

IT Services

Seasonally strong quarter to be weak due to macro

Summary

Q1 is the strongest quarter for IT companies. However, current macro conditions are expected to impact revenue growth of IT companies. BFSI, retail, communication and Hi Tech are witnessing higher stress. This coupled with slowdown in discretionary spend, project ramp downs and lower conversion of TCV to ACV is impacting near term growth. We expect even those verticals not impacted will have cautious outlook. Hence, for Q1FY24E we expect large caps to register dollar revenue in the range of flat to -2% QoQ trend aided by 0-60 bps cross currency tailwind. Among mid caps we expect -2% to +3% QoQ growth. We expect Coforge & Zensar to outperform Tier 1 growth. Further, in terms of margins we expect Tier-1 to register flat to -118 bps decline in margins mainly led by wage hike and lower revenue growth. Infosys & TCS are our top picks.

Key Highlights

- **Revenue Outlook:** Growth across tier-1 is expected to be muted. What needs to be watched out is deal trend in this quarter as that will give the trajectory of H2FY24E & FY25E. Among mid-caps, we expect Coforge (2.5% CC QoQ growth), LTIM (1% QoQ) & Zensar (1.7% QoQ) to lead the pack. We expect Cyient services revenue to be flat QoQ. While TechM to decline by 2% QoQ. In the small cap space, Newgen is expected to record 21% YoY growth in a seasonally weak quarter. **In terms of guidance we expect Infosys to narrow its top end guidance to 4-6% from 4-7%. We expect Wipro to guide 0 to -1% QoQ revenue guidance for Q2FY24E.**
- **Margins Outlook:** Most of the large caps are expected to report flat to -118 bps decline in margins due to wage hike and absence of operating leverage. However, among mid-caps most of them will report +60 bps to +85 bps improvement in margins. Only exception is Coforge (-238 bps) due to wage hikes & visa cost.

India IT Sector: Valuation and Rating

Companies	Rating	CMP	TP	Mkt Cap	Upside	P/E (x)	
		(Rs)	(Rs)	(Rs bn)	(%)	FY24E	FY25E
TCS	BUY	3,301	3,740	12,076	13	26	23
Infosys	BUY	1,335	1,618	5,540	21	21	18
HCL Tech.	HOLD	1,184	1,150	3,211	-3	21	19
Wipro	HOLD	389	420	2,135	8	17	15
Tech Mah.	HOLD	1,131	1,110	1,101	-2	18	15
LTIMindtree	HOLD	5,198	4,975	1,538	-4	31	26
Coforge	HOLD	4,711	5,000	288	6	30	24
Cyient	BUY	1,505	1,723	166	14	23	20
Birlasoft	BUY	359	390	98	9	19	16
Zensar Tech.	HOLD	387	410	87	6	20	15
Newgen	HOLD	680	660	47	-3	24	18

Source: IDBI Capital, Company

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Exhibit: Estimates

(Rs mn)

