sec research

Chart 16: Largely stable offshore mix



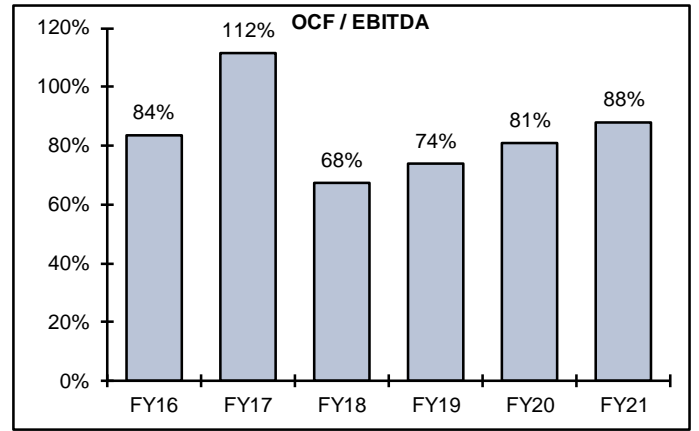
Source: Company, I-Sec research

Chart 17: Increased hiring over the quarters



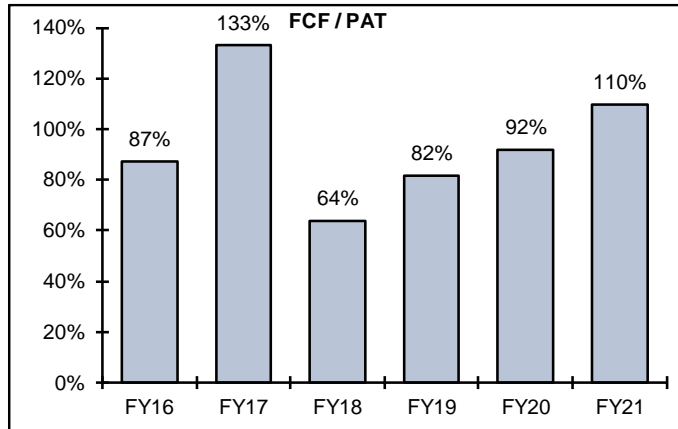
Source: Company, I-Sec research

Chart 18: Robust conversion despite pressures



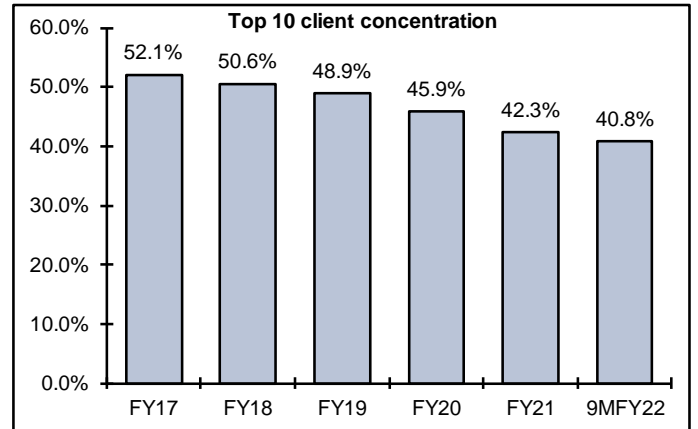
Source: Company, I-Sec research

Chart 19: Robust conversion despite pressures



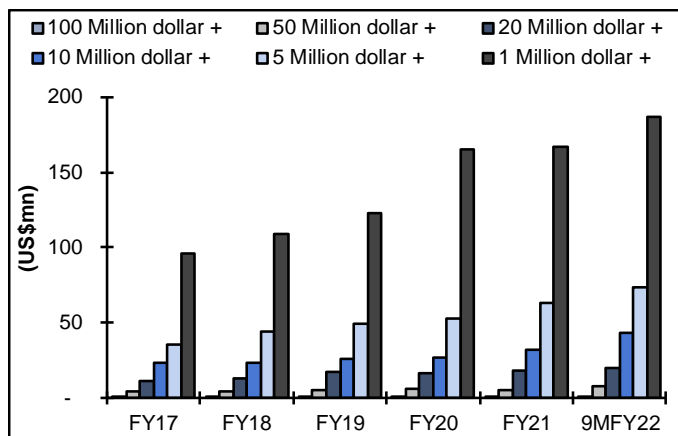
Source: Company, I-Sec research

Chart 20: Client concentration steadily reducing



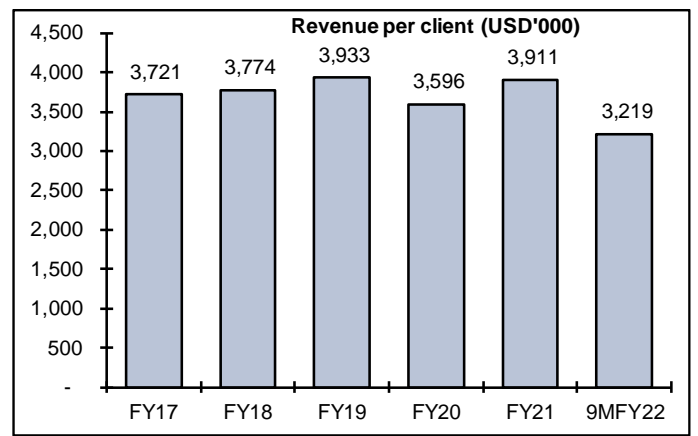
Source: Company, I-Sec research

Chart 21: Consistent increase in client base...



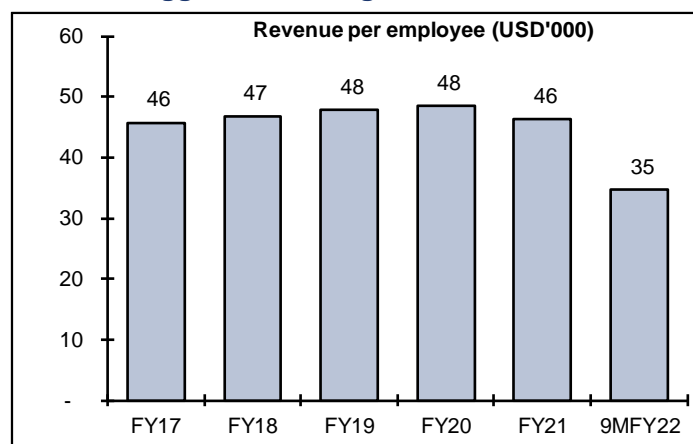
Source: Company, I-Sec research

Chart 22: ...resulting in declining trend



Source: Company, I-Sec research

Chart 23: Aggressive hiring resulted in decline



Source: Company, I-Sec research

Financial summary – Larsen & Toubro Infotech

Table 1: Profit and Loss statement

(Rs mn, year ending March 31)

	FY21	FY22E	FY23E	FY24E
Revenue (US\$mn)	1,670	2,113	2,570	3,024
Total Income (Sales)	1,23,698	1,57,390	1,95,317	2,32,866
Operating Expenses	96,447	1,26,727	1,57,425	1,85,969
EBITDA	27,251	30,663	37,892	46,897
% margin	22.0	19.5	19.4	20.1
Depreciation & Amortisation	3,325	3,465	4,178	4,981
EBIT	23,926	27,198	33,714	41,916
% margin	19.3	17.3	17.3	18.0
Other Income (net)	1,955	3,695	1,584	1,584
Recurring PBT	25,881	30,893	35,298	43,500
Tax expense	6,500	7,951	9,051	11,154
Reported net income	19,381	22,942	26,247	32,346
Extraordinary items	-	-	-	-
Restatement adjustments	-	-	-	-
Reported net income	19,381	22,942	26,247	32,346

Source: Company data, I-Sec research

Table 2: Balance sheet

(Rs mn, year ending March 31)

	FY21	FY22E	FY23E	FY24E
Liabilities				
Net Worth	73,034	84,105	1,03,359	1,28,713
Non-current Liabilities	7,734	7,162	7,162	7,162
Total Liabilities	80,768	91,267	1,10,521	1,35,875
Assets				
Fixed Assets	19,722	22,879	22,883	22,887
Other Non-current assets	6,056	10,753	10,753	10,753
Current assets	81,313	85,996	1,08,372	1,37,607
less: current liabilities	26,323	28,362	31,487	35,372
Net current assets	54,990	57,635	76,885	1,02,235
Total Assets	80,768	91,267	1,10,521	1,35,875

Source: Company data, I-Sec Research

Table 3: Cashflow statement

(Rs mn, year ending March 31)

	FY21	FY22E	FY23E	FY24E
Op. CF before W Cap changes	27,344	33,295	39,092	48,097
Working Capital change	3,052	(12,043)	(5,798)	(7,211)
Taxes	(6,400)	(7,951)	(9,051)	(11,154)
Capex	(2,737)	(6,622)	(4,182)	(4,985)
Free Cashflow	21,259	6,679	20,061	24,747
CF from other Invst Act (Ex Capex)	(13,823)	2,589	384	384
Dividend paid	(5,319)	(8,741)	(6,993)	(6,993)
Others	231	(3,703)	-	-
Increase/(Decrease) in Cash	2,348	(3,176)	13,452	18,138

Source: Company data, I-Sec research

Table 4: Key ratios

(Year ending March 31)

	FY21	FY22E	FY23E	FY24E
Per Share Data (Rs)				
Reported EPS	110.9	131.2	150.1	185.0
Book Value per share (BV)	417.8	481.1	591.2	736.3
Cash EPS	129.9	151.1	174.0	213.5
Dividend per share	40.0	50.0	40.0	40.0
Growth Ratios (%)				
Total Income (Sales) - US\$	9.5	26.5	21.6	17.7
Total Income (Sales)	13.7	27.2	24.1	19.2
EBITDA	34.3	12.5	23.6	23.8
Net Income	27.5	18.4	14.4	23.2
Reported EPS	27.0	18.4	14.4	23.2
Valuation Ratios (x)				
P/E	55.5	46.9	41.0	33.3
P/BV	14.7	12.8	10.4	8.4
EV / EBITDA	37.9	34.0	27.1	21.5
EV / Sales	8.3	6.6	5.3	4.3
Operating Ratios				
Other Income / PBT (%)	7.6	12.0	4.5	3.6
Effective Tax Rate (%)	25.1	25.7	25.6	25.6
Fixed Asset Turnover (x)	6.3	6.9	8.5	10.2
Receivables (days)	79	83	80	80
Return/Profitability Ratios (%)				
Net Income Margins	15.7	14.6	13.4	13.9
EBITDA Margins	22.0	19.5	19.4	20.1
RoCE (Based on Avg)	24.6	23.5	24.8	25.3
RoNW (Based on Avg)	30.5	29.2	28.0	27.9
Dividend Yield	0.7	0.8	0.7	0.7

Source: Company data, I-Sec research

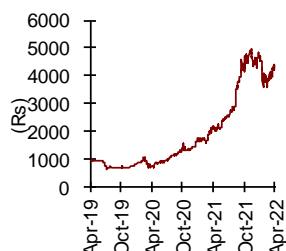
Mindtree

(HOLD; CMP: Rs4,303; TP: Rs4,266)

Shareholding pattern

	Jun '21	Sep '21	Dec '21
Promoters	61.0	61.0	61.0
Institutional investors	25.7	25.1	25.4
MFs and others	8.7	7.7	7.1
FIs/Bank	0.2	0.2	0.2
Insurance Cos.	2.8	2.0	2.2
FII	14.0	15.2	15.9
Others	13.3	13.9	13.6

Price chart



Improving growth momentum and impressive margins

Mindtree is one of the few companies that has improved on both revenue growth as well as margin fronts. Management's confidence in delivering industry-leading double-digit growth while simultaneously maintaining 20%+ EBITDA margin guidance suggests the company's capability to benefit from strong demand environment.

Bulk of the growth in 9MFY22 was driven by customer success service line (+41% YoY USD) indicating strong demand for adoption of technology for revenue maximisation, reinforcing sustainability of demand. Its strong ecosystem partnerships are underscored by strong growth in top client and increasing number of cloud deals.

Triggers & catalysts for the stock

Improving growth momentum: Mindtree has reported four consecutive quarters of 5%+ QoQ (CC) growth with healthy deal wins indicating a robust demand environment and strong traction. Positive commentary across verticals suggests Mindtree is poised for industry-leading double-digit growth. Despite deal cycles now being shorter, iterative nature of deals results in several shorter deals adding up to become large deal leading to healthy and consistent revenue growth.

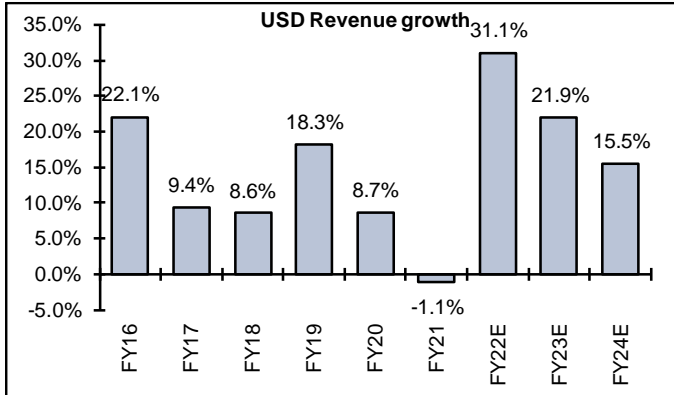
EBITDA margins to be maintained at 20%+ levels despite cost pressures: Mindtree's EBITDA margins have seen sharp expansion from 15% in FY19 to 20.8% in 9MFY22. Company has maintained margins in line with guidance of 20%+ despite cost pressures from rising attrition and multiple wage increments. Unlike peers, Mindtree's sub-con costs have reduced in past 2 quarters and it is able to leverage it as a margin lever to improve margins. Additionally, aggressive pyramid rationalisation (currently hiring 1,500 freshers per quarter vs 1,500 per year pre-covid) and revenue growth leverage will help it overcome margin headwinds and maintain EBITDA margins at around 20% over FY22-FY24E.

Valuation: Mindtree currently trades at 32x FY24E P/E for FY22-FY24 EPS CAGR of 17%, PEG of 1.7x vs the tier-2 Indian IT sector trading at 28.5x FY24E for FY22-FY24 EPS CAGR of 21% and PEG ratio of 1.3x. It is one of the few companies firing on both the engines, viz. strong sustainable growth, and steady increase in margins. We assign an **HOLD** rating to Mindtree with target multiple of 32x on FY24E EPS to arrive at a target price of Rs4,266; we expect backended returns given rich valuations.

Key Risks: 1) Weak revenue growth from Hi-tech vertical, 2) Contraction of margins, 3) INR appreciation

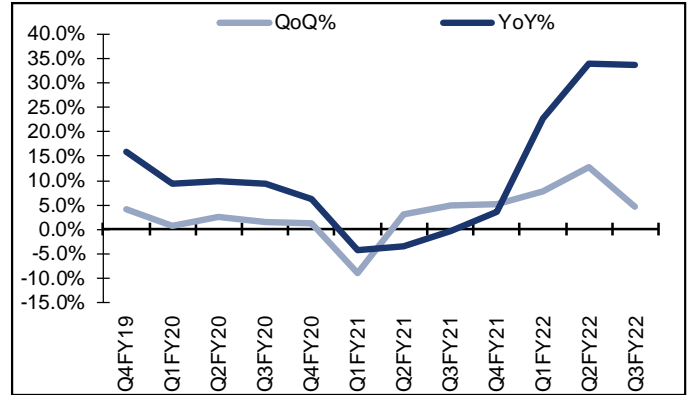
Market Cap	Rs709bn/US\$9.4bn	Year to March	2021	2022E	2023E	2024E
Reuters/Bloomberg	MINT.BO/MTCL IN	Revenue (Rs mn)	79,678	105,233	130,774	153,031
Shares Outstanding (mn)	164.8	Net Income (Rs mn)	11,083	16,085	18,416	21,955
52-week Range (Rs)	4989/2018	EPS (Rs)	67.3	97.7	111.8	133.3
Free Float (%)	39.0	% Chg YoY	75.6	45.1	14.5	19.2
FII (%)	15.9	P/E (x)	63.9	44.1	38.5	32.3
Daily Volume (US\$'000)	58,479	CEPS (Rs)	83.1	112.2	131.7	156.5
Absolute Return 3m (%)	(6.5)	EV/E (x)	41.5	31.3	25.5	21.1
Absolute Return 12m (%)	95.8	Dividend Yield	0.6	0.6	0.6	0.6
Sensex Return 3m (%)	(0.3)	RoCE (%)	14.4	12.3	14.1	15.9
Sensex Return 12m (%)	20.7	RoE (%)	29.7	34.0	31.5	29.6

Chart 1: Rev growth to remain strong on high base



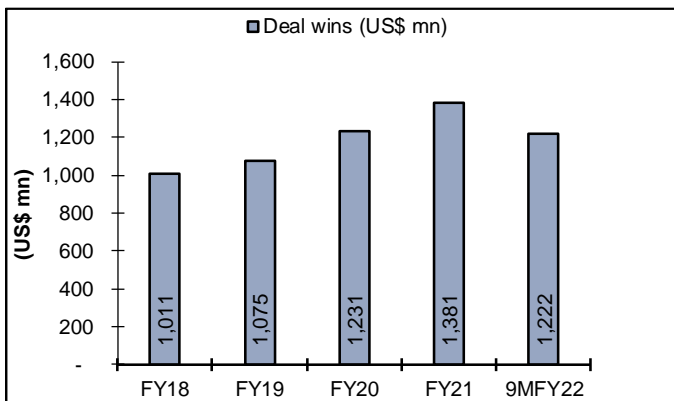
Source: Company, I-Sec research

Chart 2: Strong YoY growth



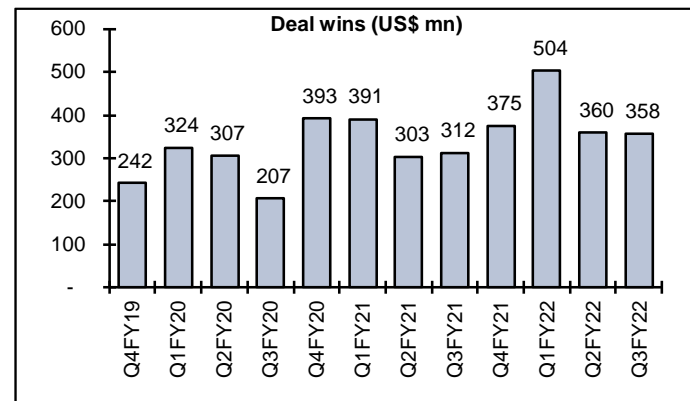
Source: Company, I-Sec research

Chart 3: Deal wins have been healthy...



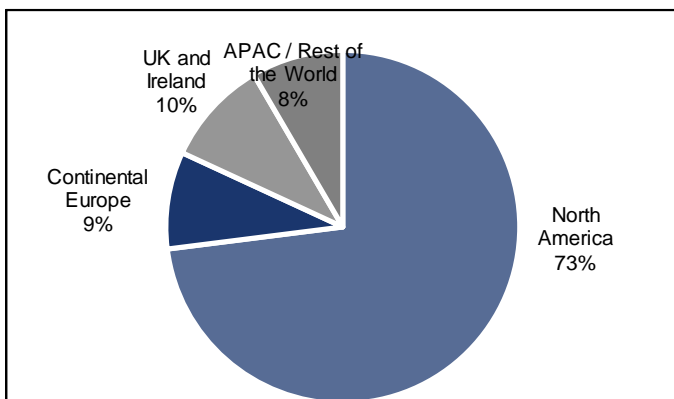
Source: Company, I-Sec research

Chart 4: ...over the period



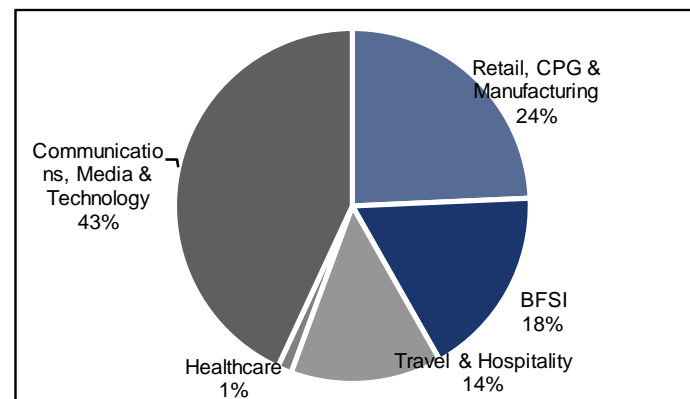
Source: Company, I-Sec research

Chart 5: Geographical mix (%)



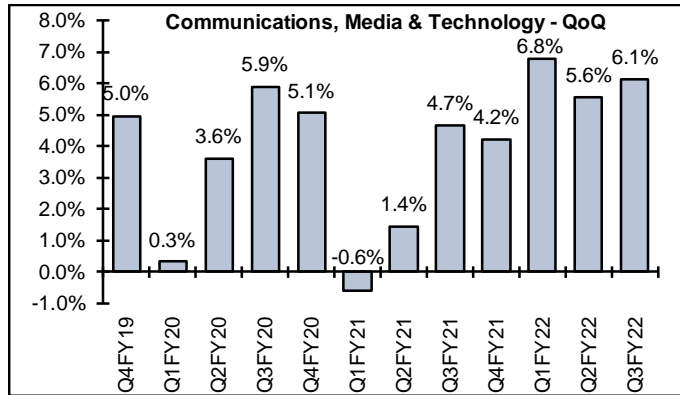
Source: Company, I-Sec research

Chart 6: Vertical mix (%)



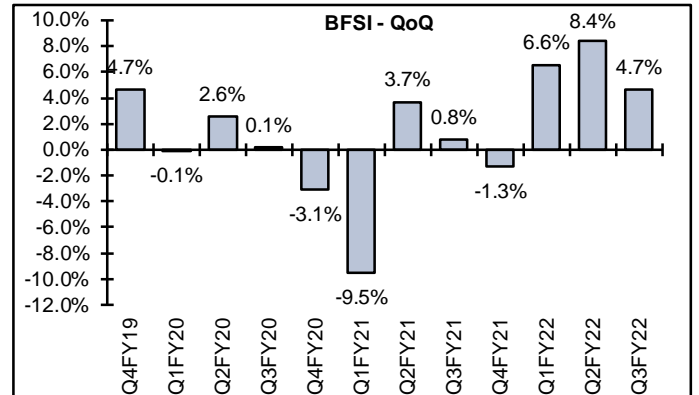
Source: Company, I-Sec research

Chart 7: CMT vertical outshining...



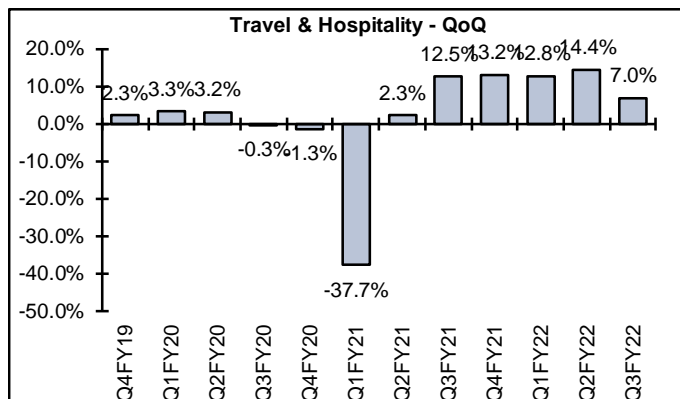
Source: Company, I-Sec research

Chart 8: BFSI growth normalising



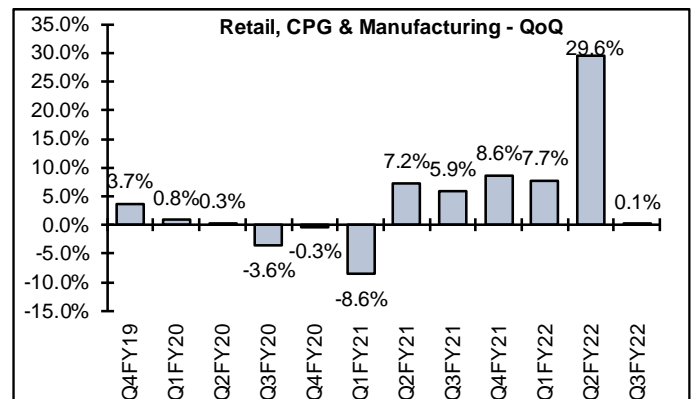
Source: Company, I-Sec research

Chart 9: Steady growth in travel & hospitality



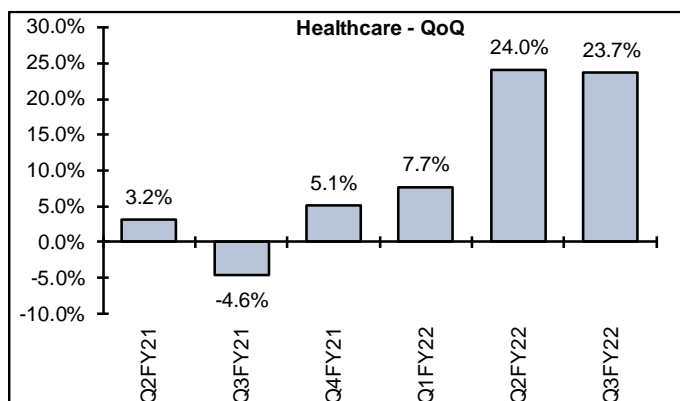
Source: Company, I-Sec research

Chart 10: Growth is now expected to pick up



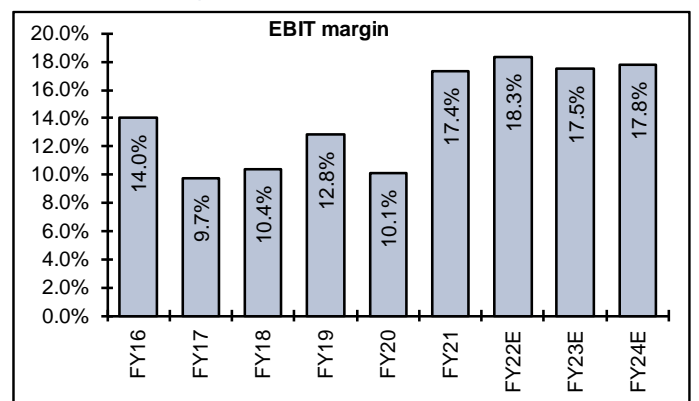
Source: Company, I-Sec research

Chart 11: Healthcare looks promising



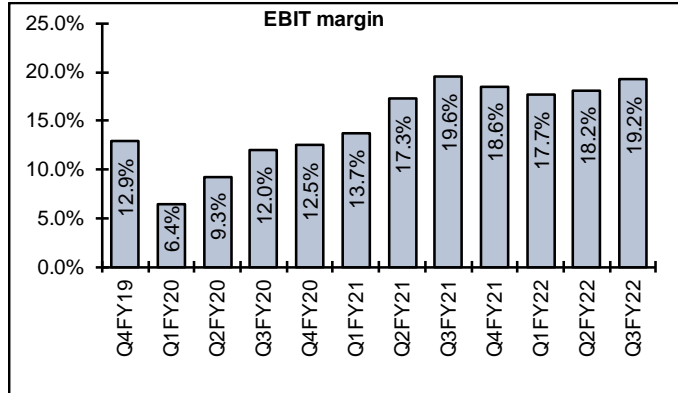
Source: Company, I-Sec research

Chart 12: Margins to contract in FY23E



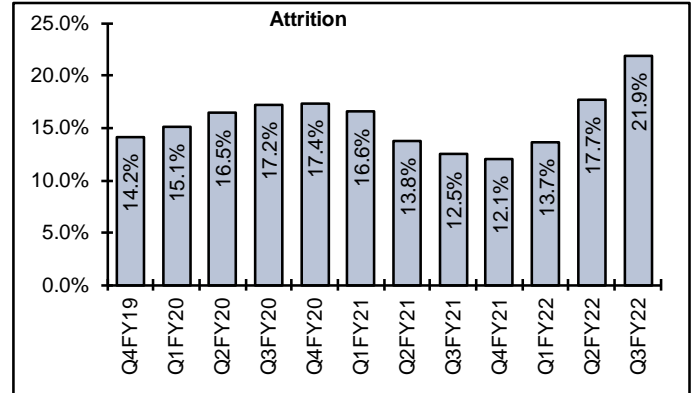
Source: Company, I-Sec research

Chart 13: Margins to remain resilient



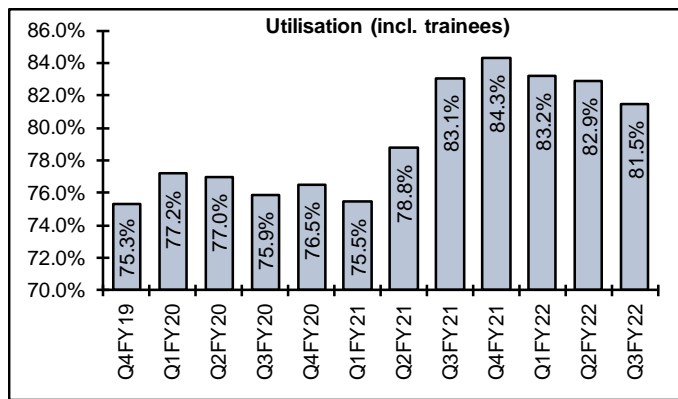
Source: Company, I-Sec research

Chart 14: Attrition gradually inching up



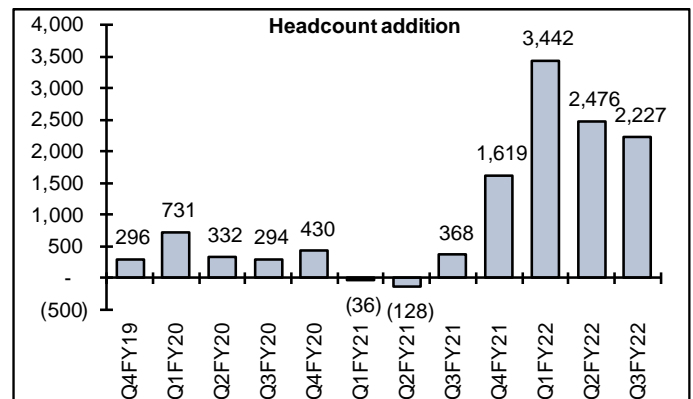
Source: Company, I-Sec research

Chart 15: Utilisation rates normalising



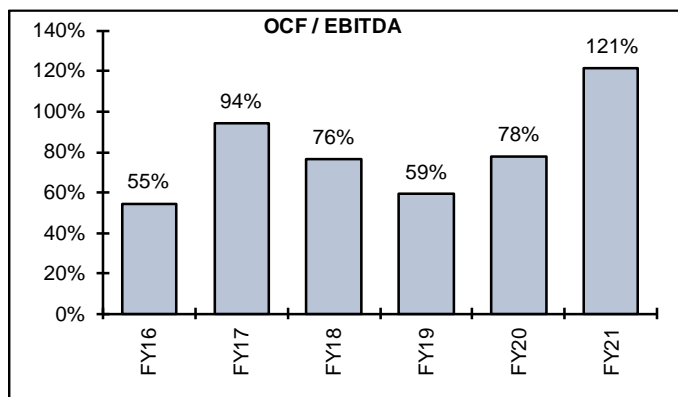
Source: Company, I-Sec research

Chart 16: Aggressive hiring to fulfil demand



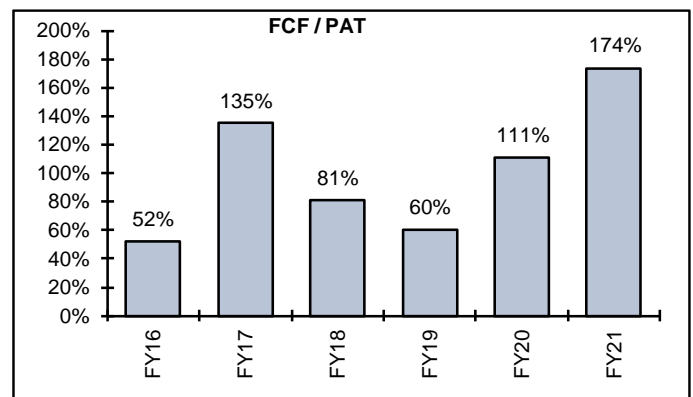
Source: Company, I-Sec research

Chart 17: Robust conversions despite...



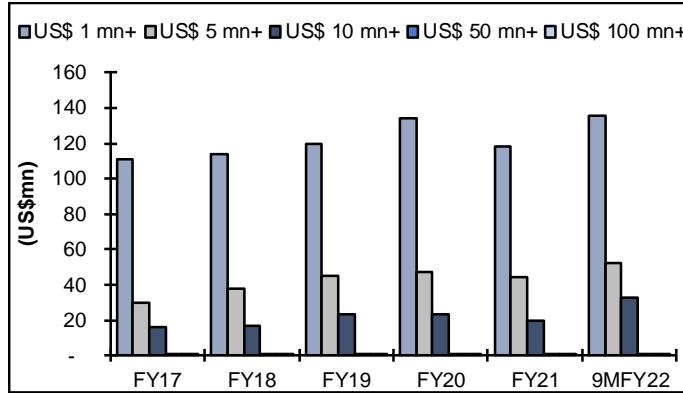
Source: Company, I-Sec research

Chart 18: ...covid-led pressures



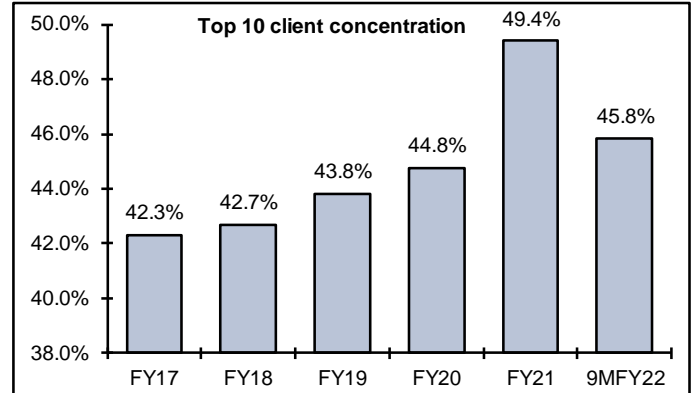
Source: Company, I-Sec research

Chart 19: Largely stable client base



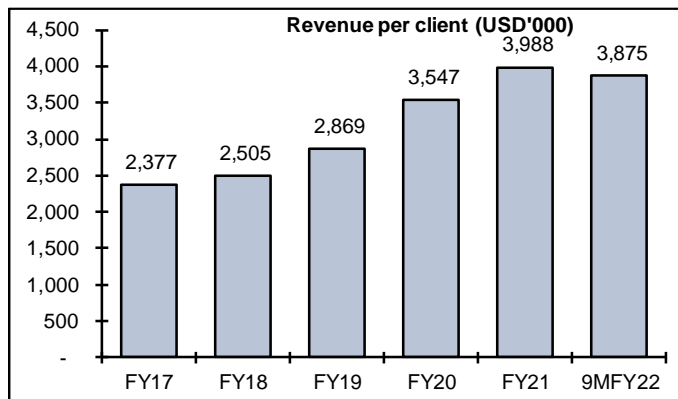
Source: Company, I-Sec research

Chart 20: Client concentration to reduce



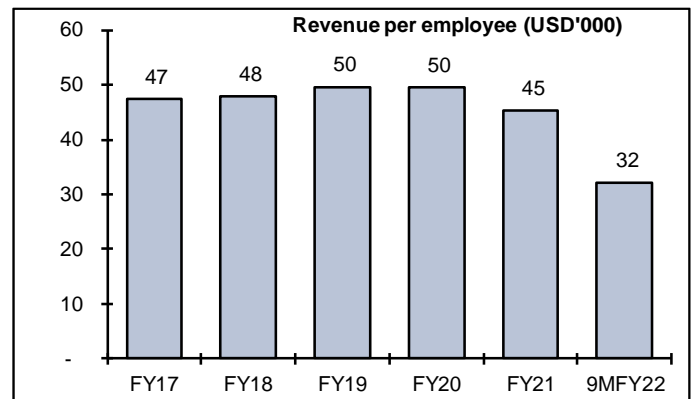
Source: Company, I-Sec research

Chart 21: Trends are now stabilising



Source: Company, I-Sec research

Chart 22: Aggressive hiring resulted in decline



Source: Company, I-Sec research

Financial summary – Mindtree

Table 1: Profit and Loss statement

(Rs mn, year ending March 31)

	FY21	FY22E	FY23E	FY24E
Revenue (US\$mn)	1,077	1,412	1,721	1,987
Total Income (Sales)	79,678	1,05,233	1,30,774	1,53,031
Operating Expenses	63,250	83,540	1,04,601	1,22,028
EBITDA	16,428	21,693	26,173	31,003
% margin	20.6	20.6	20.0	20.3
Depreciation & Amortisation	2,596	2,401	3,269	3,826
EBIT	13,832	19,291	22,903	27,177
% margin	17.4	18.3	17.5	17.8
Other Income	1,656	2,747	2,052	2,496
Interest expense	504	481	400	400
Recurring PBT	14,984	21,557	24,555	29,273
Tax expense	3,901	5,473	6,139	7,318
Recurr. profit before minority	11,083	16,085	18,416	21,955
Minority interest	-	-	-	-
Extraordinary items	-	-	-	-
Net Profit as restated	11,083	16,085	18,416	21,955

Source: Company data, I-Sec research

Table 2: Balance sheet

(Rs mn, year ending March 31)

	FY21	FY22E	FY23E	FY24E
Liabilities				
Share capital	1,647	1,648	1,648	1,648
Reserves and Surpluses	41,543	49,858	63,739	81,159
Net Worth	43,190	51,506	65,387	82,807
Minority Interest	-	-	-	-
Non-current Liabilities	4,498	4,830	4,830	4,830
Total Liabilities	47,688	56,336	70,217	87,637
Borrowings	885	883	883	883
Assets				
Fixed Assets	12,982	13,651	13,655	13,659
Other Non-current assets	4,878	6,241	6,241	6,241
Current assets	45,754	57,390	74,571	95,700
less: current liabilities	15,926	20,946	24,249	27,963
Net current assets	29,828	36,444	50,321	67,737
Total Assets	47,688	56,336	70,217	87,637

Source: Company data, I-Sec Research

Table 3: Cashflow statement

(Rs mn, year ending March 31)

	FY21	FY22E	FY23E	FY24E
Op. CF before W Cap changes	15,924	21,693	26,173	31,003
Working Capital Inflow / (Outflow)	7,204	(3,878)	(1,859)	(2,967)
Taxes	(3,168)	(5,473)	(6,139)	(7,318)
Capex	(673)	(3,070)	(3,273)	(3,830)
Free Cashflow	19,287	9,272	14,902	16,888
CF from other Invest Act (Ex Capex)	(11,160)	(3,274)	2,052	2,496
Change in share capital	1	(3,234)	0	-
Inc/(Dec) in Borrowings	(842)	332	-	-
Dividend paid	(2,880)	(4,535)	(4,535)	(4,535)
Others	(504)	(481)	(400)	(400)
Increase/(Decrease) in Cash	3,902	(1,920)	12,019	14,449

Source: Company data, I-Sec research

Table 4: Key ratios

(Year ending March 31)

	FY21	FY22E	FY23E	FY24E
Per Share Data (Rs)				
Reported EPS	67.3	97.7	111.8	133.3
Recurring Cash EPS	83.1	112.2	131.7	156.5
Book Value per share (BV)	262.4	312.7	397.0	502.8
Dividend per share	25.0	27.5	27.5	27.5
Growth Ratios (%)				
Total Income (Sales) - US\$	(1.1)	31.1	21.9	15.5
Total Income (Sales)	2.6	32.1	24.3	17.0
EBITDA	54.6	32.0	20.7	18.5
Net Income	75.7	45.1	14.5	19.2
Reported EPS	75.6	45.1	14.5	19.2
Recurring Cash EPS	50.9	35.1	17.3	18.9
Valuation Ratios (x)				
P/E	63.9	44.1	38.5	32.3
P/CEPS	51.8	38.3	32.7	27.5
P/BV	16.4	13.8	10.8	8.6
EV / EBITDA	41.5	31.3	25.5	21.1
EV / Sales	8.6	6.5	5.1	4.3
EV / FCF	35.4	73.3	44.8	38.7
Operating Ratios				
Other Income / PBT (%)	7.7	10.5	6.7	7.2
Effective Tax Rate (%)	26.0	25.4	25.0	25.0
NWC / Total Assets (%)	36.3	41.0	35.5	31.6
Receivables (days)	58	63	60	63
Payables (days)	12	17	17	17
D/E Ratio (x)	0.0	0.0	0.0	0.0
Return/Profitability Ratios (%)				
Net Income Margins	13.9	15.3	14.1	14.3
EBITDA Margins	20.6	20.6	20.0	20.3
RoNW (based on average)	29.7	34.0	31.5	29.6
Dividend Yield	0.6	0.6	0.6	0.6

Source: Company data, I-Sec research

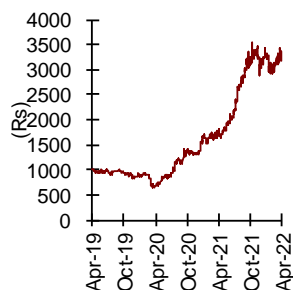
Mphasis

(BUY; CMP: Rs3,161; TP: Rs3,659)

Shareholding pattern

	Jun '21	Sep '21	Dec '21
Promoters	55.9	56.0	55.9
Institutional investors	38.9	38.8	38.9
MFs and others	13.3	13.6	13.2
FIs/Bank	0.2	0.3	0.2
Insurance Cos.	3.8	3.6	3.8
FII	21.6	21.3	21.7
Others	5.2	5.3	5.2

Price chart



Favorable risk-reward, top pick!

