IT Services

Banking crisis to weigh upon near term growth

Summary

Worsening macro conditions and recent banking crisis in US & Europe indicate slowing down of tech spends by enterprises globally. We believe enterprises will shift their focus on cutting cost resulting in higher cost take out deals, vendor consolidation & lower discretionary spend. BFSI, Telecom, Retail and Hi tech verticals are expected to be the impacted by the slowdown, thus weakening H1FY24E growth outlook. We expect even those verticals not impacted will have cautious outlook. For Q4FY23E, we expect large caps to register dollar growth of -1% - +1% QoQ in CC terms aided by 15-100 bps cross currency tailwind. Among mid-caps we expect revenue growth of -1%-3.5% QoQ (organic) in CC aided by 30-150 bps cross currency. Further, Tier I margins are expected to record QoQ growth in the range of -99 – +90 bps. We prefer Infosys among large caps and Coforge among mid-caps.

Key Highlights

- **Revenue Outlook**: Among tier 1, we expect TCS to lead the pack with 1% QoQ growth, while Infosys, Wipro and TechM are expected to register flat revenue growth QoQ. HCL is expected to register -1% QoQ growth. Among mid-caps, we expect Coforge (3.5% CC QoQ growth, +166 bps margins) & LTIM (2.6% QoQ, +221 bps margin) to lead the pack. We expect Cyient services revenue to register 1.5% QoQ organic growth in CC. While Zensar is expected to register flattish growth, Birlasoft is expected to de-grow -1% QoQ in CC. In the small cap space, Newgen is expected to record 10.3% QoQ growth in a seasonally strong quarter.

- **Margins Outlook:** Easing of supply side challenges, lower attrition & cost rationalization will boost margins. Large caps (except HCL) are expected to report 24-90 bps improvement; mid-caps (except Birlasoft) are expected to register margin expansion in the range of 60-221 bps QoQ.

India IT Sector: Valuation and Rating

Companies	Rating	CMP (Rs)	TP (Rs)	Mkt Cap (Rs bn)	*Upside (%)*	P/E (x) FY24E	P/E (x) FY25E
TCS	**HOLD**	3,206	3,615	11730	*13*	23	21
Infosys	**BUY**	1,428	1,715	5923	*20*	21	19
HCL Tech.	**HOLD**	1,086	1,140	2948	*5*	19	17
Wipro	**HOLD**	365	430	2005	*18*	15	14
Tech Mah.	**HOLD**	1,102	1,150	1073	*4*	15	14
LTIMindtree	**HOLD**	4,758	5,000	1408	*5*	28	24
Coforge	**BUY**	3,817	4,356	233	*14*	23	19
Cyient	**BUY**	993	1045	110	*5*	16	14
Birlasoft	**BUY**	261	315	72	*30*	14	12
Zensar Tech.	**BUY**	274	280	62	*2*	14	11
Newgen	**BUY**	451	480	32	*7*	16	12

Source: IDBI Capital, Company

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Exhibit: Estimates

(Rs mn)