Company		Jun 23	Mar 23	Jun 22	QoQ (%)	YoY (%)	Comments
TCS	Revenue (US\$ mn)	7,238	7,195	6,780	0.6	6.8	<ul style="list-style-type: none"> ■ We forecast flat QoQ revenue growth in CC terms and cross currency tailwind of 60 bps. ■ Increase in wages and soft demand environment are expected to impact the margins. We forecast EBIT margin to taper by 106 bps QoQ to 23.4%. ■ Would watch for: 1) strategy of new CEO; 2) TCV of deal wins; 3) timeline of deal closures and deal pipeline; 4) hiring & offshoring, 5) outlook on EBIT margin and its sustainability; 6) commentary on long term digital trends; 7) Impact on verticals due to macro situation; 8) Banking, US & Europe outlook and 9) Deal trend 10) trend in cost take out deals.
	Revenue (Rs mn)	595,072	591,620	527,580	0.6	12.8	
	EBIT (Rs mn)	139,441	144,880	121,860	-3.8	14.4	
	EBIT margin (%)	23.43%	24.49%	23.10%	(106 bps)	33.4 bps	
	Net profit (Rs mn)	108,039	113,920	94,780	-5.2	14.0	
	EPS (Rs)	29.5	31.1	25.9	-5.2	14.0	
Infosys	Revenue (US\$ mn)	4,565	4,554	4,444	0.2	2.7	<ul style="list-style-type: none"> ■ We forecast revenue growth to be flat in CC terms and cross currency tailwind of 24 bps. Growth is expected to be muted due to delayed decision making by clients and reduction in discretionary spends. ■ We expect EBIT margin to come in at 21%; flat QoQ. ■ Would watch for: 1) Large deal pipeline and wins; 2) impact on discretionary spends; 3) Attrition level and trends; 4) margin outlook; and 5) outlook on Telecom, retail, BFSI & Hi tech verticals 6) Impact on revenues due to leadership changes 7) Outlook on conversion of pipeline and project run offs.
	Revenue (Rs mn)	375,281	374,410	344,702	0.2	8.9	
	EBIT (Rs mn)	78,918	78,770	69,142	0.2	14.1	
	EBIT margin (%)	21.03%	21.04%	20.06%	(0.9 bps)	97.0 bps	
	Net profit (Rs mn)	61,072	61,280	53,602	-0.3	13.9	
	EPS (Rs)	14.7	14.8	12.76	-0.3	15.3	
Wipro	Revenue (US\$ mn)	2,810	2,853	2,780	-1.5	1.1	<ul style="list-style-type: none"> ■ We expect IT services revenue to contract by 2% in CC terms and cross currency tailwind of 50 bps. Softness in consulting business, BFSI, tech and retail verticals is expected to result in overall negative growth. ■ We forecast EBIT margin to shrink by 53 bps QoQ led by contraction in revenue growth. ■ Would watch for: 1) Outlook for Q2FY24E; 2) Outlook for consulting business; 3) Commentary on the large deal wins; 4) Leadership changes & impact; 5) Commentary on new strategy to turnaround; 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)	229,876	231,903	215,286	-0.9	6.8	
	EBIT (Rs mn)	35,060	36,587	30,856	-4.2	13.6	
	EBIT margin (%)	15.25%	15.78%	14.33%	(52.5 bps)	61.9 bps	
	Net profit (Rs mn)	29,400	30,745	25,636	-4.4	14.7	
	EPS (Rs)	5.4	5.6	4.7	-4.4	14.7	

Company		Jun 23	Mar 23	Jun 22	QoQ (%)	YoY (%)	Comments
HCLT	Revenue (US\$ mn)	3,243	3,235	3,025	0.2	7.2	<ul style="list-style-type: none"> ■ We expect sequential revenue growth of 0.25% in CC terms. Softness in growth is mainly due to one off in ER&D business and seasonally weak product revenues. ■ We expect EBIT margin to taper down by 47 bps QoQ mainly led by softness in revenue growth. ■ Would watch for: 1) Outlook on product business 2) Commentary on deal pipeline, especially large deals, pricing 3) attrition trend 4) Margin outlook; 5) M&A plans; 6) tech spends by clients 7) ER&D outlook and its drivers.
	Revenue (Rs mn)	266,574	266,060	234,640	0.2	13.6	
	EBIT (Rs mn)	47,200	48,360	39,920	-2.4	18.2	
	EBIT margin (%)	17.71%	18.18%	17.01%	(47.0 bps)	69.2 bps	
	Net profit (Rs mn)	36,827	39,830	32,830	-7.5	12.2	
	EPS (Rs)	13.6	14.7	12.1	-7.5	12.2	
TechM	Revenue (US\$ mn)	1,641	1,668	1,633	-1.6	0.5	<ul style="list-style-type: none"> ■ We expect QoQ revenue to fall by 2% in CC and positive impact of cross currency to the tune of 40 bps. Growth is expected to be impacted due to broad based demand softness. We expect communication to be a major drag. ■ We expect EBIT margin to decrease by 118 bps QoQ on account of negative revenue growth. ■ Would watch for: 1) Large deal wins; 2) New CEO strategy & ways to improve growth 3) Commentary on revival in comms bussiness & growth in enterprise bussiness, 4) 5G trends 5) Restructuring of margin; 6) Outlook on communication 7) M&A and capital allocation.
	Revenue (Rs mn)	134,935	137,182	127,079	-1.6	6.2	
	EBIT (Rs mn)	13,461	15,305	14,034	-12.1	-4.1	
	EBIT margin (%)	9.98%	11.16%	11.04%	(118 bps)	(107 bps)	
	Net profit (Rs mn)	11,570	13,304	11,316	-13.0	2.2	
	EPS (Rs)	13.2	15.2	12.9	-13.0	2.2	
LTIMindtree	Revenue (US\$ mn)	1070	1058	980	1.2	9.3	<ul style="list-style-type: none"> ■ We forecast 1% QoQ growth in CC terms and cross currency benefit of 22 bps. We expect growth to be driven by insurance & Hi Tech offset by BFS. ■ We expect EBIT margins to improve by 86 bps QoQ on account of improvement in utilisation and reduction in attrition. ■ 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.
	Revenue (Rs mn)	87,998	86,910	76,442	1.3	15.1	
	EBIT (Rs mn)	15,147	14,214	13,375	6.6	13.3	
	EBIT margin (%)	17.21%	16.35%	17.50%	85.8 bps	(28.3 bps)	
	Net profit (Rs mn)	12,008	11,137	11,072	7.9	8.5	
	EPS (Rs)	40.5	37.6	37.4	7.9	8.5	