We believe Mphasis is well positioned to benefit from strong demand environment given: 1) its ability to win deals against tier-1 peers, proving its ability to differentiate using skills rather than scale; 2) pro-active nature of deal hunting and ability to execute zero-cost transformation deals is helping them win large deals, which provide better revenue visibility; 3) unlike tier-2 peers, Mphasis is strategic to most of its large accounts and has best track record in scaling its top-20 accounts.

In an environment where peers are talking about multi-year digital deals being broken down to smaller and shorter deals, Mphasis winning four large deals in Q3FY22 with the highest deal TCV at US\$92mn is very impressive. As the underlying demand for the company improves, we expect Mphasis to deliver revenue growth of 15%/12% in FY23E/FY24E.

Triggers & catalysts for the stock

Strong growth momentum in the direct business: Mphasis has been consistently reporting strong growth in its direct business in 9MFY22 (+34% YoY, USD). In 9MFY22, it reported deal TCV of US\$1.08bn (+25% YoY) with a consistent increase in the LTM average deal size (US\$71mn in Q3FY22 vs US\$67/31mn in Q3FY21/FY20). Further, dependence on declining DXC business has reduced significantly with DXC now contributing to 5.4% of revenue and will no longer be a drag on overall company growth.

Maintained margins within band of 15.5-17%: Mphasis will maintain margins within 15.5%-17% band despite headwinds from supply-side pressures led by levers of: 1) pricing improvement driven by value-based pricing, 2) pyramid optimisation, and 3) reducing sub-contracting costs. Company also intends to ramp up capacity, diversify talent base and adopt the hybrid work model, which should additionally help in operational efficiencies. Positive upside to margins is highest for Mphasis among its peers as it has always prioritized investing back in the business and never elevated its margins.

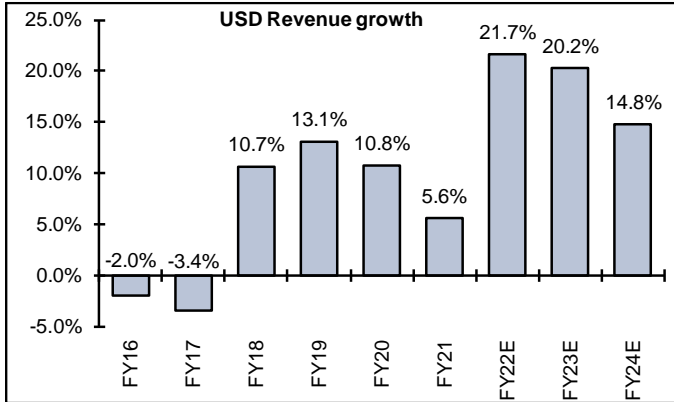
Valuation: Mphasis currently trades at 28x FY24E P/E for FY22-FY24E EPS CAGR of 23%, PEG ratio of 1.4x vs the tier-2 Indian IT sector trading at 28.5x FY24E for FY22-FY24E EPS CAGR of 21% and PEG ratio of 1.3x. Strength in direct business, strong execution & only company whose margins may improve in FY23E – makes Mphasis as one of our preferred in IT space. We assign **BUY** rating to Mphasis assigning a multiple of 32x on FY24E EPS to arrive at a target price of Rs3,659. Risk-reward is favorable.

Key Risks: 1) Weak revenue growth from direct core, 2) No expansion of margins, 3) INR appreciation, 4) Contraction in US capital market IT spends

Market Cap	Rs594bn/US\$7.8bn
Reuters/Bloomberg	MBFL.BO/MPHL IN
Shares Outstanding (mn)	187.8
52-week Range (Rs)	3546/1643
Free Float (%)	44.1
FII (%)	21.7
Daily Volume (US\$'000)	31,084
Absolute Return 3m (%)	(2.4)
Absolute Return 12m (%)	83.5
Sensex Return 3m (%)	(0.3)
Sensex Return 12m (%)	20.7

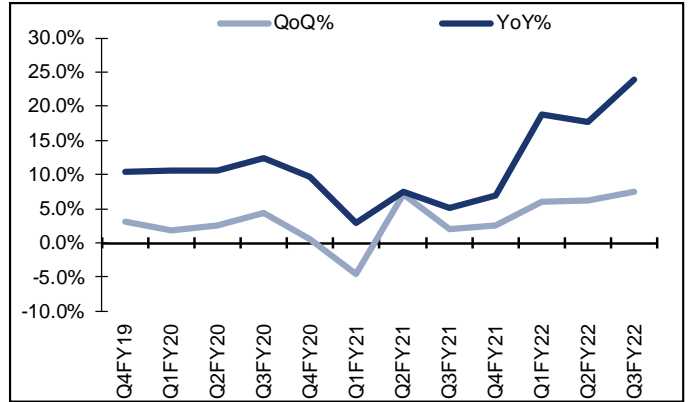
Year to March	2021	2022E	2023E	2024E
Revenue (Rs mn)	97,222	119,246	145,534	169,323
Net Income (Rs mn)	12,165	14,098	17,728	21,328
EPS (Rs)	65.2	75.6	95.0	114.3
% Chg YoY	2.7	15.9	25.7	20.3
P/E (x)	48.5	41.8	33.3	27.6
CEPS (Rs)	78.2	91.3	111.3	132.0
EV/E (x)	31.3	27.3	21.8	18.0
Dividend Yield	2.1	1.2	1.2	1.2
RoCE (%)	15.7	17.6	21.1	21.7
RoE (%)	19.7	22.3	26.6	27.0

Chart 1: Strong growth expected in FY23E...



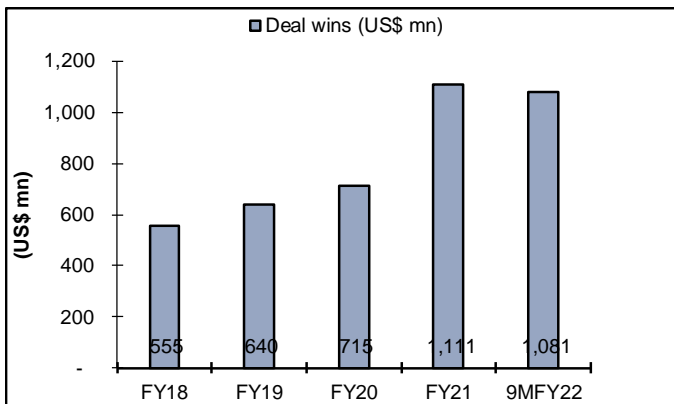
Source: Company, I-Sec research

Chart 2: ...as DXC drag reduces



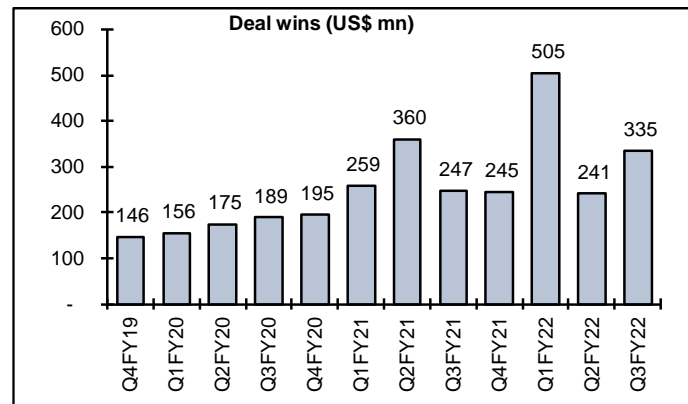
Source: Company, I-Sec research

Chart 3: Consistent deal wins...



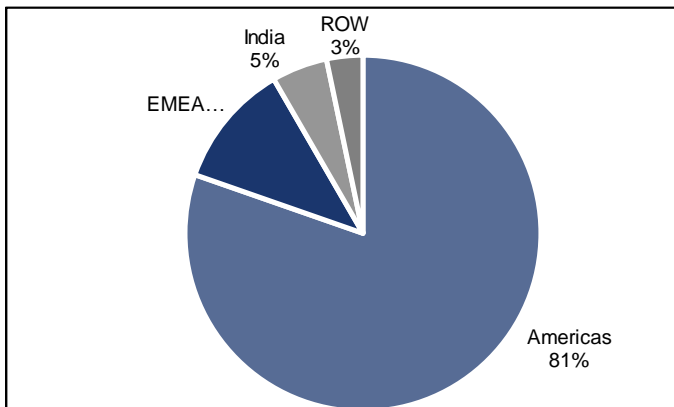
Source: Company, I-Sec research

Chart 4: ...over the quarters



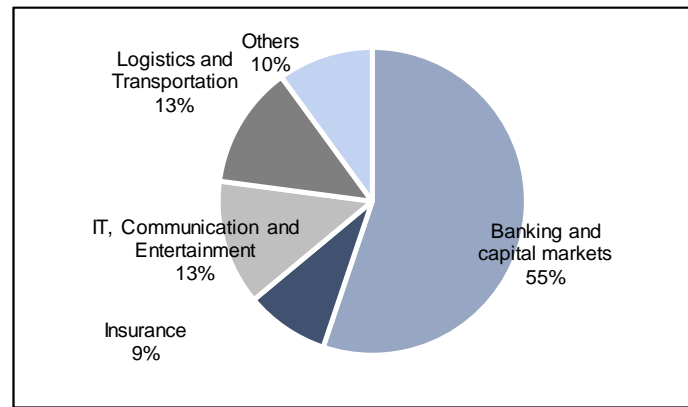
Source: Company, I-Sec research

Chart 5: Geographical mix (%)



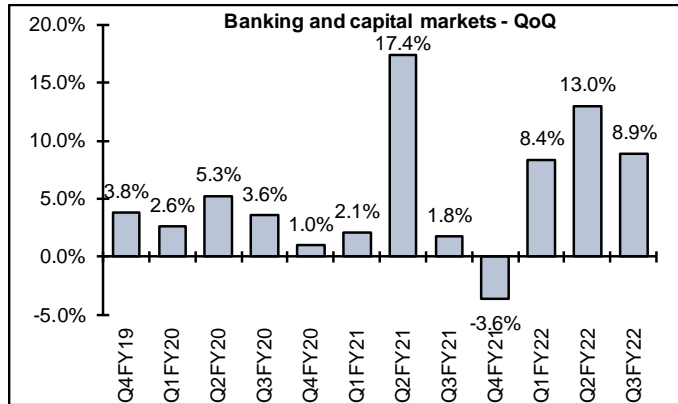
Source: Company, I-Sec research

Chart 6: Vertical mix (%)



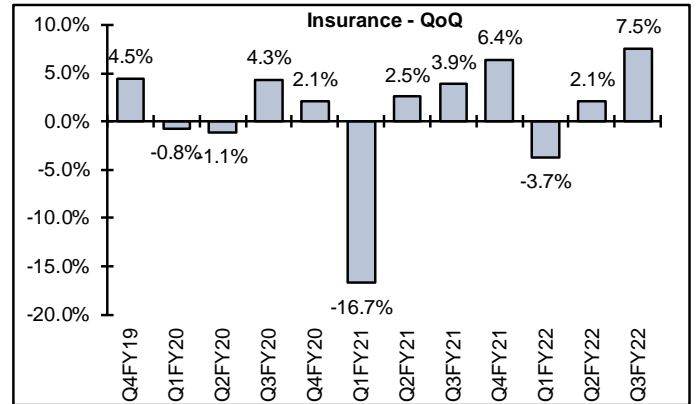
Source: Company, I-Sec research

Chart 7: BCM growth to stabilise



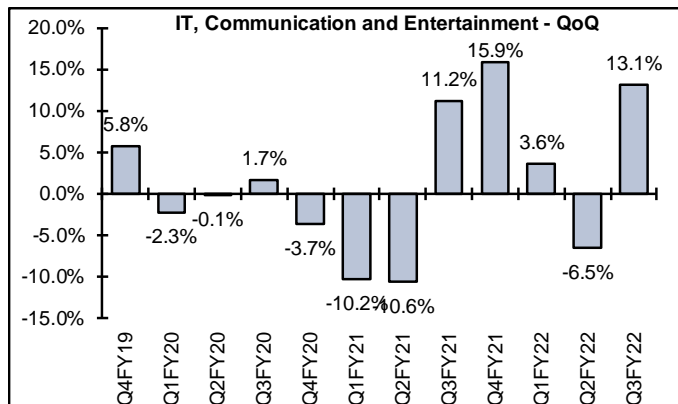
Source: Company, I-Sec research

Chart 8: Growth to normalise going ahead



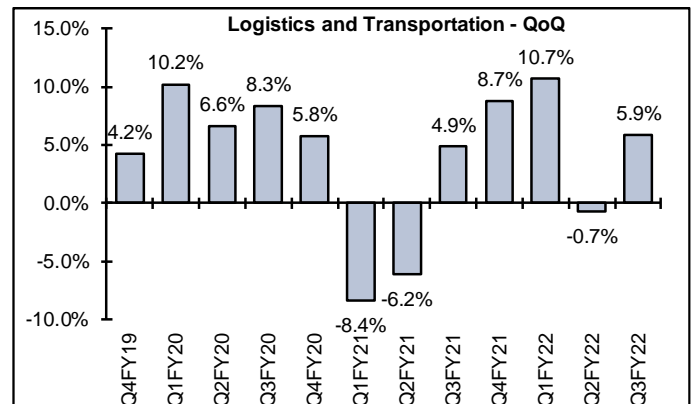
Source: Company, I-Sec research

Chart 9: Growth to normalise going ahead



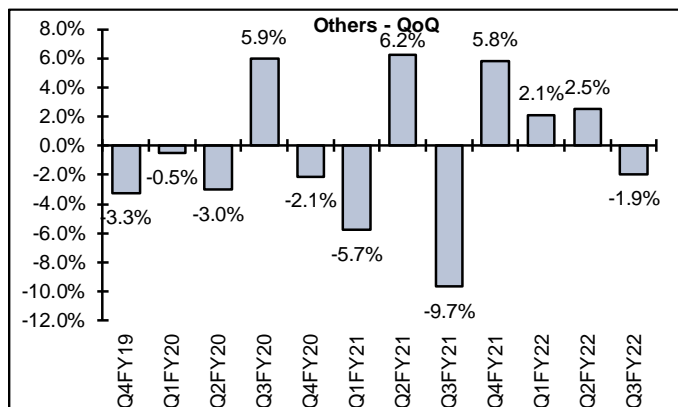
Source: Company, I-Sec research

Chart 10: Growth to normalise going ahead



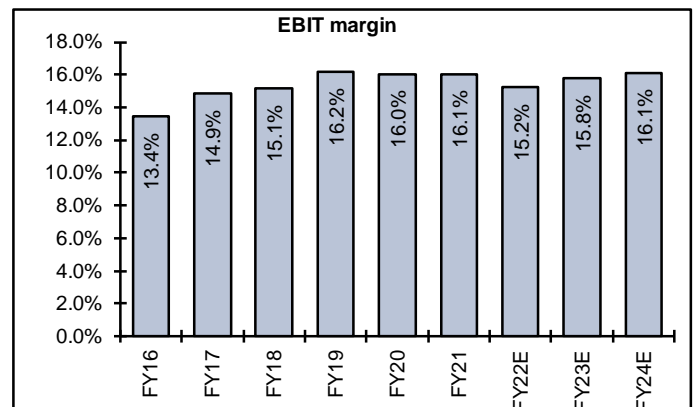
Source: Company, I-Sec research

Chart 11: Lumpy growth within the segment



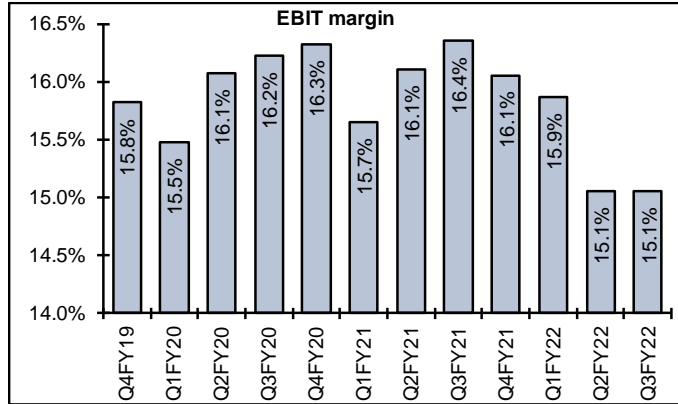
Source: Company, I-Sec research

Chart 12: Margins expected to expand



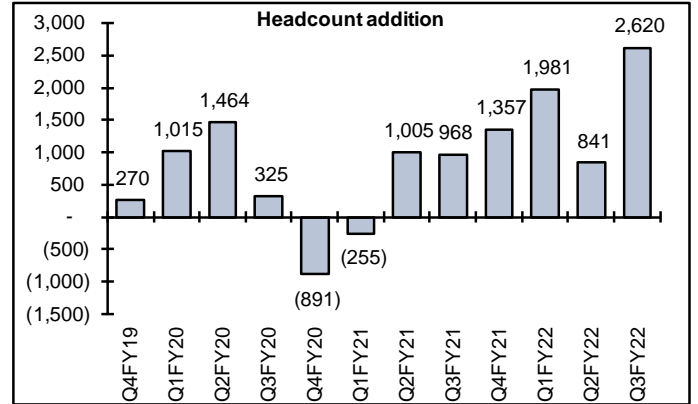
Source: Company, I-Sec research

Chart 13: Supply headwinds led to contraction



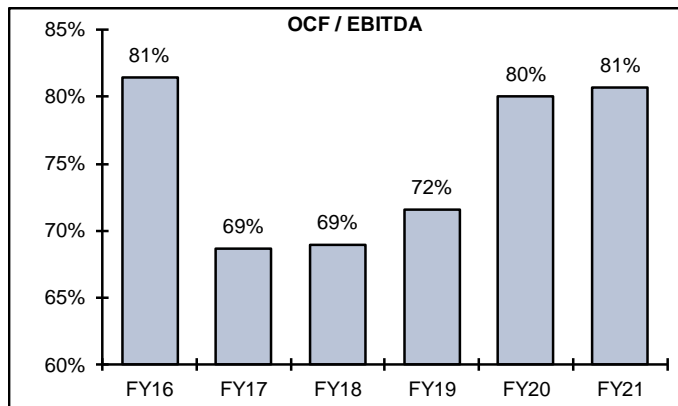
Source: Company, I-Sec research

Chart 14: Aggressive hiring to match demand



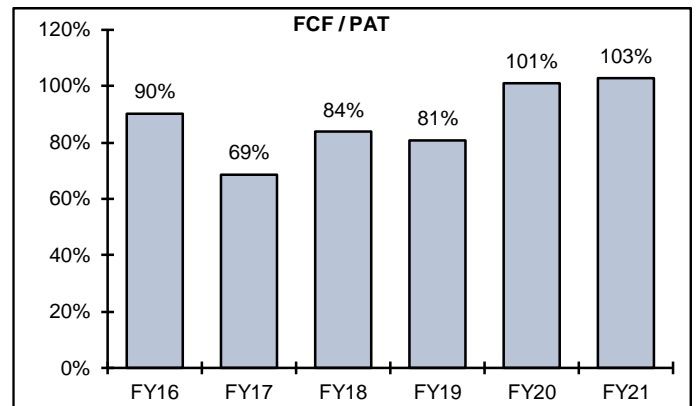
Source: Company, I-Sec research

Chart 15: Robust conversions despite...



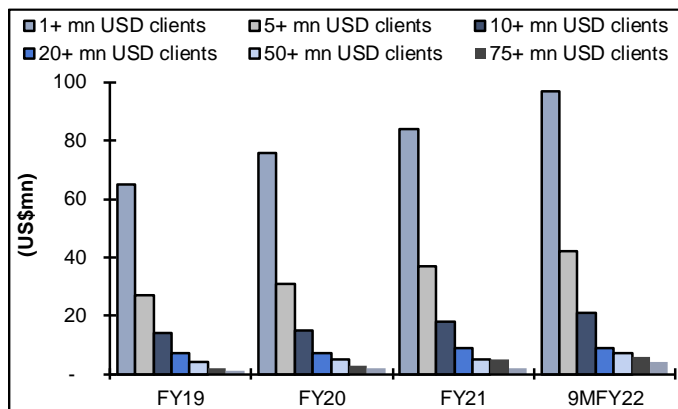
Source: Company, I-Sec research

Chart 16: ...covid-led pressures



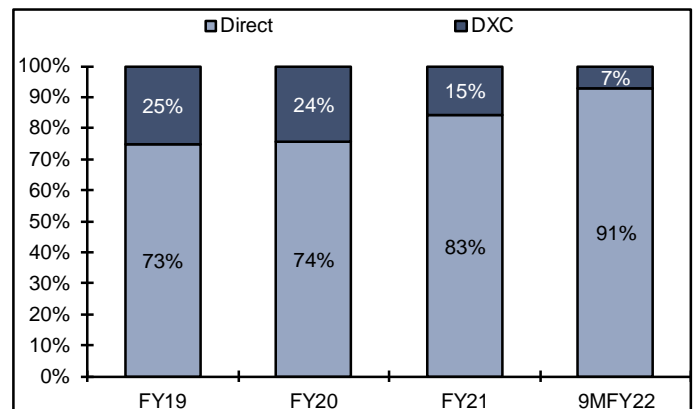
Source: Company, I-Sec research

Chart 17: Client base steadily increasing



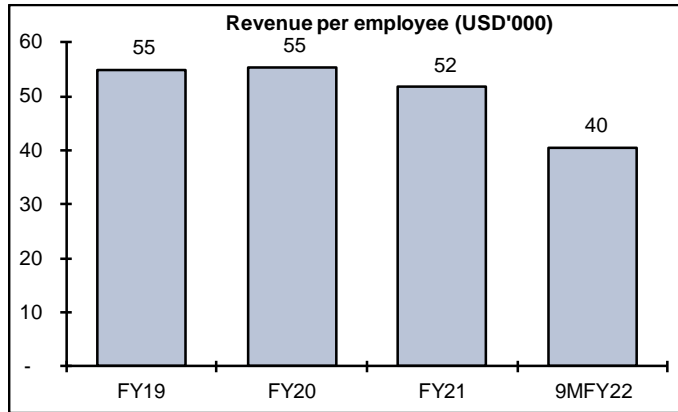
Source: Company, I-Sec research

Chart 18: DXC revenues steadily decreasing



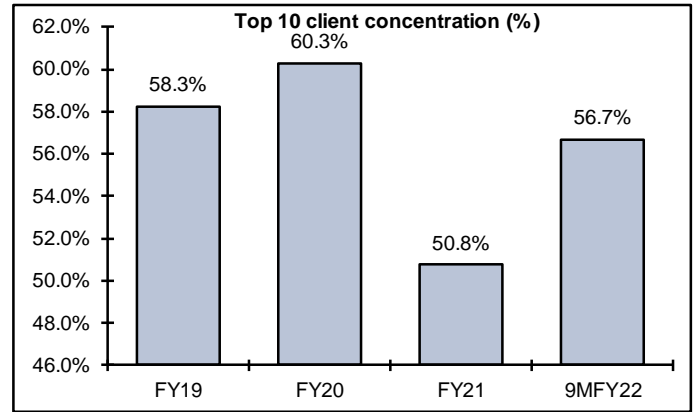
Source: Company, I-Sec research

Chart 19: Aggressive hiring resulted in decline



Source: Company, I-Sec research

Chart 20: Client concentration again inched up



Source: Company, I-Sec research

Financial summary – Mphasis

Table 1: Profit and Loss statement

(Rs mn, year ending March 31)

	FY21	FY22E	FY23E	FY24E
Revenues (US\$mn)	1,309	1,592	1,915	2,199
Operating Revenues (Sales)	97,222	1,19,246	1,45,534	1,69,323
Operating Expenses	79,196	98,161	1,19,523	1,38,713
EBITDA	18,026	21,085	26,011	30,610
% margins	18.5	17.7	17.9	18.1
Depreciation & Amortisation	2,418	2,927	3,039	3,298
EBIT	15,608	18,158	22,972	27,312
% margins	16.1	15.2	15.8	16.1
Other Income	696	789	799	1,287
Recurring PBT	16,304	18,947	23,771	28,599
Add: Extraordinaries	-	-	-	-
Less: Taxes	4,139	4,849	6,043	7,271
Less: Minority Interest	-	-	-	-
Net Income (Reported)	12,165	14,098	17,728	21,328
Recurring Net Income	12,165	14,098	17,728	21,328

Source: Company data, I-Sec research

Table 2: Balance sheet

(Rs mn, year ending March 31)

	FY21	FY22E	FY23E	FY24E
Assets				
Total Current Assets	61,354	59,604	74,109	92,191
of which cash and deposits	11,310	5,136	14,989	29,340
Total Current Liabilities & Provisions	15,421	21,569	25,014	27,775
Net Current Assets	45,933	38,035	49,096	64,416
Net Fixed Assets	8,901	9,628	9,189	8,091
Goodwill	21,326	26,853	26,853	26,853
Other long term assets	1,261	1,475	1,475	1,475
Total Assets	77,421	75,991	86,613	1,00,835
Liabilities				
Loans	5,134	6,184	6,184	6,184
Deferred Tax Liability	343	660	660	660
Other long term liabilities	6,677	7,782	7,782	7,782
Equity Share Capital	1,870	1,875	1,875	1,875
Reserves & Surplus	63,397	59,490	70,112	84,334
Net Worth	65,267	61,365	71,987	86,209
Total Liabilities	77,421	75,991	86,613	1,00,835

Source: Company data, I-Sec Research

Table 3: Cashflow statement

(Rs mn, year ending March 31)

	FY21	FY22E	FY23E	FY24E
Operating Cashflow before W Cap changes	14,998	16,060	19,568	22,940
Working Capital Inflow / (Outflow)	(453)	(1,699)	(1,208)	(969)
Capex	(2,067)	(9,181)	(2,600)	(2,200)
Free Cashflow	12,478	5,180	15,760	19,771
Cashflow from other Invst Act (Ex Capex)	(6,152)	4,490	1,199	1,687
Change in equity	268	(10,894)	-	-
Inc/(Dec) in Borrowings	(409)	1,050	-	-
Dividend & interest paid	(7,146)	(7,106)	(7,106)	(7,106)
Others	(1,328)	1,105	-	-
Increase/(Decrease) in Cash	(2,289)	(6,175)	9,853	14,352

Source: Company data, I-Sec research

Table 4: Key ratios

(Year ending March 31)

	FY21	FY22E	FY23E	FY24E
Per Share Data (Rs)				
Reported EPS	65.2	75.6	95.0	114.3
Cash EPS	78.2	91.3	111.3	132.0
Dividend per share (DPS)	65.0	38.0	38.0	38.0
Book Value per share (BV)	349.9	329.0	385.9	462.2
Growth Ratios (%)				
Operating Income (Sales) - US\$	5.6	21.7	20.2	14.8
Operating Income (Sales)	9.9	22.7	22.0	16.3
EBITDA	9.2	17.0	23.4	17.7
Recurring Net Income	2.7	15.9	25.7	20.3
Reported EPS	2.7	15.9	25.7	20.3
Cash EPS	2.9	16.7	22.0	18.6
Valuation Ratios (x)				
P/E	48.5	41.8	33.3	27.6
P/CEPS	40.4	34.6	28.4	23.9
P/BV	9.0	9.6	8.2	6.8
EV / EBITDA	31.3	27.3	21.8	18.0
EV / Sales	5.8	4.8	3.9	3.3
Operating Ratios				
Other Income / PBT (%)	4.3	4.2	3.4	4.5
Effective Tax Rate (%)	25.4	25.6	25.4	25.4
NWC / Total Assets (%)	37.3	33.7	30.6	27.3
Receivables (days)	68	71	70	68
D/E Ratio (x)	0.1	0.1	0.1	0.1
Return/Profitability Ratios (%)				
Net Income Margins	12.5	11.8	12.2	12.6
RoCE (Based on Avg)	15.7	17.6	21.1	21.7
RoNW (Based on Avg)	19.7	22.3	26.6	27.0
Dividend Payout Ratio	99.7	50.3	40.0	33.2
Dividend Yield	2.1	1.2	1.2	1.2
EBITDA Margin	18.5	17.7	17.9	18.1

Source: Company data, I-Sec research

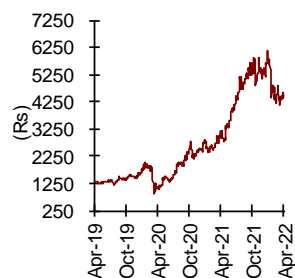
Coforge

(BUY; CMP: Rs4,373; TP: Rs5,209)

Shareholding pattern

	Jun '21	Sep '21	Dec '21
Promoters	557	50.2	50.0
Institutional investors	34.4	39.3	39.4
MFs and others	11.5	14.4	14.4
FIs/Bank	0.0	0.0	0.0
Insurance Cos.	3.0	3.7	5.5
FII	19.9	21.2	19.5
Others	9.9	10.5	10.6

Price chart



Performer, top pick!

We like Coforge given: 1) its differentiated competitive positioning in certain niche areas (e.g. insurance, wealth management, TTH); 2) sector-leading growth profile (37% YoY CC growth guidance in FY22E including 24% YoY CC organic); 3) ability to win large deals amidst demand environment filled with shorter cycle deals; 4) robust client mining across buckets reflected in highest revenue per client among peers; 5) lowest client concentration; and 6) highest revenue productivity among peers.

Large deal wins for three consecutive quarters in 9MFY22 (US\$105mn large deal in Q1, two US\$50mn large deals in Q2 and US\$45mn large deal in Q3) in an environment of higher number of short-cycle deals is impressive. Strong client mining efforts have led to doubling of US\$10mn clients in past one year.

Triggers & catalysts for the stock

Sustained growth momentum and successful integration: We like the company for its ability to drive strong growth (5.9% YoY) in covid-impacted FY21 despite ~20% of revenues coming from TTH. Sustained growth momentum in Coforge's key verticals with successful integration of its acquisitions should be a key catalyst for the company. Additionally, we expect TTH to grow strongly in FY23E given recovery in new account opening and wallet share expansion. We build-in a revenue growth CAGR of 19% over FY22-FY24E.

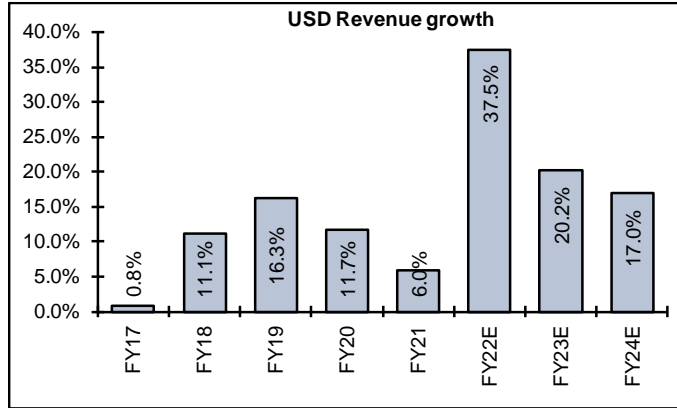
Impressive margin outlook: Pre-RSU EBITDA margin guidance for FY22 (18.9-19%) implies a margin expansion of ~130bps QoQ and strong exit rate. Attrition at 16.3% continues to be amongst the lowest in the industry. We believe there is further scope for margin improvement given scope in operational efficiencies, offshore mix and pyramid rationalisation. We build-in an EBIT margin estimate of 15.3% for FY23E/FY24E.

Valuation: COFO currently trades at 25x FY24E P/E for FY22-FY24E EPS CAGR of 26%, PEG of 1.2x vs the tier-2 Indian IT sector trading at 28.5x FY24E for FY22-FY24E EPS CAGR of 21% and PEG ratio of 1.3x. Company's focus on client mining and sub-verticals such as insurance, asset management and transportation is a competitive advantage. In these sub-verticals, it has scale equivalent to larger peers. We expect COFO growth to be at 20.2%/17% in FY23E/FY24E respectively. We assign a **BUY** rating to the stock and 30x multiple on FY24E EPS to arrive at a target price of Rs5,209.

Key Risks: 1) Weak revenue growth from BFSI vertical, 2) Contraction of margins, 3) Promoter (PE) selling, 4) INR appreciation

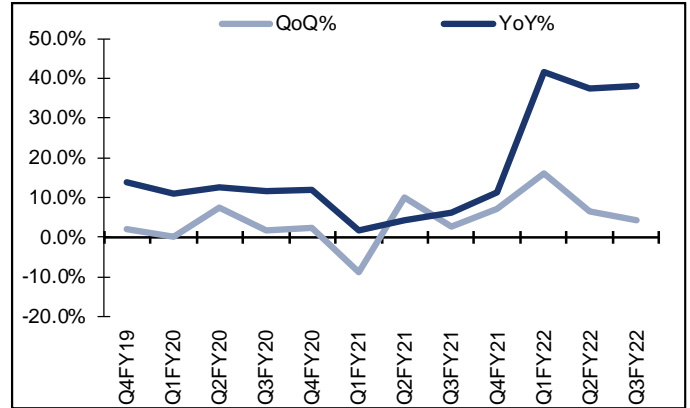
Market Cap	Rs266bn/US\$3.5bn	Year to March	2021	2022E	2023E	2024E
Bloomberg	COFORGE IN	Revenue (Rs mn)	46,628	64,245	78,997	93,608
Shares Outstanding (mn)	60.9	Net Income (Rs mn)	4,736	6,668	8,761	10,532
52-week Range (Rs)	6105/2808	EPS (Rs)	78.1	109.9	144.4	173.6
Free Float (%)	50.0	% Chg YoY	(0.0)	40.8	31.4	20.2
FII (%)	19.5	P/E (x)	66.7	47.4	36.1	30.0
Daily Volume (US\$'000)	32,387	CEPS (Rs)	108.4	147.8	196.5	238.5
Absolute Return 3m (%)	(23.8)	EV/E (x)	39.1	26.2	19.6	16.0
Absolute Return 12m (%)	43.7	Dividend Yield	0.2	0.2	0.2	0.2
Sensex Return 3m (%)	(0.3)	RoCE (%)	13.6	18.1	18.2	18.2
Sensex Return 12m (%)	20.7	RoE (%)	19.5	24.2	25.4	24.3

Chart 1: Revenue growth to remain strong



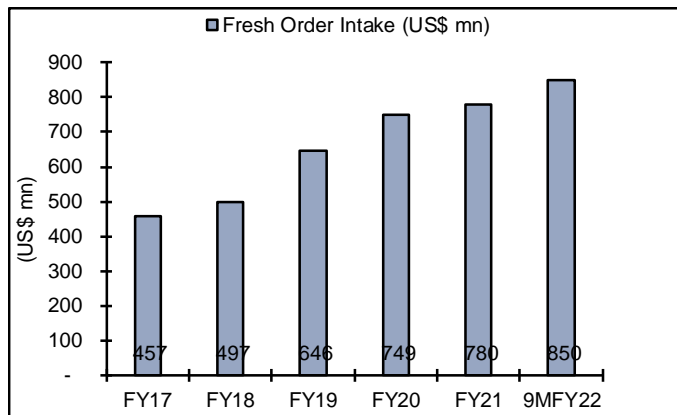
Source: Company, I-Sec research

Chart 1: Declining QoQ growth



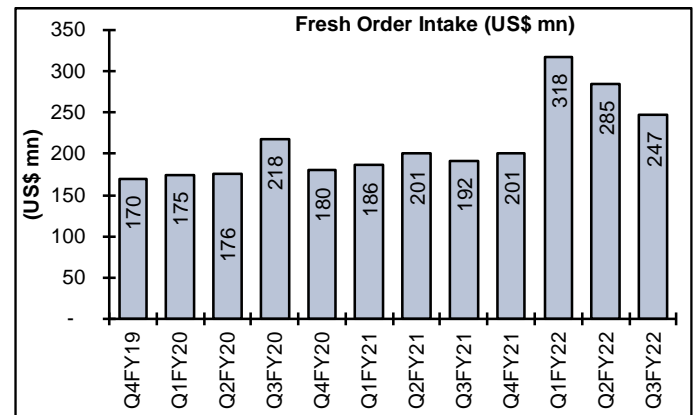
Source: Company, I-Sec research

Chart 3: Fresh order intake increased in 9MFY22...



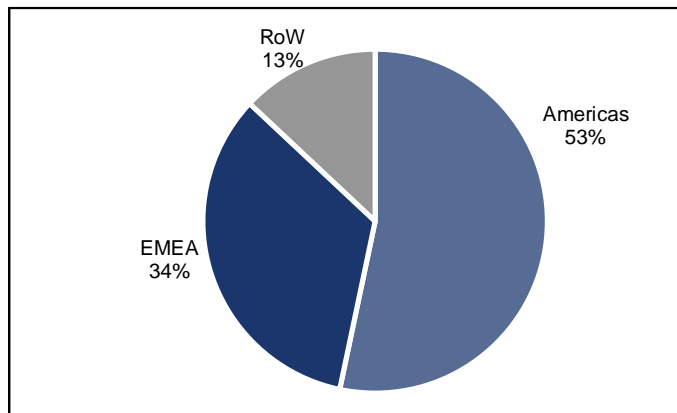
Source: Company, I-Sec research

Chart 4: ... leading to robust growth



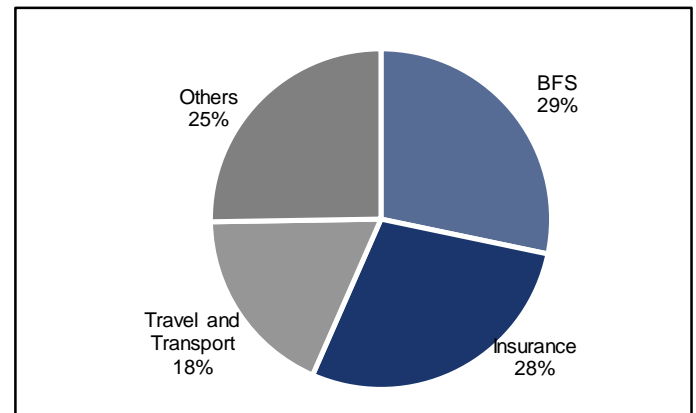
Source: Company, I-Sec research

Chart 5: Geographical mix (%)



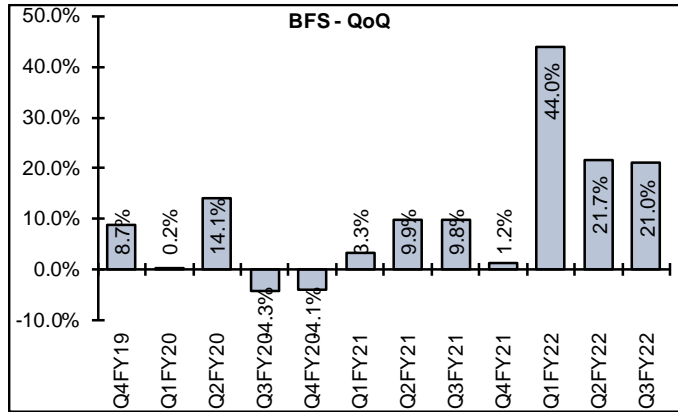
Source: Company, I-Sec research

Chart 6: Vertical mix (%)



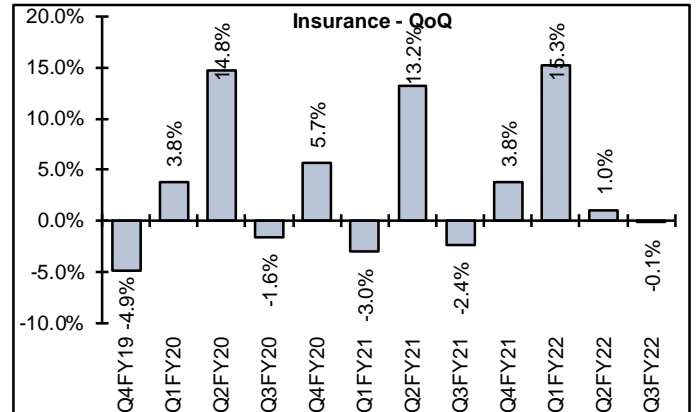
Source: Company, I-Sec research

Chart 7: BFS growth to stabilise ahead



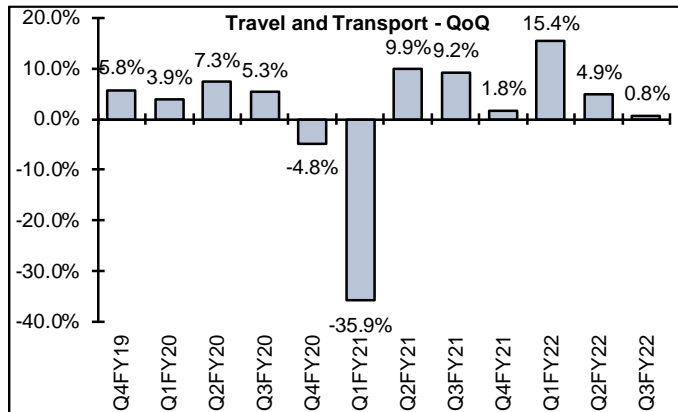
Source: Company, I-Sec research

Chart 8: Growth expected to normalise



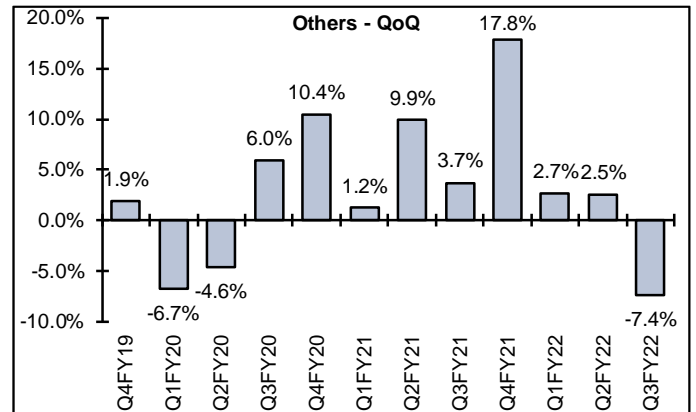
Source: Company, I-Sec research

Chart 9: Travel & transport segment to pick up



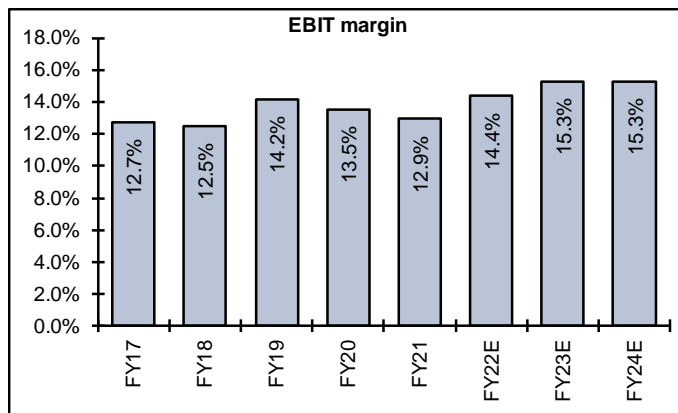
Source: Company, I-Sec research

Chart 10: Growth to normalise ahead



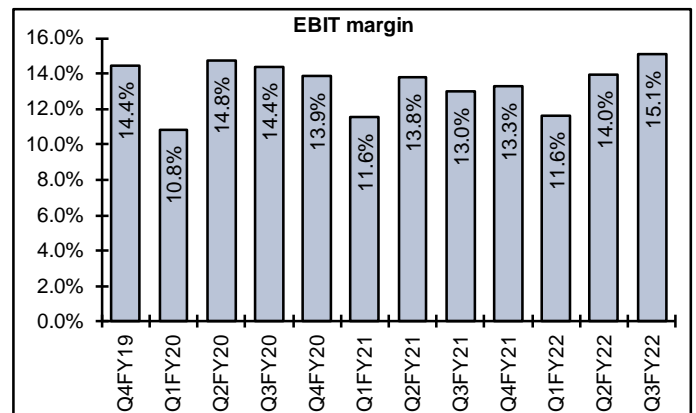
Source: Company, I-Sec research

Chart 11: Margin expansion due to...