Company		Mar 23	Dec 22	Mar 22	*QoQ (%)*	*YoY (%)*	Comments
TCS	Revenue (US$ mn)	7,217	7,075	6,696	*2.0*	*7.8*	■ We forecast QoQ revenue growth of 1% in CC terms and cross currency tailwind of 98 bps. ■ Easing of supply side challenges to aid margin expansion. We forecast 73 bps improvement in margins to 25.3%. ■ **Would watch for:** 1) commentary on clients' tech budgets; 2) strategy of new CEO; 3) TCV of deal wins; 4) timeline of deal closures and deal pipeline; 5) hiring & offshoring, 6) outlook on EBIT margin and its sustainability; 7) commentary on long term digital trends; 8) commentary on Europe; 9) Impact on verticals due to macro situation (BFSI in particular); 10) attrition trend and 11) FY24 growth & margin outlook.
	Revenue (Rs mn)	593,557	582,290	505,910	*1.9*	*17.3*	
	EBIT (Rs mn)	149,932	142840	126280	*5.0*	*18.7*	
	EBIT margin (%)	*25.26%*	*24.53%*	*24.96%*	*72.9*	*29.9*	
	Net profit (Rs mn)	113,881	108,460	99,260	*5.0*	*14.7*	
	EPS (Rs)	31.1	29.6	27.0	*5.0*	*15.1*	
Infosys	Revenue (US$ mn)	4,705	4,659	4,280	*1.0*	*9.9*	■ We forecast revenue growth to be flat in CC terms and cross currency tailwind of 100 bps. Growth is expected to be muted due to delayed decision making by clients. ■ We expect EBIT margin to expand by 83 bps QoQ to 22.3% mainly led by flatter pyramid and reduced attrition levels. ■ **Would watch for:** 1) tech budgets by clients; 2) impact on BFSI in US & Europe 3) Large deal pipeline and wins; 4) impact on discretionary spends 5) Attrition level and trends 6) margin outlook and 7) outlook on Telecom, retail, BFSI & Hi tech verticals.
	Revenue (Rs mn)	387,016	383,180	322,760	*1.0*	*19.9*	
	EBIT (Rs mn)	86,465	82,420	69,560	*4.9*	*24.3*	
	EBIT margin (%)	*22.34%*	*21.51%*	*21.55%*	*83.2*	*79.0*	
	Net profit (Rs mn)	68,526	65,860	56,860	*4.0*	*20.5*	
	EPS (Rs)	16.34	15.70	13.54	*4.0*	*20.5*	
Wipro	Revenue (US$ mn)	2,865	2,841	2,762	*0.8*	*3.7*	■ We expect flat revenue growth in CC terms and cross currency tailwind of 82 bps. Softness in consulting business, BFSI, tech and retail verticals is expected to result in overall muted growth. ■ We forecast EBIT margin to grow by 90 bps QoQ led by uptick in utilisation. ■ **Would watch for:** 1) Outlook for Q1FY24E; 2) Outlook for consulting business; 3) Commentary on the large deal wins; 4) tech budgets; 5) Commentary on client mining; 6) Commentary across verticals - especially BFSI, Consumer, Hi Tech and Manufacturing business unit 7) Attrition trends 8) M&A and capital allocation 9) Outlook on any other macro challenges.
	Revenue (Rs mn)	234,467	232,290	208,600	*0.9*	*12.4*	
	EBIT (Rs mn)	38,685	36,245	34,029	*6.7*	*13.7*	
	EBIT margin (%)	*16.50%*	*15.60%*	*16.31%*	*89.6*	*18.6*	
	Net profit (Rs mn)	32,530	30,529	30,873	*6.6*	*5.4*	
	EPS (Rs)	5.95	5.59	5.65	*6.6*	*5.4*	