Company		Jun 23	Mar 23	Jun 22	QoQ (%)	YoY (%)	Comments
CYIENT	Revenue (US\$ mn)	206.9	213	162	-2.9	28.0	<ul style="list-style-type: none"> ■ We expect revenue in CC terms to reduce by 3% QoQ and cross currency benefit of 14 bps. Growth of services revenue is expected to be flat in CC terms. DLM segment is expected to record a contraction of 18% QoQ in CC terms. In terms of verticals, transportation & sustainability and aerospace are expected to record growth while growth in connectivity is expected to be flat. ■ We forecast EBIT margin to improve by 69 bps QoQ to 14.9% as wage hike and reduction in utilisation are expected to offset margin gains accruing due to lower SG&A, price hikes and rise in billed days. ■ 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; 5) Progress on acquisitions 6) New growth verticals outlook 7) Order book trend.
	Revenue (Rs mn)	17,014	17,514	12,501	-2.9	36.1	
	EBIT (Rs mn)	2,541	2,494	1,436	1.9	76.9	
	EBIT margin (%)	14.93%	14.24%	11.49%	69.4 bps	344.7 bps	
	Net profit (Rs mn)	1,671	1760	1,161	-5.1	43.9	
	EPS (Rs)	15.1	15.9	10.5	-5.1	43.6	
Zensar	Revenue (US\$ mn)	150	148	156	2.0	-3.5	<ul style="list-style-type: none"> ■ We forecast revenue growth to be ~1.7% QoQ in CC and cross currency benefit of 28 bps. We expect BFSI to be a key growth driver. ■ We forecast EBIT margin to improve by 64 bps QoQ to 12.24% led by easing supply side challenges. ■ Would watch for: 1) Comments 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)	12,368	12,127	12,034	2.0	2.8	
	EBIT (Rs mn)	1515	1407	871	7.6	73.9	
	EBIT margin (%)	12.24%	11.60%	7.24%	64.3 bps	500.7 bps	
	Net profit (Rs mn)	1259	1192	750	5.6	67.8	
	EPS (Rs)	5.6	5.3	3.3	5.6	69.1	