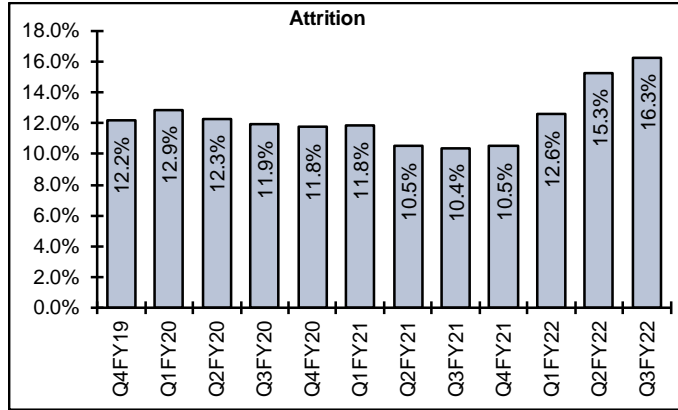
Source: Company, I-Sec research

Chart 12: ...improving operational efficiencies



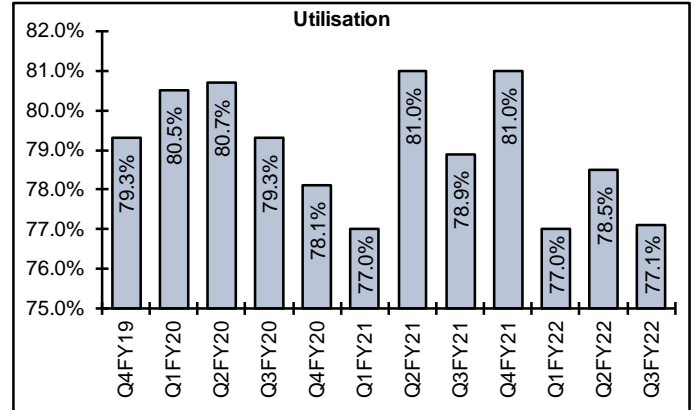
Source: Company, I-Sec research

Chart 13: Attrition higher than pre-covid levels



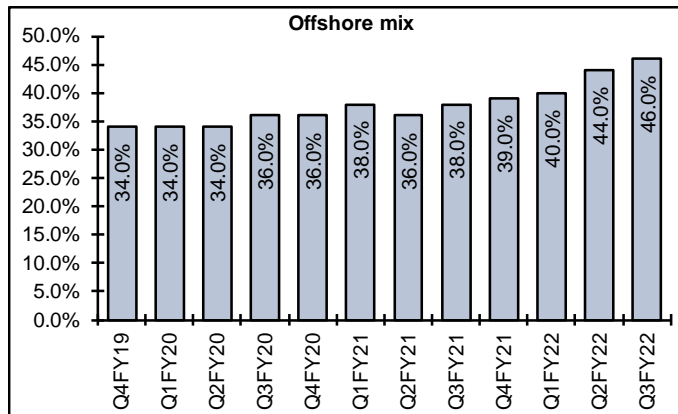
Source: Company, I-Sec research

Chart 14: Utilisation rates normalising



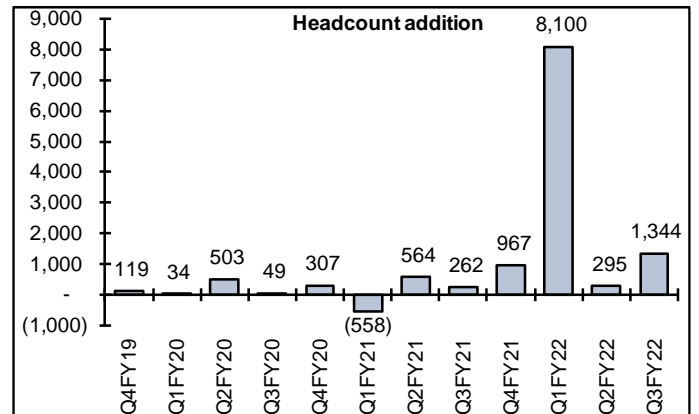
Source: Company, I-Sec research

Chart 15: Improving offshore mix



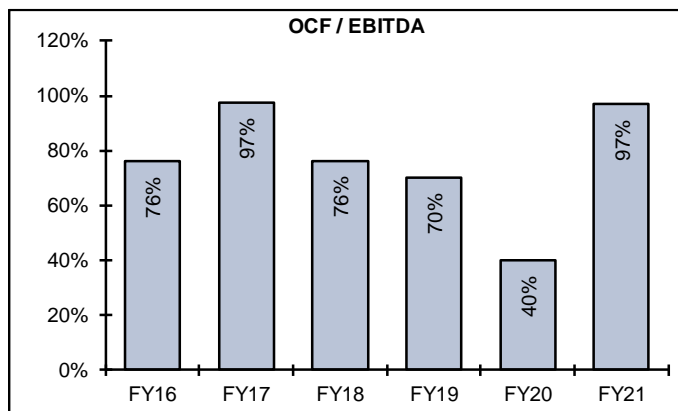
Source: Company, I-Sec research

Chart 16: Increased hiring to fulfil demand



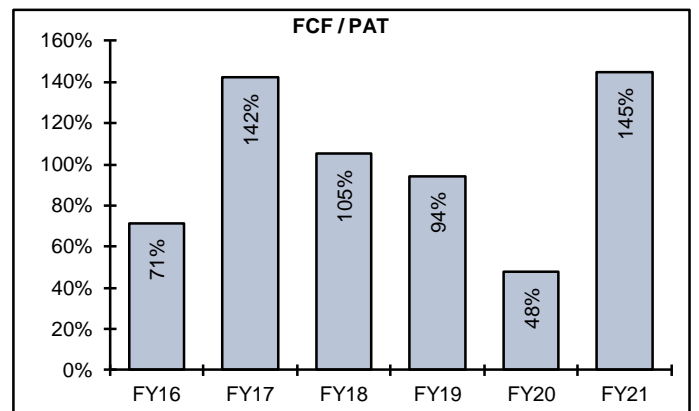
Source: Company, I-Sec research

Chart 17: Robust cash conversions despite...



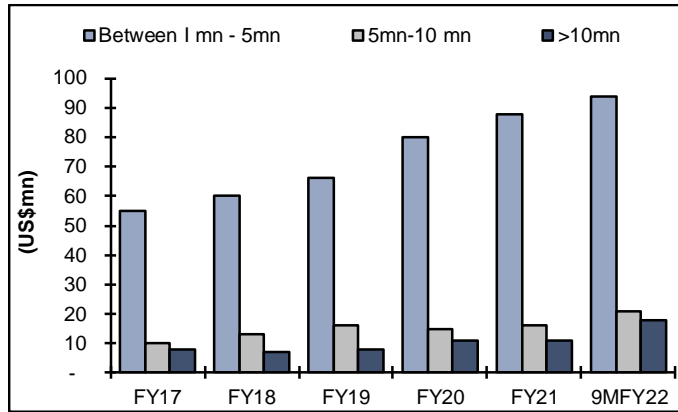
Source: Company, I-Sec research

Chart 18: ...covid-led pressures



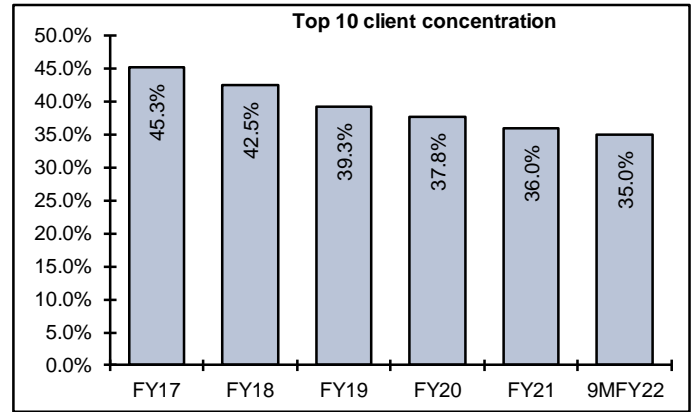
Source: Company, I-Sec research

Chart 19: Steady increase in client base



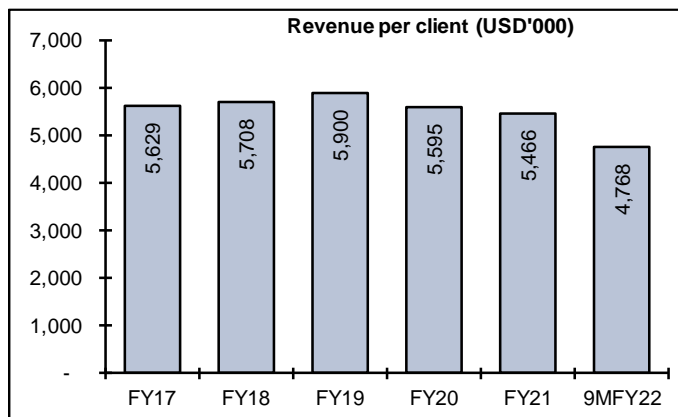
Source: Company, I-Sec research

Chart 20: Steady decline in client concentration



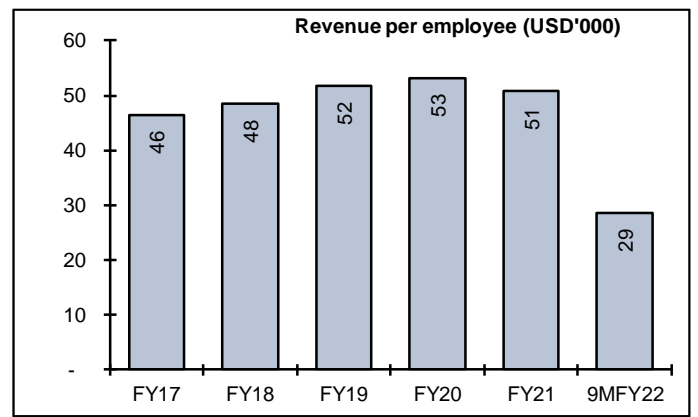
Source: Company, I-Sec research

Chart 21: Decline due to expanding base



Source: Company, I-Sec research

Chart 22: Decline due to increased hiring



Source: Company, I-Sec research

Financial summary – Coforge

Table 1: Profit and Loss statement

(Rs mn, year ending March 31)

	FY21	FY22E	FY23E	FY24E
Revenues (US\$mn)	629	865	1,039	1,216
Operating Revenues (Sales)	46,628	64,245	78,997	93,608
Operating Expenses	38,237	52,127	63,295	74,980
Costs of ESOPS	526	598	470	400
EBITDA	7,865	11,520	15,232	18,227
% margins	16.9	17.9	19.3	19.5
Depreciation & Amortisation	1,836	2,295	3,160	3,932
EBIT	6,029	9,224	12,073	14,296
% margins	12.9	14.4	15.3	15.3
Interest & Finance Chgs	-	-	-	-
Other Income	113	(127)	32	32
Recurring PBT	6,142	9,097	12,105	14,328
Add: Extraordinaries exps / (Inc)	-	195	-	-
Less: Taxes	1,302	1,725	2,784	3,295
Less: Minority Int / Add: Associates	104	509	560	500
Net Income (Reported)	4,736	6,668	8,761	10,532
Recurring Net Income	4,736	6,863	8,761	10,532

Source: Company data, I-Sec research

Table 2: Balance sheet

(Rs mn, year ending March 31)

	FY21	FY22E	FY23E	FY24E
Assets				
Total Current Assets	21,295	31,346	38,159	46,635
of which cash and deposits	7,999	14,019	17,610	23,107
Total Current Liabilities & Provisions	8,425	10,150	11,516	12,774
Net Current Assets	12,870	21,196	26,643	33,862
Investments	-	-	-	-
Net Fixed Assets	10,208	11,708	13,208	14,708
Capital Work-in-Progress	0	0	0	0
Other Long Term Assets	3,631	3,691	3,751	3,811
Total Assets	26,709	36,595	43,602	52,381
Liabilities				
LT Borrowings	-	-	-	-
Other LT Liabilities and Provisions	2,048	6,054	5,089	4,124
Minority Interest	-	-	-	-
Equity Share Capital	606	606	606	606
Face Value per share (Rs)	10	10	10	10
Reserves & Surplus	24,055	29,935	37,907	47,651
Net Worth	24,661	30,541	38,513	48,257
Total Liabilities	26,709	36,595	43,602	52,381

Source: Company data, I-Sec Research

Table 3: Cashflow statement

(Rs mn, year ending March 31)

	FY21	FY22E	FY23E	FY24E
Operating Cashflow before W Cap changes	2,511	9,091	11,888	14,432
Working Capital Inflow / (Outflow)	5,112	(2,206)	(1,756)	(1,621)
Capex	(757)	(3,795)	(4,660)	(5,432)
Free Cashflow	6,866	3,089	5,472	7,379
Cashflow from other Invst Act (Ex Capex)	(1,597)	(287)	(128)	(128)
Proceeds from Issue of Share Capital	(4,166)	-	(0)	0
Inc/(Dec) in Borrowings / Deferred Liabilities	(288)	3,971	(1,000)	(1,000)
Dividend paid	(686)	(788)	(788)	(788)
Others	(391)	35	35	35
Inc./(Dec.) in Cash & equivalents	(262)	6,020	3,591	5,497

Source: Company data, I-Sec research

Table 4: Key ratios

(Year ending March 31)

	FY21	FY22E	FY23E	FY24E
Per Share Data (Rs)				
Earnings per share (Reported)	78.1	109.9	144.4	173.6
Cash earnings per share	108.4	147.8	196.5	238.5
Dividend per share	13.0	13.0	13.0	13.0
Book Value per share	406.6	503.5	635.0	795.6
Growth Ratios (%)				
Operating Income (Sales) - US\$	6.0	37.5	20.2	17.0
Operating Income (Sales)	10.9	37.8	23.0	18.5
EBITDA	6.0	46.5	32.2	19.7
Recurring Net Income	-0.0	44.9	27.6	20.2
Reported EPS	-0.0	40.8	31.4	20.2
Valuation Ratios (x)				
P/E	66.7	47.4	36.1	30.0
P/CEPS	48.1	35.2	26.5	21.8
P/BV	12.8	10.3	8.2	6.5
EV / EBITDA	39.1	26.2	19.6	16.0
EV / Sales	6.6	4.7	3.8	3.1
EV / FCF	44.8	97.7	54.5	39.6
Operating Ratios				
Other Income / PBT (%)	1.8	-1.4	0.3	0.2
Effective Tax Rate (%)	21.2	19.4	23.0	23.0
NWC / Total Assets (%)	13.9	15.4	16.4	16.5
Receivables (days) on average	69.6	69.5	68.8	67.5
D/E Ratio (x)	-	-	-	-
Return/Profitability Ratios (%)				
Recurring Net Income Margins	10.2	10.4	11.1	11.3
RoCE (Based on Avg)	13.6	18.1	18.2	18.2
RoNW (Based on Avg)	19.5	24.2	25.4	24.3
Dividend Payout Ratio	16.6	11.8	9.0	7.5
Dividend Yield	0.2	0.2	0.2	0.2
EBITDA Margin	16.9	17.9	19.3	19.5

Source: Company data, I-Sec research

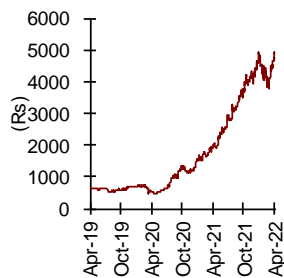
Persistent Systems

(HOLD; CMP: Rs4,697; TP: Rs4,515)

Shareholding pattern

	Jun '21	Sep '21	Dec '21
Promoters	31.3	31.3	31.3
Institutional investors	48.6	47.2	46.8
MFs and others	26.3	24.0	22.4
FIs/Bank	0.0	0.0	0.0
Insurance Cos.	2.3	3.4	4.0
FII	20.0	19.8	20.4
Others	20.1	21.5	21.9

Price chart



Significant jump in growth profile and consistent margin expansion

With consistent performance in growth and steady margin expansion, we believe Persistent is a good turnaround story. Post the management / strategy change, the company's growth trajectory has significantly improved. In the pandemic year of FY21, it posted 12.8% YoY USD revenue growth, highest in the industry and in FY22E it is on track to post ~34% YoY USD revenue growth (vs 3.2% CAGR over FY18-FY20).

9%+ QoQ (USD) growth in the past three quarters along with strong deal win momentum and aggressive headcount addition indicates revenue growth momentum should continue. Further, the company's ability to expand margins for five consecutive quarters despite supply-side cost pressures is impressive and builds confidence.

Triggers & catalysts for the stock

Aspiration to reach US\$1bn annual run-rate: Management aspires to achieve a US\$1bn annual run-rate in next 1.5-2 years. It is likely to meet this target ahead of its timeline given the impressive deal wins and strong focus on strengthening hyperscaler partnerships and scaling up cloud business through recent acquisitions. Company has a TTM TCV of US\$1.1bn and ACV of US\$882mn for 9MFY22. This coupled with strong execution capabilities should result in robust growth performance. We model 24% revenue CAGR over FY22-FY24E.

Further scope for margin expansion: There has been steady expansion in margins (from 10.4% EBIT margin in Q1FY21 to 14% in Q3FY22) despite supply-side pressures owing to improving operating metrics and revenue growth leverage. This in conjunction with pyramid rationalisation (increased fresher hiring) increases the scope for further margin expansion in the near term.

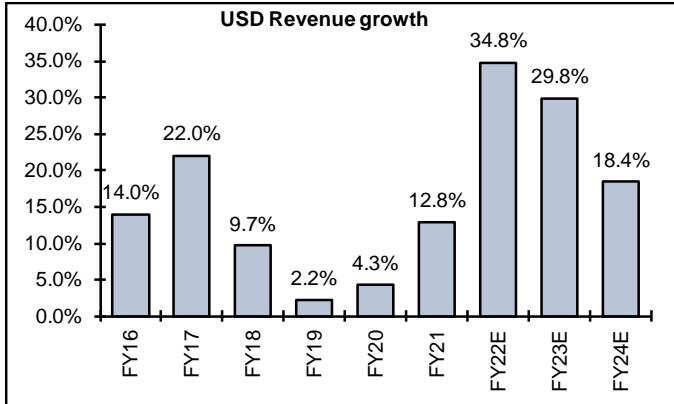
Valuation: Persistent currently trades at 34x FY24E P/E for FY22-FY24E EPS CAGR of 25%, PEG of 1.6x vs the tier-2 Indian IT sector trading at 28x FY24E for FY22-FY24E EPS CAGR of 21% and PEG ratio of 1.3x. We are really impressed with the company focusing on growth priority and it is poised to be fastest growth IT company under our coverage in FY23E/FY24E. However, valuations of ~42x (1-year forward P/E) already bakes-in such performance. We value the stock at 33x FY24E EPS arriving at a target price of Rs.4,515 with **HOLD** rating.

Key Risks: 1) Weak revenue growth, 2) Contraction of margins, 3) INR appreciation

Market Cap	Rs360bn/US\$4.8bn
Reuters/Bloomberg	PERS.BO/PSYS IN
Shares Outstanding (mn)	76.4
52-week Range (Rs)	4916/1874
Free Float (%)	68.7
FII (%)	20.4
Daily Volume (US\$'000)	19,534
Absolute Return 3m (%)	4.2
Absolute Return 12m (%)	135.7
Sensex Return 3m (%)	(0.3)
Sensex Return 12m (%)	20.7

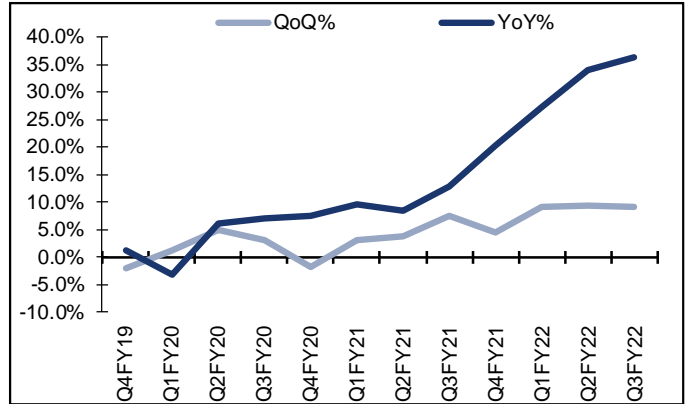
Year to March	2021	2022E	2023E	2024E
Revenue (Rs mn)	41,879	56,900	75,284	90,337
Net Income (Rs mn)	4,507	6,706	8,618	10,460
EPS (Rs)	58.9	87.7	112.7	136.8
% Chg YoY	32.4	48.8	28.5	21.4
P/E (x)	68.9	46.3	36.0	29.7
CEPS (Rs)	81.9	108.8	141.0	170.7
EV/E (x)	44.2	32.2	23.4	18.6
Dividend Yield	0.5	0.6	0.6	0.6
RoCE (%)	14.1	17.7	19.7	20.5
RoE (%)	17.4	21.4	22.7	23.0

Chart 1: Revenue growth to remain strong



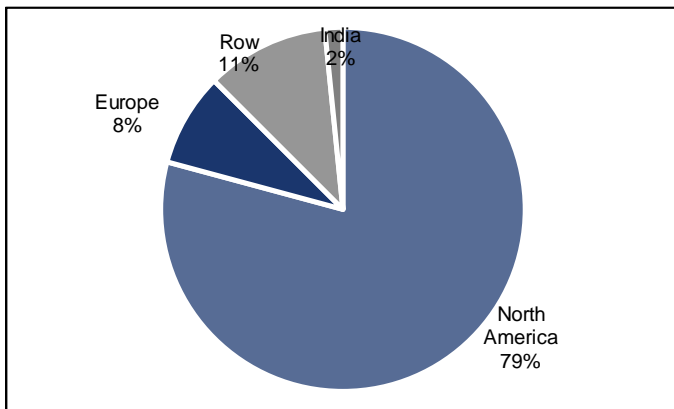
Source: Company, I-Sec research

Chart 2: Steady QoQ growth



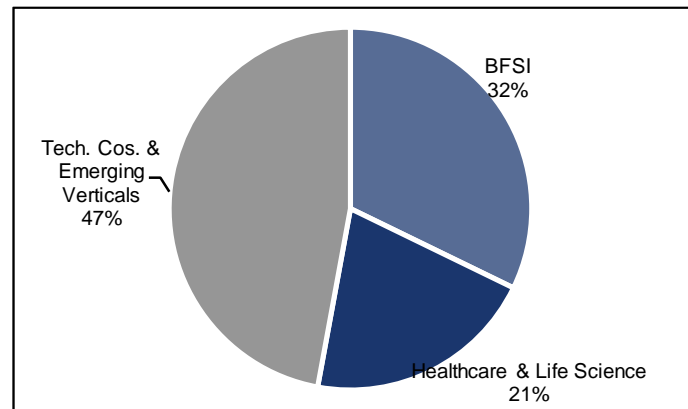
Source: Company, I-Sec research

Chart 3: Geographical mix (%)



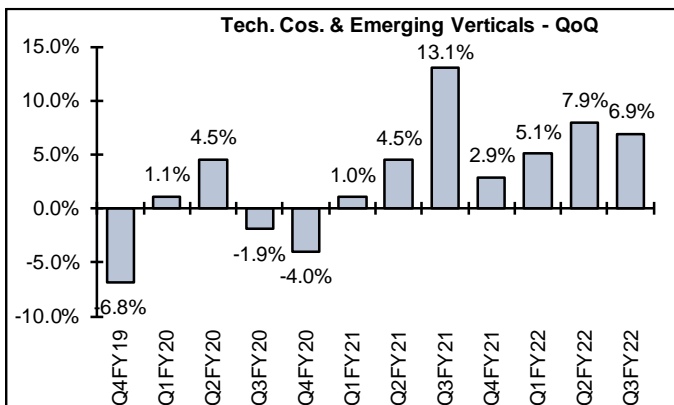
Source: Company, I-Sec research

Chart 4: Vertical mix (%)



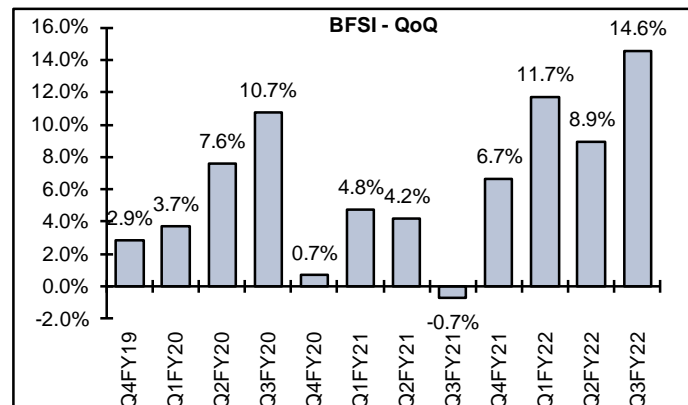
Source: Company, I-Sec research

Chart 5: Largely steady growth



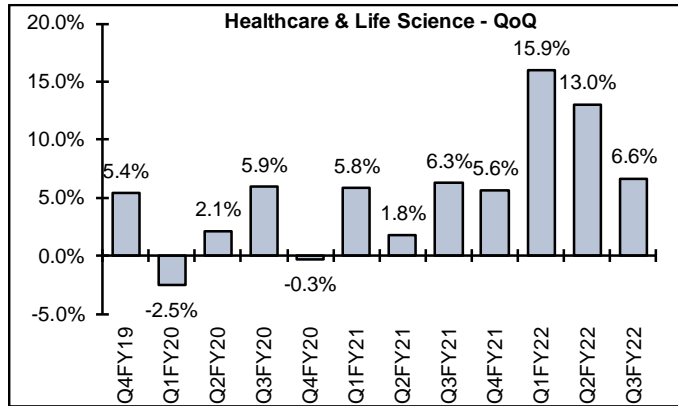
Source: Company, I-Sec research

Chart 6: BFSI growth expected to stabilise



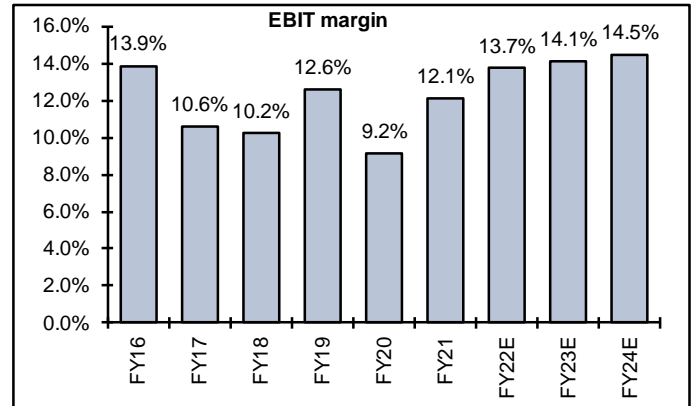
Source: Company, I-Sec research

Chart 7: Growth within the vertical to pick up



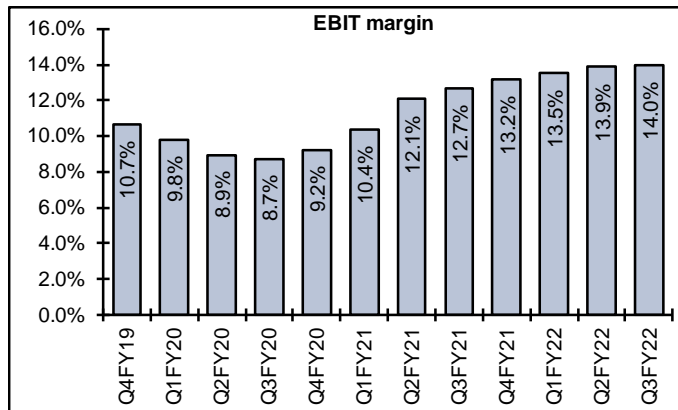
Source: Company, I-Sec research

Chart 8: Improving margin trajectory



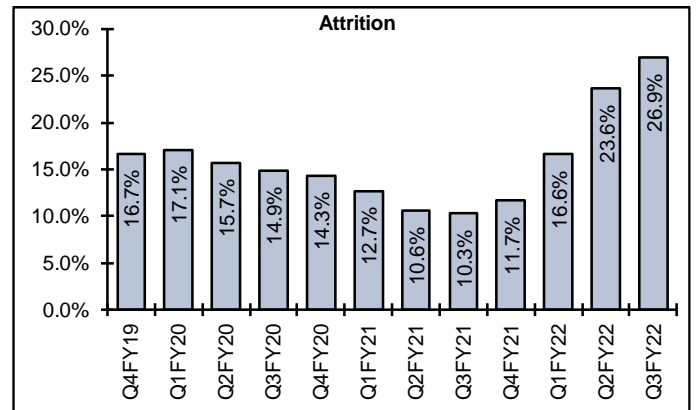
Source: Company, I-Sec research

Chart 9: Margins remained resilient



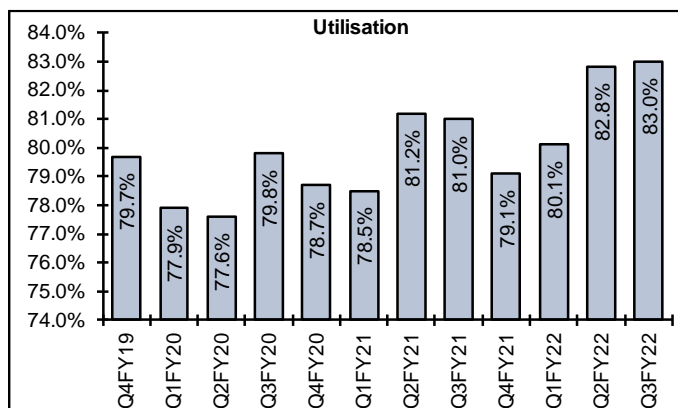
Source: Company, I-Sec research

Chart 10: Attrition higher than pre-covid levels



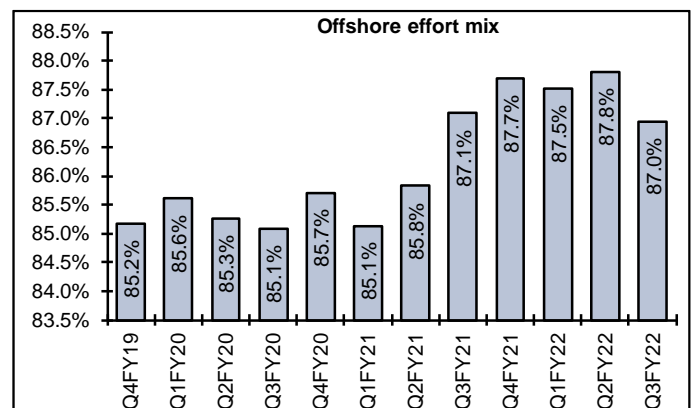
Source: Company, I-Sec research

Chart 11: Utilisation expected to stabilise



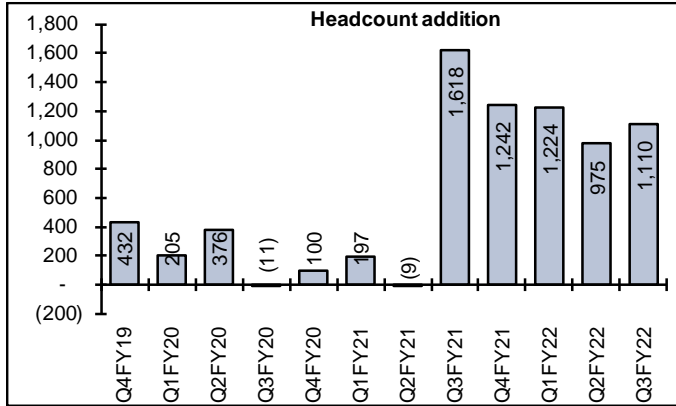
Source: Company, I-Sec research

Chart 12: Offshore mix to normalise ahead



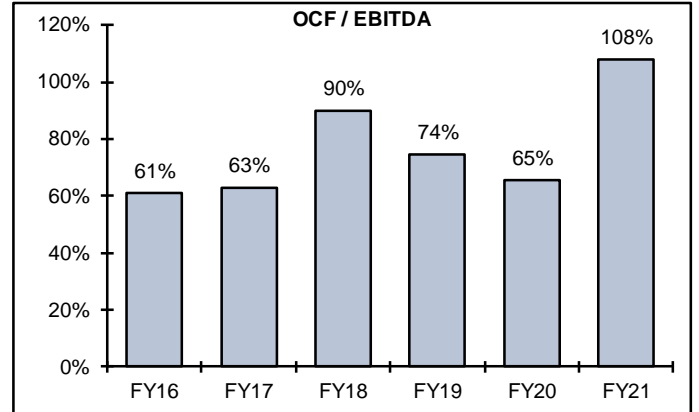
Source: Company, I-Sec research

Chart 13: Aggressive hiring to fulfil demand



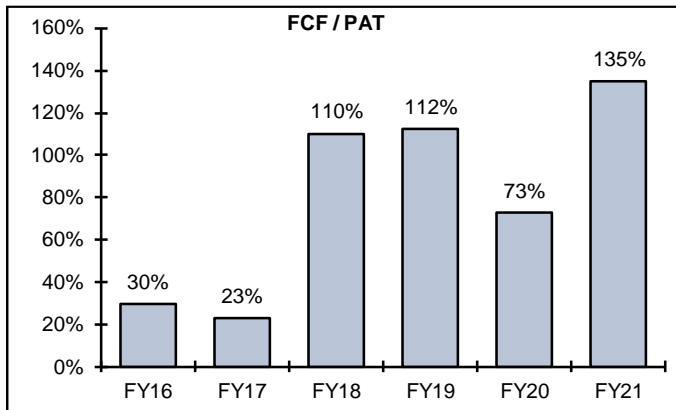
Source: Company, I-Sec research

Chart 14: Robust cash conversions



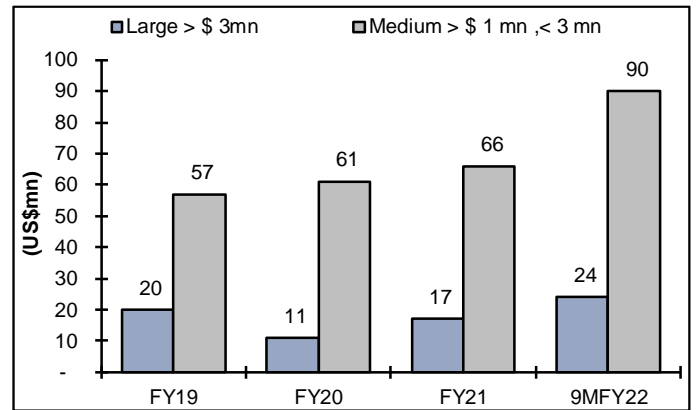
Source: Company, I-Sec research

Chart 15: Robust cash conversions



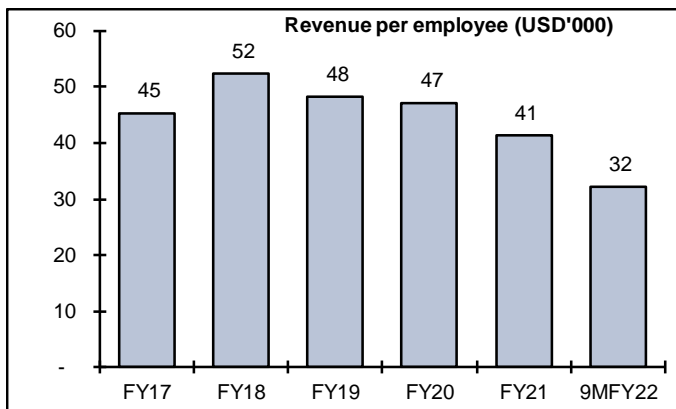
Source: Company, I-Sec research

Chart 16: Increasing client base



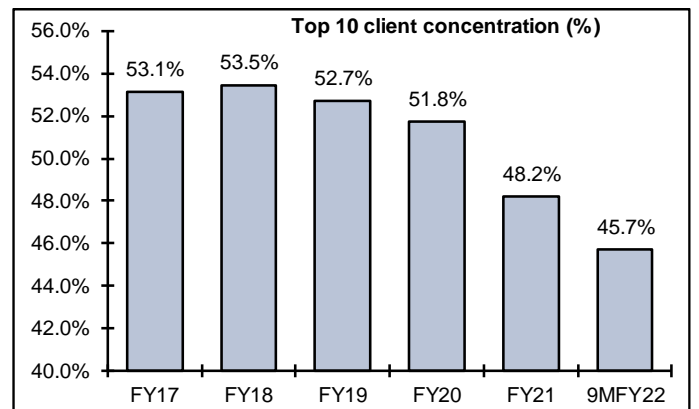
Source: Company, I-Sec research

Chart 17: Decline due to increased hiring



Source: Company, I-Sec research

Chart 18: Steady decline in client concentration



Source: Company, I-Sec research

Financial summary – Persistent Systems

Table 1: Profit and Loss statement

(Rs mn, year ending March 31)

	FY21	FY22E	FY23E	FY24E
Revenues (US\$ mn)	566	763	991	1,173
Operating Revenues (Sales)	41,879	56,900	75,284	90,337
Operating Expenses	35,049	47,467	62,493	74,647
EBITDA	6,830	9,433	12,791	15,690
% margins	16.3	16.6	17.0	17.4
Depreciation & Amortisation	1,756	1,613	2,159	2,591
EBIT	5,075	7,820	10,631	13,099
% margins	12.1	13.7	14.1	14.5
Other Income	1,020	1,180	920	920
Recurring PBT	6,094	9,000	11,551	14,018
Add: Extraordinaries exps / (Inc)	0	0	0	0
Less: Taxes	1,588	2,294	2,932	3,559
Net Income (Reported)	4,507	6,706	8,618	10,460
Revenues (US\$ mn)	4,507	6,706	8,618	10,460

Source: Company data, I-Sec research

Table 2: Balance sheet

(Rs mn, year ending March 31)

	FY21	FY22E	FY23E	FY24E
Assets				
Total Current Assets	26,703	28,933	36,286	45,351
Total Current Liabilities & Provisions	7,697	11,175	12,096	12,889
Net Current Assets	19,006	17,759	24,190	32,461
Non-current Investments	3,621	3,607	3,607	3,607
Net Fixed Assets	4,569	9,293	9,493	9,693
Capital Work-in-Progress	122	12	12	12
Other Non-Current Assets	1,640	6,215	6,215	6,215
Total Assets	28,958	36,885	43,516	51,988
Liabilities				
Borrowings	44	1,176	1,176	1,176
Other long term liabilities	957	1,110	1,110	1,110
Equity Share Capital	764	764	764	764
Reserves & Surplus	27,192	33,836	40,466	48,938
Net Worth	27,957	34,600	41,230	49,702
Total Liabilities	28,958	36,885	43,516	51,988

Source: Company data, I-Sec Research

Table 3: Cashflow statement

(Rs mn, year ending March 31)

	FY21	FY22E	FY23E	FY24E
Operating Cashflow before W Cap changes	5,282	7,318	9,978	12,251
Working Capital Inflow / (Outflow)	2,077	622	(1,951)	(1,678)
Capex	(1,281)	(6,226)	(2,359)	(2,791)
Free Cashflow	6,078	1,714	5,668	7,781
Cashflow from other Invst Act (Ex Capex)	(4,136)	(3,560)	800	800
Change in equity	-	1,924	-	-
Change in debt	(324)	1,274	-	-
Dividends paid	(1,070)	(1,988)	(1,988)	(1,988)
Others	(49)	11	-	-
Increase/(Decrease) in Cash	500	(625)	4,480	6,594

Source: Company data, I-Sec research

Table 4: Key ratios

(Year ending March 31)

	FY21	FY22E	FY23E	FY24E
Per Share Data (Rs)				
Reported EPS	58.9	87.7	112.7	136.8
Cash EPS	81.9	108.8	141.0	170.7
Dividend per share (DPS)	20.0	26.0	26.0	26.0
Book Value per share (BV)	365.7	452.6	539.3	650.1
Growth Ratios (%)				
Operating Income (Sales) - US\$	12.8	34.8	29.8	18.4
Operating Income (Sales)	17.4	35.9	32.3	20.0
EBITDA	38.6	38.1	35.6	22.7
Recurring Net Income	32.4	48.8	28.5	21.4
Reported EPS	32.4	48.8	28.5	21.4
Cash EPS	23.7	32.8	29.6	21.1
Valuation Ratios (x)				
P/E	68.9	46.3	36.0	29.7
P/CEPS	49.6	37.3	28.8	23.8
P/BV	11.1	9.0	7.5	6.2
EV / EBITDA	44.2	32.2	23.4	18.6
EV / Sales	7.2	5.3	4.0	3.2
Operating Ratios				
Other Income / PBT (%)	16.7	13.1	8.0	6.6
Effective Tax Rate (%)	26.1	25.5	25.4	25.4
Receivables (days) on average	55	57	60	58
Return/Profitability Ratios (%)				
Net Income Margins	10.8	11.8	11.4	11.6
RoCE (Based on Avg)	14.1	17.7	19.7	20.5
RoNW (Based on Avg)	17.4	21.4	22.7	23.0
Dividend Payout Ratio	33.9	29.6	23.1	19.0
Dividend Yield	0.5	0.6	0.6	0.6
EBITDA Margins	16.3	16.6	17.0	17.4

Source: Company data, I-Sec research

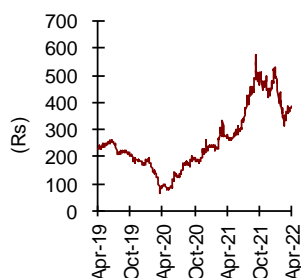
Zensar Technologies

(HOLD; CMP: Rs385, TP: Rs400)

Shareholding pattern

	Sep '21	Dec '21	Mar '21
Promoters	49.1	49.1	49.1
Institutional investors	36.7	31.9	29.9
MFs and others	9.4	13.6	12.9
FIs/Bank	0.0	0.0	0.0
Insurance Cos.	0.0	0.0	0.0
FII	27.3	18.3	17.0
Others	14.2	19.0	21.0

Price chart



Aspiration to achieve predictable and sustainable growth may take longer

Zensar's revenue growth momentum came back in Q1FY22 after seven quarters of muted growth, suggesting the new management's (CEO Mr. Ajay Bhutoria joined in Jan'21) refreshed strategy is headed in the right direction. Deal win momentum is healthy with TCV of US\$409mn in 9MFY22, although it was lower by 22% YoY.