Company		Mar 23	Dec 22	Mar 22	QoQ (%)	YoY (%)	Comments
HCLT	Revenue (US$ mn)	3,217	3,244	2,993	-0.8	7.5	■ We expect revenue growth (in CC) terms to decrease by 1% QoQ with cross currency tailwind of 15 bps. This is mainly due to seasonal softness in product revenue. ■ We expect EBIT margin to taper down by 99 bps QoQ mainly led by decline in revenue growth. ■ **Would watch for:** 1) Outlook on product business 2) Outlook on ER&D business given the turmoil in Europe; 3) Commentary on deal pipeline, especially large deals, pricing 4) attrition trend 5) Margin outlook; 6) M&A plans; 7) tech spends by clients.
	Revenue (Rs mn)	264,561	267,000	225,970	-0.9	17.1	
	EBIT (Rs mn)	49,177	52,280	40,690	-5.9	20.9	
	EBIT margin (%)	*18.59%*	*19.58%*	*18.01%*	*-99.2*	*58.1*	
	Net profit (Rs mn)	38,269	40,960	35,940	-6.6	6.5	
	EPS (Rs)	14.14	15.13	13.26	-6.6	6.6	
TechM	Revenue (US$ mn)	1,685	1,668	1,608	1.0	4.8	■ We expect flat QoQ revenue growth in CC and positive impact of cross currency to the tune of 100 bps. Growth is expected to be muted due to broad based demand softness. ■ We expect EBIT margin to improve by 24 bps QoQ on account of improved utilization. ■ **Would watch for:** 1) Large deal wins; 2) Commentary on demand across all verticals especially on enterprise business, 3) 5G trends 4) Outlook on EBIT margin; 5) Outlook on Europe 6) Outlook on communication and 7) M&A and capital allocation 8) Commentary on transition to new CEO and update on future growth objectives.
	Revenue (Rs mn)	138,590	137,346	121,163	0.9	14.4	
	EBIT (Rs mn)	16,944	16,459	16,042	2.9	5.6	
	EBIT margin (%)	*12.23%*	*11.98%*	*13.24%*	*24.2*	*-101.4*	
	Net profit (Rs mn)	13,540	12,966	15,056	4.4	-10.1	
	EPS (Rs)	15.29	14.64	17.09	4.4	-10.5	
LTIMindtree	Revenue (US$ mn)	1079	1047	945	3.1	14.3	■ We forecast 2.6% QoQ growth in CC terms and cross currency benefit of 46 bps. We expect growth to be driven by absence of furloughs and BFSI vertical. ■ We expect EBIT margins to improve by 220 bps QoQ on account of lower base and immprovement in utilisation. ■ **Would watch for:** 1) Large deal win commentary; 2) Commentary on deal pipeline & its conversion, new logo addition, pricing; 3) Commentary on supply side challenges 5) Outlook for the margins; and 6) Trend in top client and 7) Outlook on manufacturing, hi tech, manufacturing and BFSI given the high inflation 8) Synergy benefits of merger.
	Revenue (Rs mn)	88,777	86,200	71,990	3.0	23.3	
	EBIT (Rs mn)	14,284	11,967	12,932	19.4	10.5	
	EBIT margin (%)	*16.09%*	*13.88%*	*17.96%*	*220.7*	*-187.4*	
	Net profit (Rs mn)	12,324	10,005	11,337	23.2	8.7	
	EPS (Rs)	41.61	33.78	38.28	23.2	8.7	

Company		Mar 23	Dec 22	Mar 22	QoQ (%)	YoY (%)	Comments
CYIENT	Revenue (US$ mn)	211	197	157	*7.0*	*34.5*	■ We expect revenue in CC to increase by 5.5% QoQ and cross currency benefit of 150 bps. Growth is expected to be led by 3.5% QoQ (organic growth of2.5%) expansion in services revenues. DLM segment is expected to record 27% QoQ growth. In terms of verticals, growth is expected to be led by Communication and Aerospace. ■ We forecast EBIT margin to improve by 60 bps QoQ to 13.5% due to cost optimisation and price hikes. ■ **Would watch for:** 1) Outlook on verticals like Aerospace and Communications, Transportation and ENU; 2) outlook on DLM business; 3) Outlook on EBIT margin; 4) Outlook on attrition; and 5) Progress on acquisitions.
	Revenue (Rs mn)	17,333	16,182	11,812	*7.1*	*46.7*	
	EBIT (Rs mn)	2,336	2,084	1,708	*12.1*	*36.8*	
	EBIT margin (%)	*13.48%*	*12.88%*	*14.46%*	*60.1*	*-97.6*	
	Net profit (Rs mn)	1,621	1627	1,542	*-0.3*	*5.2*	
	EPS (Rs)	14.73	14.78	14.00	*-0.3*	*5.2*	
Zensar	Revenue (US$ mn)	147	146	153	*0.6*	*-4.2*	■ We forecast revenue growth to be flat QoQ in CC and cross currency benefit of 60 bps. We expect Hi-tech and manufacturing verticals to observe softness led by cautious demand envoirnment. ■ We forecast EBIT margin to improve by 154 bps QoQ to 8.65% led by operational efficiency, increase in utilization and easing supply side challenges. ■ **Would watch for:** 1) Outlook on expected turnaround in the company; 2) Outlook on the BFSI, manufacturing & retail given the global challenges; 3) Deal pipeline 4) Large deal wins 5) New logo addition and client mining trend 6) attrition trends 7) Order book trend 8) Outlook on EBIT margin and 8) strategy and organizational restructuring by new CEO.
	Revenue (Rs mn)	12,148	11,976	11,538	*1.4*	*5.3*	
	EBIT (Rs mn)	1051	852	1161	*23.3*	*-9.5*	
	EBIT margin (%)	*8.65%*	*7.11%*	*10.06%*	*153.5*	*-141.3*	
	Net profit (Rs mn)	894	765	1297	*16.9*	*-31.0*	
	EPS (Rs)	3.9	3.36	5.7	*16.9*	*-31.1*	