Company		Jun 23	Mar 23	Jun 22	QoQ (%)	YoY (%)	Comments
Birlasoft	Revenue (US\$ mn)	151	149.1	148.6	1.3	1.6	<ul style="list-style-type: none"> Revenue is expected to record growth of 1% QoQ in CC terms due to Invacare related issues, partially offset by cross currency tailwind of 30 bps. EBIT margins to expand by 63 bps QoQ due to increased utilisation. 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 related issues; 8) outlook on Europe and 9) Attrition trend 10) strategy & organizational restructuring by new CEO.
	Revenue (Rs mn)	12,380	12,264	11,544	0.9	7.2	
	EBIT (Rs mn)	1,552	1,460	1,552	6.3	0.0	
	EBIT margin (%)	12.54%	11.90%	13.45%	63.4 bps	(90.8bps)	
	Net profit (Rs mn)	1,207	1,122	1,207	7.6	0.0	
	EPS (Rs)	4.38	4.07	4.29	7.6	2.1	
Newgen	Revenue (Rs mn)	2,274	3,051	1,879	-25.5	21.0	<ul style="list-style-type: none"> We forecast revenue to grow by 21% YoY We forecast EBITDA margin to expand by 36 bps YoY to 11%. Consequently EBIT margin is expected to expand by ~41 bps YoY to 7.7%. Would watch for: 1) New logo additions; 2) Outlook on SaaS revenue growth; 3) Commentary on GSI deals 4) Outlook on EBIT margin; 5) outlook on the mature market penetration 6) Annuity trends 7) SAAS trends 8) Geo wise growth trends.
	EBIT (Rs mn)	174	897	136	-80.5	27.9	
	EBIT margin (%)	7.67%	29.39%	7.26%	-2171 bps	41.1 bps	
	Net profit (Rs mn)	200	786	192	-74.6	4.1	
	EPS (Rs)	2.80	11.04	2.74	-74.6	2.4	
Coforge	Revenue (US\$ mn)	272.5	264.4	238.7	3.1	14.1	<ul style="list-style-type: none"> We forecast revenue to grow by 2.5% QoQ in CC terms and cross currency tailwind of 60 bps. Growth is expected to be broad based across all the verticals. We forecast EBIT margin to reduce by 238 bps QoQ to 13.1% on the back of wage hikes and increased visa cost. Would watch for: 1) Outlook on top clients; 2) New logo addition and client mining trend 3) Outlook on growth & EBIT margin; 4) outlook on BFS vertical due to macro challenges; 5) Attrition trend; 6) Deal pipeline; 7) outlook on TTH and 8) Large deal wins.
	Revenue (Rs mn)	22,400	21,700	18,294	3.2	22.4	
	EBIT (Rs mn)	2,934	3,359	2,288	-12.6	28.2	
	EBIT margin (%)	13.10%	15.48%	12.51%	-238 bps	59.3 bps	
	Net profit (Rs mn)	1,975	2,474	1,497	-20.2	31.9	
	EPS (Rs)	31.7	39.8	24.2	-20.2	31.0	

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	3%	10%	6%	22%
BSE IT	2%	5%	4%	6%
TCS	0%	3%	1%	1%
INFO	1%	-6%	-11%	-9%
WPRO	-4%	7%	-1%	-6%
HCLT	4%	9%	14%	22%
TECHM	1%	3%	11%	13%
LTIM	4%	9%	19%	31%
CYL	16%	51%	85%	98%
ZENT	5%	41%	82%	42%
BSOFT	4%	37%	20%	2%
NEWGEN	6%	51%	88%	90%
COFORGE	3%	24%	21%	33%

Source: Bloomberg

Exhibit: Cross-currency movement trend

Currency	Details	Q2FY22	Q3FY22	Q4FY22	Q1FY23	Q2FY23	Q3FY23	Q4FY23	Q1FY24
USD/INR	Average	73.8	74.9	75.2	77.2	79.8	82.2	82.3	82.2
	QoQ	(0.5)	1.5	0.4	2.7	3	3	0	(0)
	Closing	74.2	74.7	76.0	79.0	81.9	82.9	82.2	82.0
	QoQ	(0.2)	0.8	1.7	3.9	4	1	(1)	(0)
GBP/USD	Average	1.4	1.3	1.3	1.3	1.2	1.2	1.2	1.3
	QoQ	2.1	(0.4)	(0.5)	(6.1)	(6)	(0)	3	3
	Closing	1.4	1.3	1.3	1.2	1.1	1.2	1.2	1.3
	QoQ	(2.2)	(0.7)	(2.4)	(7.0)	(11)	10	2	3
EUR/USD	Average	1.2	1.1	1.1	1.1	1.0	1.0	1.1	1.1
	QoQ	1.4	(3.9)	(1.9)	(5.5)	(5)	1	5	2
	Closing	1.2	1.1	1.1	1.1	1.0	1.1	1.1	1.1
	QoQ	(1.6)	(3.1)	(1.7)	(5.4)	(7)	9	2	1
AUD/USD	Average	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7
	QoQ	2.1	(2.1)	(0.6)	(0.6)	(5)	(4)	4	(2)
	Closing	0.7	0.7	0.8	0.7	0.7	0.7	0.7	0.7
	QoQ	(3.4)	(0.2)	4.0	(11.1)	(2)	3	(1)	(1)

Source: Bloomberg



Notes

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

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