Share of digital revenue continues to increase and now accounts for 71.5% of revenue, (+40 bps QoQ, +650 bps YoY in Q3FY22). Ramp-up in headcount and aggressive fresher hiring have led to headcount increase of 35% YoY. However, attrition has become an acute challenge for the company and is likely to limit growth and margin expansion in the near term.

Triggers & catalysts for the stock

Aspiration to achieve predictable and sustainable growth may take longer: Post strategy refresh by new CEO, growth was steady in 9MFY22, but in Q4FY22 the company is likely to face order fulfillment challenges due to severe talent crunch. Growth momentum is back in banking, retail and emerging verticals, but manufacturing and hitech revenues are still below pre-covid levels.

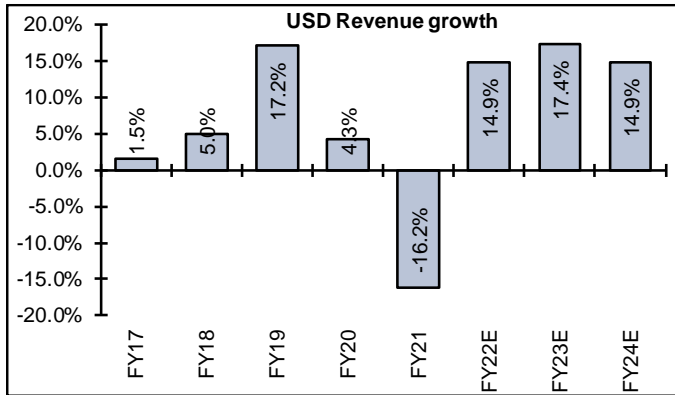
Sharp decline in margins in FY22; margins to remain muted in FY23E: Zensar's EBIT margin declined by ~600bps YoY over past four quarters led by very high supply-side cost pressures (higher than normal increments, etc.) due to high attrition levels (26.7% in Q3FY22) and investments in building sales team and tech leadership. Margins are expected to remain under pressure in FY23E given higher than industry average attrition, gradual return of travel and facility costs, and investments for growth.

Valuation: Zensar currently trades at 15x FY24E P/E for FY22-FY24 EPS CAGR of 23%, PEG of 0.6x vs the tier-2 Indian IT sector trading at 28x FY24E for FY22-FY24E EPS CAGR of 21% and PEG ratio of 1.3x. We await further conviction on the turnaround of the company before turning constructive on the stock. We assign a **HOLD** rating with target price of Rs400, i.e. 16x FY24E EPS.

Key Risks: 1) Weak revenue growth, 2) Contraction of margins, 3) INR appreciation

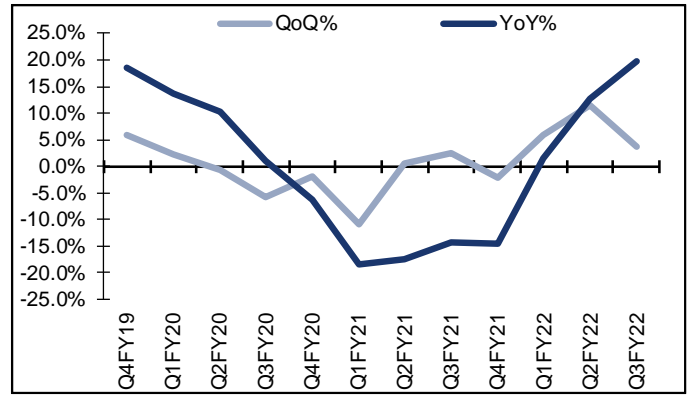
Market Cap	Rs87bn/US\$1.1bn	Year to March	2021	2022E	2023E	2024E
Reuters/Bloomberg	ZENT.BO/ZENT IN	Revenue (Rs mn)	36,681	42,308	50,644	58,981
Shares Outstanding (mn)	226.2	Net Income (Rs mn)	3,497	3,703	4,403	5,616
52-week Range (Rs)	579/263	EPS (Rs)	15.6	16.5	19.6	25.0
Free Float (%)	50.9	% Chg YoY	30.5	5.9	18.9	27.6
FII (%)	17.0	P/E (x)	24.7	23.4	19.6	15.4
Daily Volume (US\$'000)	11,031	CEPS (Rs)	23.3	24.8	28.8	35.5
Absolute Return 3m (%)	(22.6)	EV/E (x)	11.1	11.3	8.9	6.8
Absolute Return 12m (%)	41.6	Dividend Yield	0.9	1.2	1.1	1.3
Sensex Return 3m (%)	(0.3)	RoCE (%)	14.4	12.3	14.1	15.9
Sensex Return 12m (%)	20.7	RoE (%)	15.8	15.0	15.8	17.7

Chart 1: Expect robust growth over FY22-FY24E



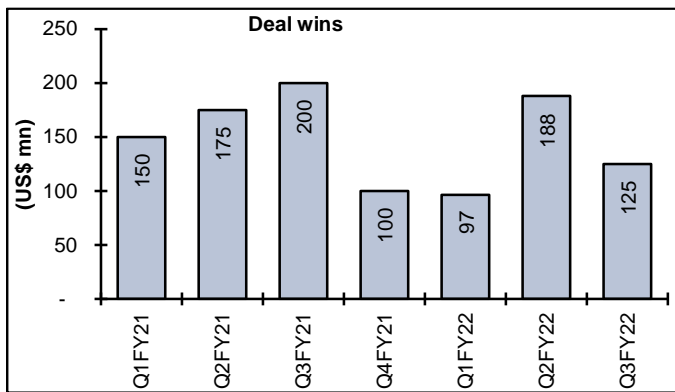
Source: Company, I-Sec research

Chart 2: growth picked up from Q1FY22...



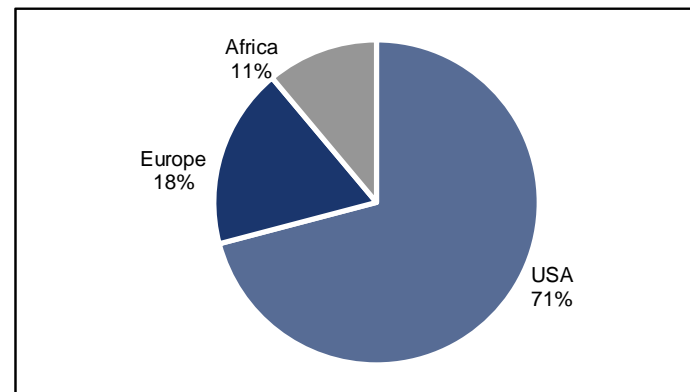
Source: Company, I-Sec research

Chart 3: Healthy deal wins over the period



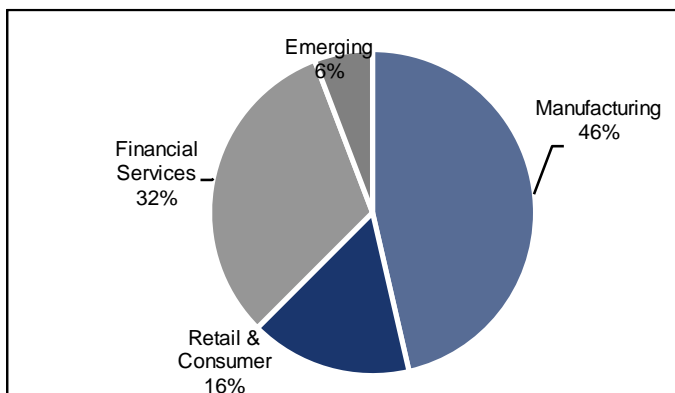
Source: Company, I-Sec research

Chart 4: Geographical mix (%)



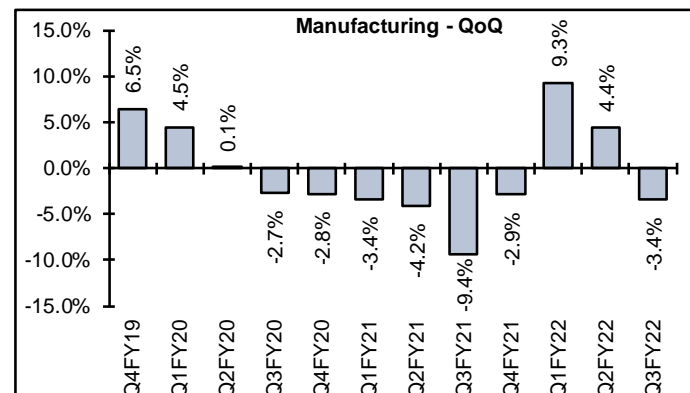
Source: Company, I-Sec research

Chart 5: Vertical mix (%)



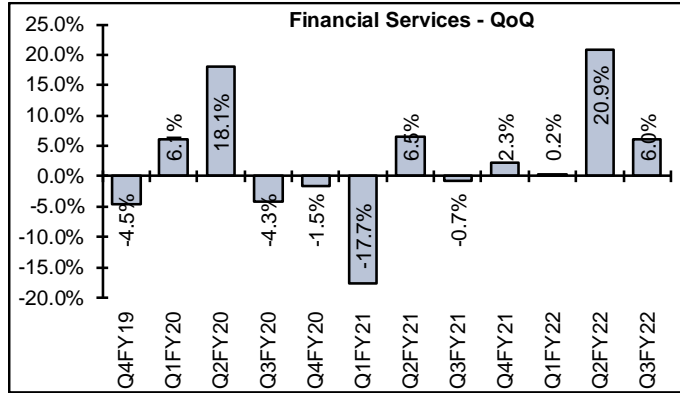
Source: Company, I-Sec research

Chart 6: Manufacturing expected to pick up



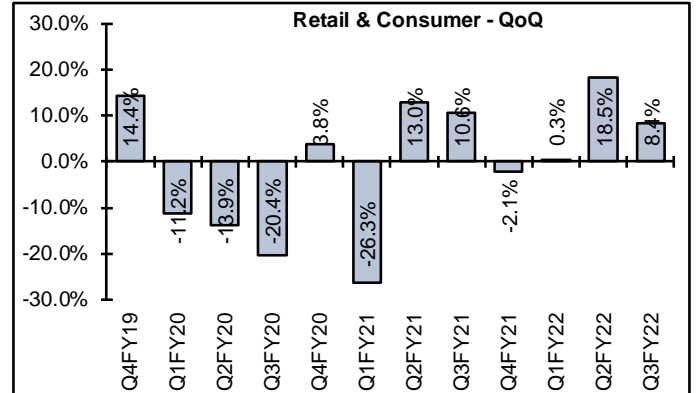
Source: Company, I-Sec research

Chart 7: Financial services to stabilise ahead



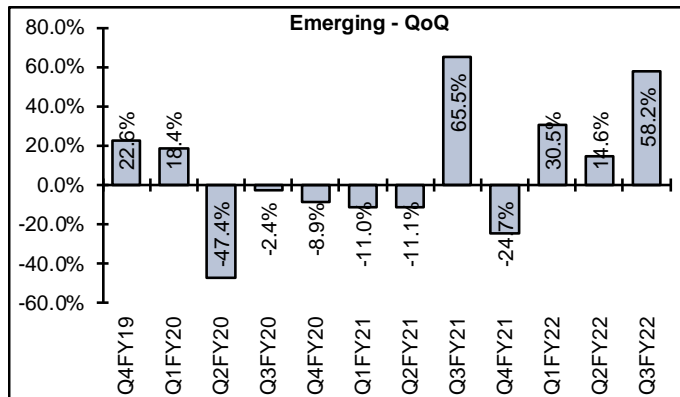
Source: Company, I-Sec research

Chart 8: Retail spends expected to pick up



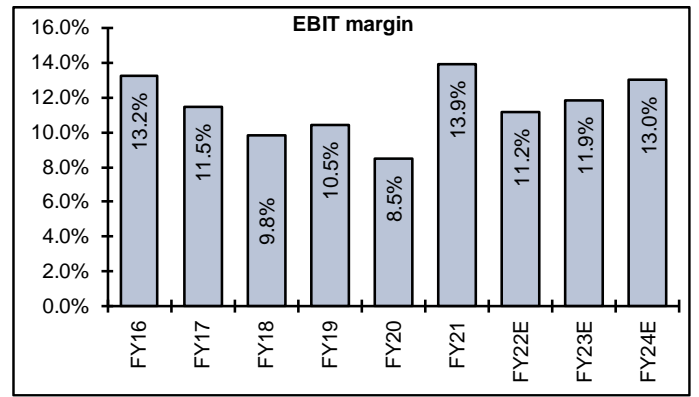
Source: Company, I-Sec research

Chart 9: Growth to stabilise in emerging



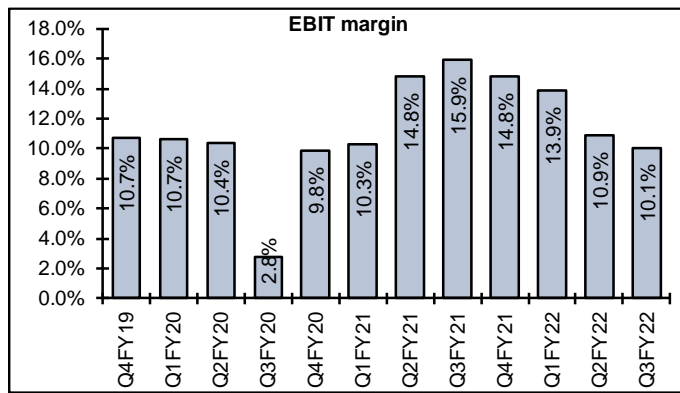
Source: Company, I-Sec research

Chart 10: Margins to expand slightly



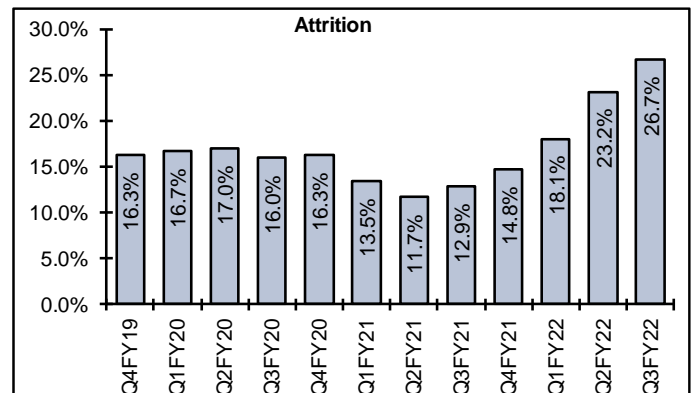
Source: Company, I-Sec research

Chart 11: Supply pressures led to contraction



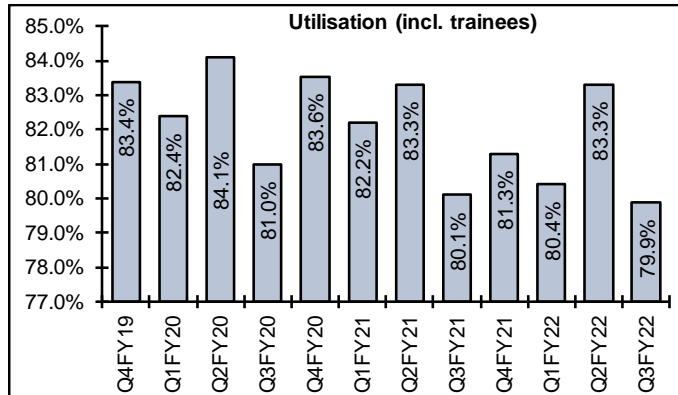
Source: Company, I-Sec research

Chart 12: Attrition higher than pre-covid levels



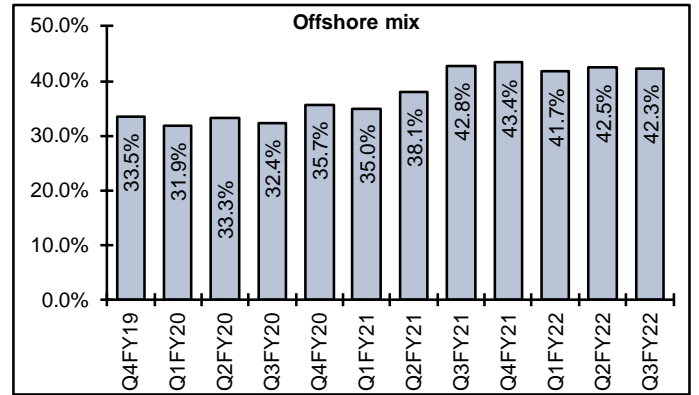
Source: Company, I-Sec research

Chart 13: Utilisation rates normalising



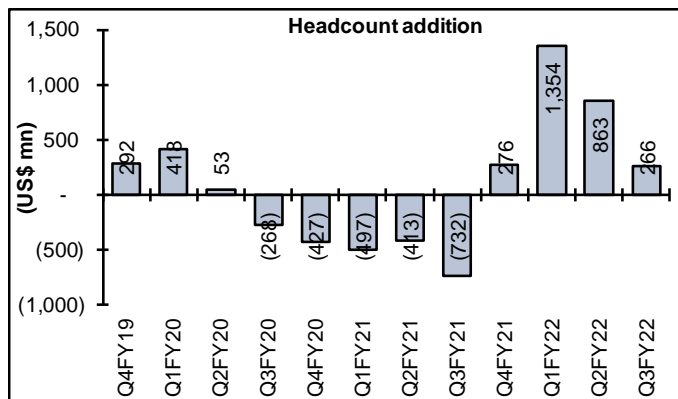
Source: Company, I-Sec research

Chart 14: Offshore mix is largely stable



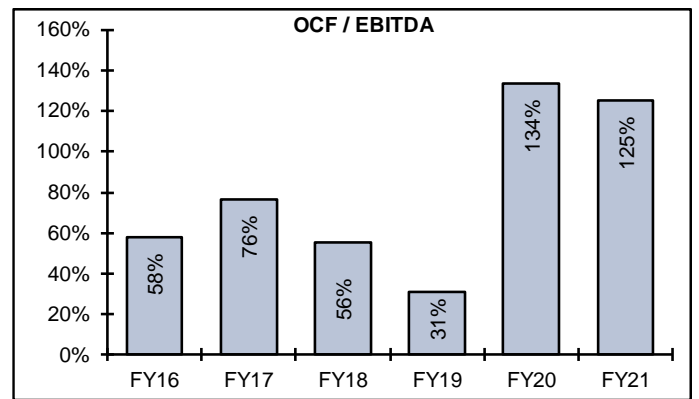
Source: Company, I-Sec research

Chart 15: Increased hiring to fulfil demand



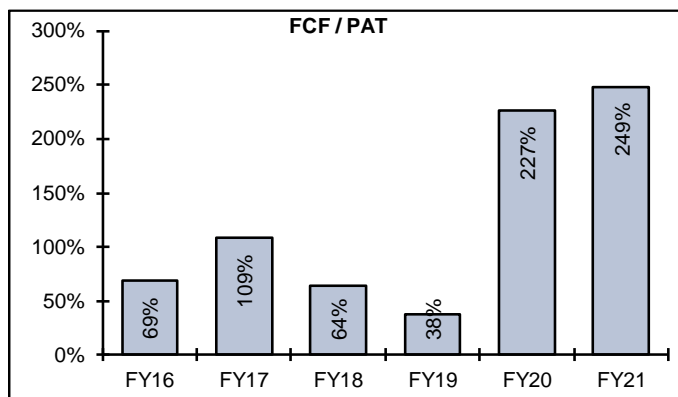
Source: Company, I-Sec research

Chart 16: Healthy cash conversions



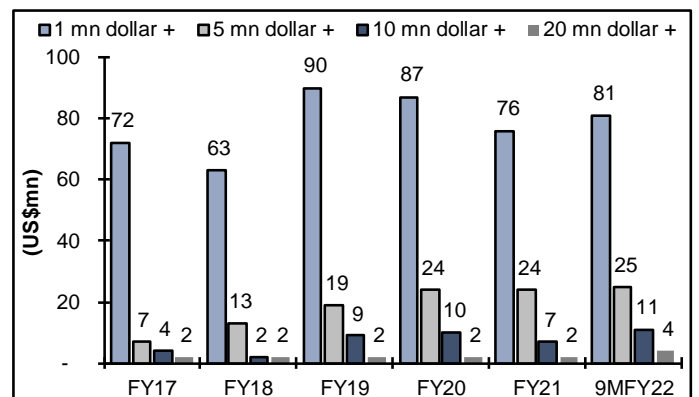
Source: Company, I-Sec research

Chart 17: Healthy cash conversions



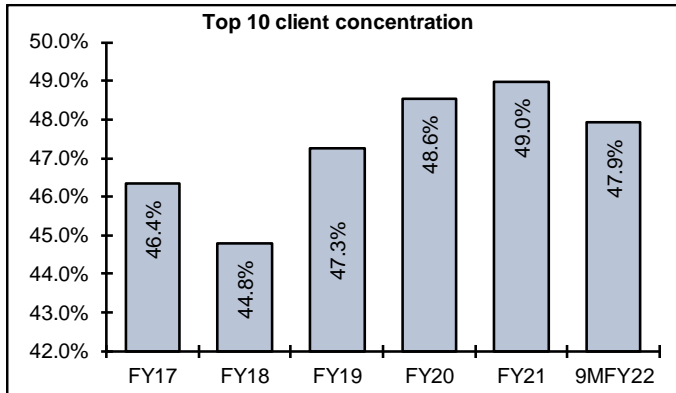
Source: Company, I-Sec research

Chart 18: Client mining



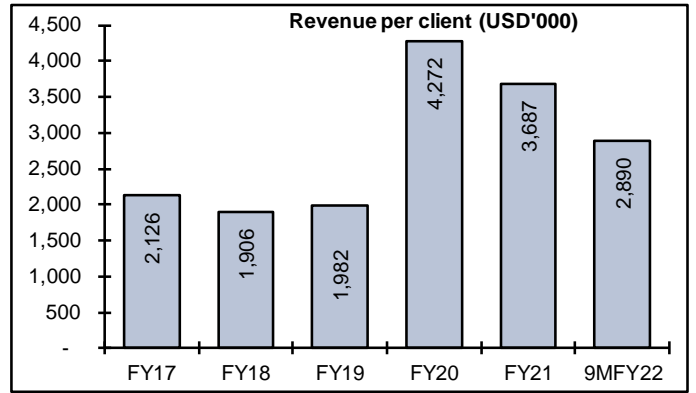
Source: Company, I-Sec research

Chart 19: Client concentration now declining



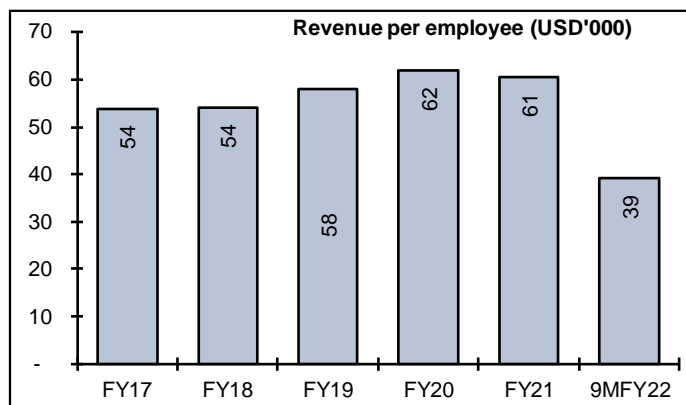
Source: Company, I-Sec research

Chart 20: Decline due to expanding client base



Source: Company, I-Sec research

Chart 21: Decline due to increased hiring



Source: Company, I-Sec research

Financial summary – Zensar Technologies

Table 1: Profit and Loss statement

(Rs mn, year ending March 31)

	FY21	FY22E	FY23E	FY24E
Revenue (US\$mn)	494	568	666	766
Total Income (Sales)	36,681	42,308	50,644	58,981
Operating Expenses	29,840	35,709	42,567	48,954
EBITDA	6,841	6,599	8,077	10,027
% margin	18.6	15.6	15.9	17.0
Depreciation & Amortisation	1,732	1,859	2,062	2,359
EBIT	5,109	4,741	6,015	7,667
% margin	13.9	11.2	11.9	13.0
Other Income	229	724	400	400
Interest expense	511	365	370	372
Recurring PBT	4,827	5,100	6,045	7,696
Tax expense	1,260	1,342	1,602	2,039
Recurr. profit before minority	3,567	3,757	4,443	5,656
Minority interest	(70)	(54)	(40)	(40)
Extraordinary items	-	-	-	-
Net Profit as restated	3,497	3,703	4,403	5,616

Source: Company data, I-Sec research

Table 2: Balance sheet

(Rs mn, year ending March 31)

	FY21	FY22E	FY23E	FY24E
Liabilities				
Share capital	451	451	451	451
Reserves and Surpluses	22,972	25,664	29,123	33,594
Net Worth	23,423	26,115	29,575	34,045
Minority Interest	287	341	381	421
Non-current Liabilities	3,239	3,239	3,239	3,239
Total Liabilities	26,949	29,695	33,195	37,705
Borrowings	-	-	-	-
Assets				
Fixed Assets	11,330	11,334	11,338	11,342
Other Non-current assets	3,076	3,076	3,076	3,076
Current assets	19,928	23,621	27,831	33,061
less: current liabilities	7,384	8,336	9,050	9,774
Net current assets	12,543	15,285	18,781	23,287
Total Assets	26,949	29,695	33,195	37,705

Source: Company data, I-Sec Research

Table 3: Cashflow statement

(Rs mn, year ending March 31)

	FY21	FY22E	FY23E	FY24E
Op. CF before W Cap changes	6,237	6,767	8,037	9,987
Working Capital Inflow / (Outflow)	3,744	(1,282)	(963)	(975)
Taxes	(1,400)	(1,342)	(1,602)	(2,039)
Capex	110	(1,863)	(2,066)	(2,363)
Free Cashflow	8,690	2,280	3,407	4,609
CF from other Invest Act (Ex Capex)	(5,393)	502	400	400
Change in share capital	15	54	40	40
Inc/(Dec) in Borrowings	(4,376)	-	-	-
Dividend paid	(271)	(1,011)	(944)	(1,146)
Others	(37)	(365)	(370)	(372)
Increase/(Decrease) in Cash	(1,372)	1,460	2,533	3,531

Source: Company data, I-Sec research

Table 4: Key ratios

(Year ending March 31)

	FY21	FY22E	FY23E	FY24E
Per Share Data (Rs)				
Reported EPS	15.6	16.5	19.6	25.0
Recurring Cash EPS	23.3	24.8	28.8	35.5
Book Value per share (BV)	104.2	116.2	131.6	151.5
Dividend per share	3.6	4.5	4.2	5.1
Growth Ratios (%)				
Total Income (Sales) - US\$	(16.2)	14.9	17.4	14.9
Total Income (Sales)	(12.2)	15.3	19.7	16.5
EBITDA	33.4	(3.5)	22.4	24.1
Net Income	30.5	5.9	18.9	27.6
Reported EPS	30.5	5.9	18.9	27.6
Recurring Cash EPS	22.4	6.4	16.2	23.4
Valuation Ratios (x)				
P/E	24.7	23.4	19.6	15.4
P/CEPS	16.5	15.6	13.4	10.8
P/BV	3.7	3.3	2.9	2.5
EV / EBITDA	11.1	11.3	8.9	6.8
EV / Sales	2.1	1.8	1.4	1.2
EV / FCF	8.7	32.7	21.1	14.8
Operating Ratios				
Other Income / PBT (%)	(5.9)	7.0	0.5	0.4
Effective Tax Rate (%)	26.1	26.3	26.5	26.5
NWC / Total Assets (%)	16.2	18.0	18.5	18.5
Receivables (days)	58.6	66.1	64.8	64.0
Payables (days)	31.4	35.5	34.8	34.3
D/E Ratio (x)	-	-	-	-
Return/Profitability Ratios (%)				
Net Income Margins	9.5	8.8	8.7	9.5
EBITDA Margins	18.6	15.6	15.9	17.0
RoNW (based on average)	15.8	15.0	15.8	17.7
Dividend Yield	0.9	1.2	1.1	1.3

Source: Company data, I-Sec research

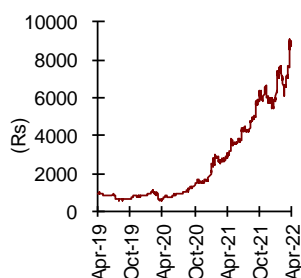
Tata Elxsi

(SELL; CMP: Rs8,685; TP: Rs4,875)

Shareholding pattern

	Jun '21	Sep '21	Dec '21
Promoters	44.5	44.5	44.3
Institutional investors	17.6	17.7	17.5
MFs and others	4.5	3.8	3.6
FIs/Bank	0.5	0.5	0.5
Insurance Cos.	0.3	0.2	1.2
FII	12.3	13.1	12.2
Others	37.9	37.8	38.2

Price chart



Impending margin reversion is a risk to premium valuations

TELX has emerged the fastest-growing company among Indian ER&D peers growing 9% YoY in FY21 and 37% YoY in FY22. It is well positioned to benefit from higher outsourcing of ER&D spends and poised for market shares gains given: 1) its focus on design-led opportunity generation enabling it to garner higher wallet share and better pricing; 2) investments in sales teams, which grew 20% in FY22 vs FY19; and 3) strong capabilities in emerging technologies across verticals (CASE in auto, OTT in media, digital and telehealth in medical, etc.).

TELX has superior operating metrics compared to peers: 1) lowest cost of delivery; 2) highest offshore mix; 3) reducing client concentration and, at the same time, superior client mining capabilities. Rising share of fixed-price projects has aided margin expansion, which is impressive as it showcases TELX's project cost management capabilities and ability to deliver value to customers.

Triggers & catalysts for the stock

Revenue growth leadership in ER&D space to continue: We expect revenue growth leadership of Tata Elxsi to continue over FY23E-FY24E driven by: 1) higher offshore R&D spends on digital, 2) strong client mining capabilities (top 1 / top 2-4 clients grew 48%/43% YoY in 9MFY22), 3) focus on winning longer-duration larger sized deals by becoming strategic partners for clients (e.g. Aesculap and Schaeffler deal wins), and 4) expansion in fast-growing healthcare sector and diversification in auto to de-risk growth. It targets to achieve 20% of its revenue from healthcare sector and 20% of auto revenue from non-auto segments over the medium term.

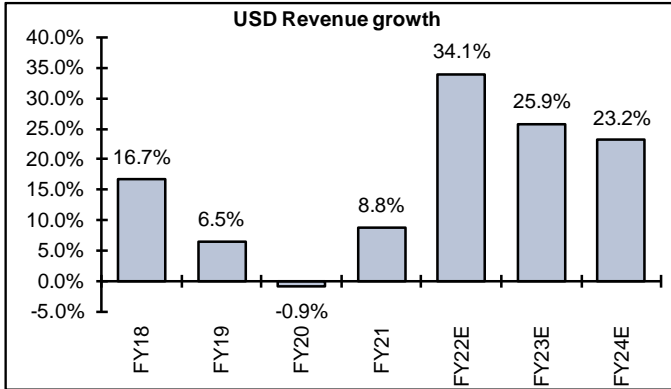
Margins have peaked out and expected to revert: EBIT margins increased sharply to ~30% vs pre-covid levels of 25-26%. Margins are not likely to expand further given the supply-side challenges due to high attrition, reversal of elevated offshore mix (75% in Q3FY22 vs 55-57% pre-covid), peaked-out utilisation and return of travel and facility costs post normalisation of global economy. However, we expect margins to stabilise above pre-covid levels due to greater acceptability of clients towards offshoring and supported by levers of revenue growth leverage and pyramid optimisation. We build-in EBIT margins of 25.7%/25.5% for FY23E/FY24E.

Valuation: We like the company for its robust growth profile and maintenance of margin above pre-covid levels. However, we believe the run-up in the stock price bakes-in the company's performance and that it is currently overvalued. TELX currently trades at 68x FY24E P/E for FY22-FY24E EPS CAGR of 21%. We value it at 38x FY24E EPS arriving at a target price of Rs4,875. **SELL.**

Key Risks: 1) Strong large deal win momentum, 2) Margin expansion, 3) INR Depreciation, 4) Continuation of discretionary spends

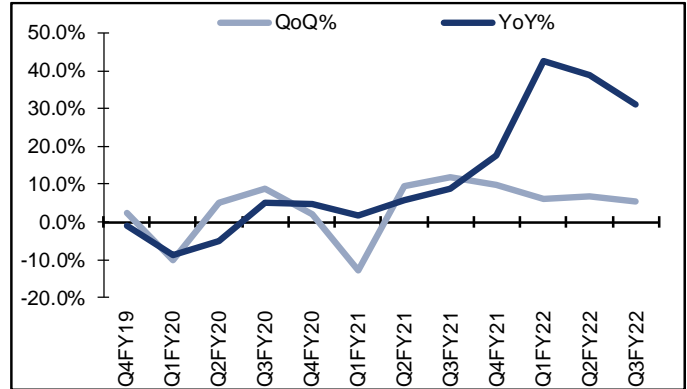
Market Cap	Rs540bn/US\$7.1bn	Year to March	2021	2022E	2023E	2024E
Reuters/Bloomberg	TTEX.BO/TELX IN	Revenue (Rs mn)	18,262	24,671	31,652	39,505
Shares Outstanding (mn)	62.2	Net Income (Rs mn)	3,681	5,493	6,439	7,989
52-week Range (Rs)	9036/2827	EPS (Rs)	59.1	88.2	103.4	128.3
Free Float (%)	55.7	% Chg YoY	43.7	49.2	17.2	24.1
FII (%)	12.2	P/E (x)	146.9	98.5	84.0	67.7
Daily Volume (US\$'000)	41,064	CEPS (Rs)	66.2	96.4	113.6	141.0
Absolute Return 3m (%)	49.8	EV/E (x)	101.9	69.6	59.9	48.0
Absolute Return 12m (%)	196.7	Dividend Yield	0.6	0.3	0.3	0.4
Sensex Return 3m (%)	(0.3)	RoCE (%)	26.2	32.0	29.1	28.8
Sensex Return 12m (%)	20.7	RoE (%)	30.1	35.6	32.8	32.2

Chart 1: Revenue growth to remain strong...