Company		Mar 23	Dec 22	Mar 22	QoQ (%)	YoY (%)	Comments
Birlasoft	Revenue (US$ mn)	147	148.4	146.4	*-0.7*	*0.7*	■ Revenue is expected to record negative growth of 1% QoQ in CC terms due to Invacare related issues, partially offset by cross currency tailwind of 30 bps. ■ EBIT margins to taper down by 118 bps QoQ due to lower revenue growth led by client specific issues. ■ **Would watch for:** 1) Outlook on top clients; 2) Deal pipeline 3) Large deal wins 4) new logo addition and client mining trend 5) Outlook on EBIT margin; 6) outlook on BFSI, manufacturing & hitech due to high inflation trend; 7) commentary on client realted issues; 8) outlook on Europe and 9) Attrition trend 10) strategy & organizational restructuring by new CEO and 11) creation of any further provision due to client bankruptcy.
	Revenue (Rs mn)	12,120	12,219	11,014	*-0.8*	*10.0*	
	EBIT (Rs mn)	1,220	1,374	1,546	*-11.2*	*-21.1*	
	EBIT margin (%)	*10.07%*	*11.24%*	*14.03%*	*-117.5*	*-396.6*	
	Net profit (Rs mn)	1,006	1,347	1,329	*-25.3*	*-24.3*	
	EPS (Rs)	3.63	4.86	4.68	*-25.3*	*-22.5*	
Newgen	Revenue (Rs mn)	2,812	2,549	2,314	*10.3*	*21.5*	■ We forecast revenue to grow by 22% YoY led by seasonally strong quarter. ■ We forecast EBITDA margin to expand by 650 bps QoQ to 30%. Consequently EBIT margin is expected to expand by ~36 bps YoY to 27.3% on the back of robust revenue growth. ■ **Would watch for:** 1) Outlook on new logo addition; 2) Outlook on SaaS revenue growth; 3) Commentary on GSI deals 4) Outlook on EBIT margin; 5) outlook on the mature market penetration6) Annuity trends 7) SAAS trends 8) Geo wise growth trends.
	EBIT (Rs mn)	769	528	625	*45.8*	*23.1*	
	EBIT margin (%)	*27.36%*	*20.70%*	*27.00%*	*666.7*	*35.9*	
	Net profit (Rs mn)	687	482	574	*42.6*	*19.7*	
	EPS (Rs)	9.8	6.9	8.2	*42.6*	*19.5*	
Coforge	Revenue (US$ mn)	263	252	232	*4.6*	*13.3*	■ We forecast revenue to grow by 3.5% QoQ in CC terms and cross currency tailwind of 110 bps. Growth is expected to be led by Insurance and TTH verticals. ■ We forecast EBIT margin to expand by ~166 bps QoQ to 16.2% on the back of improved utilization, CC tailwind and easing supply side challenges. ■ **Would watch for:** 1) Outlook on top clients; 2) impact of banking crisis on BFS vertical 3) commentary on tech budgets 4) new logo addition and client mining trend 5) Outlook on growth & EBIT margin; 6) outlook on BFS vertical due to high inflation trend; 7) Attrition trend; 8) Deal pipeline; 9) outlook on TTH and 10) Large deal wins.
	Revenue (Rs mn)	21656	20558	17429	*5.3*	*24.3*	
	EBIT (Rs mn)	3509	2991	2709	*17.3*	*29.5*	
	EBIT margin (%)	*16.2%*	*14.5%*	*15.5%*	*165.5*	*66.1*	
	Net profit (Rs mn)	2739	2282	2077	*20.0*	*31.9*	
	EPS (Rs)	44.33	36.92	33.61	*20.0*	*31.9*	