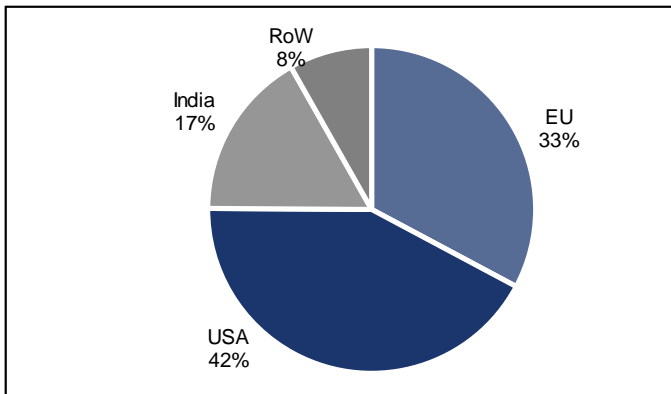
Source: Company, I-Sec research

Chart 2: QoQ growth to normalize



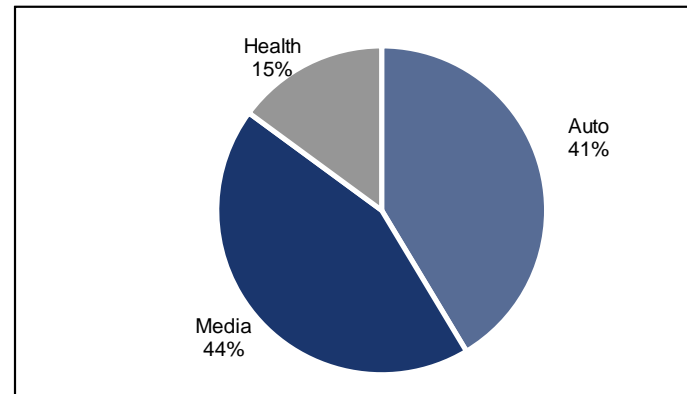
Source: Company, I-Sec research

Chart 3: Geographical mix (%)



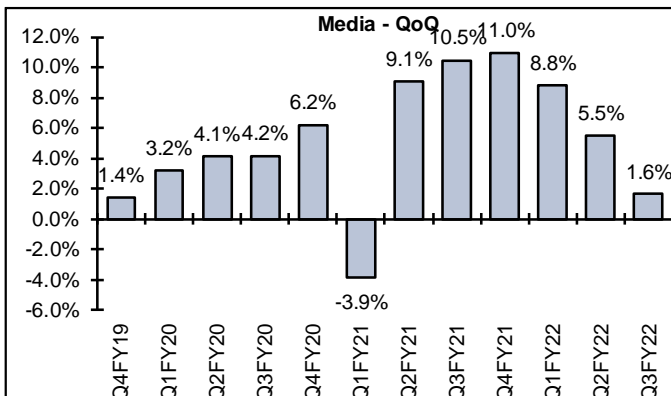
Source: Company, I-Sec research

Chart 4: Vertical mix (%)



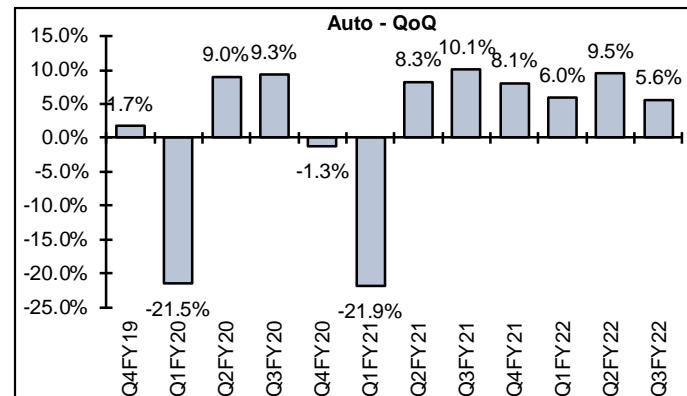
Source: Company, I-Sec research

Chart 5: Growth in media normalising



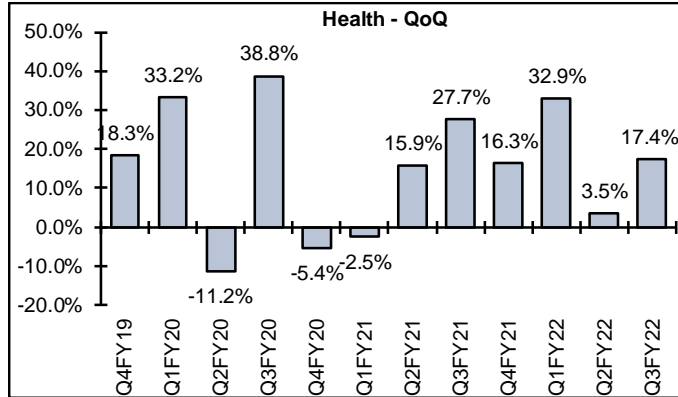
Source: Company, I-Sec research

Chart 6: Steady growth in the auto industry



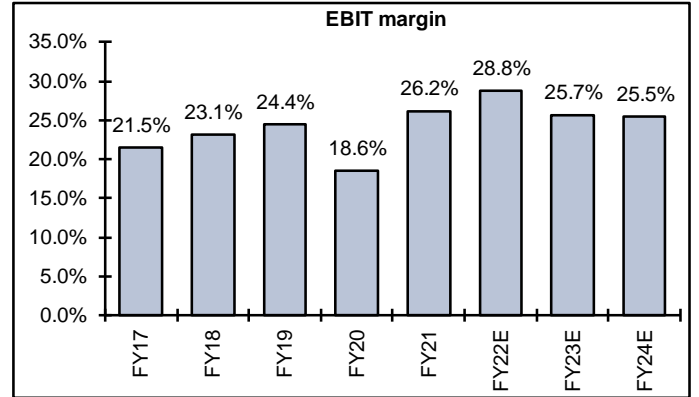
Source: Company, I-Sec research

Chart 7: Health to pick up going forward



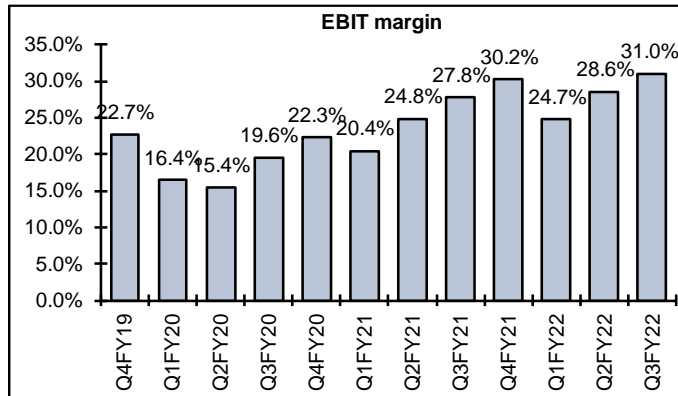
Source: Company, I-Sec research

Chart 8: Margins to contract in FY23E



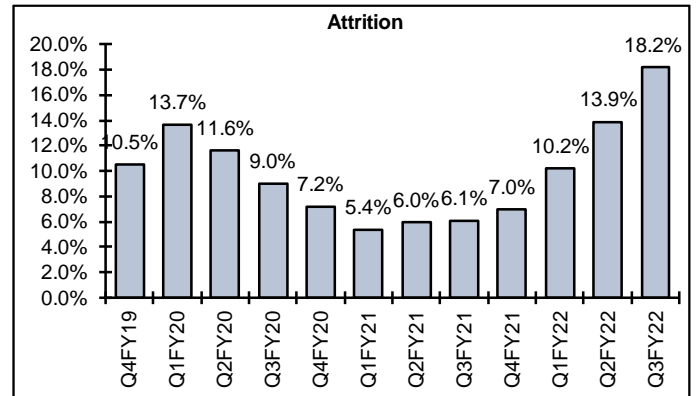
Source: Company, I-Sec research

Chart 9: Improving efficiencies led to expansion



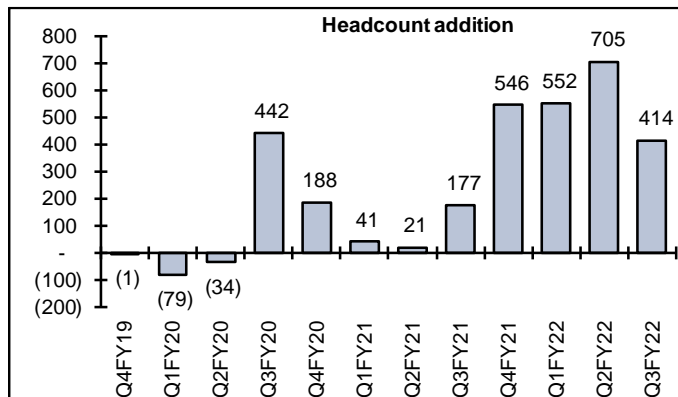
Source: Company, I-Sec research

Chart 10: Attrition much higher than pre-covid



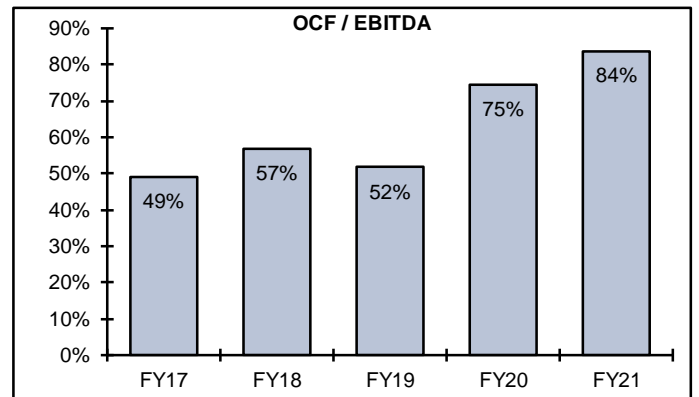
Source: Company, I-Sec research

Chart 11: Aggressive hiring to fulfil demand



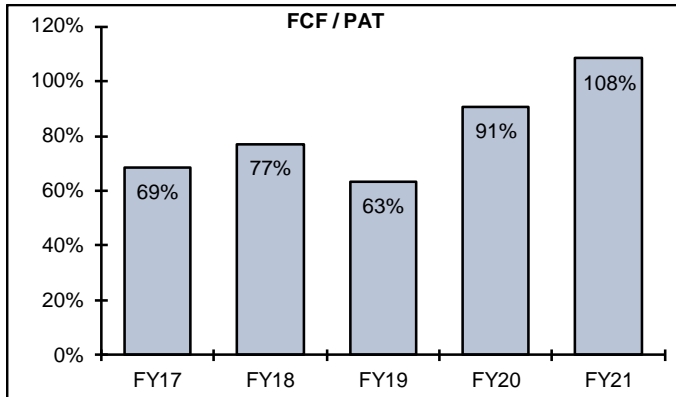
Source: Company, I-Sec research

Chart 12: Robust cash conversions



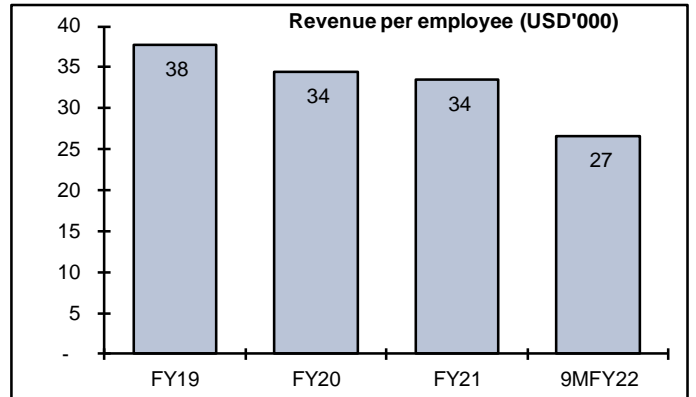
Source: Company, I-Sec research

Chart 13: Robust cash conversions



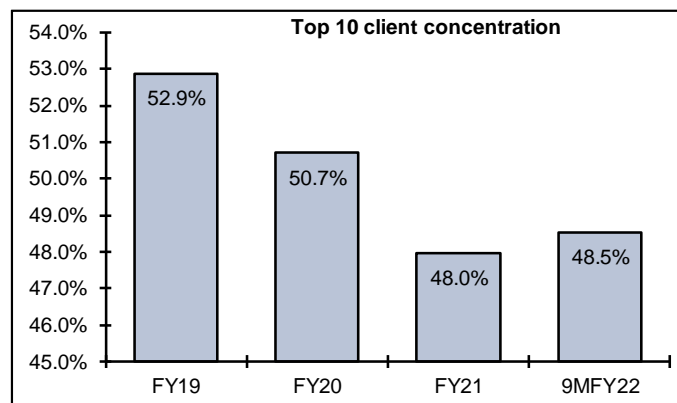
Source: Company, I-Sec research

Chart 14: Decline due to expanding base



Source: Company, I-Sec research

Chart 15: Client concentration largely stable



Source: Company, I-Sec research

Financial summary – Tata Elxsi

Table 1: Profit and Loss statement

(Rs mn, year ending March 31)

	FY21	FY22E	FY23E	FY24E
Revenue (US\$mn)	247	331	416	513
Total Income (Sales)	18,262	24,671	31,652	39,505
Operating Expenses	13,037	17,066	22,875	28,633
EBITDA	5,224	7,605	8,777	10,872
% margin	28.6	30.8	27.7	27.5
Depreciation & Amortisation	444	509	633	790
EBIT	4,780	7,096	8,144	10,082
% margin	26.2	28.8	25.7	25.5
Other Income	398	394	633	790
Interest expense	59	81	76	76
Recurring PBT	5,119	7,409	8,701	10,796
Tax expense	1,437	1,916	2,262	2,807
Recurr. profit before minority	3,681	5,493	6,439	7,989
Minority interest	-	-	-	-
Extraordinary items	-	-	-	-
Net Profit as restated	3,681	5,493	6,439	7,989

Source: Company data, I-Sec research

Table 2: Balance sheet

(Rs mn, year ending March 31)

	FY21	FY22E	FY23E	FY24E
Liabilities				
Share capital	623	623	623	623
Reserves and Surpluses	12,899	16,710	21,280	27,090
Net Worth	13,522	17,333	21,903	27,712
Minority Interest	-	-	-	-
Non-current Liabilities	1,001	1,051	1,101	1,151
Total Liabilities	14,522	18,383	23,003	28,863
Assets				
Fixed Assets	1,769	1,686	1,676	1,666
Other Non-current assets	1,484	1,484	1,484	1,484
Current assets	13,913	18,017	22,892	29,025
less: current liabilities	2,645	2,805	3,049	3,313
Net current assets	11,269	15,213	19,843	25,712
Total Assets	14,522	18,383	23,003	28,863

Source: Company data, I-Sec Research

Table 3: Cashflow statement

(Rs mn, year ending March 31)

	FY21	FY22E	FY23E	FY24E
Op. CF before W Cap changes	5,489	7,605	8,777	10,872
Working Capital Inflow / (Outflow)				
Taxes	(1,237)	(1,916)	(2,262)	(2,807)
Capex	(388)	(427)	(623)	(780)
Free Cashflow	3,986	4,469	4,731	5,892
CF from other Invest Act (Ex Capex)	(3,989)	394	633	790
Change in share capital	-	-	-	-
Inc/(Dec) in Borrowings	(237)	(81)	(76)	(76)
Dividend paid	(1,027)	(1,681)	(1,868)	(2,180)
Others	-	-	-	-
Increase/(Decrease) in Cash	(1,267)	3,100	3,420	4,426

Source: Company data, I-Sec research

Table 4: Key ratios

(Year ending March 31)

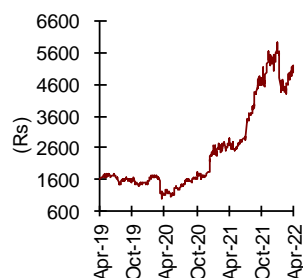
	FY21	FY22E	FY23E	FY24E
Per Share Data (Rs)				
Reported EPS	59.1	88.2	103.4	128.3
Recurring Cash EPS	66.2	96.4	113.6	141.0
Book Value per share (BV)	217.1	278.3	351.7	445.0
Dividend per share	48.0	27.0	30.0	35.0
Growth Ratios (%)				
Total Income (Sales) - US\$	8.8	34.1	25.9	23.2
Total Income (Sales)	13.4	35.1	28.3	24.8
EBITDA	52.3	45.6	15.4	23.9
Net Income	43.7	49.2	17.2	24.1
Reported EPS	43.7	49.2	17.2	24.1
Recurring Cash EPS	37.7	45.5	17.8	24.1
Valuation Ratios (x)				
P/E	146.9	98.5	84.0	67.7
P/CEPS	131.1	90.1	76.5	61.6
P/BV	40.0	31.2	24.7	19.5
EV / EBITDA	101.9	69.6	59.9	48.0
EV / Sales	29.1	21.4	16.6	13.2
EV / FCF	133.5	118.4	111.1	88.5
Operating Ratios				
Other Income / PBT (%)	6.6	4.2	6.4	6.6
Effective Tax Rate (%)	28.1	25.9	26.0	26.0
NWC / Total Assets (%)	15.6	16.6	18.1	19.2
Receivables (days)	80.4	74.4	74.7	75.7
Payables (days)	11.2	10.4	10.7	10.8
D/E Ratio (x)	-	-	-	-
Return/Profitability Ratios (%)				
Net Income Margins	20.2	22.3	20.3	20.2
EBITDA Margins	28.6	30.8	27.7	27.5
RoNW (based on average)	30.1	35.6	32.8	32.2
Dividend Yield	0.6	0.3	0.3	0.4

Source: Company data, I-Sec research

L&T Technology Services

(REDUCE; CMP: Rs4,993; TP: Rs4,413)**Shareholding pattern**

	Jun '21	Sep '21	Dec '21
Promoters	74.2	74.2	73.9
Institutional investors	15.6	15.6	14.7
MFs and others	6.0	5.5	4.8
FIs/Bank	0.2	0.2	0.2
Insurance Cos.	0.0	0.0	0.0
FII	9.4	9.9	9.7
Others	10.2	10.2	11.4

Price chart**Building blocks in place for multi-year strong growth**

LTTS, the biggest pure play ER&D company in India (in terms of revenues), garners largest share of ER&D spends for four out of its top-5 clients and ranks among top-2 vendors for several of its top-30 clients given its deep domain and digital engineering expertise across all five verticals and strong focus on client mining. Diversified presence across all verticals enables it to capture upside in all verticals and protects itself from downcycle in any single vertical.

LTTS's digital revenue share has increased consistently (56% in Q322 vs 52% in 4Q21). We believe the strategy is in place for strong multi-year growth and management's target of US\$1.5bn annualised revenue run-rate by Q4FY25 is achievable given focus on six strategic high-growth areas, client mining and large deal wins. We model revenue CAGR of 19% over FY22-FY24E

Triggers & catalysts for the stock

Strong client mining programmes and focus on large deals: LTTS is winning larger wallet share and larger deal sizes through focus on client mining. It has set-up a large deal team to proactively identify problems and offer solutions that can be scaled across clients. In Q3FY22 it had huge success in client mining with a US\$45mn large deal in EACV space. This was its third deal from same client in past three quarters adding to total TCv of US\$90mn from the client in 9MFY22.

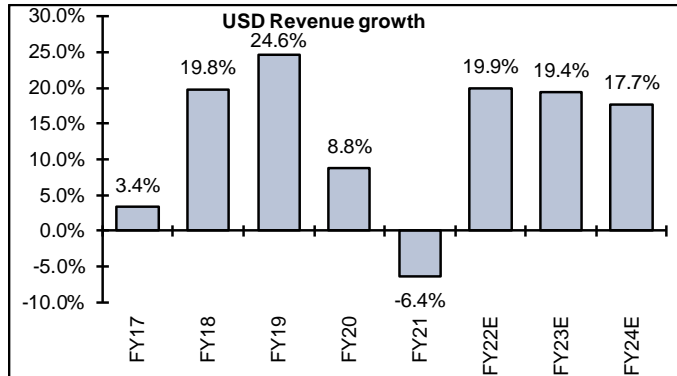
EBIT margins to sustain above 18%: Consistent improvement in EBIT margin for six consecutive quarters led to highest-ever margin of 18.6% in Q3FY22. Company targets to maintain EBIT margin above 18%. We expect margins to remain range-bound in the near term (>18%) given supply-side pressures and reinvestment back in the business for growth.

Valuation: LTTS currently trades at 39x FY24E P/E for FY22-FY24E EPS CAGR of 20%, PEG of 2.1x vs the ER&D sector trading at 40x FY24E for FY22-FY24E EPS CAGR of 20% and PEG ratio of 2x. Despite strong environment, robust revenue growth and stable margins, we do not find the risk-reward favorable. We value the stock at 34x FY24E EPS assigning a REDUCE rating with target price of Rs4,413.

Key Risks: 1) Strong large deal win momentum, 2) Margin expansion, 3) INR Depreciation, 4) Continuation of discretionary spends

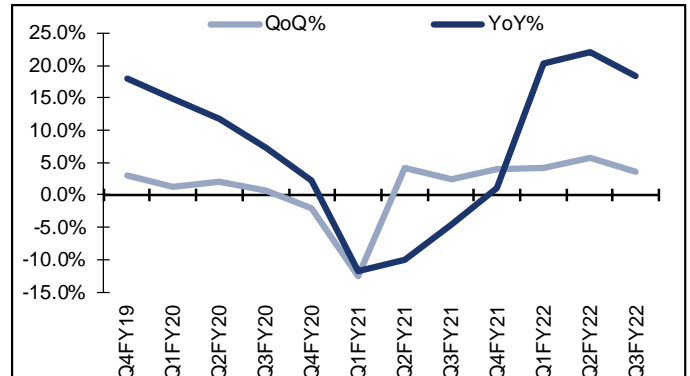
Market Cap	Rs527bn/US\$7bn	Year to March	2021	2022E	2023E	2024E
Reuters/Bloomberg	LTTS IN	Revenue (Rs mn)	54,497	65,838	80,138	95,554
Shares Outstanding (mn)	105.5	Net Income (Rs mn)	6,633	9,469	11,466	13,586
52-week Range (Rs)	5916/2506	EPS (Rs)	63.4	90.5	109.5	129.8
Free Float (%)	26.1	% Chg YoY	(19.1)	42.8	21.1	18.5
FII (%)	9.7	P/E (x)	78.8	55.2	45.6	38.5
Daily Volume (US\$'000)	23,750	CEPS (Rs)	84.2	111.2	133.6	158.5
Absolute Return 3m (%)	(13.4)	EV/E (x)	50.2	35.3	29.2	24.1
Absolute Return 12m (%)	75.8	Dividend Yield	0.4	0.7	0.7	0.7
Sensex Return 3m (%)	(0.3)	RoCE (%)	16.2	20.3	21.3	21.7
Sensex Return 12m (%)	20.7	RoE (%)	21.3	25.0	25.5	25.2

Chart 1: Revenue growth expected to be...



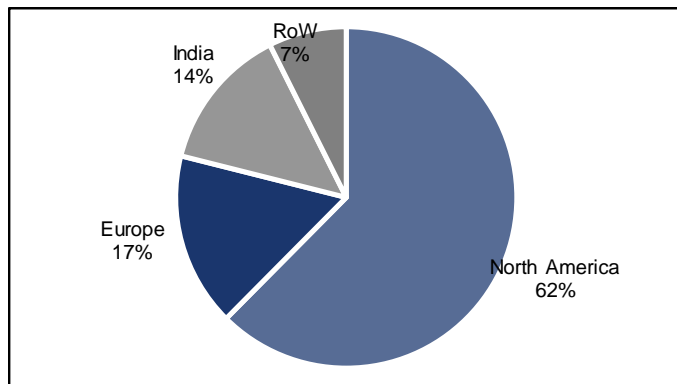
Source: Company, I-Sec research

Chart 2: ...healthy over FY22-FY24E



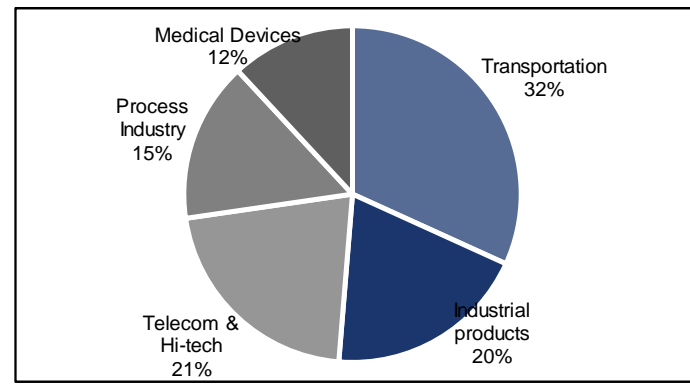
Source: Company, I-Sec research

Chart 3: Geographical mix (%)



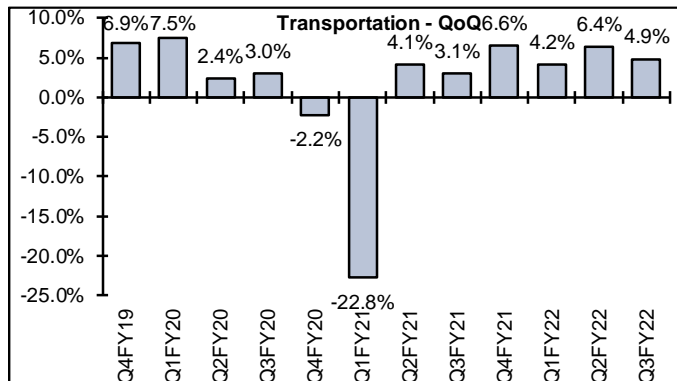
Source: Company, I-Sec research

Chart 4: Vertical mix (%)



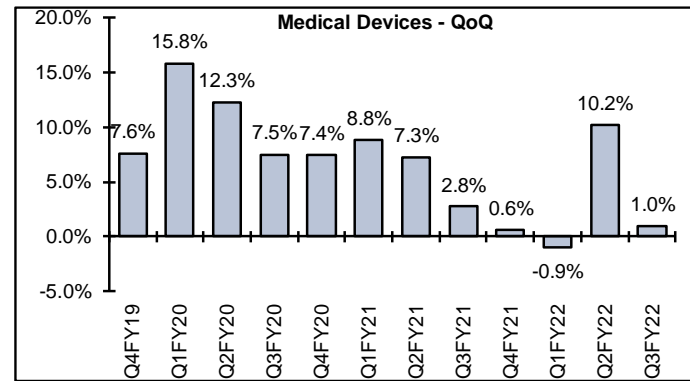
Source: Company, I-Sec research

Chart 5: Transportation now stabilising



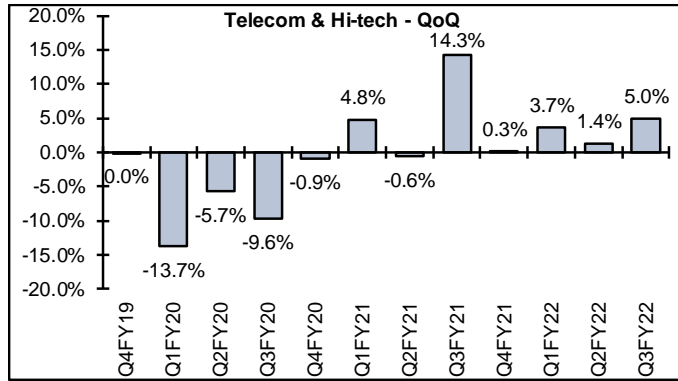
Source: Company, I-Sec research

Chart 6: Medical devices to pick up growth



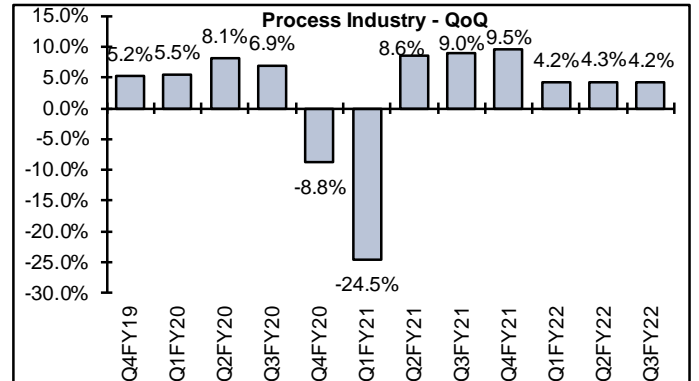
Source: Company, I-Sec research

Chart 7: Growth to now stabilize in Hi-tech



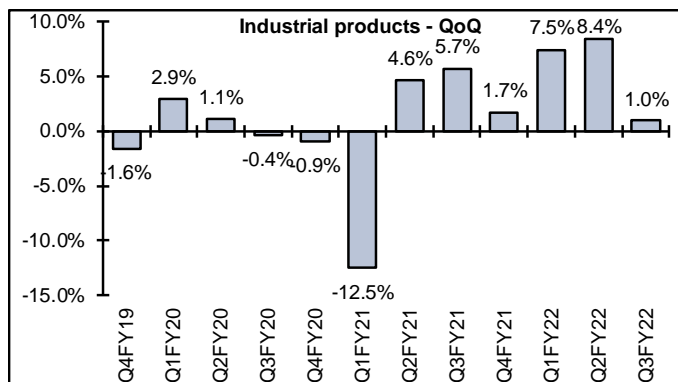
Source: Company, I-Sec research

Chart 8: Steady growth in process industry



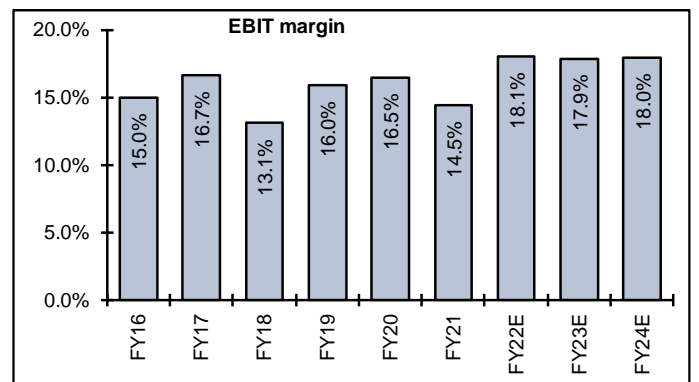
Source: Company, I-Sec research

Chart 9: Growth to normalize in Industrial products



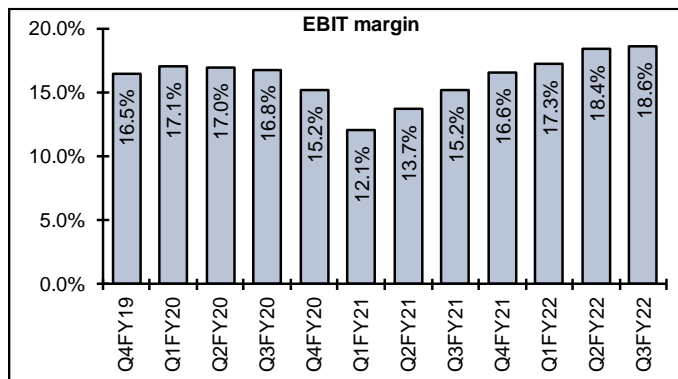
Source: Company, I-Sec research

Chart 10: Largely steady margins over FY22-FY24E



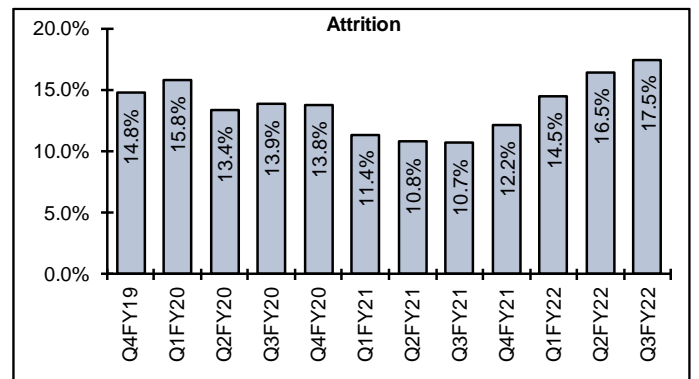
Source: Company, I-Sec research

Chart 11: Improving efficiencies led to expansion



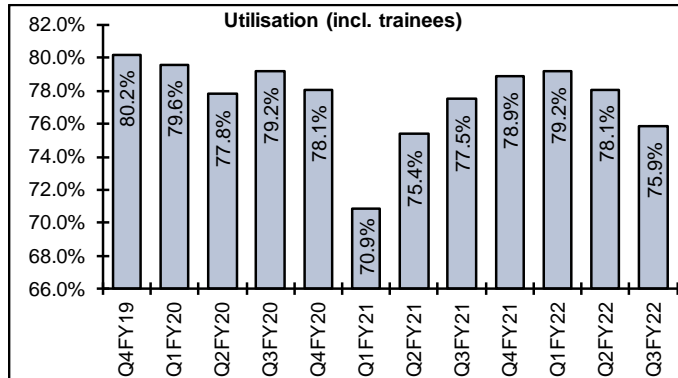
Source: Company, I-Sec research

Chart 12: Attrition higher than pre-covid levels



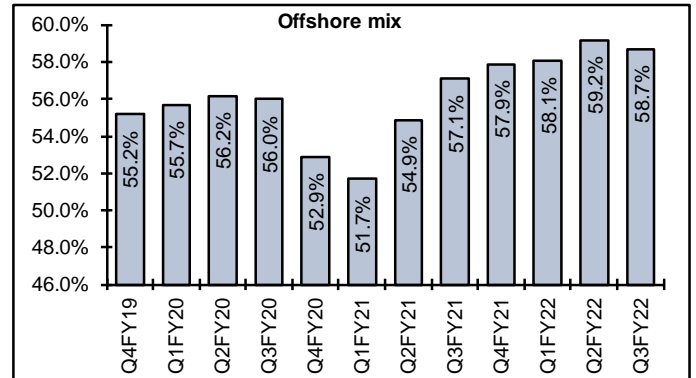
Source: Company, I-Sec research

Chart 13: Utilisation now normalising



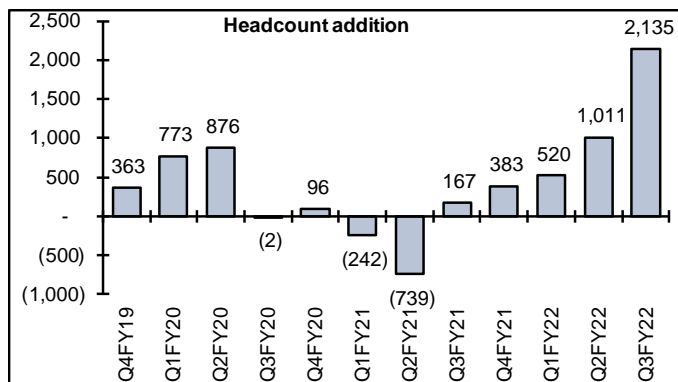
Source: Company, I-Sec research

Chart 14: Offshore mix expected to normalise



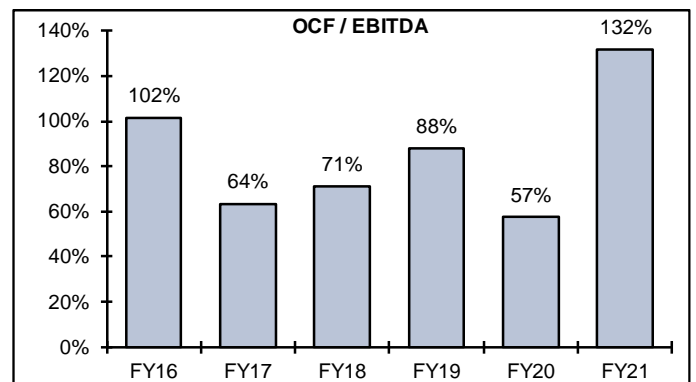
Source: Company, I-Sec research

Chart 15: Aggressive hiring to fulfil demand



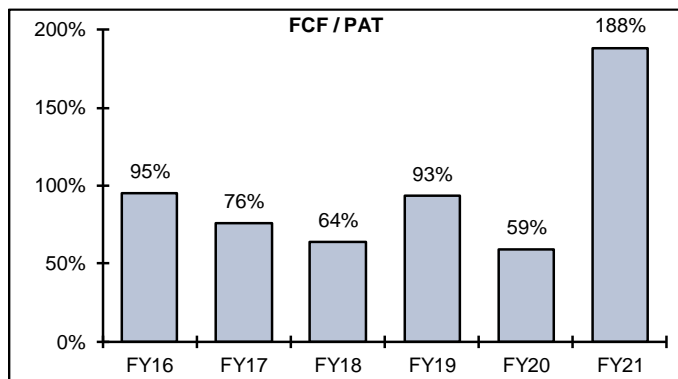
Source: Company, I-Sec research

Chart 16: Robust cash conversions



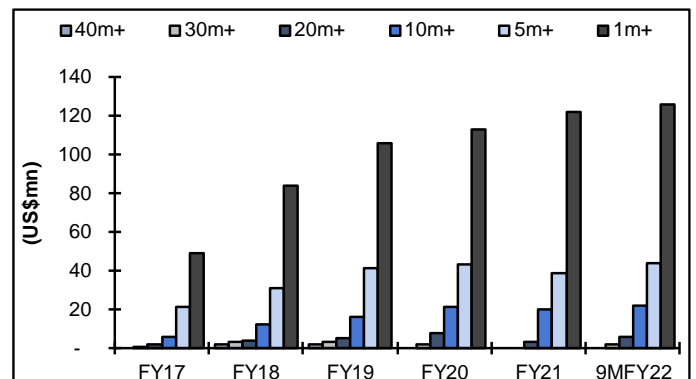
Source: Company, I-Sec research

Chart 17: Robust cash conversions



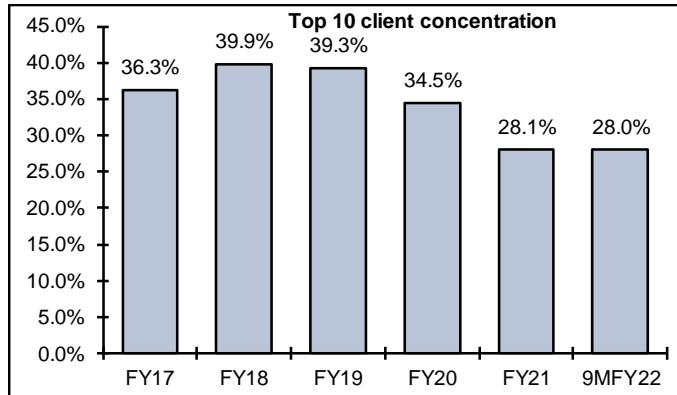
Source: Company, I-Sec research

Chart 18: Steady increase in client base



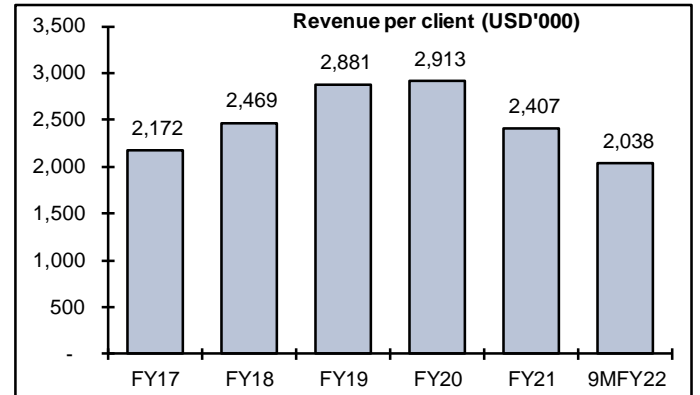
Source: Company, I-Sec research

Chart 19: Steady decline in client concentration



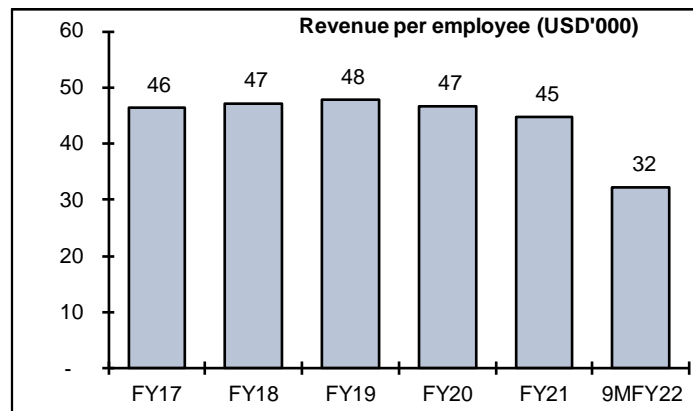
Source: Company, I-Sec research

Chart 20: Decline due to expanding base



Source: Company, I-Sec research

Chart 21: Decline due to increased hiring



Source: Company, I-Sec research

Financial summary – L&T Technology Services

Table 1: Profit and Loss statement

(Rs mn, year ending March 31)

	FY21	FY22E	FY23E	FY24E
Revenue (US\$mn)	737	883	1,054	1,241
Total Income (Sales)	54,497	65,838	80,138	95,554
Operating Expenses	44,423	51,752	63,267	75,353
EBITDA	10,074	14,086	16,871	20,201
% margin	18.5	21.4	21.1	21.1
Depreciation & Amortisation	2,183	2,169	2,517	3,001
EBIT	7,891	11,917	14,354	17,200
% margin	14.5	18.1	17.9	18.0
Other Income	1,537	1,475	1,480	1,480
Interest expense	455	443	444	444
Recurring PBT	8,973	12,949	15,390	18,236
Tax expense	2,308	3,448	3,925	4,650
Recurr. profit before minority	6,665	9,501	11,466	13,586
Minority interest	(32)	(32)	-	-
Extraordinary items	-	-	-	-
Net Profit as restated	6,633	9,469	11,466	13,586

Source: Company data, I-Sec research

Table 2: Balance sheet

(Rs mn, year ending March 31)

	FY21	FY22E	FY23E	FY24E
Liabilities				
Share capital	210	210	210	210
Reserves and Surpluses	34,521	40,822	48,662	58,621
Net Worth	34,731	41,032	48,872	58,831
Minority Interest	101	118	118	118
Non-current Liabilities	4,915	5,170	5,170	5,170
Total Liabilities	39,747	46,320	54,160	64,119
Borrowings	-	-	-	-
Assets				
Fixed Assets	12,943	12,776	12,780	12,784
Other Non-current assets	2,760	3,818	3,818	3,818
Current assets	35,026	44,649	52,485	62,440
less: current liabilities	10,982	14,923	14,923	14,923
Net current assets	24,044	29,726	37,562	47,517
Total Assets	39,747	46,320	54,160	64,119

Source: Company data, I-Sec Research

Table 3: Cashflow statement

(Rs mn, year ending March 31)

	FY21	FY22E	FY23E	FY24E
Op. CF before W Cap changes	9,619	14,054	16,871	20,201
Working Capital Inflow / (Outflow)				
Taxes	6,177	3,290	(3,867)	(4,173)
Capex	(2,523)	(3,448)	(3,925)	(4,650)
Free Cashflow	(771)	(2,002)	(2,521)	(3,005)
CF from other Invest Act (Ex Capex)	12,502	11,894	6,559	8,373
Change in share capital	(9,283)	1,209	1,480	1,480
Inc/(Dec) in Borrowings	1	475	(0)	(0)
Dividend paid	(287)	255	-	-
Others	(2,198)	(3,626)	(3,626)	(3,626)
Increase/(Decrease) in Cash	(1,143)	(443)	(444)	(444)
	(408)	9,764	3,969	5,783

Source: Company data, I-Sec research

Table 4: Key ratios

(Year ending March 31)

	FY21	FY22E	FY23E	FY24E
Per Share Data (Rs)				
Reported EPS	63.4	90.5	109.5	129.8
Recurring Cash EPS	84.2	111.2	133.6	158.5
Book Value per share (BV)	331.8	392.0	466.9	562.0
Dividend per share	22.0	34.5	34.5	34.5
Growth Ratios (%)				
Total Income (Sales) - US\$	(6.4)	19.9	19.4	17.7
Total Income (Sales)	(3.0)	20.8	21.7	19.2
EBITDA	(9.3)	39.8	19.8	19.7
Net Income	(19.0)	42.8	21.1	18.5
Reported EPS	(19.1)	42.8	21.1	18.5
Recurring Cash EPS	(12.1)	32.0	20.1	18.6
Valuation Ratios (x)				
P/E	78.8	55.2	45.6	38.5
P/CEPS	59.3	44.9	37.4	31.5
P/BV	15.0	12.7	10.7	8.9
EV / EBITDA	50.2	35.3	29.2	24.1
EV / Sales	9.3	7.5	6.1	5.1
EV / FCF	40.5	41.8	75.1	58.2
Operating Ratios				
Other Income / PBT (%)	12.1	8.0	6.7	5.7
Effective Tax Rate (%)	25.7	26.6	25.5	25.5
NWC / Total Assets (%)	43.9	29.7	32.0	33.2
Receivables (days)	83	84	83	83
D/E Ratio (x)	-	-	-	-
Return/Profitability Ratios (%)				
Net Income Margins	12.2	14.4	14.3	14.2
EBITDA Margins	18.5	21.4	21.1	21.1
RoNW (based on average)	21.3	25.0	25.5	25.2
Dividend Yield	0.4	0.7	0.7	0.7

Source: Company data, I-Sec research

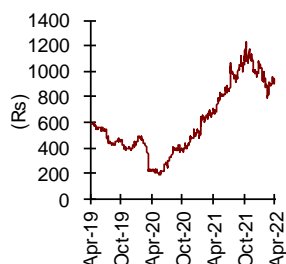
Cyient

(ADD; CMP: Rs906, TP: Rs1,025)

Shareholding pattern

	Jun '21	Sep '21	Dec '21
Promoters	23.5	23.4	23.4
Institutional investors	59.6	58.5	57.5
MFs and others	19.5	21.2	21.2
FIs/Bank	0.0	0.0	0.0
Insurance Cos.	0.5	0.4	0.3
FII	39.6	36.9	36.0
Others	16.9	18.1	19.1

Price chart



Services business to outperform

We believe the drag on overall performance on account of semi-conductor issue in the DLM business should be offset by outperformance in the services segment. Post the management / strategy change, improved performance in the company is noteworthy and continued execution of the same should make Cyient a good turnaround story.