Source: IDBI Capital Research; Note: data for EBIT Margin YOY and QOQ is in bps.

Exhibit: Stock price performance

Change (%)	1-mnth	3-mnth	6-mnth	1-yr
SENSEX	-1%	-3%	3%	1%
BSE IT	-4%	-1%	4%	-22%
TCS	-5%	-2%	7%	-14%
INFO	-5%	-5%	1%	-25%
WPRO	-7%	-7%	-7%	-38%
HCLT	-1%	5%	17%	-7%
TECHM	-2%	8%	9%	-27%
LTIM	0%	8%	6%	-23%
CYL	7%	25%	28%	9%
ZENT	-5%	29%	30%	-25%
BSOFT	-6%	-13%	-8%	-43%
NEWGEN	-2%	26%	27%	-3%
COFORGE	-12%	-2%	13%	-15%

Source: Bloomberg

Exhibit: Cross-currency movement trend

Currency	Details	Q1FY22	Q2FY22	Q3FY22	Q4FY22	Q1FY23	Q2FY23	Q3FY23	Q4FY23
USD/INR	Average	74.1	73.8	74.9	75.2	77.2	79.8	82.2	82.3
	QoQ	*1.7*	*(0.5)*	*1.5*	*0.4*	*2.7*	*3*	*3*	*0*
	Closing	74.3	74.2	74.7	76.0	79.0	81.9	82.9	82.2
	QoQ	*1.7*	*(0.2)*	*0.8*	*1.7*	*3.9*	*4*	*1*	*(1)*
GBP/USD	Average	1.3	1.4	1.3	1.3	1.3	1.2	1.2	1.2
	QoQ	*(3.8)*	*2.1*	*(0.4)*	*(0.5)*	*(6.1)*	*(6)*	*(0)*	*3*
	Closing	1.4	1.4	1.3	1.3	1.2	1.1	1.2	1.2
	QoQ	*0.3*	*(2.2)*	*(0.7)*	*(2.4)*	*(7.0)*	*(11)*	*10*	*2*
EUR/USD	Average	1.2	1.2	1.1	1.1	1.1	1.0	1.0	1.1
	QoQ	*(2.6)*	*1.4*	*(3.9)*	*(1.9)*	*(5.5)*	*(5)*	*1*	*5*
	Closing	1.2	1.2	1.1	1.1	1.1	1.0	1.1	1.1
	QoQ	*1.0*	*(1.6)*	*(3.1)*	*(1.7)*	*(5.4)*	*(7)*	*9*	*2*
AUD/USD	Average	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7
	QoQ	*(5.6)*	*2.1*	*(2.1)*	*(0.6)*	*(0.6)*	*(5)*	*(4)*	*4*
	Closing	0.7	0.7	0.7	0.8	0.7	0.7	0.7	0.7
	QoQ	*(1.3)*	*(3.4)*	*(0.2)*	*4.0*	*(11.1)*	*(2)*	*3*	*(1)*

Source: Bloomberg

Notes

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BUY: 15%+; **HOLD:** -5% to 15%; **SELL:** -5% and below.

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