Management's confidence to sustain an elevated level of margins in the services segment is a key positive given the supply-side cost pressures. Services margins above 15% in FY23E should be aided by improved pricing, pyramid rationalisation and automation. We build-in revenue and EPS CAGRs of 12%/14% over FY22-FY24E.

Triggers & catalysts for the stock

Continued momentum in services while DLM recovers: In Q3FY22, management downgraded its DLM growth guidance to low single digit (15-20% earlier) indicating a sharp decline in Q4FY22. This was led by the semi-conductor shortage in the industry and the same is expected to recover in 12-15 months. We believe, the drag from this segment should be offset by outperformance in the services business over the coming quarters given the changed focus of the company.

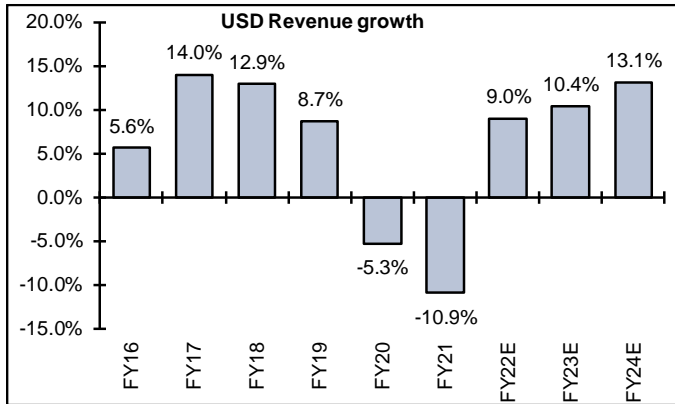
Improving margin outlook: Management's guidance to maintain services margins above 15% is impressive in the current context. Moreover, the company is confident that it would not be dragged down due to decline in DLM revenues as Cyient is prioritising delivery to high-margin business resulting in higher DLM margins. We build-in EBIT margins of 13.5%/13.7% over FY23E/FY24E.

Valuation: While robust performance in the services segment is a key positive, we await the drag from DLM to subside before turning constructive on the stock given the turnaround story. Cyient currently trades at 16x FY24E P/E for FY22-FY24 EPS CAGR of 14%, PEG of 1x vs ER&D sector trading at 40x FY24E for FY22-FY24E EPS CAGR of 20% and PEG ratio of 2x. We value the stock at 18x FY24E EPS arriving at target price of Rs1,025 with an **ADD** rating.

Key Risks: 1) Weak revenue growth, 2) Contraction of margins, 3) INR appreciation

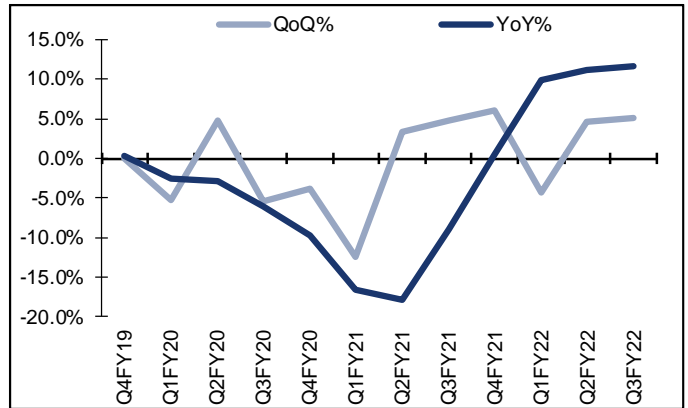
Market Cap	Rs100bn/US\$1.3bn	Year to March	2021	2022E	2023E	2024E
Reuters/Bloomberg	CYL IN	Revenue (Rs mn)	41,325	45,231	50,902	58,330
Shares Outstanding (mn)	110.3	Net Income (Rs mn)	3,601	4,866	5,432	6,263
52-week Range (Rs)	1228/663	EPS (Rs)	32.7	44.2	49.4	57.0
Free Float (%)	76.6	% Chg YoY	5.1	35.1	11.6	15.3
FII (%)	36.0	P/E (x)	27.7	20.5	18.3	15.9
Daily Volume (US\$'000)	4,305	CEPS (Rs)	50.4	62.2	70.7	81.3
Absolute Return 3m (%)	(11.7)	EV/E (x)	14.9	11.6	10.1	8.5
Absolute Return 12m (%)	33.1	Dividend Yield	1.9	3.0	3.0	3.0
Sensex Return 3m (%)	(0.3)	RoCE (%)	12.0	16.4	17.1	18.5
Sensex Return 12m (%)	20.7	RoE (%)	13.1	16.7	18.1	19.0

Chart 1: Steady revenue growth



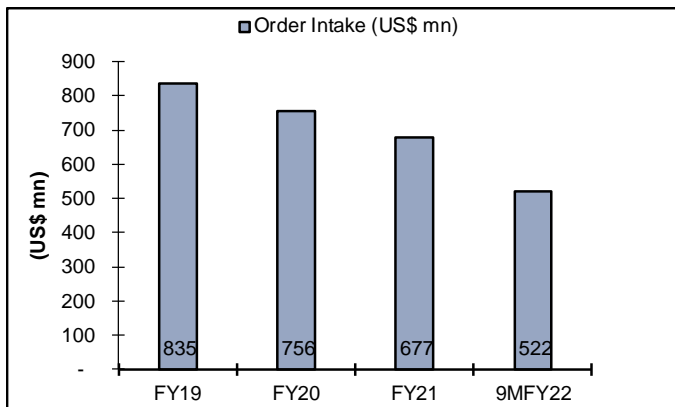
Source: Company, I-Sec research

Chart 2: Steady growth over the quarters



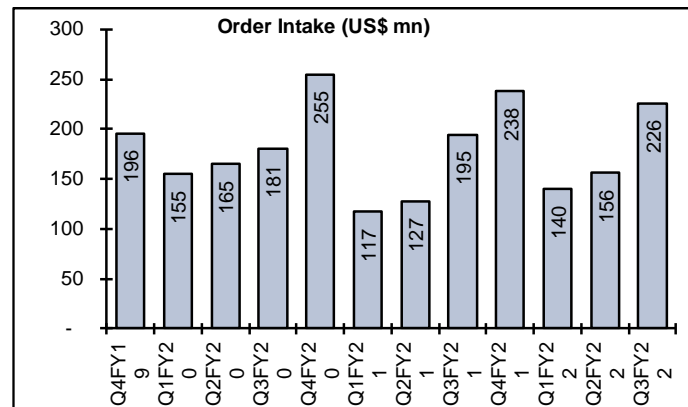
Source: Company, I-Sec research

Chart 3: Declining trend in order intake despite...



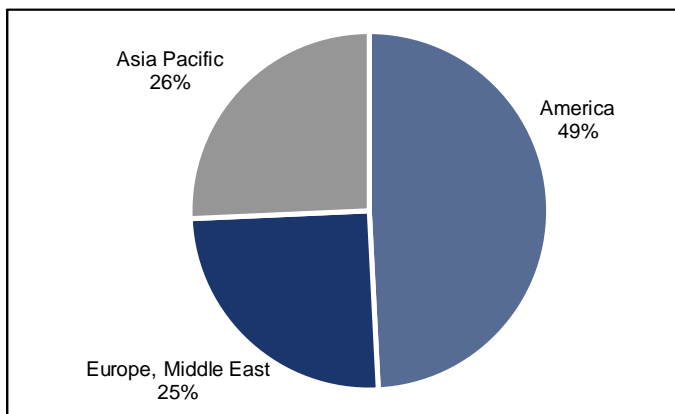
Source: Company, I-Sec research

Chart 4: ...healthy deal wins every quarter



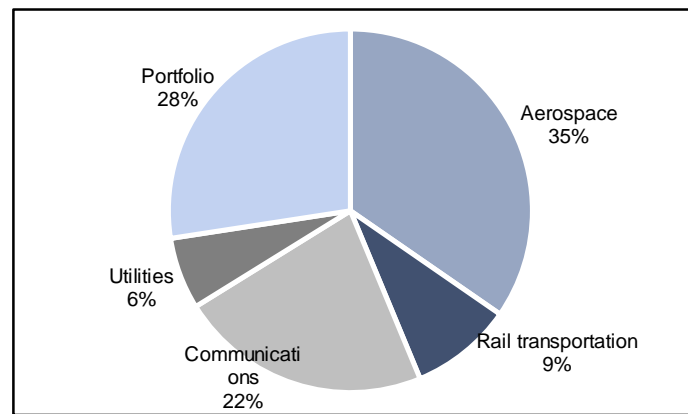
Source: Company, I-Sec research

Chart 5: Geographical mix (%)



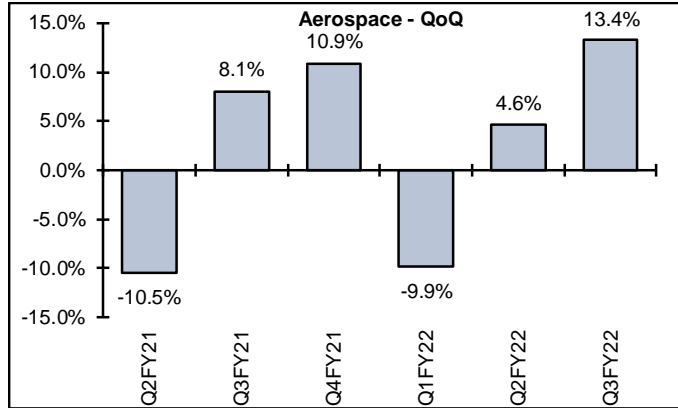
Source: Company, I-Sec research

Chart 6: Vertical mix (%)



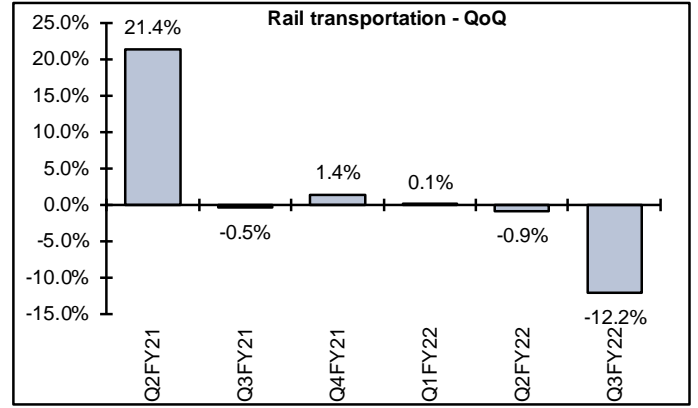
Source: Company, I-Sec research

Chart 7: Growth to pick up within aerospace



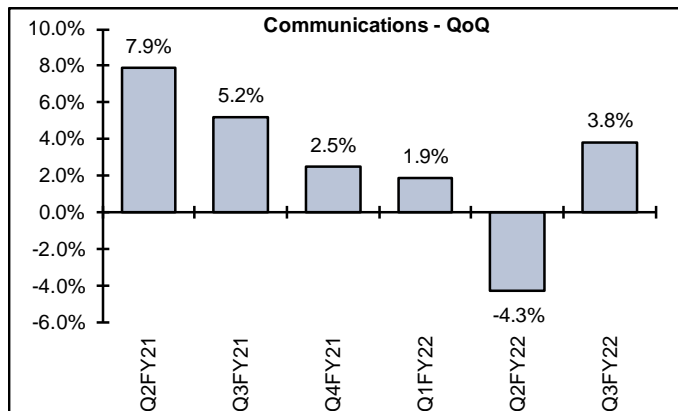
Source: Company, I-Sec research

Chart 8: Expected Rail transport to normalise



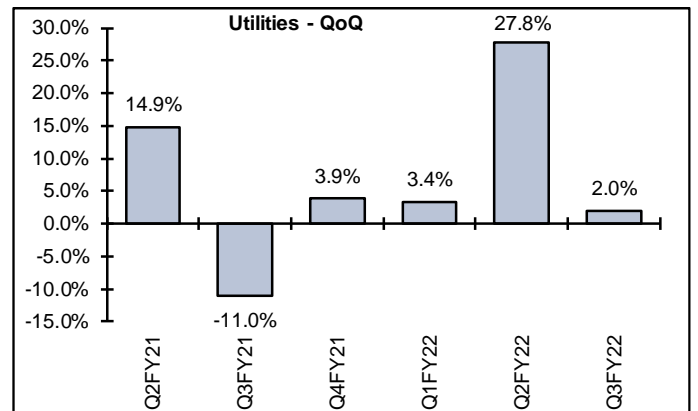
Source: Company, I-Sec research

Chart 9: Communication to pick up



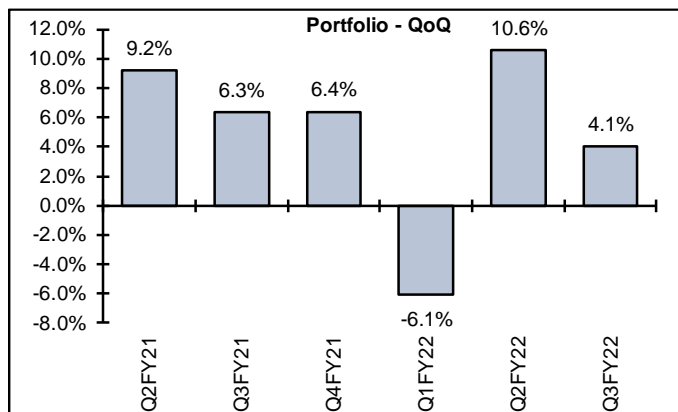
Source: Company, I-Sec research

Chart 10: Growth to normalize in Utilities



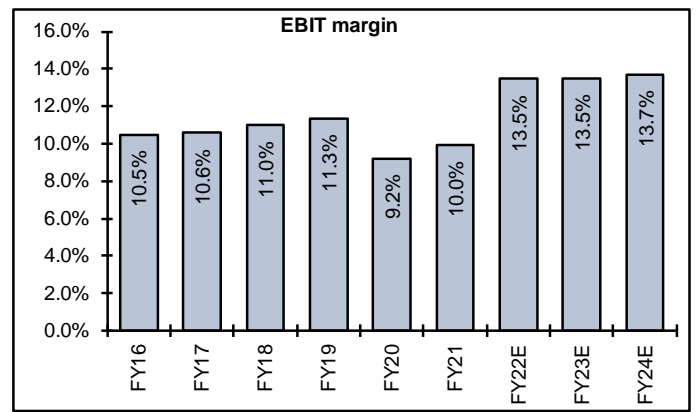
Source: Company, I-Sec research

Chart 11: Growth to stabilise going ahead



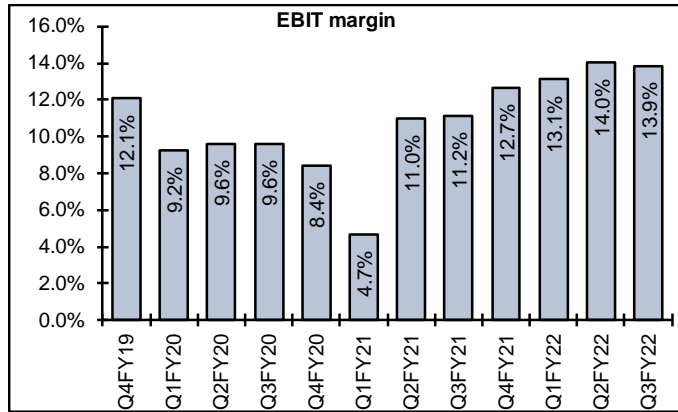
Source: Company, I-Sec research

Chart 12: Margins to remain largely stable



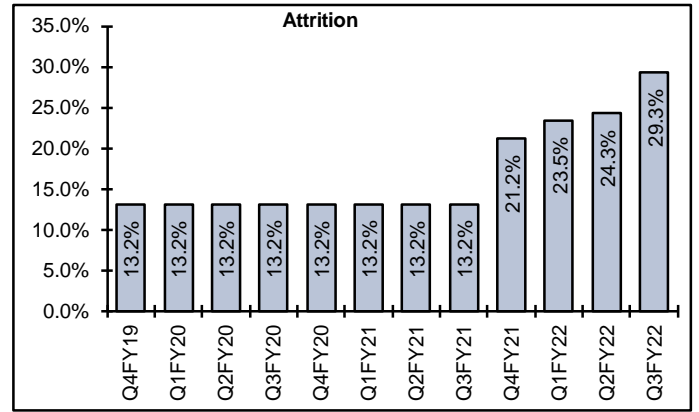
Source: Company, I-Sec research

Chart 13: Margins remained resilient



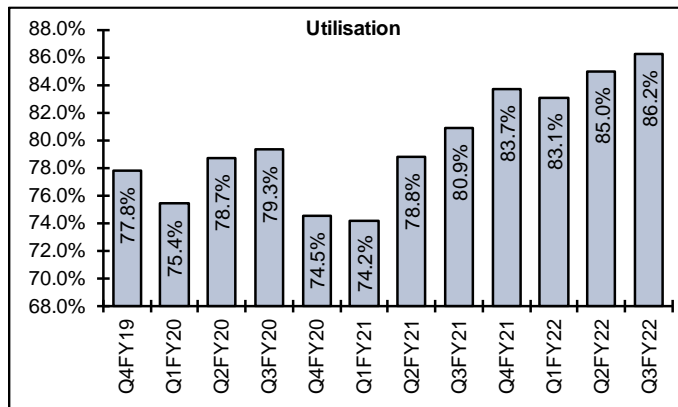
Source: Company, I-Sec research

Chart 14: Attrition much higher than pre-covid



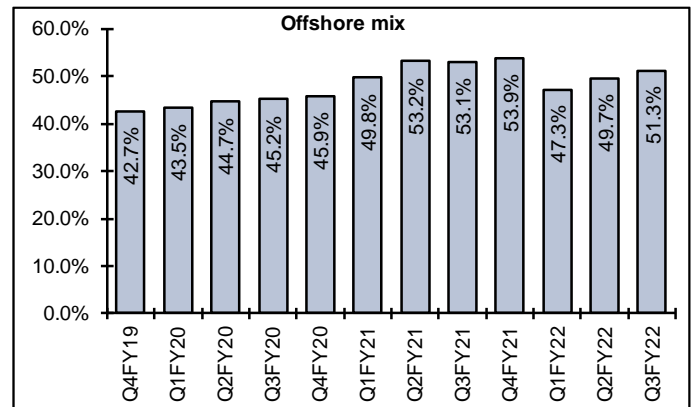
Source: Company, I-Sec research

Chart 15: Utilisation inching up



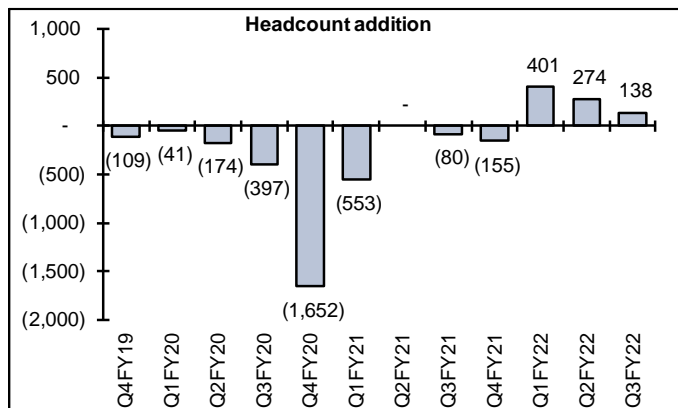
Source: Company, I-Sec research

Chart 16: Largely stable offshore mix



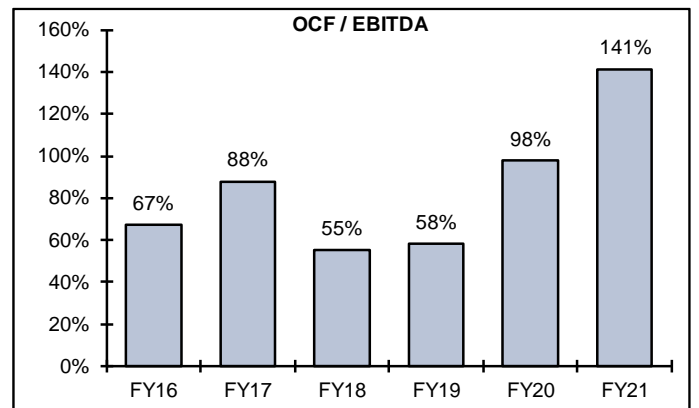
Source: Company, I-Sec research

Chart 17: Increased hiring to fulfil demand



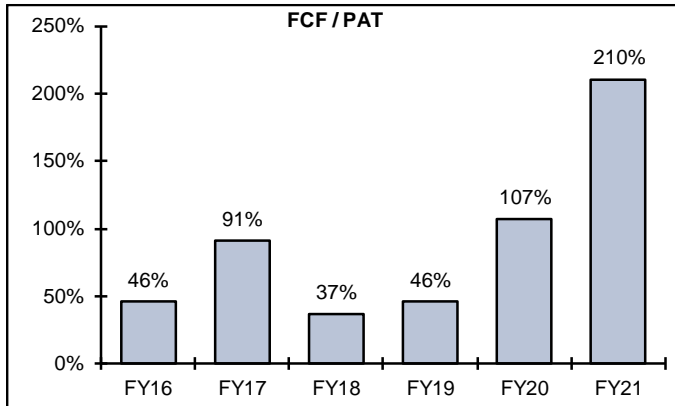
Source: Company, I-Sec research

Chart 18: Robust cash conversions



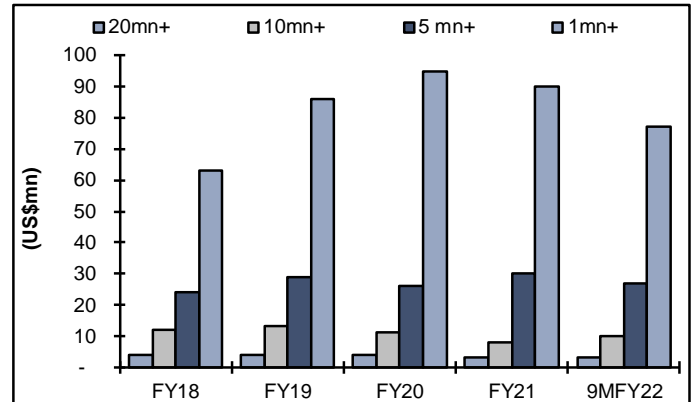
Source: Company, I-Sec research

Chart 19: Robust cash conversions



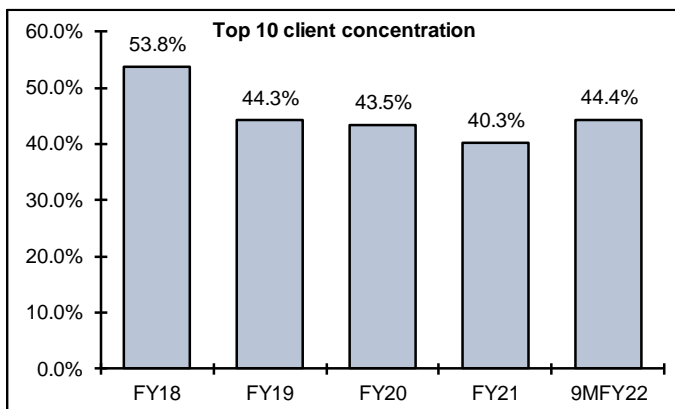
Source: Company, I-Sec research

Chart 20: Largely stable client base



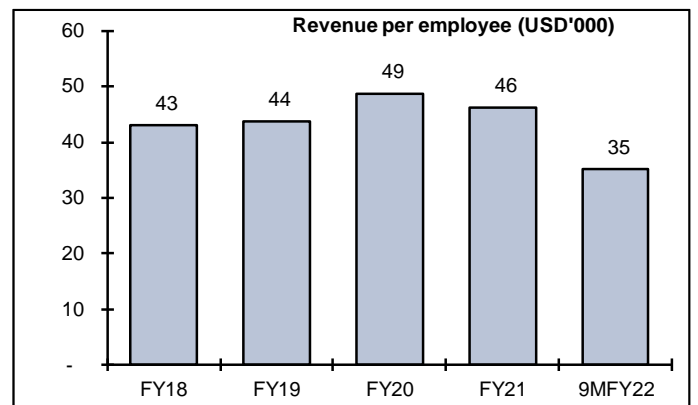
Source: Company, I-Sec research

Chart 21: Client concentration inched up



Source: Company, I-Sec research

Chart 22: Decline due to increased hiring



Source: Company, I-Sec research

Financial summary – Cyient

Table 1: Profit and Loss statement

(Rs mn, year ending March 31)

	FY21	FY22E	FY23E	FY24E
Revenue (US\$mn)	557	607	670	758
Total Income (Sales)	41,325	45,231	50,902	58,330
Operating Expenses	35,265	37,170	41,689	47,660
EBITDA	6,060	8,061	9,213	10,670
% margin	14.7	17.8	18.1	18.3
Depreciation & Amortisation	1,944	1,975	2,342	2,683
EBIT	4,116	6,085	6,872	7,987
% margin	10.0	13.5	13.5	13.7
Other Income	1,166	826	884	884
Interest expense	472	433	464	464
Recurring PBT	4,810	6,478	7,292	8,407
Tax expense	1,133	1,613	1,859	2,144
Recurr. profit before minority	3,677	4,865	5,432	6,263
Minority interest	(0)	0	-	-
Extraordinary items	76	-	-	-
Net Profit as restated	3,601	4,866	5,432	6,263

Source: Company data, I-Sec research

Table 2: Balance sheet

(Rs mn, year ending March 31)

	FY21	FY22E	FY23E	FY24E
Liabilities				
Share capital	550	551	551	551
Reserves and Surpluses	28,991	28,249	30,745	34,072
Net Worth	29,541	28,800	31,296	34,623
Minority Interest	-	-	-	-
Non-current Liabilities	4,297	3,776	3,776	3,776
Total Liabilities	33,838	32,576	35,072	38,399
Borrowings	5,129	5,434	5,434	5,434
Assets				
Fixed Assets	14,485	13,640	14,040	14,440
Other Non-current assets	1,925	5,258	5,258	5,258
Current assets	28,518	26,170	29,493	33,794
less: current liabilities	11,090	12,492	13,718	15,093
Net current assets	17,428	13,678	15,774	18,701
Total Assets	33,838	32,576	35,072	38,399

Source: Company data, I-Sec Research

Table 3: Cashflow statement

(Rs mn, year ending March 31)

	FY21	FY22E	FY23E	FY24E
Op. CF before W Cap changes	5,512	8,061	9,213	10,670
Working Capital Inflow / (Outflow)	4,338	353	(992)	(1,112)
Taxes	(1,292)	(1,613)	(1,859)	(2,144)
Capex	(985)	(1,130)	(2,742)	(3,083)
Free Cashflow	7,573	5,670	3,621	4,331
CF from other Invst Act (Ex Capex)	(22)	(2,808)	884	884
Change in share capital	37	(2,661)	-	-
Inc/(Dec) in Borrowings	(1,921)	(521)	-	-
Dividend paid	(10)	(2,946)	(2,937)	(2,937)
Others	(213)	(433)	(464)	(464)
Increase/(Decrease) in Cash	5,444	(3,698)	1,104	1,814

Source: Company data, I-Sec research

Table 4: Key ratios

(Year ending March 31)

	FY21	FY22E	FY23E	FY24E
Per Share Data (Rs)				
Reported EPS	32.7	44.2	49.4	57.0
Recurring Cash EPS	50.4	62.2	70.7	81.3
Book Value per share (BV)	268.6	261.9	284.6	314.8
Dividend per share	17.0	27.0	27.0	27.0
Growth Ratios (%)				
Total Income (Sales) - US\$	(10.9)	9.0	10.4	13.1
Total Income (Sales)	(6.7)	9.5	12.5	14.6
EBITDA	1.7	33.0	14.3	15.8
Net Income	5.1	35.1	11.6	15.3
Reported EPS	5.1	35.1	11.6	15.3
Recurring Cash EPS	4.6	23.4	13.6	15.1
Valuation Ratios (x)				
P/E	27.7	20.5	18.3	15.9
P/CEPS	18.0	14.6	12.8	11.1
P/BV	3.4	3.5	3.2	2.9
EV / EBITDA	14.9	11.6	10.1	8.5
EV / Sales	2.2	2.1	1.8	1.6
EV / FCF	11.9	16.5	25.6	21.0
Operating Ratios				
Other Income / PBT (%)	14.7	6.1	5.8	5.0
Effective Tax Rate (%)	23.9	24.9	25.5	25.5
NWC / Total Assets (%)	11.3	13.4	14.4	15.2
Receivables (days)	71	69	71	71
Payables (days)	40	39	40	40
D/E Ratio (x)	0.2	0.2	0.2	0.2
Return/Profitability Ratios (%)				
Net Income Margins	8.7	10.8	10.7	10.7
EBITDA Margins	14.7	17.8	18.1	18.3
RoNW (based on average)	13.1	16.7	18.1	19.0
Dividend Yield	1.9	3.0	3.0	3.0

Source: Company data, I-Sec research

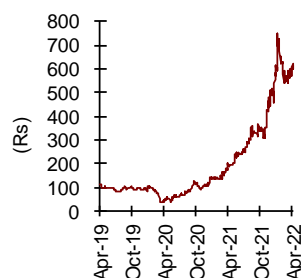
KPIT Technologies

(REDUCE; CMP: Rs615; TP: Rs535)

Shareholding pattern

	Sep '21	Dec '21	Mar '22
Promoters	40.1	40.1	40.1
Institutional investors	33.5	33.7	28.3
MFs and others	10.7	11.3	9.5
FIs/Bank	0.0	0.0	0.0
Insurance Cos.	0.0	0.0	0.0
FII	22.8	22.4	18.8
Others	26.4	26.2	31.6

Price chart



Staying ahead of the curve in autonomous mobility space

KPIT, a pure play automotive software integrator is well positioned to benefit from increased R&D spending on CASE (connected, autonomous, shared, electric) given its deep domain expertise in niche areas such as L3-L5 autonomous driving, vehicle-to-anywhere connectivity, electrification platforms and charging infrastructure. It has marquee clientele (10 of top-15 global automotive OEMs) with strong outlook on CASE R&D spending budgets.

KPIT is investing in future opportunities in the mobility space from new-age EV companies, semiconductor OEMs, tech giants (Microsoft, Apple, Amazon) and 5G telecom providers (strong network connectivity needed for autonomous vehicles) to stay ahead of the curve. For example, KPIT has partnered with Microsoft to offer solutions in the area of homologation of autonomous vehicles.

Triggers & catalysts for the stock

Key revenue growth drivers in place: KPIT grew 20.5% YoY in 9MFY22 and we expect the momentum to continue led by: 1) increased CASE R&D spends by clients and wallet share gains; 2) potential to scale up new-age EV clients (Lucid, Rivian, Nio etc.); 3) additional opportunities arising from work with semiconductor companies on improving hardware-to-software integration. Europe's decision to ban sale of ICE vehicles starting 2035 (vs 2040 earlier) and increasing regulatory pressure to reduce vehicle pollution will further increase EV R&D spends.

Scope to improve margins: KPIT's margins improved to 18% in 9MFY22 vs ~14% pre-covid led by higher offshoring, increasing share of managed services improving productivity and better realisations. Increasing share of revenue from newer technology areas is resulting in better pricing. Offshoring, productivity improvement, employee pyramid and fixed-cost leverage will continue to aid margins amidst supply-side cost pressures and investments in strengthening sales.

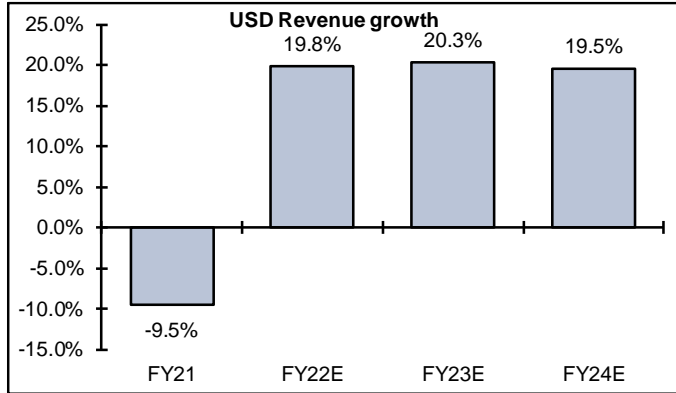
Valuation: KPIT currently trades at 39x FY24E P/E for FY22-FY24E EPS CAGR of 29%. We believe, at current levels the stock is fairly valued and see limited upside hereafter. We assign a target price of Rs535 valuing the company at 34x FY24E EPS.

REDUCE.

Key Risks: 1) Strong large deal win momentum, 2) Margin expansion, 3) INR Depreciation, 4) Continuation of discretionary spends

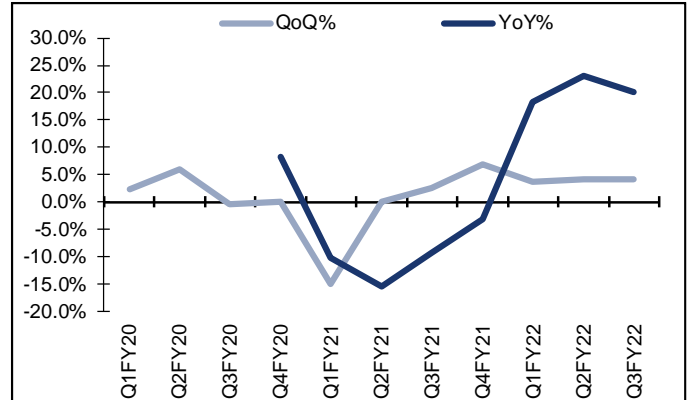
Market Cap	Rs169bn/US\$2.2bn	Year to March	2021	2022E	2023E	2024E
Reuters/Bloomberg	KPITTECH IN	Revenue (Rs mn)	20,357	24,431	30,109	36,469
Shares Outstanding (mn)	274.1	Net Income (Rs mn)	1,158	2,684	3,399	4,229
52-week Range (Rs)	746/187	EPS (Rs)	4.3	10.0	12.6	15.7
Free Float (%)	59.9	% Chg YoY	(21.1)	131.8	26.6	24.4
FII (%)	18.8	P/E (x)	142.9	61.6	48.7	39.1
Daily Volume (US\$'000)	15,400	CEPS (Rs)	9.3	14.5	18.2	22.5
Absolute Return 3m (%)	(13.3)	EV/E (x)	53.0	37.2	28.8	22.8
Absolute Return 12m (%)	218.8	Dividend Yield	0.2	0.4	0.4	0.4
Sensex Return 3m (%)	(0.3)	RoCE (%)	7.8	15.3	17.2	18.2
Sensex Return 12m (%)	20.7	RoE (%)	10.3	20.8	22.5	23.3

Chart 1: Expect steady growth over FY22-FY24E



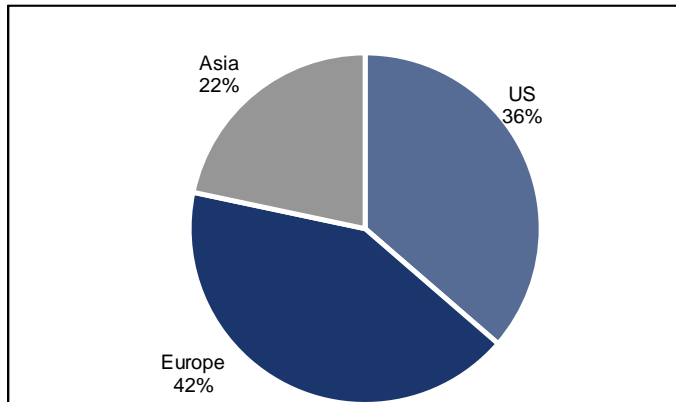
Source: Company, I-Sec research

Chart 2: QoQ growth has stabilised



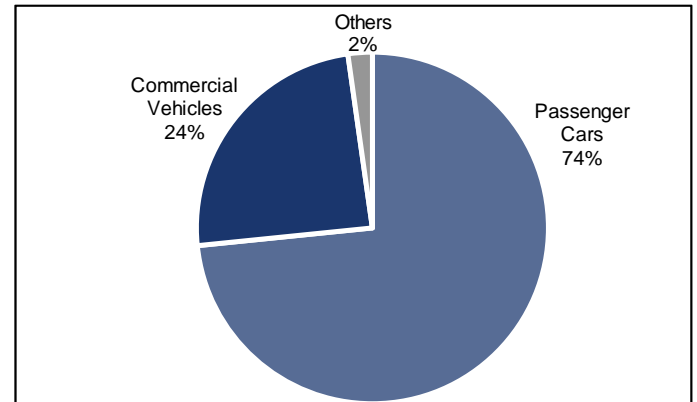
Source: Company, I-Sec research

Chart 3: Geographical mix (%)



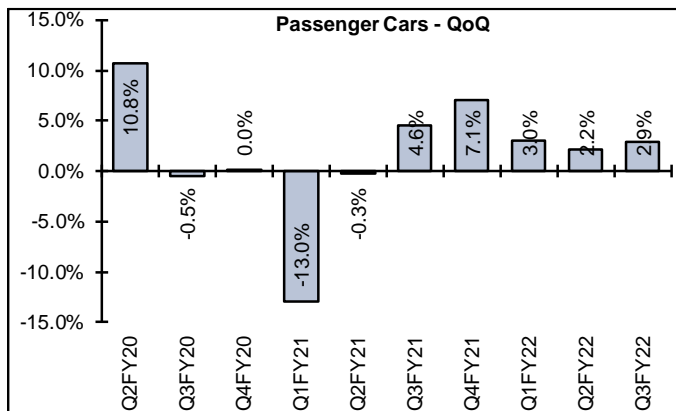
Source: Company, I-Sec research

Chart 4: Vertical mix (%)



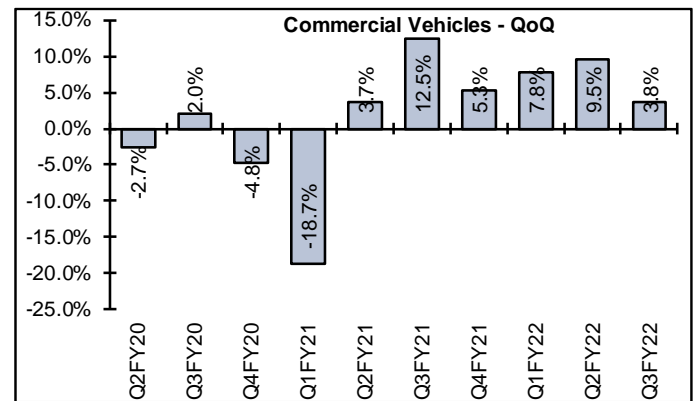
Source: Company, I-Sec research

Chart 5: Steady growth in passenger cars



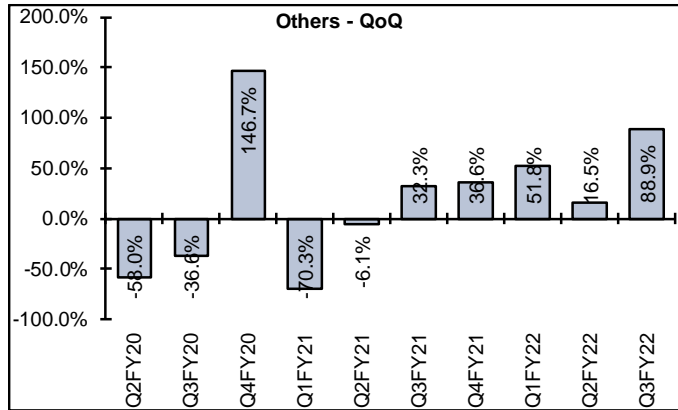
Source: Company, I-Sec research

Chart 6: Growth normalizing in CV segment



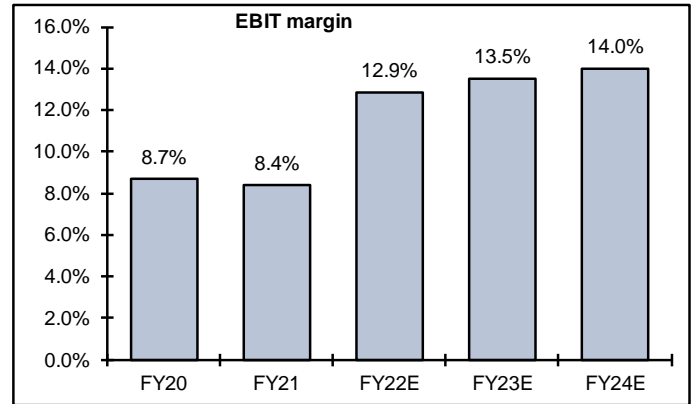
Source: Company, I-Sec research

Chart 7: Growth to normalize in Others



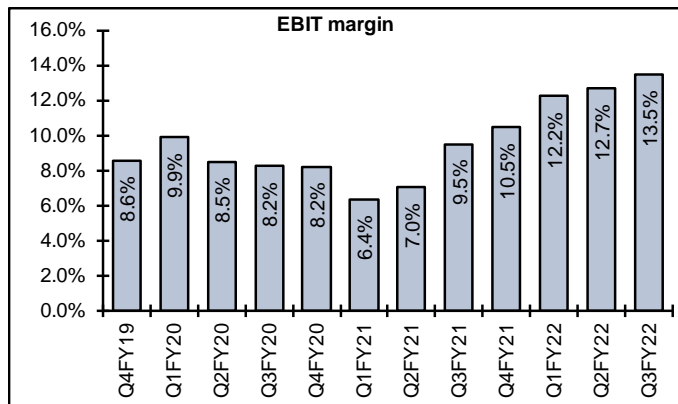
Source: Company, I-Sec research

Chart 8: Margins to expand going forward



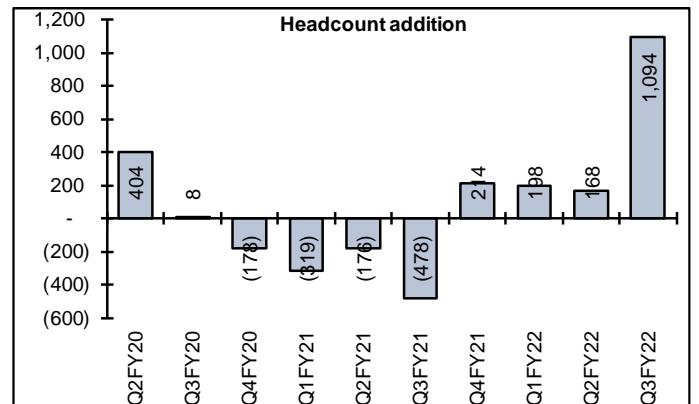
Source: Company, I-Sec research

Chart 9: Improving margin trajectory



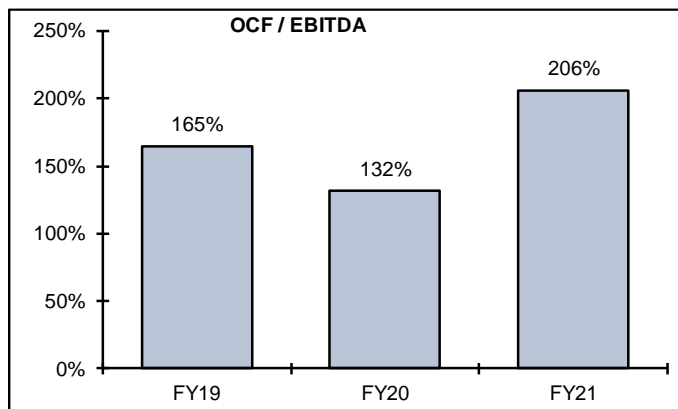
Source: Company, I-Sec research

Chart 10: Increased hiring to fulfil demand



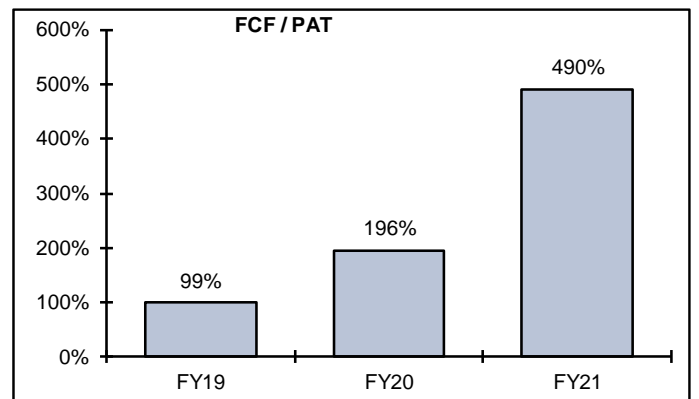
Source: Company, I-Sec research

Chart 11: Robust cash conversions despite...



Source: Company, I-Sec research

Chart 12: ...covid-led pressures



Source: Company, I-Sec research

Financial summary – KPIT Technologies

Table 1: Profit and Loss statement

(Rs mn, year ending March 31)

	FY21	FY22E	FY23E	FY24E
Total Income (Sales)	20,357	24,431	30,109	36,469
Operating Expenses	17,312	20,067	24,532	29,540
EBITDA	3,046	4,364	5,577	6,929
% margin	15.0	17.9	18.5	19.0
Depreciation & Amortisation	1,332	1,221	1,507	1,826
EBIT	1,714	3,143	4,070	5,103
% margin	8.4	12.9	13.5	14.0
Other Income	184	403	342	342
Interest expense	173	168	179	179
Recurring PBT	1,725	3,378	4,232	5,266
Tax expense	599	694	833	1,037
Recurr. profit before minority	1,126	2,684	3,399	4,229
Minority interest	-	-	-	-
Extraordinary items	32	-	-	-
Net Profit as restated	1,158	2,684	3,399	4,229

Source: Company data, I-Sec research

Table 2: Balance sheet

(Rs mn, year ending March 31)

	FY21	FY22E	FY23E	FY24E
Liabilities				
Share capital	2,690	2,699	2,699	2,699
Reserves and Surpluses	9,378	11,088	13,745	17,232
Net Worth	12,068	13,787	16,444	19,931
Minority Interest	29	-	-	-
Non-current Liabilities	2,302	2,584	2,584	2,584
Total Liabilities	14,399	16,371	19,028	22,515
Borrowings	31	-	-	-
Assets				
Fixed Assets	5,890	6,440	6,493	6,497
Other Non-current assets	829	1,290	1,290	1,290
Current assets	12,957	14,752	17,710	21,620
less: current liabilities	5,277	6,112	6,465	6,892
Net current assets	7,680	8,641	11,245	14,728
Total Assets	14,399	16,371	19,028	22,515

Source: Company data, I-Sec Research

Table 3: Cashflow statement

(Rs mn, year ending March 31)

	FY21	FY22E	FY23E	FY24E
Op. CF before W Cap changes	2,122	4,196	5,398	6,750
Working Capital Inflow / (Outflow)	4,481	(1,835)	(906)	(1,095)
Taxes	(327)	(694)	(833)	(1,037)
Capex	(600)	(1,771)	(1,560)	(1,830)
Free Cashflow	5,676	(105)	2,098	2,789
CF from other Invest Act (Ex Capex)	(4,409)	(107)	342	342
Change in share capital	7	(252)	-	(0)
Inc/(Dec) in Borrowings	(943)	(24)	-	-
Dividend paid	-	(742)	(742)	(742)
Others	(211)	306	-	-
Increase/(Decrease) in Cash	120	(924)	1,698	2,388

Source: Company data, I-Sec research

Table 4: Key ratios

(Year ending March 31)

	FY21	FY22E	FY23E	FY24E
Per Share Data (Rs)				
Reported EPS	4.3	10.0	12.6	15.7
Recurring Cash EPS	9.3	14.5	18.2	22.5
Book Value per share (BV)	44.9	51.3	61.1	74.1
Dividend per share	1.5	2.8	2.8	2.8
Growth Ratios (%)				
Total Income (Sales) - US\$	(9.5)	19.8	20.3	19.5
Total Income (Sales)	(5.6)	20.0	23.2	21.1
EBITDA	3.1	43.3	27.8	24.2
Net Income	(21.1)	131.8	26.6	24.4
Reported EPS	(21.1)	131.8	26.6	24.4
Recurring Cash EPS	(2.3)	56.8	25.7	23.4
Valuation Ratios (x)				
P/E	142.9	61.6	48.7	39.1
P/CEPS	66.4	42.4	33.7	27.3
P/BV	13.7	12.0	10.1	8.3
EV / EBITDA	53.0	37.2	28.8	22.8
EV / Sales	7.9	6.6	5.3	4.3
Operating Ratios				
Other Income / PBT (%)	0.6	7.0	3.8	3.1
Effective Tax Rate (%)	34.1	20.6	19.7	19.7
NWC / Total Assets (%)	24.5	29.8	29.9	29.6
Receivables (days)	55	60	59	59
Payables (days)	24	25	24	24
D/E Ratio (x)	0.0	-	-	-
Return/Profitability Ratios (%)				
Net Income Margins	5.7	11.0	11.3	11.6
EBITDA Margins	15.0	17.9	18.5	19.0
RoNW (based on average)	10.3	20.8	22.5	23.3
Dividend Yield	0.2	0.4	0.4	0.4

Source: Company data, I-Sec research

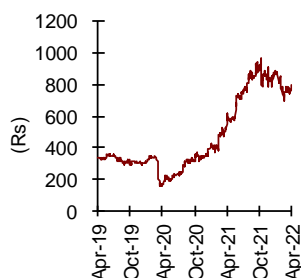
Sonata Software

(ADD; CMP: Rs800; TP: Rs904)

Shareholding pattern

	Jun '21	Sep '21	Dec '21
Promoters	28.2	28.2	28.2
Institutional investors	28.3	29.5	28.6
MFs and others	12.1	12.5	13.8
FIs/Bank	0.0	0.0	0.0
Insurance Cos.	0.0	0.0	0.0
FII	16.2	17.0	14.8
Others	43.5	42.3	43.2

Price chart



Well Placed!

We like Sonata given: 1) its strong digital capabilities helping it to benefit from accelerated growth in digital (digital revenue share increased from 38% in 3Q20 to 72% in 3Q22) 2) it is well placed to capture structural shift in demand towards platforms or SaaS models, 3) it majorly provides high-end IT services that command higher pricing resulting in strong EBITDA margin profile (~26-28%), and 4) increasing share of cloud-based annuity deals and alliance with AWS and GCP, which will sustain the strong growth momentum in domestic business.

Sonata's domestic reseller business (contributes 23% to EBITDA) is a steady cashflow business with high RoCE (41% in Q3FY22). It is the top value-added reseller for Microsoft and serves all the top 1,000 large enterprises in India. It is the only player that has survived three decades in the very low-margin (2.5-4% EBITDA margin) competitive value added reseller market in India.

Triggers & catalysts for the stock

Strong growth momentum led by cloud and digital to sustain: Strong growth momentum in IITS (26% YoY in 9MFY22) driven by digital-based competencies like managed cloud services, Microsoft and open source platform based services are likely to sustain. Digital revenue has grown at a strong CQGR of 10% over past four quarters. Strong growth momentum in DPS business is also expected to continue driven by cloud-based annuity deals.

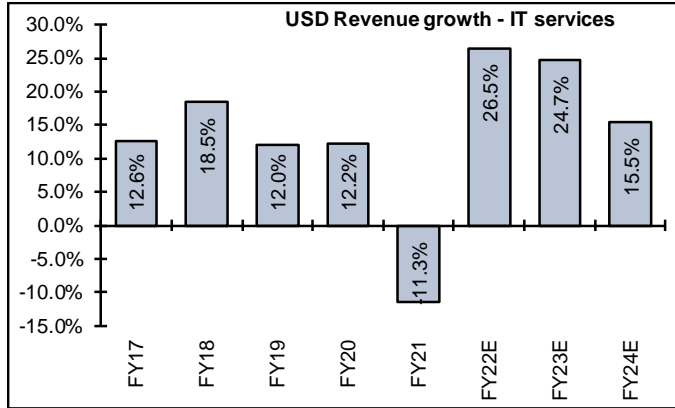
IITS EBITDA margins likely to face supply-side headwinds in the near term: Company has sustained segmental IITS EBITDA margins above 28% (vs ~25-26% pre-covid) for past five quarters led by revenue growth leverage. We expect margins to come under pressure in the near term led by supply-side cost pressures (wage increments, hiring, retention costs, etc.) due to higher attrition.

Valuation: The stock currently trades at 16x FY24E P/E for FY22-FY24 EPS CAGR of 18%. Strong digital capabilities help the company to capture opportunities arising in the current demand environment. This, along with a strong EBITDA margin profile, makes Sonata an attractive stock at current levels. We value the company at 18x FY24E EPS with a target price of Rs 904 with **ADD** rating.

Key Risks: 1) Weak revenue growth in microsoft dynamics, 2) Elevated margin pressure, 3) INR appreciation

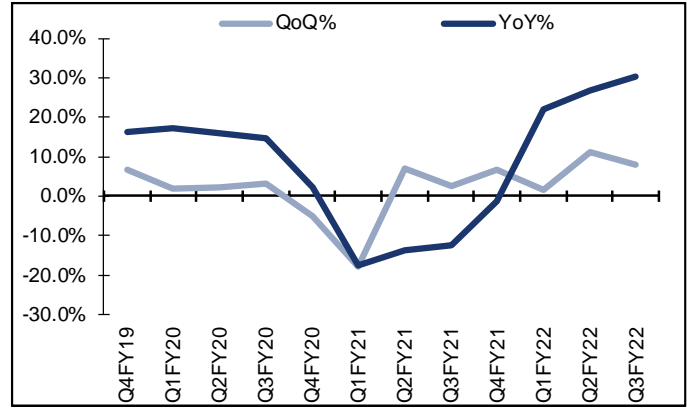
Market Cap	Rs84bn/US\$1.1bn	Year to March	2021	2022E	2023E	2024E
Reuters/Bloomberg	SOFT.BO/SSOF IN	Revenue (Rs mn)	42,281	54,590	67,325	80,068
Shares Outstanding (mn)	105.2	Net Income (Rs mn)	2,440	3,733	4,523	5,222
52-week Range (Rs)	961/560	EPS (Rs)	23.5	35.9	43.5	50.2
Free Float (%)	71.8	% Chg YoY	(11.9)	52.9	21.1	15.4
FII (%)	14.8	P/E (x)	34.1	22.3	18.4	15.9
Daily Volume (US\$'000)	2,853	CEPS (Rs)	27.3	40.5	48.0	55.6
Absolute Return 3m (%)	(7.5)	EV/E (x)	20.3	15.5	12.1	9.9
Absolute Return 12m (%)	37.7	Dividend Yield	1.5	2.3	2.8	3.3
Sensex Return 3m (%)	(0.3)	RoCE (%)	26.3	30.7	33.8	34.9
Sensex Return 12m (%)	20.7	RoE (%)	31.0	38.0	39.3	38.8

Chart 1: Strong revenue growth ahead..



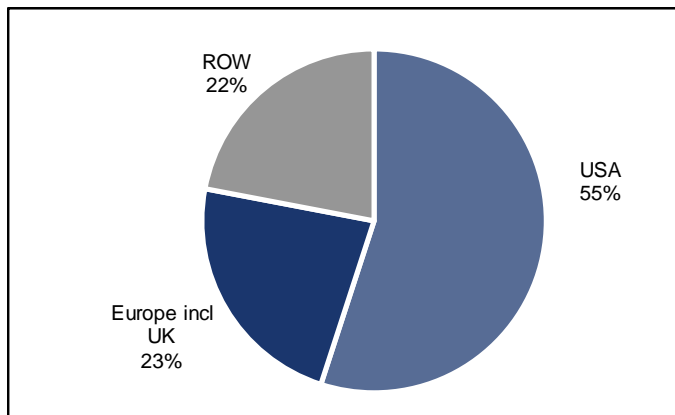
Source: Company, I-Sec research

Chart 2: Strong YoY growth



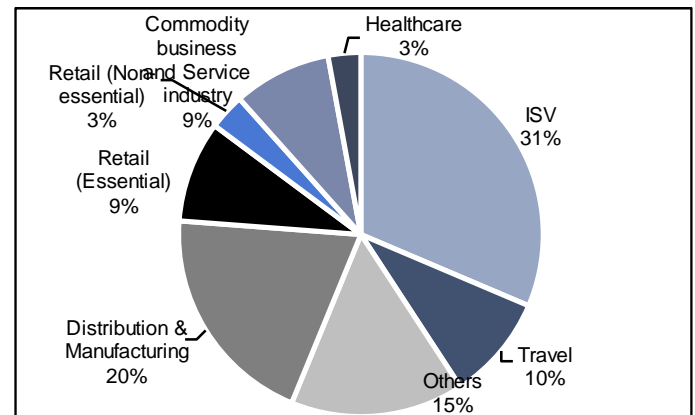
Source: Company, I-Sec research

Chart 3: Geographical mix (%)



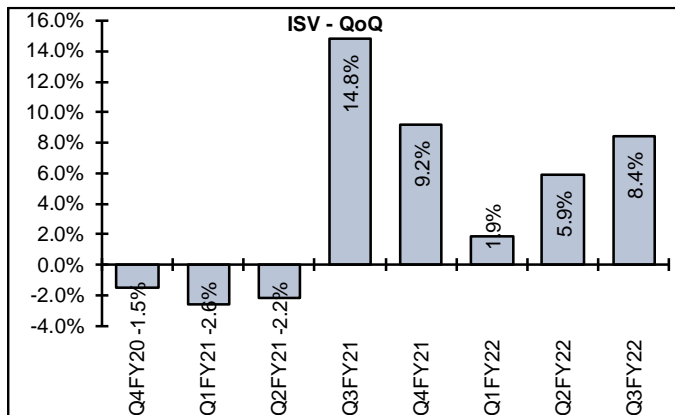
Source: Company, I-Sec research

Chart 4: Vertical mix (%)



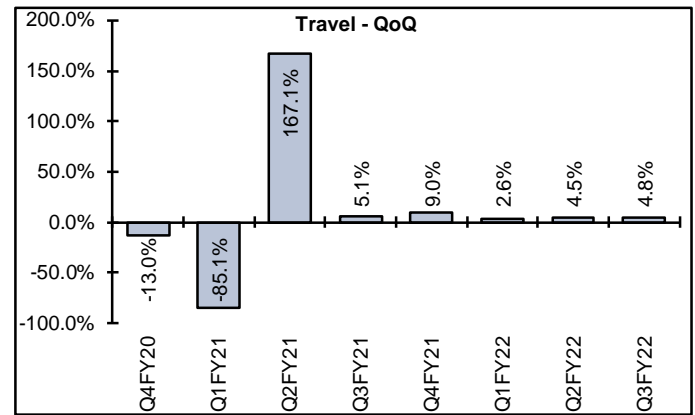
Source: Company, I-Sec research

Chart 5: Growth expected to pick up in ISV



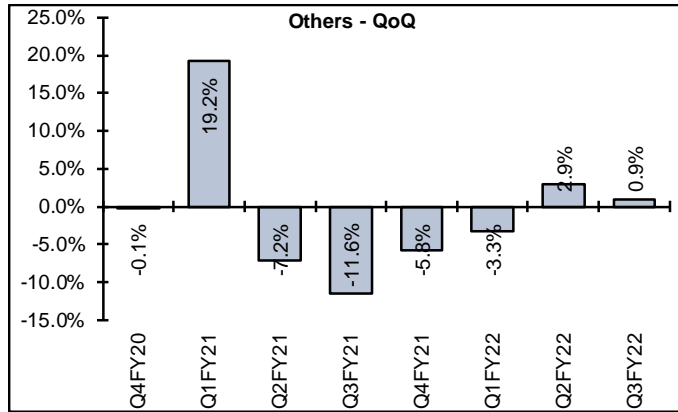
Source: Company, I-Sec research

Chart 6: Growth in travel has now stabilised



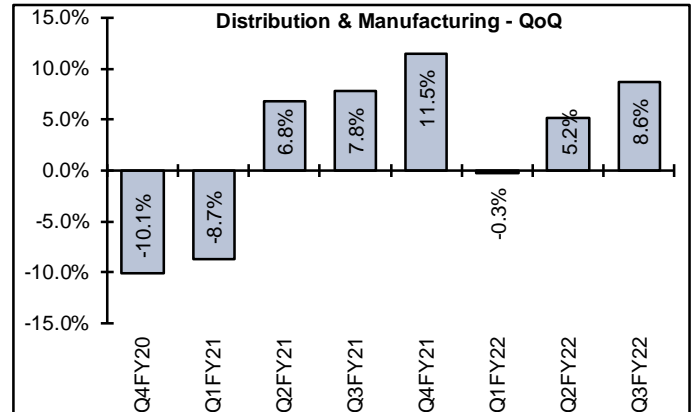
Source: Company, I-Sec research

Chart 7: Growth to stabilise in Others



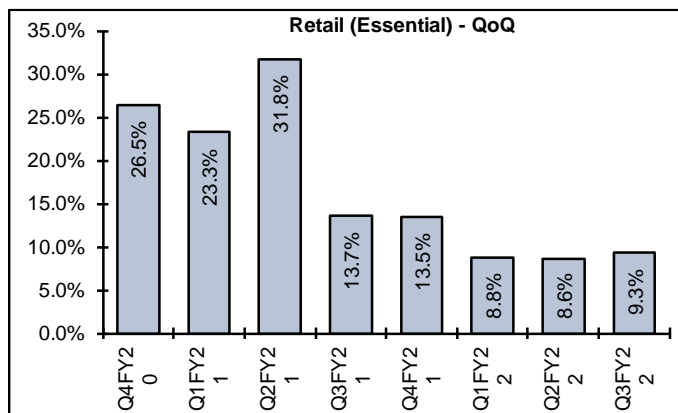
Source: Company, I-Sec research

Chart 8: Manufacturing growth to pick up



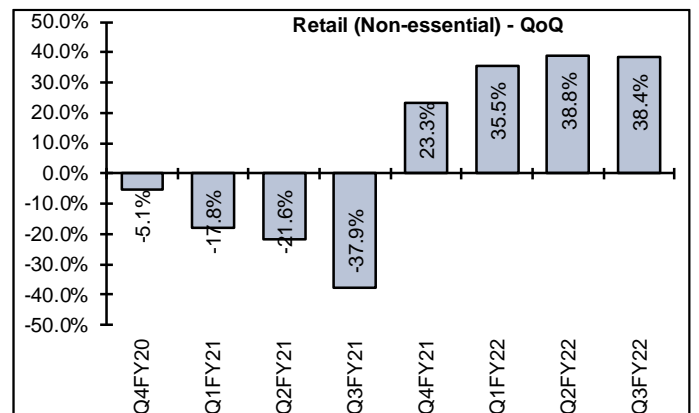
Source: Company, I-Sec research

Chart 9: Growth is largely stabilized in essential retail



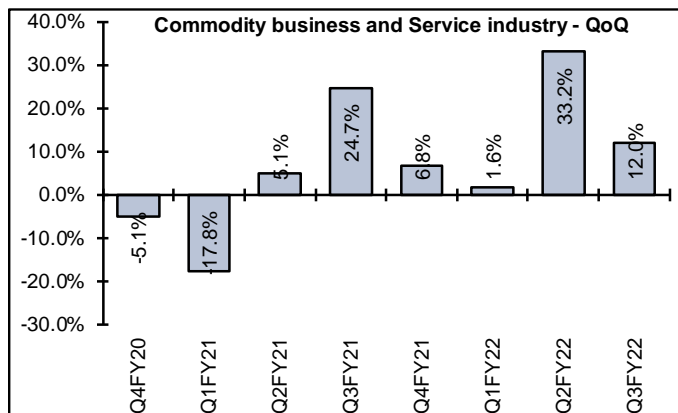
Source: Company, I-Sec research

Chart 10: Expect growth to pick up in non-essential retail



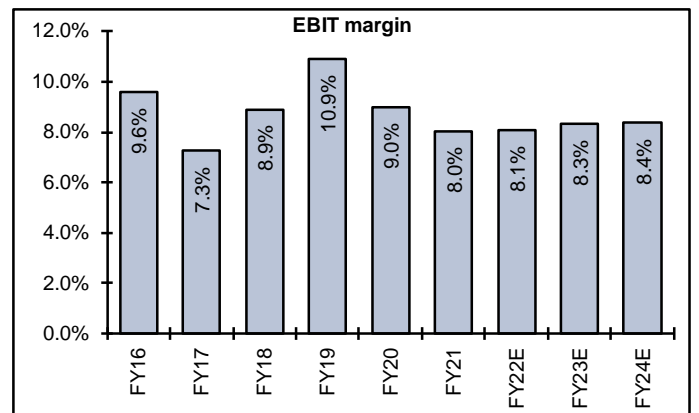
Source: Company, I-Sec research

Chart 11: Growth is normalizing in Commodities



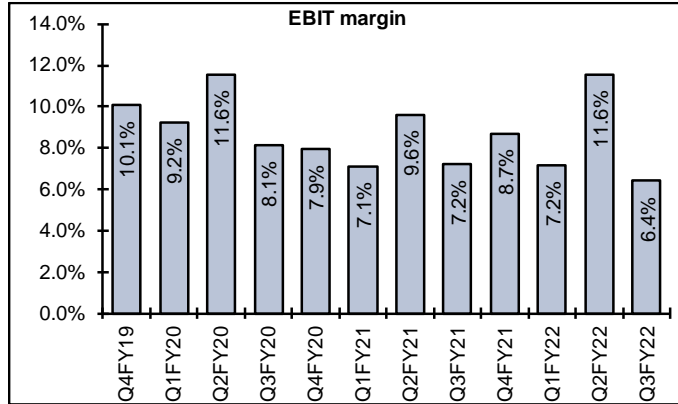
Source: Company, I-Sec research

Chart 12: Expect largely stable margins



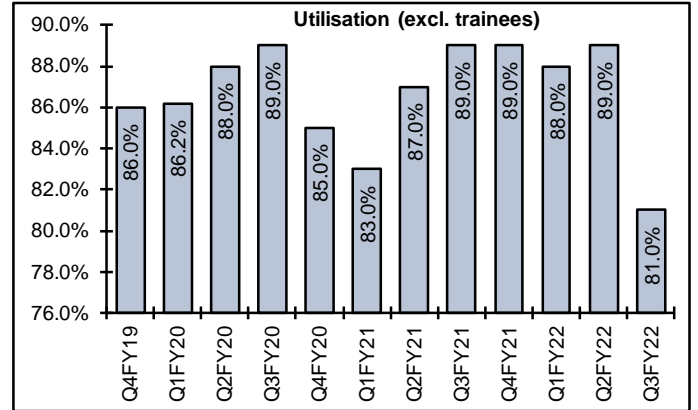
Source: Company, I-Sec research

Chart 13: Supply pressures impacting margins



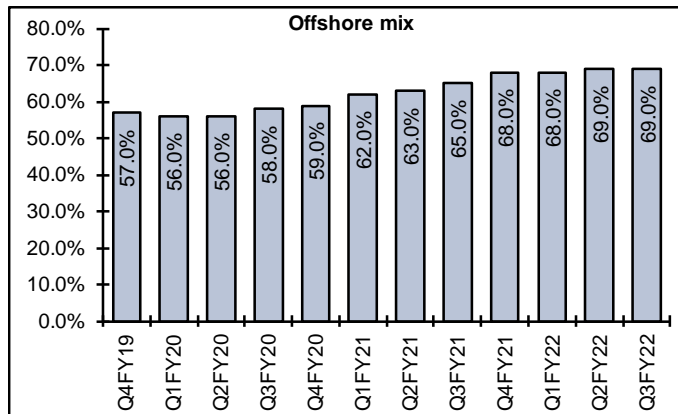
Source: Company, I-Sec research

Chart 14: Utilisation to normalise ahead



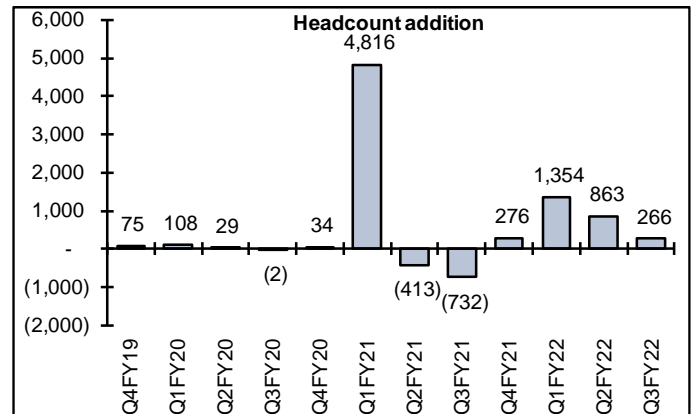
Source: Company, I-Sec research

Chart 15: Offshore mix remained stable



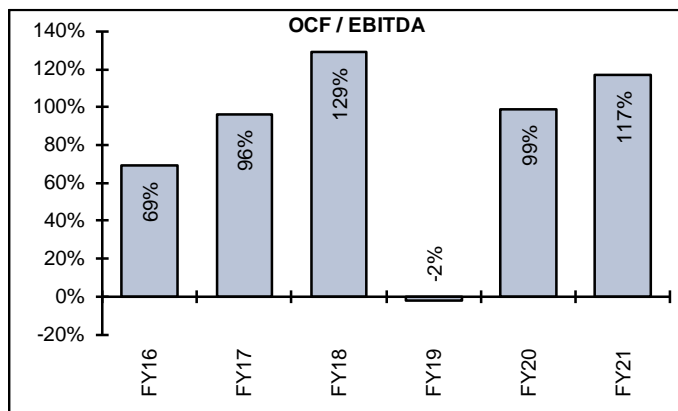
Source: Company, I-Sec research

Chart 16: Hiring increased in 9MFY22



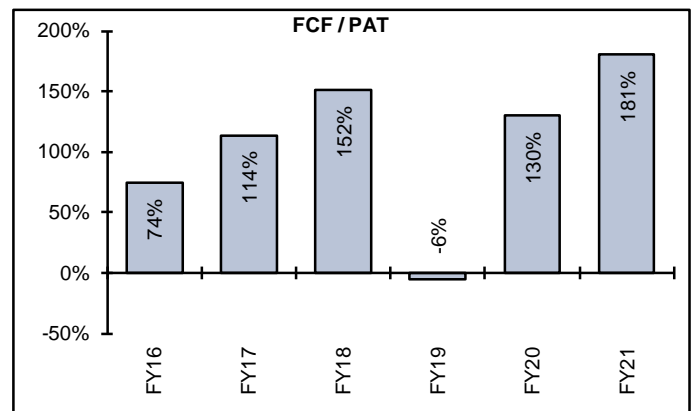
Source: Company, I-Sec research

Chart 17: Robust cash conversions despite...



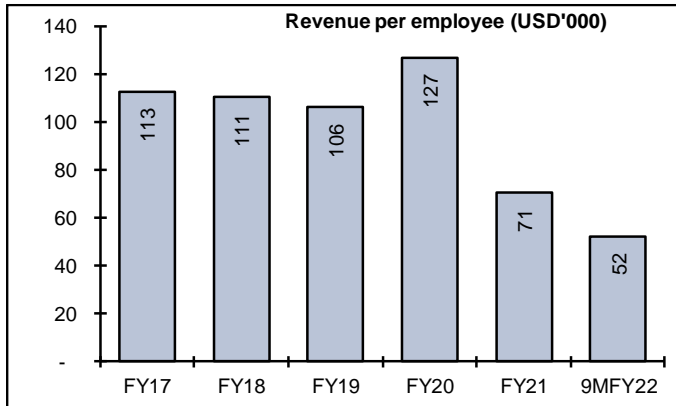
Source: Company, I-Sec research

Chart 18: ...covid-led pressures



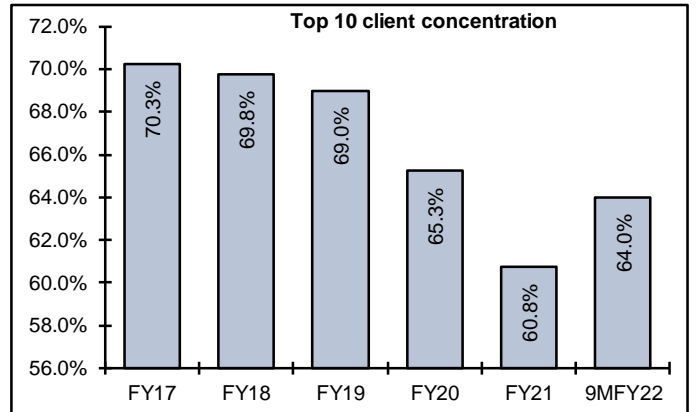
Source: Company, I-Sec research

Chart 19: Decline due to expanding base



Source: Company, I-Sec research

Chart 20: Client concentration again inched up



Source: Company, I-Sec research

Financial summary – Sonata Software

Table 1: Profit and Loss statement

(Rs mn, year ending March 31)

	FY21	FY22E	FY23E	FY24E
Revenue (US\$mn)	576	740	886	1,040
Total Income (Sales)	42,281	54,590	67,325	80,068
Operating Expenses	38,487	49,709	61,243	72,812
EBITDA	3,794	4,881	6,082	7,257
% margin	9.0	8.9	9.0	9.1
Depreciation & Amortisation	396	480	471	560
EBIT	3,398	4,401	5,611	6,696
% margin	8.0	8.1	8.3	8.4
Other Income	277	722	560	400
Interest expense	154	183	180	180
Recurring PBT	3,522	4,940	5,991	6,916
Tax expense	1,082	1,207	1,468	1,694
Recurr. profit before minority	2,440	3,733	4,523	5,222
Minority interest	0	0	0	0
Extraordinary items	-	-	-	-
Net Profit as restated	2,440	3,733	4,523	5,222

Source: Company data, I-Sec research

Table 2: Balance sheet

(Rs mn, year ending March 31)

	FY21	FY22E	FY23E	FY24E
Liabilities				
Share capital	104	104	104	104
Reserves and Surpluses	8,951	10,496	12,332	14,381
Net Worth	9,055	10,600	12,436	14,484
Minority Interest	(0)	(1)	(1)	(1)
Non-current Liabilities	1,021	1,021	1,021	1,021
Total Liabilities	10,075	11,620	13,456	15,504
Borrowings	897	897	897	897
Assets				
Fixed Assets	3,238	3,328	3,418	3,508
Other Non-current assets	1,540	1,640	1,740	1,840
Current assets	14,692	17,900	22,247	25,849
less: current liabilities	9,394	11,247	13,948	15,693
Net current assets	5,298	6,652	8,298	10,156
Total Assets	10,075	11,620	13,456	15,504

Source: Company data, I-Sec Research

Table 3: Cashflow statement

(Rs mn, year ending March 31)

	FY21	FY22E	FY23E	FY24E
Op. CF before W Cap changes	3,640	4,881	6,082	7,257
Working Capital Inflow / (Outflow)	2,119	19	50	14
Taxes	(1,332)	(1,207)	(1,468)	(1,694)
Capex	(18)	(570)	(561)	(650)
Free Cashflow	4,408	3,123	4,103	4,926
CF from other Invest Act (Ex Capex)	(1,123)	622	460	300
Change in share capital	-	(317)	(389)	(459)
Inc/(Dec) in Borrowings	(181)	-	-	-
Dividend paid	(407)	(1,872)	(2,299)	(2,715)
Others	(34)	(183)	(180)	(180)
Increase/(Decrease) in Cash	2,664	1,373	1,695	1,872

Source: Company data, I-Sec research

Table 4: Key ratios

(Year ending March 31)

	FY21	FY22E	FY23E	FY24E
Per Share Data (Rs)				
Reported EPS	23.5	35.9	43.5	50.2
Recurring Cash EPS	27.3	40.5	48.0	55.6
Book Value per share (BV)	87.1	101.9	119.6	139.2
Dividend per share	11.8	18.0	22.1	26.1
Growth Ratios (%)				
Total Income (Sales) - US\$	7.7	28.5	19.7	17.4
Total Income (Sales)	13.0	29.1	23.3	18.9
EBITDA	1.8	28.7	24.6	19.3
Net Income	(11.9)	53.0	21.2	15.4
Reported EPS	(11.9)	52.9	21.1	15.4
Recurring Cash EPS	(9.5)	48.4	18.5	15.8
Valuation Ratios (x)				
P/E	34.1	22.3	18.4	15.9
P/CEPS	29.3	19.8	16.7	14.4
P/BV	9.2	7.9	6.7	5.7
EV / EBITDA	20.3	15.5	12.1	9.9
EV / Sales	1.8	1.4	1.1	0.9
EV / FCF	17.5	24.2	18.0	14.6
Operating Ratios				
Other Income / PBT (%)	3.5	10.9	6.3	3.2
Effective Tax Rate (%)	30.7	24.4	24.5	24.5
NWC / Total Assets (%)	(1.1)	(1.0)	(1.0)	(0.9)
Receivables (days)	53.2	52.4	55.8	54.1
Payables (days)	58.6	57.8	61.5	59.7
D/E Ratio (x)	0.1	0.1	0.1	0.1
Return/Profitability Ratios (%)				
Net Income Margins	5.8	6.8	6.7	6.5
EBITDA Margins	9.0	8.9	9.0	9.1
RoNW (based on average)	31.0	38.0	39.3	38.8
Dividend Yield	1.5	2.3	2.8	3.3

Source: Company data, I-Sec research

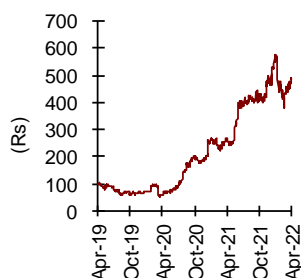
Birlasoft

(HOLD; CMP: Rs490; TP: Rs508)

Shareholding pattern

	Jun '21	Sep '21	Dec '21
Promoters	40.7	40.7	40.6
Institutional investors	36.9	39.3	38.8
MFs and others	16.1	18.7	18.3
FIs/Bank	0.0	0.3	0.0
Insurance Cos.	1.3	1.3	1.4
FII	19.5	19.0	19.1
Others	22.4	20.0	20.6

Price chart



Elevated attrition may hurt margins

Birlasoft has transformed its business post integration of KPIT's ERP business and onboarding of new leadership team. It has improved revenue visibility with increased share of annuity business, which now accounts for 72% of revenue (vs 50% at the time of merger). With strong focus on mining existing clients, hunting new logos and cross-selling, its deal TCv has moved up to average US\$120mn per quarter from US\$83mn a year ago.

Birlasoft has significantly improved its EBITDA margins from 9.7% in FY19 to ~15.3% in FY22E. Impending supply-side pressures because of high attrition may limit margin expansion in near term. We estimate 14.9%/16% EBITDA margins in FY23E/FY24E.

Triggers & catalysts for the stock

Aspiration to reach US\$1bn: Focus on: 1) increasing annuity share of business, 2) separation of farming sales engine from hunting, and 3) cross-selling – has led to improved revenue growth momentum (14.7% YoY in 9MFY22). Company has strong domain expertise in manufacturing and life sciences, and is also growing well in BFSI led by its top account. TCv has been growing faster than revenue with 9MFY22 deal TCv growth of 20% YoY. We believe the aspiration to reach US\$1bn in FY25 is very aggressive and has to be supported by continued organic revenue acceleration as well as inorganic additions.

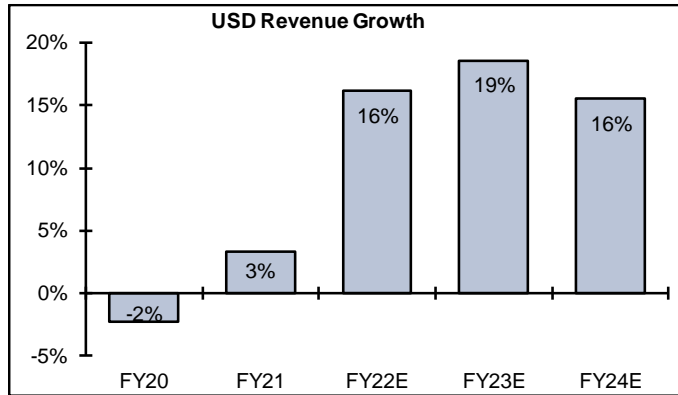
Supply-side pressures may limit margin expansion in the near term: Birlasoft has significantly improved its EBITDA margin from 9.7% in FY19 to ~15.3% in FY22E. Its margin is stable at ~15% despite high attrition of 31% and decline of 1% in net headcount in Q3FY22 and high sub-con expenses. However, we believe supply-side pressures may limit further margin expansion and estimate 14.9%/16% margins in FY23E/FY24E (~40bps lower than consensus).

Valuation: We like the company for its recent performance and expect it to post a robust revenue CAGR of 17% over FY22-FY24E along with expansion of EBITDA margins to 16% in FY24E. The stock currently trades at 21x FY24E P/E for FY22-FY24E EPS CAGR of 19%. We value it at 22x FY24E EPS arriving at a target price of Rs508. **HOLD.**

Key Risks: 1) Slowdown in enterprise portfolio growth, 2) Elevated attrition, 3) INR appreciation

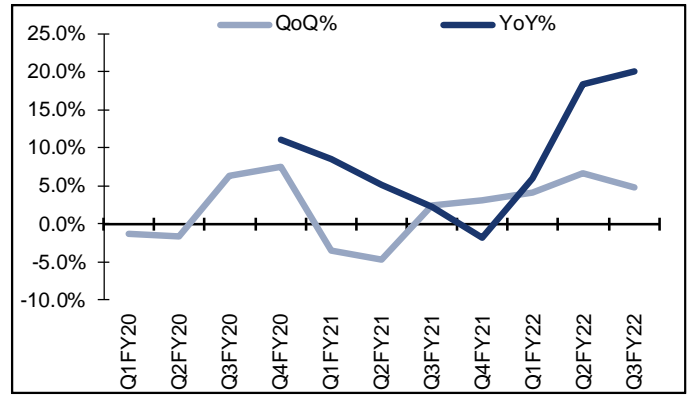
Market Cap	Rs137bn/US\$1.8bn	Year to March	2021	2022E	2023E	2024E
Reuters/Bloomberg	BSOFT IN	Revenue (Rs mn)	35,558	41,451	50,189	58,735
Shares Outstanding (mn)	279.5	Net Income (Rs mn)	3,209	4,479	5,083	6,387
52-week Range (Rs)	577/242	EPS (Rs)	11.6	16.2	18.4	23.1
Free Float (%)	59.4	% Chg YoY	43.1	39.6	13.5	25.6
FII (%)	19.1	P/E (x)	42.2	30.3	26.7	21.2
Daily Volume (US\$'000)	23,973	CEPS (Rs)	14.5	18.9	22.0	27.3
Absolute Return 3m (%)	(15.2)	EV/E (x)	(1.0)	(1.0)	(1.1)	(1.2)
Absolute Return 12m (%)	85.2	Dividend Yield	0.7	0.8	0.8	0.8
Sensex Return 3m (%)	(0.3)	RoCE (%)	14.3	16.6	17.0	18.7
Sensex Return 12m (%)	20.7	RoE (%)	15.8	19.3	19.3	20.7

Chart 1: Healthy revenue growth over FY22-FY24E



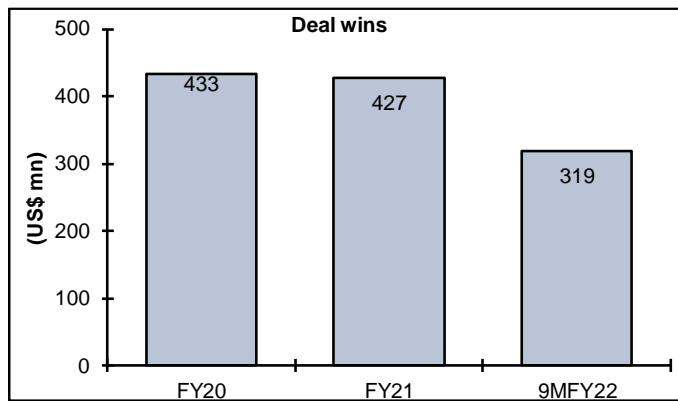
Source: Company, I-Sec research

Chart 2: Strong YoY growth



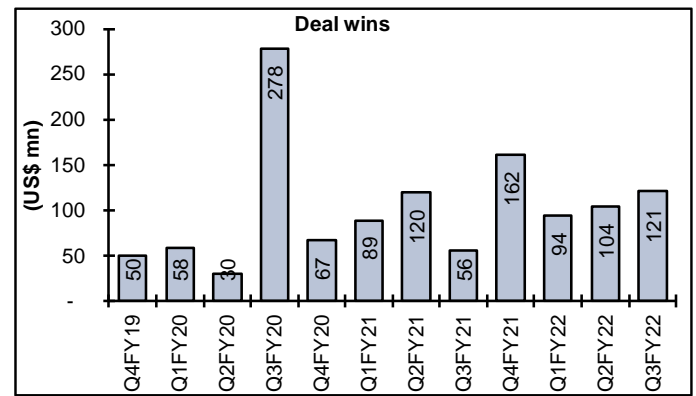
Source: Company, I-Sec research

Chart 3: Deal wins remain healthy



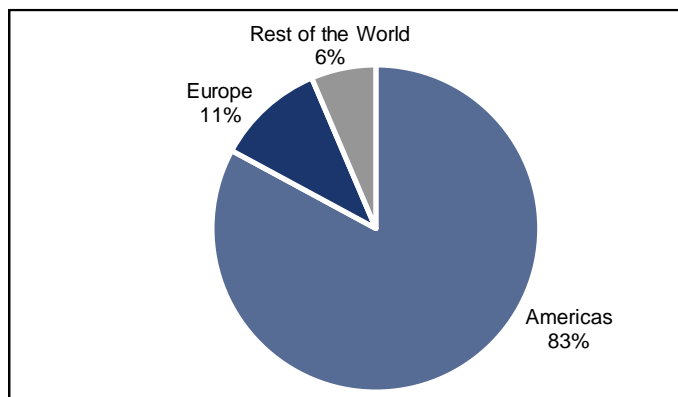
Source: Company, I-Sec research

Chart 4: Steady deal wins every quarter



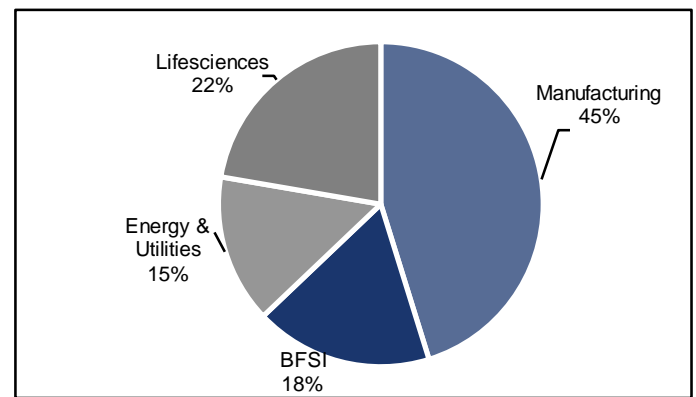
Source: Company, I-Sec research

Chart 5: Geographical mix (%)



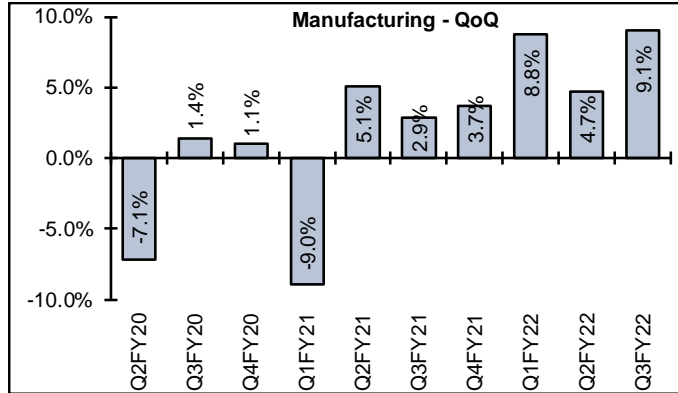
Source: Company, I-Sec research

Chart 6: Vertical mix (%)



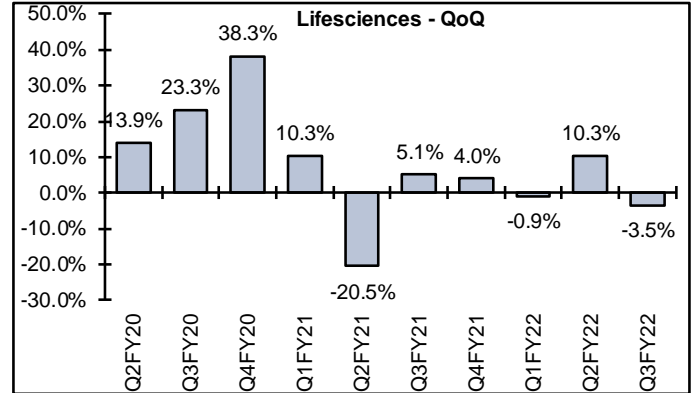
Source: Company, I-Sec research

Chart 7: Growth expected to pick up in Mfg.



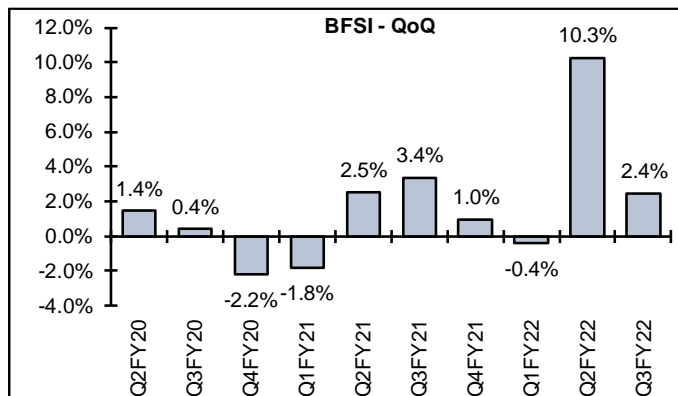
Source: Company, I-Sec research

Chart 8: Life sciences to fare well going forward



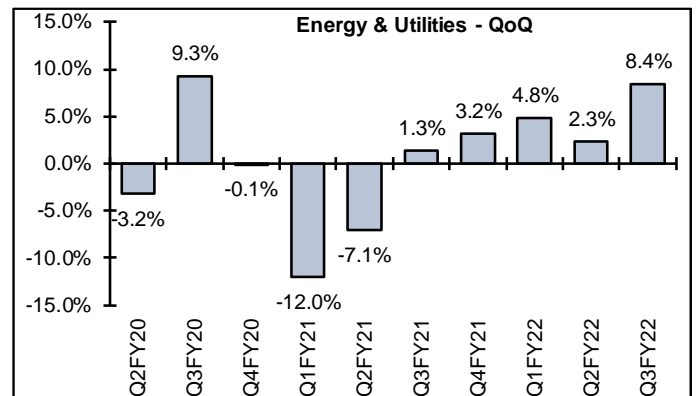
Source: Company, I-Sec research

Chart 9: BFSI growth to normalise



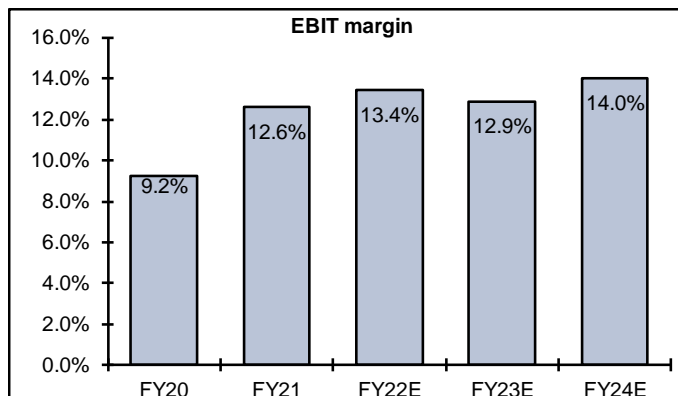
Source: Company, I-Sec research

Chart 10: E&U growth to pick up ahead



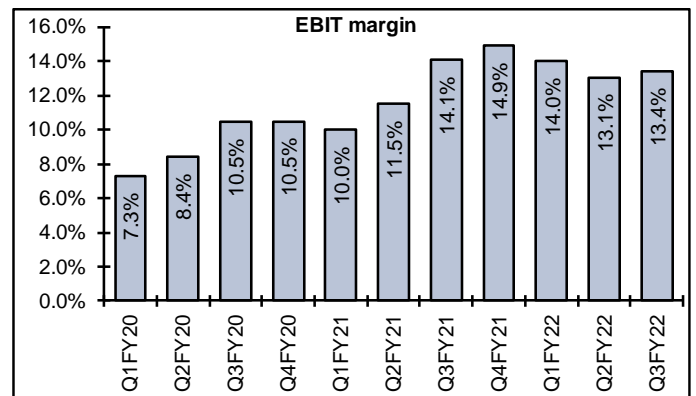
Source: Company, I-Sec research

Chart 11: Margins to expand over FY22-FY24E



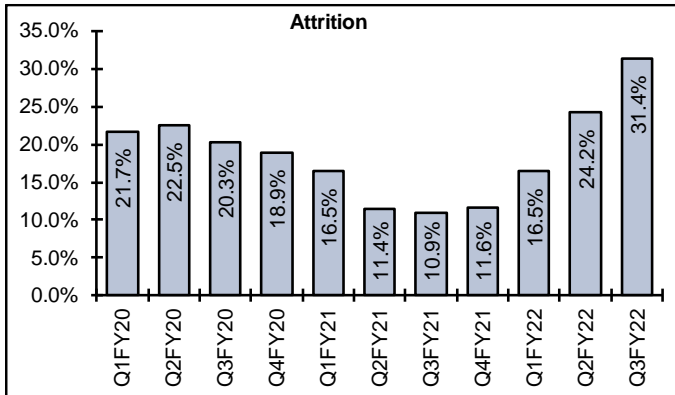
Source: Company, I-Sec research

Chart 12: Supply pressures led to contraction



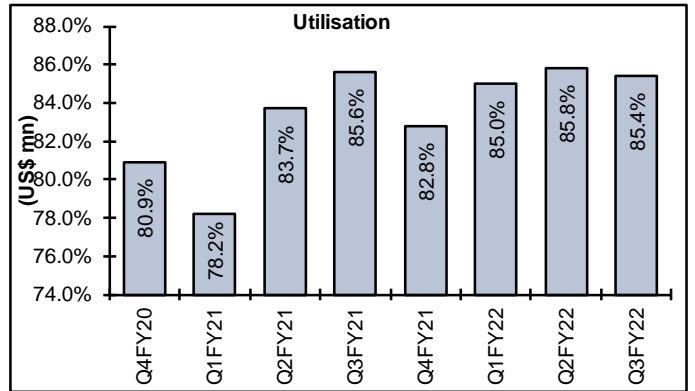
Source: Company, I-Sec research

Chart 13: Attrition much higher than pre-covid



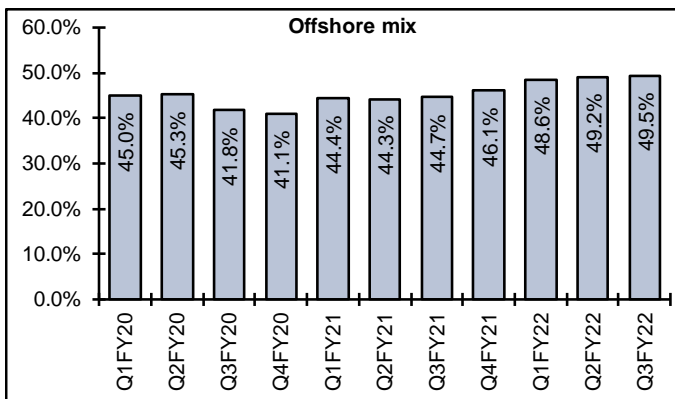
Source: Company, I-Sec research

Chart 14: Utilisation remains largely stable



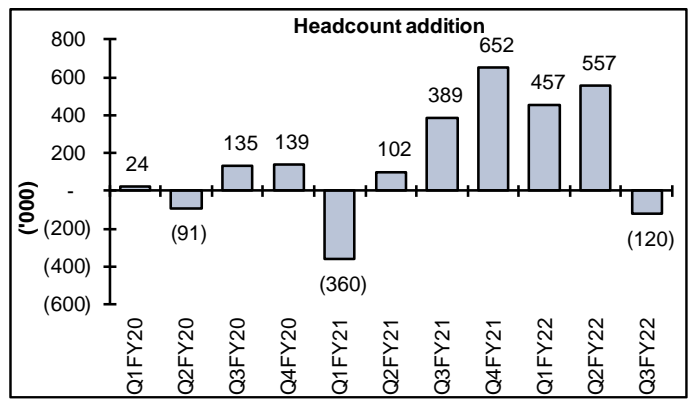
Source: Company, I-Sec research

Chart 15: Offshore mix remains largely stable



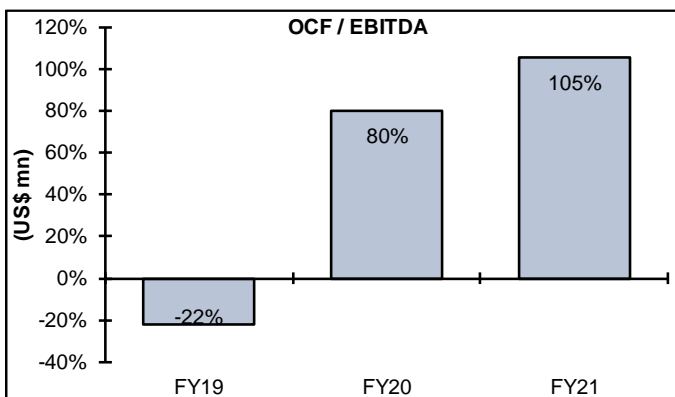
Source: Company, I-Sec research

Chart 16: Increased hiring to fulfil demand



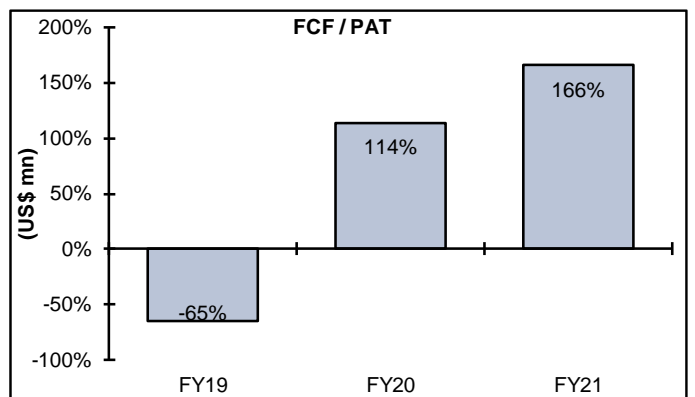
Source: Company, I-Sec research

Chart 17: Robust cash conversions despite...



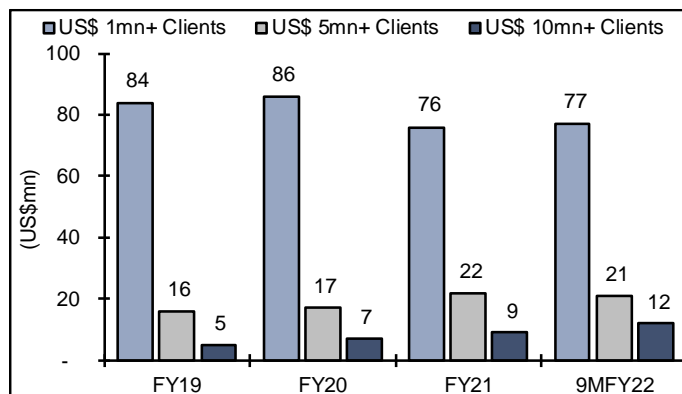
Source: Company, I-Sec research

Chart 18: ...COVID-led pressures



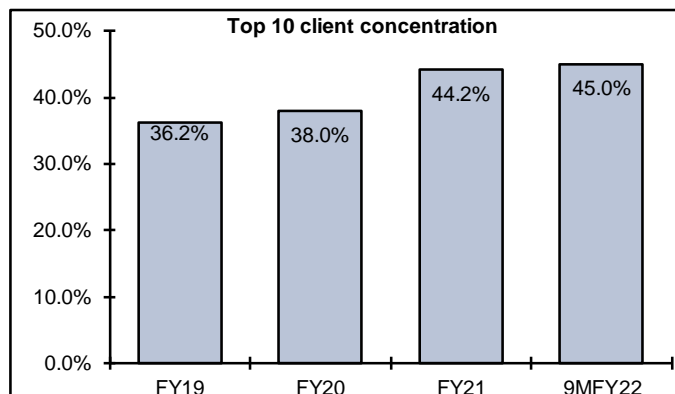
Source: Company, I-Sec research

Chart 19: Steady increase in US\$10m+ clients



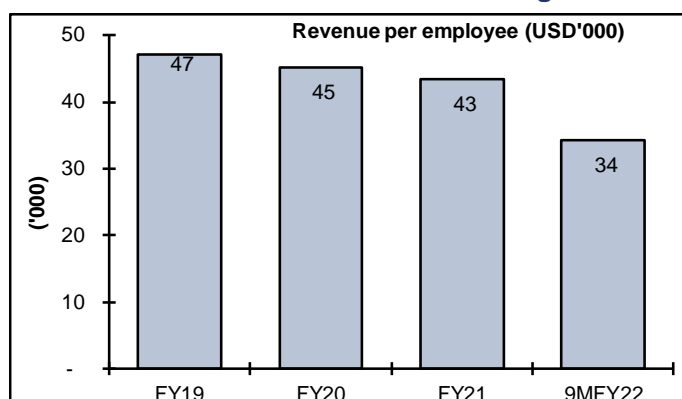
Source: Company, I-Sec research

Chart 20: Client concentration inching up



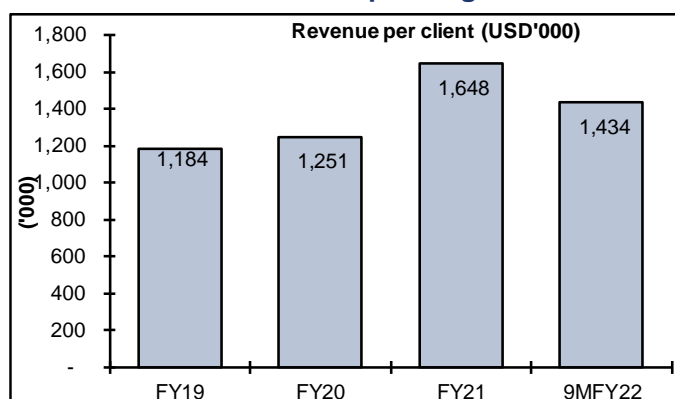
Source: Company, I-Sec research

Chart 21: Decline due to increased hiring



Source: Company, I-Sec research

Chart 22: Decline due to expanding base



Source: Company, I-Sec research

Financial summary – Birlasoft

Table 1: Profit and Loss statement

(Rs mn, year ending March 31)

	FY21	FY22E	FY23E	FY24E
Revenue (US\$mn)	480	557	660	763
Total Income (Sales)	35,558	41,451	50,189	58,735
Operating Expenses	30,265	35,121	42,720	49,338
EBITDA	5,293	6,330	7,469	9,398
% margin	14.9	15.3	14.9	16.0
Depreciation & Amortisation	803	762	1,004	1,175
EBIT	4,490	5,569	6,466	8,223
% margin	12.6	13.4	12.9	14.0
Other Income	190	565	512	512
Interest expense	131	124	124	124
Recurring PBT	4,549	6,010	6,854	8,611
Tax expense	1,340	1,531	1,770	2,224
Recurr. profit before minority	3,209	4,479	5,083	6,387
Minority interest	-	-	-	-
Extraordinary items	-	-	-	-
Net Profit as restated	3,209	4,479	5,083	6,387

Source: Company data, I-Sec research

Table 2: Balance sheet

(Rs mn, year ending March 31)

	FY21	FY22E	FY23E	FY24E
Liabilities				
Share capital	555	557	557	557
Reserves and Surpluses	21,245	23,968	27,707	32,749
Net Worth	21,799	24,525	28,264	33,306
Minority Interest	-	-	-	-
Non-current Liabilities	1,802	1,829	1,829	1,829
Total Liabilities	23,601	26,354	30,093	35,135
Borrowings	-	-	-	-
Assets				
Fixed Assets	7,047	7,199	7,203	7,207
Other Non-current assets	1,845	2,040	2,040	2,040
Current assets	21,053	23,718	27,848	33,313
less: current liabilities	6,344	6,603	6,997	7,424
Net current assets	14,709	17,115	20,850	25,888
Total Assets	23,601	26,354	30,093	35,135

Source: Company data, I-Sec Research

Table 3: Cashflow statement

(Rs mn, year ending March 31)

	FY21	FY22E	FY23E	FY24E
Op. CF before W Cap changes	3,781	6,206	7,345	9,274
Working Capital Inflow / (Outflow)				
Taxes	2,464	(1,221)	(1,928)	(2,084)
Capex	(667)	(1,531)	(1,770)	(2,224)
Free Cashflow	5,330	2,541	2,640	3,787
CF from other Invest Act (Ex Capex)	(4,196)	(1,580)	512	512
Change in share capital	2	(413)	(0)	0
Inc/(Dec) in Borrowings	(395)	-	-	-
Dividend paid	(554)	(1,340)	(1,344)	(1,344)
Others	(21)	27	-	-
Increase/(Decrease) in Cash	165	(764)	1,807	2,954

Source: Company data, I-Sec research

Table 4: Key ratios

(Year ending March 31)

	FY21	FY22E	FY23E	FY24E
Per Share Data (Rs)				
Reported Basic EPS	11.6	16.2	18.4	23.1
Recurring Cash EPS	14.5	18.9	22.0	27.3
Book Value per share (BV)	78.8	88.7	102.2	120.4
Dividend per share	3.5	4.0	4.0	4.0
Growth Ratios (%)				
Total Income (Sales) - US\$	3.4	16.1	18.6	15.5
Total Income (Sales)	8.0	16.6	21.1	17.0
EBITDA	36.8	19.6	18.0	25.8
Net Income	43.1	39.6	13.5	25.6
Basic EPS	43.1	39.6	13.5	25.6
Recurring Cash EPS	30.8	30.6	16.2	24.2
Valuation Ratios (x)				
P/E	42.2	30.3	26.7	21.2
P/CEPS	33.8	25.9	22.3	17.9
P/BV	6.2	5.5	4.8	4.1
EV / EBITDA	(1.0)	(1.0)	(1.1)	(1.2)
EV / Sales	(0.1)	(0.2)	(0.2)	(0.2)
EV / FCF	(1.0)	(2.5)	(3.1)	(2.9)
Operating Ratios				
Other Income / PBT (%)	4.2	9.4	7.5	5.9
Effective Tax Rate (%)	29.5	25.5	25.8	25.8
NWC / Total Assets (%)	33.6	40.1	40.8	40.5
Receivables (days)	53.2	58.8	57.6	57.7
Payables (days)	13.5	18.4	18.1	18.1
D/E Ratio (x)	-	-	-	-
Return/Profitability Ratios (%)				
Net Income Margins	9.0	10.8	10.1	10.9
EBITDA Margins	14.9	15.3	14.9	16.0
RoNW (based on average)	15.8	19.3	19.3	20.7
Dividend Yield	0.7	0.8	0.8	0.8

Source: Company data, I-Sec research

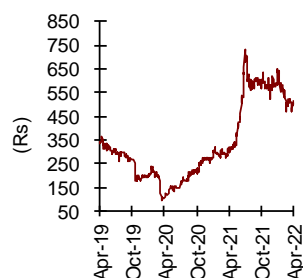
Newgen Software Technologies

(ADD; CMP: Rs512, TP: Rs573)

Shareholding pattern

	Jun '21	Sep '21	Dec '21
Promoters	55.2	55.2	55.2
Institutional investors	23.2	25.7	25.0
MFs and others	4.6	4.2	4.7
FIs/Bank	0.0	0.0	0.0
Insurance Cos.	0.0	0.0	0.0
FII	18.6	21.5	20.3
Others	21.6	19.1	19.8

Price chart



GSI partnerships to bear fruit in the near term

Recent management commentary hints at a robust demand environment and healthy pipeline; however, the GSI partnerships formed by the company are yet to bear fruit. Longer timelines to close deals have pushed out revenues from these GSIs and we expect them to aid revenue growth in FY23E.

Further, given that typical projects are shorter and smaller, building new client relationships is key for companies like Newgen, which is inherently dependent on travel opening up. We expect the company to report growth of 21%/22% in FY23E/FY24E on the back of entrance into new geographies through GSIs and adding new client logos post travel opening up.

Triggers & catalysts for the stock

GSIs to generate revenue in the near term: Newgen earlier believed that their partnership with the GSIs would aid their revenue growth from FY22 itself. However, it was observed that deals typically have a 6-8-month closure period, hence the delay in generating revenues. We believe these partnerships should start generating revenues by FY23E aiding Newgen to achieve a 20%+ CAGR over FY22-FY24E. Further, the company's aspiration to achieve at least 50% of its revenue from these GSI partnerships indicate a robust underlying opportunity.

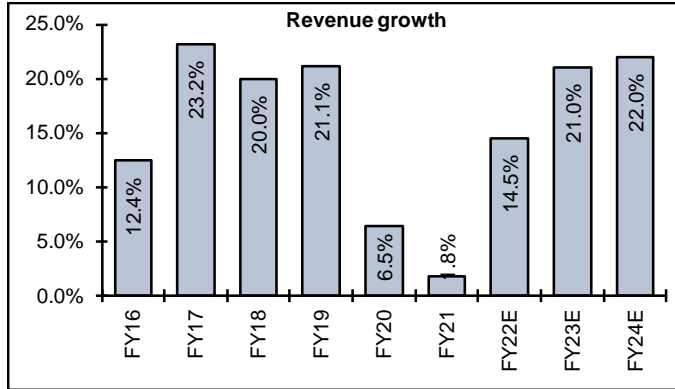
Conservative margin outlook: Management has guided for a 23-25% EBITDA margin over the medium term, largely owing to the increase in SaaS revenues and decline in its license revenues. However, we believe the guidance is conservative given that companies like Newgen typically have higher proportion of fixed costs leading to positive operating leverage as scale increases. Company's ability to achieve margins above the stated band should be a key positive.

Valuation: Increased focus on gaining new logos and a foothold in *Fortune 2000* accounts with the help of GSIs should help Newgen get better visibility and acceptability within the client ecosystem. Conversion of the same remains key. Considering the aforementioned, we estimate an EPS CAGR of ~23% over FY22-FY24E. We assign **ADD** rating our target price of Rs573.

Key Risks: 1) Inability to generate revenues through GSIs, 2) Faster transition to SaaS from on-premise in emerging markets

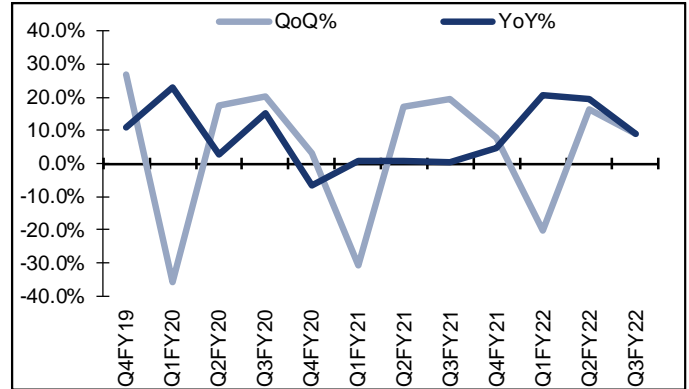
Market Cap	Rs35.8bn/US\$472mn	Year to March	2021	2022E	2023E	2024E
Reuters/Bloomberg	NEWGEN IN	Revenue (Rs mn)	6,726	7,702	9,319	11,369
Shares Outstanding (mn)	70.0	Net Income (Rs mn)	1,265	1,331	1,664	2,042
52-week Range (Rs)	735/299	EPS (Rs)	18.1	18.9	23.3	28.4
Free Float (%)	44.8	% Chg YoY	72.2	4.2	23.8	21.5
FII (%)	20.3	P/E (x)	28.3	27.2	21.9	18.1
Daily Volume (US\$'000)	1,162	CEPS (Rs)	21.0	21.6	26.6	32.3
Absolute Return 3m (%)	(16.3)	EV/E (x)	17.0	17.3	14.1	11.5
Absolute Return 12m (%)	65.3	Dividend Yield	0.4	0.7	0.8	1.0
Sensex Return 3m (%)	(0.3)	RoCE (%)	20.4	22.0	24.9	26.9
Sensex Return 12m (%)	20.7	RoE (%)	20.8	18.6	20.0	20.9

Chart 1: Revenue growth to pick up ahead...



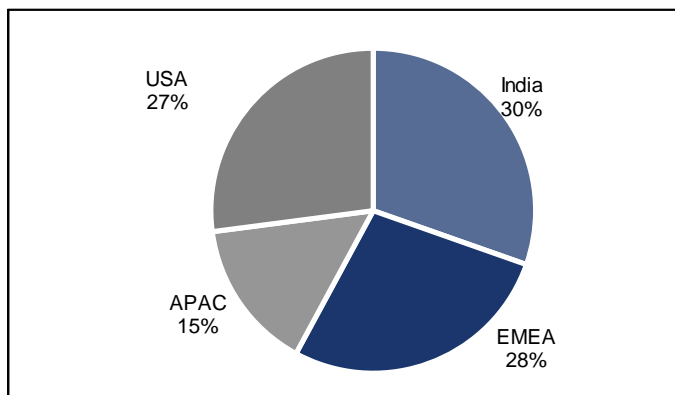
Source: Company, I-Sec research

Chart 2: ...due to GSI partnerships



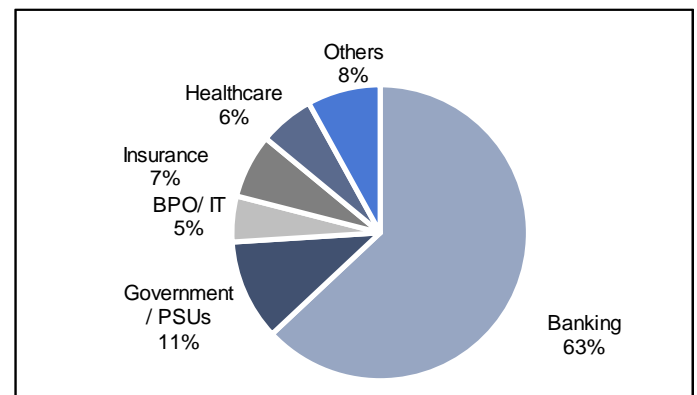
Source: Company, I-Sec research

Chart 3: Geographical mix (%)



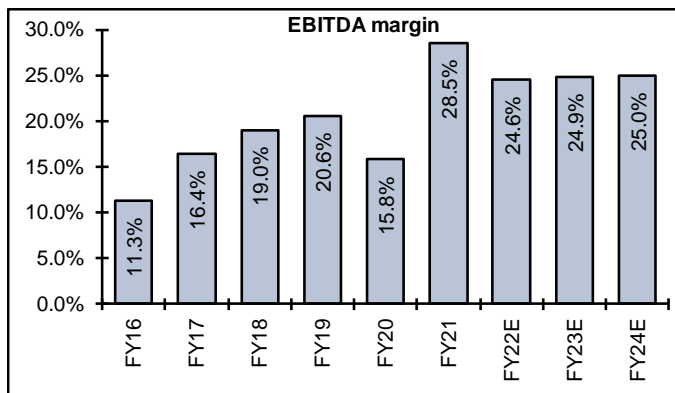
Source: Company, I-Sec research

Chart 4: Vertical mix (%)



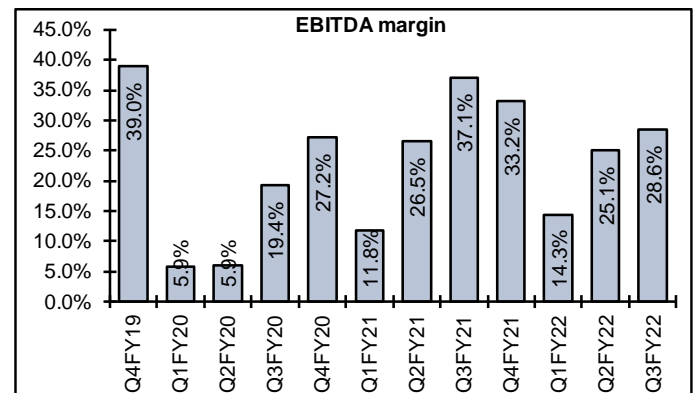
Source: Company, I-Sec research

Chart 5: Margins to expand over FY22-FY24E



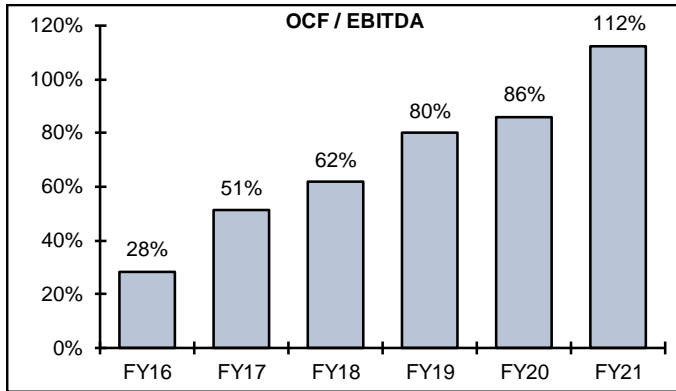
Source: Company, I-Sec research

Chart 6: Margins to stabilise going forward



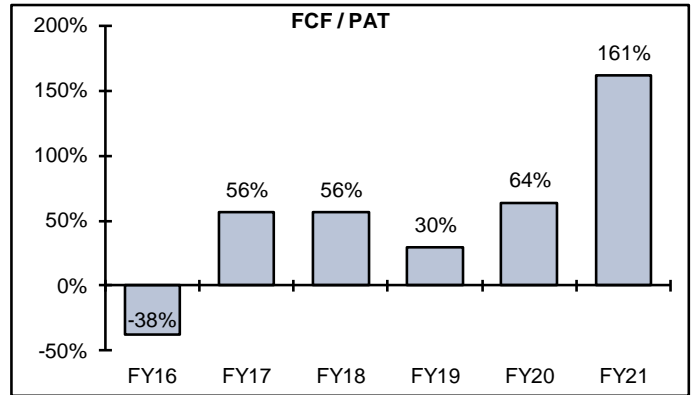
Source: Company, I-Sec research

Chart 7: Robust cash conversions despite...



Source: Company, I-Sec research

Chart 8: ...covid-led pressures



Source: Company, I-Sec research

Financial summary – Newgen Software Technologies

Table 1: Profit and Loss statement

(Rs mn, year ending March 31)

	FY21	FY22E	FY23E	FY24E
Operating Revenues				
(Sales)	6,726	7,702	9,319	11,369
Operating Expenses	4,807	5,808	7,000	8,528
EBITDA	1,919	1,894	2,319	2,841
% margins	28.5	24.6	24.9	25.0
Depreciation & Amortisation	201	193	233	284
EBIT	1,718	1,701	2,086	2,557
% margins	25.5	22.1	22.4	22.5
Other Income	150	175	200	220
Interest & Finance Chgs	56	125	125	125
Profit / (Loss) before Taxation	1,812	1,751	2,161	2,652
Less: Taxes	547	420	497	610
Net Profit/(Loss)	1,265	1,331	1,664	2,042

Source: Company data, I-Sec research

Table 2: Balance sheet

(Rs mn, year ending March 31)

	FY21	FY22E	FY23E	FY24E
Assets				
Total Current Assets	6,489	7,813	9,699	12,085
Total Current Liabilities & Provisions	2,124	2,235	2,794	3,550
Net Current Assets	4,365	5,578	6,906	8,535
Net Fixed Assets	2,049	2,011	1,964	1,908
Tangible assets	1,578	1,540	1,493	1,436
Intangible assets and ROU	471	471	471	471
Long-term loans and advances	370	119	136	159
Other Long Term Assets	99	169	204	249
Deferred tax assets (net)	198	198	198	198
Total Assets	7,082	8,074	9,409	11,048
Liabilities				
Long term provisions	286	253	306	374
Other Long Term Liabilities	139	139	139	139
Equity Share Capital	693	693	693	693
Reserves & Surplus	5,964	6,989	8,270	9,842
Net Worth	6,657	7,682	8,963	10,535
Total Liabilities	7,082	8,074	9,409	11,048

Source: Company data, I-Sec Research

Table 3: Cashflow statement

(Rs mn, year ending March 31)

	FY21	FY22E	FY23E	FY24E
Operating Cashflow before W Cap changes	1,926	1,473	1,822	2,231
Working Capital Inflow / (Outflow)	231	(339)	(243)	(260)
Capex	(116)	(154)	(186)	(227)
Free Cashflow	2,041	980	1,392	1,744
Cashflow from other Invst Act (Ex Capex)	(1,314)	175	200	220
Proceeds from Issue of Share Capital	-	-	-	-
Inc/(Dec) in Borrowings / Deferred Liabilities	(875)	-	-	-
Interest & Dividend paid	(149)	(431)	(508)	(595)
Increase/(Decrease) in Cash	(296)	724	1,085	1,369

Source: Company data, I-Sec research

Table 4: Key ratios

(Year ending March 31)

	FY21	FY22E	FY23E	FY24E
Per Share Data (Rs)				
Earnings per share (Diluted Reported)	18.1	18.9	23.3	28.4
Earnings per share (Basic Reported)	18.2	19.0	23.5	28.5
Cash earnings per share	21.0	21.6	26.6	32.3
Dividend per share	2.0	3.5	4.3	5.2
Book Value per share	95.3	108.8	125.7	146.3
Growth Ratios (%)				
Operating Income (Sales)	1.8	14.5	21.0	22.0
EBITDA	83.5	(1.3)	22.5	22.5
Recurring Net Income	73.9	5.2	25.0	22.7
Diluted Recurring EPS	72.2	4.2	23.8	21.5
Diluted Recurring CEPS	56.7	2.9	23.3	21.4
Valuation Ratios (x)				
P/E	28.3	27.2	21.9	18.1
P/CEPS	24.4	23.7	19.2	15.8
P/BV	5.4	4.7	4.1	3.5
EV / EBITDA	17.0	17.3	14.1	11.5
EV / Sales	4.9	4.2	3.5	2.9
EV / FCF	16.0	33.3	23.5	18.7
Operating Ratios				
Software Development Exp./Sales (%)	48.7	50.0	51.0	50.9
SG&A/Sales (%)	22.8	25.4	24.1	24.1
Other Income / PBT (%)	8.3	10.0	9.3	8.3
Effective Tax Rate (%)	30.2	24.0	23.0	23.0
Fixed Asset Turnover (x) on average	4.2	4.9	6.1	7.7
Receivables (days)	129.4	135.0	135.0	135.0
Payables (days)	12.3	13.0	13.0	13.0
D/E Ratio (x)	0.0	0.0	0.0	0.0
Return/Profitability Ratios (%)				
Recurring Net Income Margins	18.8	17.3	17.9	18.0
RoCEex Cash (Based on Avg)	20.4	22.0	24.9	26.9
RoNW (Based on Avg)	20.8	18.6	20.0	20.9
Dividend Payout Ratio	11.0	23.0	23.0	23.0
Dividend Yield	0.4	0.7	0.8	1.0
EBITDA Margin	28.5	24.6	24.9	25.0

Source: Company data, I-Sec research

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